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Working Paper No. 1067

Revisiting the Foreign Debt Problem and the “External Constraint” in the Periphery: An MMT Perspective

by

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I. Introduction¹

In the search for the causes of the debt crises suffered by Global South² countries (Fischer and Storm 2023), economists often encounter a number of “usual suspects”. One alleged cause is fiscal mismanagement or profligacy, a view often espoused by conservative economists. The worst debt crises such as the current ones in Sri Lanka and Lebanon have undoubtedly something to do with unwise economic management. However, the limitation of such a view is that it lacks a structural character. Often, debt crises are triggered by external events over which Southern countries have little control. Fiscal mismanagement could only be an *aggravating* factor.

Among the alleged *structural* causes are the terms of trade deterioration. This concept means that the prices obtained by Southern countries for their exports, mostly primary or low-wage based products, tend to decline compared to the prices of their imports, mostly manufactured and high-wage based products. In other words, over the long run, there is the tendency (and constraint) for primary commodity exporters to increase their export volume in order to obtain the same volume of imports (Harvey et al. 2010). As the prices of primary products are set abroad and are marked by their volatility, debt crises in the South have often been preceded by a decline in the terms of trade.

Another structural factor is interest rate hikes by Northern central banks. When the Fed raised its interest rates at the end of the 1970s and early 1980s, with the so-called Volcker Shock, this created a global debt crisis in what was then called the Third World. Many countries in Latin America and in Africa that had to service US dollar denominated loans experienced lost decades (1980s; 1990s). Likewise, the recent rate hikes by leading central banks have negatively affected the capacity of Southern countries to refinance themselves on international financial markets; their rollover risk increased. Linked to interest rates hikes is the phenomenon of predatory lending. When Southern countries experience economic booms, they tend to issue debts in foreign currencies in international capital markets, offering high yields as a result of the exaggerated risk premiums demanded by private creditors. In periods of economic downturn, it becomes difficult for them to service their foreign debt for the same reason.

What compounds the problem is that there is no functional international mechanism to deal with sovereigns that are unable to service their debt in foreign currency. These sovereigns are ordinarily at the mercy of their creditors who often hide behind the International Monetary Fund (IMF) to impose punitive economic measures through the institutionalization of sovereign debtors’ prisons (Doyle 2019; Sylla and Doyle 2020).

These different aspects are certainly relevant as they help to understand to some extent the recurrence of debt crises in the Global South and their severity. Given their diversity, they lead to a range of policy proposals. Some are usually counter-productive (austerity policies, so-called “structural adjustment” plans) or not economically feasible in the short to medium run (strong

¹ I would like to thank Pavlina Tcherneva for having allowed me the opportunity and intellectual space to engage with the topic of this paper. Thank you as well to Dirk Ehnts, Simone Deos, Oleksandr Valchyshen, and Stefan Zylinski for their helpful comments and criticism. All remaining errors are my own.

² Global South/Southern countries is used here as a relational concept to refer more or less to the former “Third World” countries, most of them being currently ranked as “low and middle income” countries.

industrial development). Others are politically unlikely, such as the establishment of an international sovereign debt restructuring mechanism that would include all foreign creditors — bilateral, multilateral, private — and that would prioritize economic development and peoples’ rights instead of creditors’ dictates (Laskaridis 2023).

One point all these views — and the derived policy recommendations — share is the implicit assumption that it is normal for Southern sovereigns to issue debts in foreign currencies (foreign units of account). This paper challenges this widely held and usually unquestioned assumption by relying on Modern Money Theory (MMT) insights. It argues that the MMT lens helps economists understand the root causes of the foreign debt problem of Southern countries and envisage progressive domestic policy measures that are under their control. The empirical focus will be on African countries, most of them having a “least developed country” or “developing country” status.

The remainder of the paper is organized as follows. Section II is about the “MMT question” or why sovereigns in the Global South would issue debts in foreign currencies. Section III unpacks the concept of “external constraints” or “balance-of-payments constraints” often used to dismiss the analytical and policy relevance of MMT. Section IV is a brief illustration using the African continent as a case study. Section V concludes the paper.

II. Addressing the “MMT Question”

In a piece published by the *Financial Times*, Anglo-Sudanese billionaire and philanthropist Mo Ibrahim raised an important issue: “why a debt level at 40 percent is ‘high’ for poor countries when rich countries can continue to borrow at 136 percent of GDP?”. He remarked: “I believe the answer is the unsustainable interest rates that poor countries are saddled with. Put simply, the rich borrow cheaply but the poor have to pay excessive rates, driving them into default in most cases” (Mo Ibrahim 2023).

Mo Ibrahim has a point. Indeed, African sovereign bonds suffer from an “unjustified” premium, due notably to the power of credit rating agencies (Fofack 2021; UNDP 2023). Economists Michael Olabisi and Howard Stein showed that African governments paid an extra/unjustified cost of 2.9% on their foreign currency denominated bonds. For the period 2008-2014, this ‘African premium’ implied \$2.2 billion loss for them. Another piece of evidence in support for the Mo Ibrahim hypothesis is that the debt-to-GDP ratios³ of Southern countries, including those that recently defaulted on their debt obligations, have been generally lower in comparison to richer countries. In 2022, Japan had a sovereign debt-to-GDP ratio of 254%, vs. 144% for the US, 113% for Canada, and 104% for the UK (OECD 2023). Yet none of these countries experienced a sovereign debt crisis. By contrast, Argentina, Ecuador, Zambia and Sri Lanka all defaulted on their foreign debt obligations while recording lower ratios (World Bank 2022; S&P Global 2022).

³ Though widely used for comparative purposes, it is important to stress that this ratio compares a (debt) stock and a flow (GDP). It cannot be interpreted as an indicator of a government’s solvency or the soundness of its economic management.

Mo Ibrahim's answer to the question he raised is, however, insufficient. One must turn to MMT for a more compelling and comprehensive account.

MMT conceives of monetary sovereignty as a situation where a government meets the following conditions: it issues a national or federal *fiat currency*, that is a currency not pegged to gold or any currency, in which it receives the payment of taxes; the debts it issues are denominated in the unit of account it legally defined. Monetarily sovereign governments, in this specific sense, issue claims on themselves in the national money unit of account. They do not have any *intrinsic* financial constraint: they can afford whatever is for sale in their own currency. They can always pay the obligations due in their own currency. Their main constraint is the availability of real resources, (i.e. labor, land, raw materials, equipment, technologies, organizational skills, etc.). If the economy spends beyond its real resource constraint, inflation will likely be the result. Monetarily sovereign governments must deal with an *inflation risk* rather than a *solvency risk*.

This concept of monetary sovereignty helps to understand that the external indebtedness problem of the Global South governments reflects, above all, their *lower degree of (economic and) monetary sovereignty*. Governments that are monetarily sovereign are those that do not have to issue debt instruments in a foreign currency and that usually have significant control over domestic banks and other important non-bank businesses. Indeed, these entities might have a sizable non publicly guaranteed debt denominated in foreign currency which can expose the national government to take them over.⁴

As a rule, the debts of monetarily sovereign governments are essentially denominated in the national currency and, in principle, their central banks have control over the interest rates applied on them. This explains why the Japanese government with a debt-to-GDP ratio of 254% is not experiencing a debt crisis while (partially) dollarized countries such as Argentina and Ecuador are often in debt distress while having much less sovereign debt. These Southern governments face a solvency risk as they do not issue the US dollar and other currencies in which their debts are denominated. Neither do they have control over the interest rates on their foreign debts.

A related and important observation here is that the countries having the highest sovereign debts ratios in the world — like the US, Japan, the UK, etc. — happen to be the creditors of most of the Global South sovereigns, and especially those that are in debt distress. One implication of this situation is that, given the former countries' monetary sovereignty, they can collectively afford to cancel in whole or in part the debts of the latter. MMT clarifies that, from the perspective of rich countries such as the US, the cancellation of the external debt of Southern sovereigns is not a question of *affordability*, especially given its relatively small size. It would be rather a matter of *accountability* and *coordination* between different debtors, creditors, and other relevant actors. To give a sense of magnitudes involved, in 2021, the public and publicly guaranteed (PPG) external

⁴ For at least 28 countries out of 48 in sub-Saharan Africa, the share of private non-guaranteed debt (PNG) was less than 6% of the total long term external debt stock in 2022, i.e. at least 94% of the long term external debt stock is public and publicly guaranteed (PPG). Three countries — Mozambique (30.8%), Nigeria (16.3%), and South Africa (16.2%) — represented 63.1% of the long term PNG external debt of sub-Saharan Africa in 2022 (see World Bank 2022). The PNG debt is often rather opaque to the extent that it can hide accounting practices by transnational corporations to evade taxation or facilitate illicit financial flows.

debt stock of the 131 countries classified as Low-and-Middle-Income (China, Russia and India not counted) stood at \$2.6 trillion,⁵ an amount less than Germany's current public debt stock.⁶ Regarding sub-Saharan Africa, the \$471 billion PPG external debt stock was associated with a debt service of \$43 billion in 2021 (World Bank 2022).

Once one gets the point about monetary sovereignty, the “MMT question” becomes unavoidable: why do Southern countries issue debts in foreign units of account? After all, why would they open the “Pandora’s box” of foreign debt? Four main explanations can be found in the economic literature.⁷

A valid explanation is a lack of democratic control and accountability that results in the issuance of “odious debts” (i.e. loans extended to sovereigns by creditors who are aware that they would not be used for public purpose). Many Southern countries inherited “odious debts” at the time they gained independence (e.g., Haiti, the “Belgian” Congo); the payment of these debts constrained their development and placed them in a vicious cycle of economic impoverishment and political instability. The story of odious debts is still alive in many Southern countries where the political elite faces no public scrutiny or are complicit with imperialist practices (Ndikumana and Boyce 2011; Toussaint 2016, 2018; Hudson 2017; Perkins 2023).

A second view asserts that Southern sovereigns have to issue debts in foreign currency because they would lack “money” and “savings”. This is a wrong answer to the MMT question. As MMT shows, currency-issuing governments cannot run out of their own currency while savings are not an a priori constraint on investment. To quote an article published by the Bank of England (2014), “Saving does not by itself increase the deposits or ‘funds available’ for banks to lend [...] rather than banks lending out deposits that are placed with them, the act of lending creates deposits — the reverse of the sequence typically described in textbooks” (McLeay, Radia & Thomas, 2014: 15).

A third answer to the MMT question is provided by some strands of the heterodox economics literature - Post-Keynesianism and Latin American Structuralism. According to this view, the countries of the South face a “balance of payments” or “external” constraint resulting from a “shortage of foreign exchange” (Boianovsky and Solís 2014; Fischer 2018; see also Thirlwall 2012). They must have access to US dollars to buy their imports (which must grow with their economic development). As they generally run trade and current account deficits, this situation results in the issuance of foreign currency debts when their foreign exchange reserves are insufficient. This “lack of foreign exchange” explanation is plausible but it remains superficial.

⁵ Author’s calculation based on World Bank (2022).

⁶ World Bank. 2023.

<https://databank.worldbank.org/data/embed-int/Table-C1.-Total-Gross-Public-Sector-by-Sector/id/a90ed5c15b?ht=1500> (accessed 24 November 2023)

⁷ The remainder of this section relies on Sylla (2023a) which discusses mainstream economics’ concept of “original sin”: the so-called inability of governments (and firms) in some countries to obtain external loans denominated in their own currency (the “international component”) or to obtain long-term domestic loans in their own currency (the “domestic component”). See for example: Eichengreen, Hausmann & Panizza (2005).

The “lack of foreign exchange” can only be a relative concept — a shortage of US dollars for *particular* purposes. Indeed, from an MMT perspective, currency-issuing governments have no intrinsic financial constraint to implement projects that essentially require real resources that are available locally or can be developed locally. This paper will call them locally-resourced projects (LPs) to distinguish them from externally-resourced projects (EPs) – projects that mobilize real resources from abroad. Southern governments issuing their own currency can afford any LPs. Better, as expenses related to LPs happen in the domestic currency, any external financing aimed at implementing them would actually result in foreign exchange accumulation. Suppose that Ghana has everything needed in terms of real resources to build schools to achieve universal schooling. Any external financing received by the government to that end would be converted to the domestic currency (i.e. new domestic currency deposits are created) to pay for local expenses. The foreign financing itself would increase the foreign exchange deposits of the Ghanaian economy, as this project does not necessitate any spending abroad.

As long as Southern countries base their development on LPs, their foreign exchange needs will be limited. However, if they choose to rather rely on foreign real resources, they might face a foreign exchange constraint. For example, if Ghana wants to build schools with foreign real resources (technology, equipment, labor, etc.), it might need to have access to foreign exchange reserves. If it does not have enough, it might have to issue debts in foreign currencies⁸ that will have to be repaid with other sources of foreign finance, given that public schools are not built with the purpose of generating US dollars.

In a nutshell, from an MMT perspective, a situation of technical and material dependence in the South is *a sufficient but not necessary condition* for sovereigns to issue debts in foreign currency. Whether a debt denominated in foreign currency is necessary will depend on (i) allocative choices: the possibility of relying on domestic rather than foreign real resources; (ii) international payment possibilities: whether or not the desired foreign real resources are available for sale in the domestic currency; (iii) the size of the foreign currency earnings; and (iv) how these foreign currency earnings are distributed and spent.

III. Unpacking the “External Constraint”

Critics often make the argument that MMT is not policy-relevant to most of the Global South countries due to their “external constraint” or “balance of payment constraint”. I will argue a contrary view below: MMT is policy-relevant to the Global South as it clarifies the mis-specified concept of “external constraint”. Indeed, using an MMT-informed balance of payment analysis, one can see that the concept of “external constraint” confuses at least three analytically distinct issues: dependency vis-à-vis foreign real resources; an international payment problem; political economy considerations.

⁸ One might say that Southern countries could just exchange their currency on the foreign exchange market instead of issuing a foreign currency debt. Indeed. But this will tend to depreciate their exchange rate and to feed imported inflation, especially if they are highly dependent on food and energy imports. As the exchange rate pass-through might be more or less significant, issuing a debt in an international reserve currency can be seen as an alternative way of handling the inflation constraint.

As no country is self-sufficient in every domain, all countries have a real resource constraint. All countries need to obtain imports from the world economy. To this extent, all countries face a “foreign real resource constraint”, even those like the United States that issues the international reserve currency. But the degree of national resource self-sufficiency or dependency varies across countries. The richest countries are more self-sufficient for at least two reasons: they are able to control and mobilize real resources at home and abroad (thanks to their diplomacy, their transnational companies, their armies and their power inside global governance institutions); they can buy foreign real resources in their own currencies with limited impact on their exchange rate and domestic inflation most of the time. This leads to a second aspect.

Most Global South countries face an international payment problem. They generally need to have access to hard currencies (e.g. the US dollar) to buy their imports. For Southern countries that are resource-rich, the payment problem can be circumvented if they manage to obtain export earnings beyond their import needs. By contrast, for those that are resource-poor or that are not able to generate external earnings to cover their import needs – or precisely the part of their imports not paid by Foreign Direct Investment (FDI) – the international payment problem can become a *transfer problem*. The deficit of foreign exchange could lead to a depreciation of the exchange rate, which increases the domestic currency burden of the foreign debt and might lead to imported inflation.

Resource-poor countries⁹ face a double constraint: they are import-dependent and they generally do not generate enough foreign earnings to buy their critical import needs and service other international payments. The most binding constraint here is the domestic real resource constraint. It is not the international payment one. It would be erroneous to call this a “balance of payment constraint” because these countries just do not have the capacity to develop economically based on their own domestic resources and creativity. They do not have a “balance of payment constraint”. They are resource-constrained. What is perceived as a “balance of payment constraint” is actually a real resource constraint. These countries should probably benefit from special treatment, including unilateral transfers from the rest of the world (Mitchell 2016) or join more economically viable political entities.

Anyway, from an MMT perspective, it is clear that these countries could not afford to forgo mobilizing whatever limited real resources they possess to the fullest extent, starting with their labor capacity. Otherwise, they risk suffering an alternation of growth and austerity cycles and probably a denationalization of their economy (in order to obtain the needed foreign exchange, the few strategic sectors or valuable resources such as land might be sold to foreign actors or be put to work for external interests).

To recap briefly, the concept of “external constraint”, in the current academic usage, is used to conflate the foreign real resource constraint and the international payment problem. Further, it wrongly portrays the situation of countries that, for the time being, simply do not have the

⁹ Resource-poor and resource-rich are relative categories. As long as countries dispose of some labor capacity, there is always a minimum in terms of well-being they could offer their populations. Countries that are resource-poor at one point might become economically attractive at a later one. Factors such as geographic location and a highly skilled labor force can become valuable assets depending on circumstances.

domestic real resources needed to support their development in the long run as a “balance of payment constraints”.

This being said, one way, resource-poor and resource-rich countries alike can alleviate the international payment problem is through economic diplomacy: they could try to reorient their trade towards countries that accept to provide swap lines or to trade in domestic currencies.¹⁰ In contrast to the immediate postwar context, where the US was the world industrial and commercial center, the use of the US dollar as the major currency for invoicing and payment is no longer justified by the US relative economic might. In other words, the international payment problem is not necessarily a rigid constraint. Countries could, on a bilateral or multilateral basis, circumvent the need to trade in hard currencies, if such is their wish.¹¹

Another limitation of the concept of “external constraints” is that it erroneously includes realities that are more the results of domestic political economy considerations than the (perceived) defects of the international financial system. Now, to offer some examples:

First, any domestic decision or policy that weakens (i) the usual export earning capacity of the national economy and (ii) the national share of foreign earnings (vs. foreign investors’ share), all else being equal, will negatively affect the capacity to acquire foreign real resources. For example, if governments decide to privatize the export sector or do not receive a fair share of export earnings, or cannot effectively control the export sector, etc., they allow a significant share of their real resources to be transferred abroad. They will deprive themselves of foreign earnings that could have helped them acquire foreign goods and stabilize their exchange rate (see the following section).

Second, any domestic decision or policy that leads to artificial import dependency in some critical sectors, all else being equal, will tend to increase the demand for foreign currency. For example, many countries in Africa were relatively food self-sufficient in the 1980s. With trade liberalization imposed by the World Bank and World Trade Organization, they became import-dependent on food. This demand for foreign currency to buy food imports cannot be labelled as an intrinsic “external constraint”.¹² It is the outcome of domestic policy choices that can be (could have been) removed.

Third, there are domestic decisions or policies that lead to non-necessary – or non-priority – foreign exchange demands. The case of luxury goods by the elites comes to mind as well as the

¹⁰ In 2017, nearly half the value of cross-border commercial payments from Africa was invoiced in US dollars. Yet North America received only 10% of these commercial payments. This gap reflected the fact that the US dollar is the currency used for cross-border payments within the continent and abroad, namely for Africa-Asia trade (SWIFT 2018). Given its growing trade ties with Africa, China has been experimenting with its African partners alternatives to the dollar system such as commercial swap lines.

¹¹ In the framework of the African Continental Free Trade Area (AfCFTA), the Afreximbank launched the Pan-African Payment and Settlement System (PAPSS), an initiative aiming at facilitating intra-African trade in domestic currencies.

¹² A global peasant organization like Via Campesina advocates “food sovereignty” (ability to grow your own food with your own seeds and distribution networks with a view to empower small family producers), in opposition to World Bank’s “food security” approach which privileges market access through global value chains as well as the privatization and marketization of indigenous seeds worldwide.

demand by the same elites and portfolio investors to have their assets in local currency converted and held in foreign currency in international bank jurisdictions. Selective and effective trade, currency, and capital controls are a necessity in such circumstances. Less discussed, though very concerning, are development projects with speculative and Ponzi profiles.

Development projects can be studied according to their balance-of-payments footprint. Taking inspiration from Minsky classical typology (Kregel 2004, 2006), one can distinguish four types: those (i) that are foreign exchange-neutral; (ii) that generate net foreign earnings (hedge position); (iii) that have an uncertain foreign exchange profile (speculative position); (iv) that are net consumers of foreign exchange (Ponzi position).

By definition, LPs are projects that do not require foreign financing and that are either foreign exchange-neutral or provide net foreign earnings (for example by having an import substitution impact). In principle, for LPs, there is no solvency risk and no adverse direct balance-of-payments effects.

EPs are projects that require foreign real resources and foreign sources of finance. They can “pay for” themselves in the medium to the long run if they result in net foreign earnings (hedge profile). Their profiles can also be speculative and Ponzi-like (i.e. they cannot generate the foreign currency needed to service the external financing that made them possible). This is the case, for example, of infrastructure projects subject to the so-called “currency mismatch”. During the last two decades, African governments often issued Eurobonds to partly finance projects which only generate income streams in domestic currency and which do not necessarily boost the export sector earning prospects or reduce the demand for foreign exchange (through import substitution for example). For these projects, this paper will call them Ponzi-projects, the issue is not their profitability. They can be highly profitable. The issue is, rather, that they only generate domestic currency income. Governments have to find sources of foreign finance external to them in order to service the debt contracted to initially finance them and to allow for the conversion and repatriation of profits made in local currency by the foreign companies operating them. Generally, these Ponzi-projects are implemented within the framework of so-called Public-Private-Partnerships (PPPs). These PPPs often involve what Daniela Gabor called “derisking” practices – for example guaranteeing a minimum demand to foreign corporations running them and protecting them against exchange rate risk (Gabor 2020, 2021; Gabor & Sylla 2020).

One general point here is that when the PPP-derisking approach is generalized to sectors for which domestic real resources exist and which do not generate foreign earnings (like internal transportation, health, education), this could create more foreign currency debts and contingent liabilities for governments (i.e. the financial commitments they pledge to honor in case an undesirable scenario happens – like compensating a foreign company for a shortage in actual domestic demand) and a surge in dispensable income transfers to abroad. One policy implication is that critical or essential infrastructure projects with a Ponzi profile – i.e. net consumers of foreign exchange – should remain as much as possible in the *public* or even the *national* domain in the South. Beyond facilitating universal access at lower costs, other benefits would be lower foreign currency liabilities and fewer negative balance-of-payments impacts. For Global South

sovereigns, taking foreign currency-denominated loans to finance projects with a Ponzi profile is a risky bet, as the serviceability of those loans will generally depend on the optimistic assumption of *business as usual* – no negative shock affecting traditional sources of foreign income and no significant change regarding external creditors’ “confidence”.

In sum, reliance on foreign capital might not necessarily be a bad deal as long as external finance is carefully mobilized for projects with a hedge profile. However, if Southern countries take foreign loans or attract foreign capital to invest mostly in EPs with speculative and Ponzi profiles, they create problems for themselves, unless they are Saudi Arabia or Qatar (which have vast foreign assets of their own to tap on).

In its current usage, the concept of “external constraint” tends to mistakenly take as a “given” the cumulated result of inappropriate or careless domestic policy decisions that weaken the national capacity to earn foreign exchange and increase dispensable foreign exchange demands. Due to all these limitations, the concept of “external constraint” can be misleading if it is not carefully unpacked. However, given that it is often accompanied with unsophisticated views about “trade deficits” (see box), the basic MMT distinction between financial constraints and real resource constraints should be privileged (Mitchell 2016; Nersisyan and Wray 2023). In the case of the Global South, the so-called “external constraint” is *first of all* a real resource constraint (need to acquire foreign goods), but it is *expressed* in a mainly financial form insofar as the foreign real resources have to be acquired in a foreign currency (need to obtain the foreign currency) (Sylla, forthcoming).

Box: On Trade Deficits

The trade balance is one of the three main components of the current account balance. It usually attracts a lot of attention, due, namely, to the strength of mercantilist prejudice (itself the product of a gold standard mentality). Trade deficits, in particular, are often interpreted as a bad economic outcome (lack of competitiveness, a contributing factor to external indebtedness, etc.). The reality is, however, more complex than the superficial impression one might derive from aggregate trade balances.

To start, there are at least two statistical biases that affect the reliability of trade balances. First, the globalization and fragmentation of production – the rise of the so-called “trade in tasks” – mean that a given product (say the iPad or iPhone) can cross national borders several times at different stages of its manufacturing before being sold as a final product. When international trade happens mostly within global value chains, what matters is the distribution of value-added across countries. Exporting countries do not necessarily get the amounts indicated by official export figures: what you see is not what you get (Maurer & Degain 2010). These developments have not been fully reflected in the compilation of trade statistics. As a result, according to an estimate by the UNCTAD (2013), the gross value of global exports is inflated by 28% due to their multiple-counting. This statistical bias affects mostly countries that are deeply inserted into global

value chains – so-called emerging countries like China and rich ones like the US. Second, trade balances, especially for commodity exporters, are biased by the fraudulent practices of transnational corporations (TNCs). “Trade misinvoicing” – under-invoicing exports and over-invoicing imports – deprives the African continent of between \$30 to \$52 billion every year (UNCTAD 2020).

The prevalent view that trade deficits should result in the issuance of a debt denominated in a foreign currency or a decrease in official foreign exchange reserves has to be nuanced. Two aspects must be taken into account. First, imports from FDI constitute a special case, as the TNCs can themselves finance in hard currency the goods they import. If the trade deficit reflects mostly increased import value declared by TNCs, it need not entail any reduction in official foreign exchange reserves, or an issuance of a debt denominated in a foreign currency, especially considering that TNCs tend to over-invoice their imports. Second, trade deficits mean different things according to the economic and monetary status/strategy.

Trade deficits can reflect deteriorating terms of trade or temporary supply shocks in the case of resource-rich countries that usually record trade and current account surpluses. Some enduring trade deficits are clear evidence of “development deficits”. Such is the case of countries that accepted the mantra of trade liberalization according to “comparative advantage” and that ended up being highly import-dependent and unable to generate enough foreign earnings owing to a lack of structural transformation (Rekiso 2020). By contrast, some trade deficits are “development gains” – such as when countries import technology, equipment, and other inputs to spur their industrial development. The classic case is South Korea which recorded chronic merchandise trade deficits from the 1950s to the mid-1980s. Its first merchandise trade surpluses intervened in the context of a recession and slowing imports (Fischer 2018).

In colonial or neo-colonial contexts, where a (former) metropole controls the export sector and is the major provider of imported goods, its “trade deficits” are somehow a statistical artifact: economic and financial operations happening within the metropolitan economy are recorded as an “international” trade between the (neo)colony and the (former) metropole. Niger is a good example. For a long time, its major export product has been uranium, which was controlled by the French company Areva (renamed Orano afterwards). Given the fact that France was the main commercial provider to Niger and that the Niger uranium sector was operated by French capital (with small royalties accruing to the Niger government), Niger’s “external” trade with its former colonizer was actually internal to the latter’s economy. Eventual French “trade deficits” with Niger were spurious from an economic point of view: a French company operating in an African country sold uranium-based products to France! The recorded “trade deficit” means that the French economy sold less to Niger than what it paid for its uranium “imports”.

Another important case concerns countries such as the USA that issues the international reserve currency. US net imports – trade deficits – mean net real resource accumulation from abroad. Its payment “deficit” in US dollars is the counterpart to the surplus set of goods (measured in money terms) it received. Issuing the international reserve currency provides a “privilege”: countries having trade surpluses with the US often use their excess dollar balances to buy US Treasury securities (Hudson 2021). To illustrate this “privilege”, here is a quote from French economist

Jacque Rueff: “If I had an agreement with my tailor that whatever money I pay him he returns to me the very same day as a loan, I would have no objection at all to ordering more suits from him” (Rueff and Hirsch 1965:3).

A last consideration to keep in mind concerns countries that accumulate high trade surpluses but end up sometimes with current account deficits due to the primary income account deficit. This scenario is observed in countries where foreign capital dominates the export sector and is given a red carpet by local authorities. Take the case of Equatorial Guinea, one of the richest African countries in GDP per capita terms, yet ranked among the Least Developed countries (LDCs) until 2017. In 2006, at the height of the commodity boom, this oil-producer recorded export earnings representing 96% of its GDP and a trade surplus as high as 72.6% of its GDP (AfDB 2012). However, due to the large primary income balance deficit – net income payments to abroad (essentially profit and dividend repatriations by oil companies) – ranging on an annual basis between a minimum of 20% of GDP and a maximum of 66.4% of GDP since 2000 – the current account has often been in deficit.¹³ As the net income payments/the primary income balance represent the difference between GDP and GNI, a higher GDP, in such a context, signals first of all the good “health” of the foreign-controlled sector. Indeed, profit and dividend repatriations as well as interest payments on the external debt contribute to widen the gap between GDP and GNI. As Equatorial Guinea inhabitants might have discovered, not all kinds of “GDP growth” should be celebrated: the average real GDP per capita which reached its peak in 2008 declined by 59% by 2022.¹⁴ No major event (like a civil war, international financial sanctions, etc.) happened in the meantime. As a member of the CFA franc, Equatorial Guinea with its central African neighbors are the only oil-exporting countries in the world that choose a rigid peg against the euro.

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IV. A Brief illustration

Recurring debt crises in many Global South countries no doubt reflect the flaws of the multilateral system: the lack of a supportive global framework for national industrial policies, the high costs of external finance, inadequate financing when global shocks occur, the lack of an efficient international sovereign debt restructuring mechanism, etc. However, in the case of resource-rich countries, debt crises often reveal (i) a lack of fiscal and technical control over real domestic resources and (ii) inappropriate or even unsustainable allocative choices. This paper will illustrate this argument with the case of African countries.

Most African countries are resource-rich: they have abundant labor reserves as well as commodities desired by the rest of the world. Generally, they faced debt crises in contexts marked by external shocks resulting in a deterioration of their terms of trade or an increase in the costs of accessing external finance. Once more, the importance of a sound industrial policy strategy which helps overcome some of the challenges associated with the export of raw materials cannot be

¹³ According to World Bank international development indicators (accessed on November 24 2023).

¹⁴ *Ibid.*

overstated. However, being a commodity exporter does not imply being perpetually trapped in debt crises. Some countries are resource-wealthy with a relatively small population. In principle, with good economic management, they should be able to create lasting prosperity for their populations with limited need for their governments to be indebted in foreign currencies.¹⁵

One troubling question has to be raised: why are a number of African countries now in debt distress while they benefitted first from debt relief in the early 2000s and then from a decade of strong increase for the prices of their commodities? In principle, if they used their export earnings wisely, they could have limited the need to issue foreign currency-denominated debts or they would have been better prepared to face a fall in their export earnings. If they also used their foreign currency denominated loans rationally, they could have boosted their economic capacity through the implementation of projects that would create new sources of foreign income or that have an import-substitution impact.

This paper's hypothesis is that two developments occurred during the so-called period of "Africa rising", from the early 2000s to 2019. First, with the global liquidity 'glut' that followed the Great Financial Crisis during which African governments carelessly issued Eurobonds offering high yields to finance "Ponzi projects" and service the outstanding debts. Some of them subscribed to derisking practices, Ghana, a defaulter on its domestic and external obligations, being a good example (Gabor & Sylla 2020). Second, a significant part of the foreign earnings was captured by transnational corporations operating in their export sector through income transfers and real resource theft. I would like here to briefly focus on this second aspect.

It is certainly strange that most discussions on Global South's external debt tend to evade the elephant in the room: Foreign direct investment (FDI).¹⁶ Given the international payment problem, most countries must earn the foreign currency that allows them to pay for their imports. They essentially derive their foreign *earnings* from their export of hydrocarbons, mining and agricultural products which are controlled in many places by foreign companies.¹⁷ As FDI organizes production in the export sector as well as sales abroad, it has a kind of 'first claim' on the foreign income it generates and which allows the "servicing" of its returns – profits, dividends and remunerations of expatriate workers. The share of FDI in the actual (as opposed to declared) export income can be very sizable, depending on the balance power vis-à-vis local authorities who might concede very favorable investment conditions and lack the technical capacity to

¹⁵ Oil-exporting Libya, under Gaddafi, had an insignificant foreign debt and its population enjoyed relatively high standards of living (AfDB et al 2012). Equatorial Guinea also used to have a very low external debt but the majority of its 1.6 million population is still poor. While in Libya, under Gaddafi, the oil income was "nationalized", benefiting mostly the national economy and less the transnational companies, this has not been the case for Equatorial Guinea, a country where net income payments often reached sizable proportions. See box on "trade deficits".

¹⁶ FDI is defined by the OECD as "a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. Ownership of 10% or more of the voting power in an enterprise in one economy by an investor in another economy is evidence of such a relationship."

See OECD:

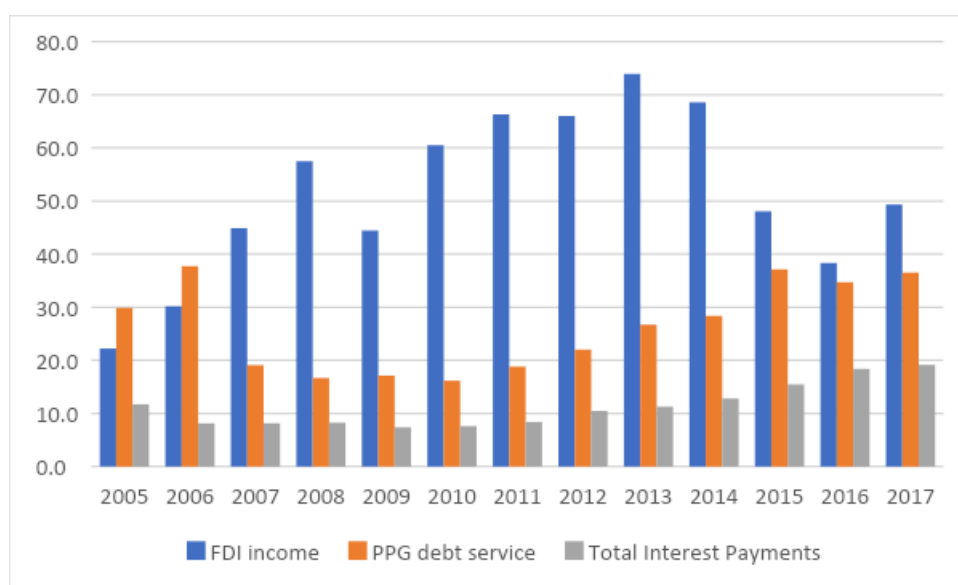
https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-fdi/indicator-group/english_9a523b18-en

¹⁷ Some Southern countries receive sizable income remittances from migrant workers.

monitor productive activities and their financial accounts. In many African countries, what is superficially diagnosed as a “lack of foreign exchange” or “external constraint” often hides a questionable distribution of export income in favor of FDI and at the expense of the national economy.

In the balance-of-payments, the returns (primary income) on Foreign Direct Investment (FDI) – essentially profits and dividends – are recorded in debit in the primary income account of the current account balance while FDI inflows and outflows are recorded in the financial account. The external debt service is recorded as debit in two places: in the financial account (principals) and in the primary income account balance (interest payments). Figure 1 compares between 2005 and 2017 FDI income, total interest payments on external debt, PPG external debt service. For this period, the World Bank provides complete annual estimates of FDI income for 34 African countries that contribute more than 90% of the continent’s GDP.

Figure 1. FDI Income, Total Interest Payments, and Debt Service on Public External Debt for a Sample of 34 African Countries (2000–2017), in current \$ billion.



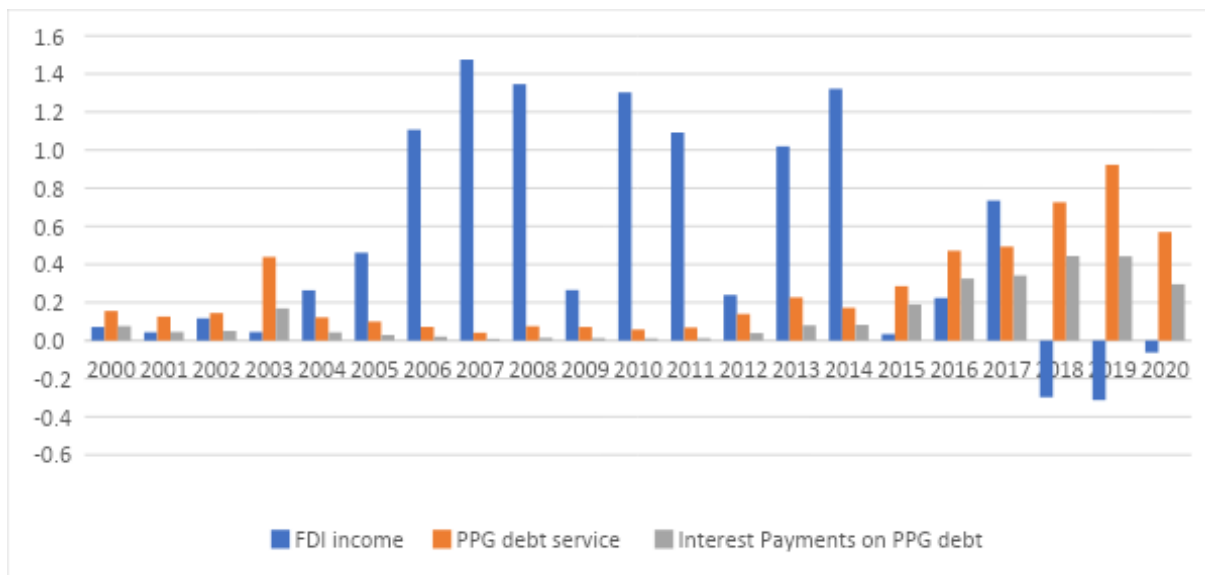
Source: Author’s calculations based on World Bank International Debt Database, accessed on 21 November 2023. PPG = Public and Publicly Guaranteed.

As can be seen, FDI income has been higher than total interest payments (public and private) every year during the period under study. From 2007 to 2017, a period overlapping with the commodity boom, FDI income has become consistently higher than the PPG external debt service. For example, in 2013 the external PPG debt service amounted to \$26.7 billion compared to \$74 billion for FDI income. One could rightly say that, to some extent, interest payments and the debt service have been somehow lowered by the partial cancellation of African sovereign

debts by their official creditors at the beginning of the 2000s (under the Heavily Indebted Poor Countries scheme and the Multilateral Debt relief Initiative). However, the more general point here is the following: sovereign debt dynamics cannot be analyzed without taking into account income transfers and real resource theft by FDI. For resource-rich countries, the need to issue debt in foreign currency often arises from the last two factors.

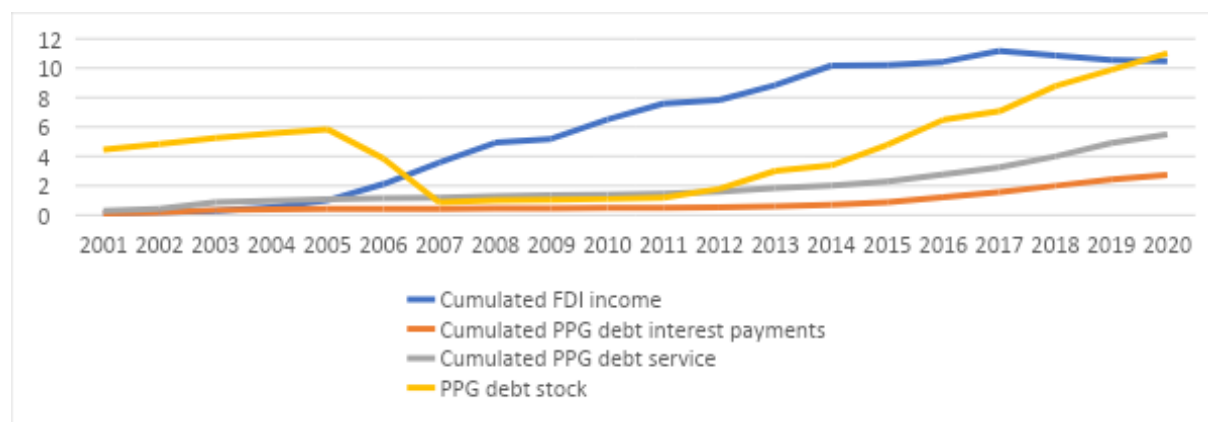
Let us illustrate this observation with the case of Zambia (see also Fischer 2020), this copper-producing country benefited from debt relief in the mid-2000s. Between 2000 and 2006, the external PPG debt stock declined from \$4.4 billion (128% of GNI) to \$0.86 billion (7.4% of GNI), an 80.6% decrease. This “restructuring” was conditional on the privatization of the copper sector for the benefit of Canadian mining companies that also enjoyed favorable tax and legal terms (Engler 2023). With the commodity boom, FDI income skyrocketed, deteriorating further the primary income account. The cumulated FDI income flows from 2000 to 2005 stood at \$1 billion compared to \$5.49 billion for the period 2006-2010. Between the years 2000 and 2020, cumulated FDI income flows reached \$10.5 billion vs. \$2.7 billion for interest payments on the external PPG debt and \$5.5 billion for the PPG external debt service. As for the PPG debt stock, it was relatively low until 2012 (12% of GNI). Between 2013 and 2019, it increased threefold in absolute terms, from \$3 billion to \$9.9 billion (in relative terms, from 12.6% of GNI to 48.1% of GNI). See figures 2 and 3.

Figure 2. Zambia: FDI Income, Interest Payments on PPG external debt, and PPG external Debt Service (2000–2020), in current billion \$.



Source: World Bank International Debt Database, accessed on 21 November 2023. PPG = Public and Publicly Guaranteed.

Figure 3: Zambia: cumulated FDI Income flows, cumulated Interest Payments flows on PPG external debt, cumulated PPG external Debt Service flows and PPG debt stock (2000–2020), in current billion \$.



Source: Author’s calculations based on World Bank International Debt Database, accessed on 21 November 2023. PPG = Public and Publicly Guaranteed.

However, the profits and dividend repatriations by FDI in Zambia are just the tip of the iceberg. The financial haemorrhaging has been compounded by Illicit Financial Flows (IFFs) – i.e. “financial flows that are illicit in origin, transfer or use, that reflect an exchange of value and that cross country borders” (UNCTAD & ECA 2023: 5). Available estimates suggest that Zambia would have lost \$10.6 billion in the form of illicit financial flows between 1970 and 1996 (355% of its 1996 GDP; Boyce and Ndikumana 2000), \$8.8 billion between 2001 and 2010 (Kar and Freitas 2012: 73), and \$12.5 billion between 2013 and 2015 (Nicolaou-Manias and Wu 2016; UNCTAD 2020: 46). By way of comparison, Zambia’s PPG external debt was \$1.2 billion in 2010, rising to \$12.5 billion by 2021 (World Bank 2022: 155).

A recent report from the IMF acknowledged these trends:

“Zambia’s BOP [balance of payments] has historically been characterized by large leakages in the form of sizable private sector assets held abroad. These outflows averaged about one third of copper exports over the last 5 years and have been as high as about 20 percent of GDP in 2012 and 2014. These outflows have largely offset the significant FDI inflows of the early 2010s and contributed to the gradual depletion of reserves before the 2021 SDR allocation.” (IMF 2023: 56)

The report added that “50 to 90 percent of copper exports in 2020-21 were not repatriated” and that “understanding how these proceeds were used is key to completing the assessment of the possible data gaps” (*Ibid.*).

Resource-rich countries like Zambia suffer a double penalty. First, due to large income transfers and real resource theft, they are deprived of foreign earnings that could have prevented the need to issue foreign currency debts and helped stabilize their exchange rates. Second, to “plug the

holes” thus created, they often open the “Pandora's box”: their governments issue debts in foreign currencies offering high interest rates; debts that appear to have been mobilized mostly for “general budget support”, “financing fiscal deficit”, “refinancing the domestic debt”, etc. (Bonizzi et al 2020: 47). When they become insolvent following external shocks, their exchange rate tends to depreciate,¹⁸ leading to a higher domestic currency burden of the external debt service. In such circumstances, they are asked by the IMF to implement austerity policies and other measures that will strengthen their so-called “external constraint” – the foreign income earning capacity by the national economy is damaged while its demand for foreign exchange tends to increase due to stronger import-dependence, income transfers and real resource theft. The debt “restructuring” process under the aegis of the IMF will thus likely be at best a cautery on a wooden leg. At worst, it risks paving the way to a future debt crisis, as it happened with Zambia. After a significant debt cancellation, it took “only” 14 years for the Zambian government to fall again into insolvency – to default on a \$42.5 million coupon payment on \$1 billion Eurobonds maturing in 2024 (Reuters 2020).

V. Conclusion

Most debates and policy proposals about Southern countries’ external debt problem take for granted the view that it is normal for their governments to issue debts denominated in foreign currencies. This paper tried to challenge this view by assessing the relevance of the main explanations to the “MMT question”. While Southern sovereigns might issue debts in foreign currencies due to a lack of democratic control and accountability, the explanations in terms of a lack of money and savings are erroneous. The view stressing a “lack of foreign exchange” is superficial: resource-rich countries often manage to generate enough foreign earnings but they suffer high income transfers and resource theft due to a lack of technical and fiscal control over their export sectors. The related explanation in terms of “external constraint” or “balance-of-payments constraint” is not satisfying either, as these concepts conflate a number of different issues. They often interpret as constraints imposed by the world economy situations that reflect domestic real resource constraints and that are the result of inappropriate or unsustainable domestic policy choices. Ultimately, Southern countries, like the Northern ones, have a real resource constraint. If their policies fail to take it into account, the result is usually inflation plus debt distress, given their lower degree of monetary sovereignty.

The MMT perspective adopted in this paper leads to a number of policy insights or recommendations. To start with countries currently in debt distress, “fiscal consolidation” and privatization of domestic assets for the benefit of foreign capital are often the policy options imposed by the IMF. It must be said however that monetarily sovereign governments could afford to provide significant debt write-offs to their Southern counterparts, if they have the political will. Given the increased complexity of the creditors landscape, the most important issue would be one of coordination.

¹⁸ The Zambian currency, the kwacha, depreciated 23.3% against the US dollar in 2019, 42.3% in 2020, and 9.3% in 2021. It started to appreciate in 2022 (IMF 2023: 31).

Beyond the need for significant relief, lasting solutions to sovereign debt crises in the South will have to be found. This will necessitate an embrace of functional finance predicated on a clear understanding of the actual constraints. As Nersisyan and Wray (2023) wrote:

“[C]larifying what the actual constraints are matters for policy. Indeed, misunderstanding how sovereign currency works prevents many nations from living up to their resource capacity by adopting an unnecessarily restrictive fiscal stance while they leave domestic resources unemployed. Most nations’ ability to mobilize their domestic resources using domestic currency is much greater than typically understood. Further, understanding what the actual constraints are can help governments to try to overcome them by using their domestic resources.”

Unless they want to be locked into a pattern of economic instability, underemployment of their human resources, recurrent debt crises, etc. Southern countries could not afford to not use their currency-issuing powers in a way that is consistent with their real resource constraints and their international payment possibilities. They could try to make progress on the four fronts below:

1. As most of them are resource-rich, if they manage to achieve more technical and fiscal control over their export sectors, they could increase their ability to finance their imports out of their foreign earnings with less need to issue debts in foreign currency.
2. If they rely for their development on real resources that are available domestically or that they can develop themselves (LPs), their policy space will be further expanded. One way to go in that direction is to implement a Job Guarantee program (Tcherneva 2020). Such a program could be designed in a way to limit its balance of payments footprint. Economic benefits would include full employment, better living conditions for the populations and enlarged domestic markets that will help the development of SMEs (Sylla 2023b).
3. They could invest in economic diplomacy to ease the international payment problem (possibility to obtain swap lines or to implement bilateral-multilateral payment and settlement systems, etc.).
4. They should be cautious and selective about externally-resourced projects that have speculative and Ponzi profiles. When they are economically strategic, concessional forms of external finance should be privileged while avoiding derisking commitments for the benefit of private global finance.

The point about these different policy avenues is the realization that no reform of the international financial system can be a panacea when the basic macrofinancial framework for progressive economic and industrial policy is absent at the national level.

Finally, when it comes to the global ecological transition, it is certain that Southern countries will need significant real resource transfers *gratis* (waiver on intellectual property rights and technological patents, technology transfers, technical support, etc.). To the extent that their national foreign earning capacity might be adversely affected (reduced demand for their fossil fuel exports, negative shocks in the agricultural sector, etc.), it will be virtually impossible for them, within the current global economic, monetary and financial order, to collectively achieve a painless green transition, absent compensating and supporting financial transfers. To address the

climate crisis in a spirit of international solidarity, and in a way to break from centuries of unequal ecological exchange between North and South, the rehabilitation of public finance and the design of a new multilateral framework are core requirements (Gabor and Sylla 2023).

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