External Debt in Africa

Policy brief no.3 - October 2010

In 2009, with an external debt of around US$300 billion, African countries spent about 16% of the continent's export earnings on servicing their external debt. This is significantly less than during the height of the African debt crisis in the 1990s, when debt service at times exceeded 40% of export earnings[1] (HIPC and MDRI status of implementation, IDA and IMF 2009). Yet, it still diverts scarce fiscal resources from crucial areas of spending for development and growth.

As a result, Africa's external debt – consisting of multilateral, bilateral and private debt – has impeded economic growth and sustainable human development in numerous countries.

Although the international community achieved commendable efforts towards debt relief for poor countries, reducing the debt burden and achieving debt sustainability remains a key challenge for Africa.

In 2005, African countries agreed that debt cancellations should be the ultimate goal for Africa and should be linked with the implementation of the MDGs and access for African products to foreign markets.

The origins of the debt crisis lie in the global economic recession of the 1970s triggered by the oil price shocks. Due to slow growth and low interest rates, many developing countries built up a stock of debt that became unsustainable when interest rates rose in the early 1980s and commodity prices plummeted.

Against this background, the protracted nature of the crisis eventually led to a coordinated policy response by the Bretton Woods Institutions, the Structural Adjustment Programmes (SAPs), which required drastic macroeconomic policy reforms to stabilise the recipient countries' economy as a condition for access to new loans.

This document is part of a series of policy briefs produced by the United Nations Office of the Special Advisor on Africa (OSAA) and the NEPAD-OECD Africa Investment Initiative for high-level African policymakers and development partners. The policy briefs give a concise overview of key economic and development issues affecting Africa today. The briefs are available at www.un.org/africa/osaa, and at www.oecd.org/daf/investment/africa. This collaboration also includes the publication "Economic Diversification in Africa: A Review of Selected Countries". For more information, please contact: David Mehdi Hamam, Chief (OSAA) at hamamm@un.org or Karim Dahou, Executive Manager (NEPAD-OECD Initiative) at karim.dahou@oecd.org.

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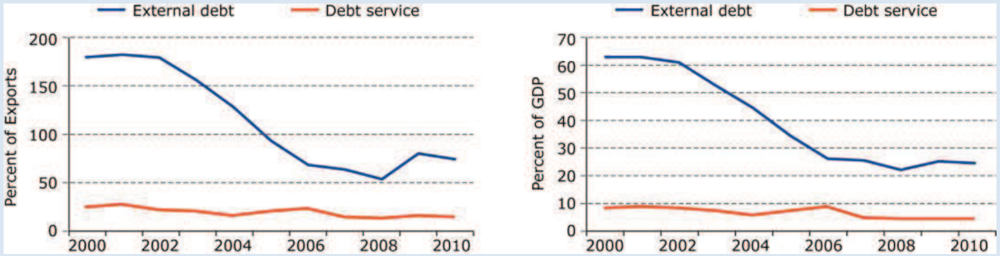
Figure 1: African Debt and Debt Service



Source: International Monetary Fund, World Economic Outlook Database, October 2009.

The SAPs did not bring about the high growth that would have been necessary to put a serious dent in debt levels. As a result, in 1996 a more comprehensive approach was introduced through the Highly Indebted Poor Countries (HIPC) Initiative. It is aimed at ensuring debt sustainability while freeing up resources for social development and entailed coordinated action by the international financial community, including multilateral institutions. In 1999 HIPC was enhanced by lowering debt burden thresholds and providing earlier relief to indebted countries.

To benefit from the HIPC Initiative, countries have to go through a two step process: a decision point and a completion point. To reach the decision point, a country must, among other criteria, face an unsustainable debt burden (150 percent for the ratio of the net present value of debt (NPV) to exports of goods and services and 250 percent for the ratio of NPV to fiscal revenue) and have a Poverty Reduction Strategy Paper (PRSP) in place.

At this initial stage, interim debt relief may be provided. In order to reach the completion point and receive full reduction in debt available under the HIPC Initiative, key reforms agreed at the decision point and in the PRSP must be implemented.

In 2005, the Gleneagles Summit of the G8 supplemented HIPC by endorsing the Multilateral Debt Relief Initiative (MDRI) for the 100% cancellation of debt owed to the World Bank, the IMF and the African Development Bank by countries that have reached completion point. Together, HIPC and MDRI represent a significant commitment by the international community to alleviating African countries' debt.

The estimated total cost of these initiatives so far is US$ 103 billion in end-2008 net present value terms.[2] As of July 2010, 23 of the 33 eligible African countries have reached completion-point and thus received substantial debt relief (see Table 1).

In addition to the multilateral efforts, a number of bilateral initiatives significantly reduced Africa's debt burden as well. A prominent example is the Nigerian debt relief in 2005, where creditor countries in the Paris Club wrote off close to a third of the country's debt.

Table 1. African Countries in HIPC

Status	Countries
23 Post-completion-point countries as of July 2010	Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Democratic Republic of Congo, Ethiopia, The Gambia, Ghana, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Republic of Congo, Rwanda, São Tomé & Príncipe, Senegal, Sierra Leone, Tanzania, Uganda, Zambia
6 Post-decision-point countries	Chad, Côte d'Ivoire, Guinea, Guinea Bissau, Liberia, Togo
4 Pre-decision-point countries	Comoros, Eritrea, Somalia, Sudan

Source: IMF, 2010

Policy challenges and opportunities

Debt relief efforts have helped to bring down Africa's total debt substantially (see Figure 1), allowing the benefiting countries to increase their poverty reducing expenditures by 2 percentage points of GDP on average between 2001 and 2008. Debt service as a percentage of exports decreased from roughly 27% in 2000 to 12% in 2008.[3]

However, key challenges remain. Important creditors such as smaller multilateral institutions, non-Paris Club official bilateral creditors and commercial creditors, which together account for 25% of total HIPC Initiative costs, have only delivered a small share of expected relief. Vulture funds litigation remains a serious threat to debt relief initiatives, since HIPCs are being forced to repay far more than their initial agreements to commercial creditors and vulture funds, through legal actions.

Indeed, many African countries, even those benefitting from HIPC and MDRI, are still in debt distress or at high risk of becoming so, according to the IMF and World Bank's debt sustainability analysis. This analysis considers debt indicators and prospects for new borrowing to assess a country's ability to service future debt, and has confirmed that many countries are in danger of assuming even more unsustainable debt. This includes three post completion point countries: Burkina Faso, Burundi and the Gambia. On the other hand, the overall outlook has been barely affected by the crisis – only one African country, Eritrea, had its rating downgraded from high risk to 'in debt distress', reflecting the expectation that the deterioration of debt ratios due to the crisis is of short term nature only.[4]

Due to the protracted nature of the debt crisis, more far-reaching solutions to the problem have also been put on the table.

The Group of 77 and China in 2009 have called for a temporary debt moratorium for low-income countries. They also called for the establishment of a sovereign debt resolution mechanism, or an international bankruptcy court.

Apart from debt reduction and relief measures, the international community also invests in capacity building initiatives to improve debt management of

Impact of the Financial Crisis

The global economic crisis has hit Africa hard, despite its relatively weak financial integration with the rest of the world. Remittances and exports sank, tight credit worldwide reduced Foreign Direct Investments (FDI) and portfolio investments, and commodity exporters suffered from depressed prices, leading to a weakened domestic growth performance in Africa – down to 1.9% in 2009 from more than 5% the previous year (IMF World Economic Outlook, 2009). Middle-income and oil-exporting economies were hardest hit by the crisis. In addition, since the beginning of the crisis, African countries' foreign exchange markets experienced enormous pressure specifically by registering high depreciations to the US dollar in which most of the external debt is denominated. This situation imposed serious debt service burdens to African countries. Africa's debt increased markedly in 2009, to 25% of GDP on average, up from 22% in 2008.

This situation led African countries to call for a temporary moratorium on debt payments to free up resources for development in June 2009. However, the limited integration of most low-income countries in Africa into the global economy will allow them to bounce back quickly. The IMF expects a quick recovery and projects the African continent to grow by 4.3% in 2010 and 5.3% in 2011, which will also improve the debt outlook.

African countries. Effective public debt management will reduce financial vulnerabilities and contribute to macroeconomic stability, thereby increasing investor's confidence and securing future borrowing. One such project is the OECD Forum on African Public Debt Management and Bond Markets, where African debt managers can enhance their understanding of sound policies and practices of public debt management.

Outlook and prospects

Despite meaningful progress in debt relief a number of challenges remain. Support has been maintained to ensure sustainability after HIPC/MDRI completion and maximum benefits from debt relief.

With regards to sustainability, the United Kingdom has passed legislation to mitigate the effects of vulture funds litigation on African countries, in particular for the African HIPCs. The United States is currently discussing such a measure.

Recently, several countries have emerged as new creditors to African countries which increases the availability of resources for development financing. However, these new creditors should not undermine debt sustainability in Africa.

Notes

1 IMF World Economic Outlook Database
2 IDA and IMF (2009): HIPC and MDRI – Status of Implementation
3 IDA and IMF (2009): HIPC and MDRI – Status of Implementation
4 IDA and IMF (2010): Preserving Debt Sustainability in Low-Income Countries in the Wake of the Global Crisis.