Debt and Africa's poor: the World Bank relents

Michael Holman reports on a 180-degree policy shift on how to cope with the continent's $160bn debt mountain

The World Bank's "new vision" for resolving the external debt problem of the world's 40 poorest countries could prove to be one of the most important steps in the resolution of Africa's development crisis.

The bank's proposals, set out in a document being circulated to leading creditors, mark a fundamental shift in World Bank policy on the issue of debt relief for its most impoverished borrowers – something the bank has until now refused to countenance, but which development agencies such as Oxfam, the British charity, have long been pressing for.

Settling the issue of multilateral debt will, says the bank, "set the stage for the most significant breakthrough in dealing with the debt of poor countries since the Brady plan for private commercial banks, and the Naples Terms agreement for Paris Club creditors".

But as the document, backed by Mr James Wolfensohn, the World Bank's recently appointed president, points out, "the challenges are not easy to meet: the risks are high, but so are the stakes".

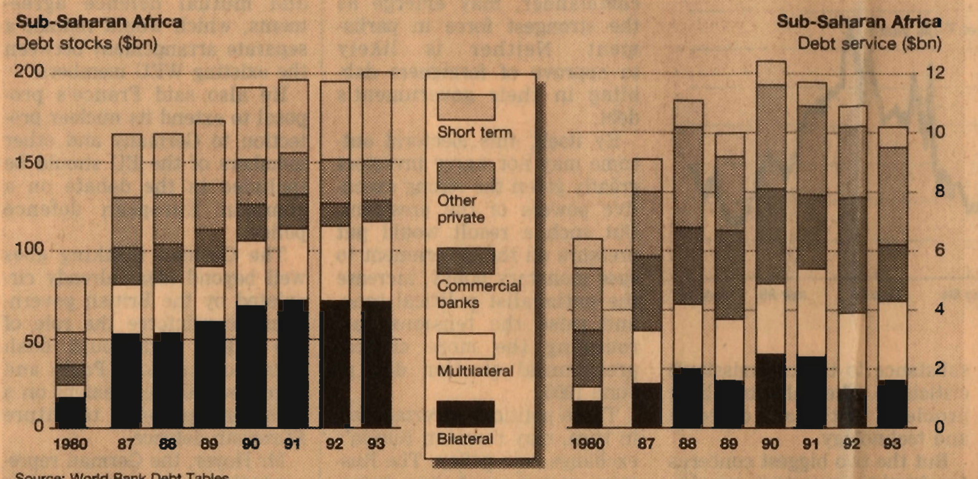
First the bank must win support for its call for a comprehensive debt settlement from other creditors. As bank officials make clear, existing measures for commercial bank and official debt are not enough.

Among the risks is the danger that the plan could backfire, opening up divisions within the ranks or donors and creditors, rather than produce the effective consensus the bank is seeking.

There is neither unanimity about the impact external debt is having on Africa's recovery efforts, nor on how the burden can best be eased.

Germany, Japan and the IMF are among the lenders and institutions who will have to be won over by the bank, and

Africa's debt profile



Source: World Bank Debt Tables

THE MAIN POINTS

- **The new facility would pay principal and interest on multilateral debt on behalf of the debtors, as it fell due**
- **Eligibity will require "proven policy performance record" and prior stock reduction agreements with commercial banks and the Paris Club**
- **Projected spending would be $400m a year for the next five years, decreasing to $300m for the second five years, and to $100m in the third**
- **Nearly two thirds of poorest country debt is owed to bilateral official creditors; multilateral debt accounts for about 20 per cent**
- **The IMF holds 22 per cent of the multilateral debt affected, IBRD (15 per cent), the Africa Development Bank (13 per cent) and IDA (25 per cent)**

the differences between members of this group could easily be exacerbated during the debate the document seems certain to provoke.

From the African perspective, however, the debt burden has become unmanageable and unpayable.

Dr Percy Mistry, a former bank economist and specialist on African economies, has traced three phases to the build up of African debt.

From less than $3bn in 1962, with a debt service ratio of less than 2 per cent, it grew to $146bn in 1990, equivalent to 110 per cent of the region's GDP. Service payments – if they could have been met – would take up three times its annual export earnings.

Today that debt has climbed to $160bn. But its structure has been changing, with multilateral debt obligations – notably to the World Bank – assuming a greater significance.

In 1980 this category accounted for 17 per cent of long term debt and 11 per cent of servicing. By 1994, multilateral debt accounted for nearly 26 per cent of the total and nearly 48 per cent of servicing.

It is these figures, and the example of countries such as Uganda, whose reform efforts are hampered by the size of repayments to the very institutions that should have been most sympathetic to their predicament, that helped contribute to the bank's decision to change its hitherto inflexible approach to multilateral debt.

The bank has addressed the problem through the proposed creation of the $11bn Multilateral Debt Facility.

This willingness to accept that some of its most impoverished borrowers need help – "a 180 degree policy shift", as one official put it – is perhaps one of the most important policy changes in the institution's 50 year history.

Two years ago it warned that debt rescheduling terms then offered "are not enough to ensure that African countries can service external debts in the medium and long term as scheduled. A more radical approach is needed".

Now the bank has led the way, but there is a strong possibility that it will not win the consensus it says is essential.

Canada and Britain are expected to welcome the initiative, says the document, as would the US "if not required to produce additional funds".

But France would need to be won over, although likely to be swayed by whether Ivory Coast would be eligible for the facility.

Germany too might be hard to convince, but Japan will be the hardest to persuade. Tokyo "sees a fundamental inconsistency between simultaneous provision of debt stock relief and new money".

But the most important response will be that of the International Monetary Fund and, according to bank officials, the fund response has been at best lukewarm.

Nor is the bank itself without potential internal division.

Some senior officials are concerned about the impact on its creditworthiness, which could make it more expensive to raise new funds, with the cost in turn having to be passed on to third world borrowers.

The document acknowledges this danger. "The facility may create the perception of a write-off precedent . . . as a fundamental change in the bank's financial policy, and as a precedent for future action".

The bank emphasises that it will require prior debt relief action by other creditors and that it will impose strict eligibility criteria – namely, poor countries implementing bank approved policies.

If external debt was seen as the main problem facing Africa's recovery efforts, consensus might be easier to achieve.

But many economists, inside and outside the bank and the IMF are far from convinced that the external debt is the obstacle to development that is made out.

Poor implementation of economic reform, weak management and lack of political will, are at least equally to blame, they argue.

And unless the economic environment is competitive with Asian and other contenders for foreign investment, Africa's share of foreign direct investment, barely 1 per cent of the world total, is not likely to improve.

Furthermore, most African countries have set a limit – usually between 25 to 30 per cent – of the foreign exchange earnings they will set aside for debt servicing. Arrears accumulate, but resources are available. The problem, say economists, remains Africa's failure to use these resources efficiently.

The counter arguments, however, have it seems been enough to win over the bank.

Aside from the sheer impossibility of repaying the debt, and the discouraging effect it can have on would-be investors, it helps undermine Africa's scarcest and most precious resource - the skilled personnel needed to implement the reforms.

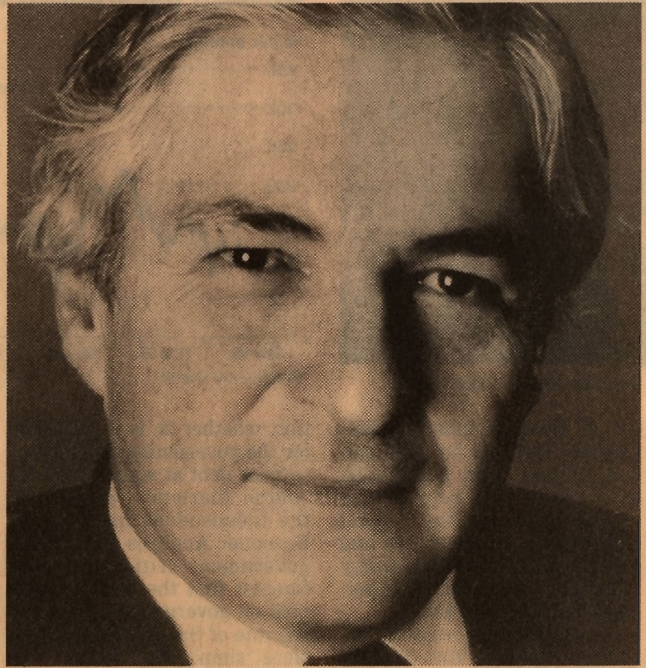
Some 8,000 reschedulings have taken place in Africa between 1984 and 1992, demanding the time of ministers and senior civil servants travelling back and forth to western capitals instead of at their desks and putting development plans into practice.

And for those in opposition in countries whose governments are mismanaging the economy, and who wish to pursue reform, the structural adjustment programme is hard to sell, for under current rescheduling terms the debt burden will still take generations to reduce to sustainable levels.

Initial reaction from African governments has been enthusiastic, but ministers and officials are awaiting next month's annual meetings of the bank and IMF in Washington to assess the support the proposals will get.

"The critical voice is that of the Fund," said one West African minister, "and I'm not going to celebrate until that institution endorses it.

"In the meantime, I'm not holding my breath."



Wolfensohn: the risks are high but so are the stakes