Africa's rising debt Conference

Opening keynote address by Antoinette Monsio Sayeh

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Opening

Thank you very much for that introduction [Alex and Simon] and for your kind invitation.

A very good morning to all. I'm most pleased to visit ODI again, to deliver this opening keynote, and to listen to and learn from other colleagues at this important conference.

The development community has rightly been concerned about the rapid pace of debt accumulation in Sub-Saharan Africa (SSA). When I participated in the Debt Management Facility (DMF) Stakeholders' Forum in Brussels last May, alarm bells had seemingly already reached a crescendo in the IMF's March 2018 Policy Paper "Macroeconomic Developments and Prospects in Low-Income Developing Countries". But alarming – and sometimes alarmist – commentary has continued since then, with countless blogs and admonitions to country authorities and creditors alike. As valid as they are, these concerns must remain grounded in the difficult reality of SSA countries needing large volumes of financing for meeting the Sustainable Development Goals (SDGs). Let's remember that borrowing is in and of itself not a bad thing, that the issue is not to never borrow, but to do so by safeguarding debt sustainability while maximizing the returns to development.

Those were certainly the expectations in the heyday of the Heavily Indebted Poor Countries' or HIPC Initiative whose primary objective was to help expand fiscal space for developmentspending. It is also important to recognize that the changed composition of debt since HIPC – i.e. with some countries being able to tap into international markets for financing – is a positive reflection of their transition from low-income countries to frontier market economies. Being a feature of development, this market access is to be valued. The response to increased debt vulnerabilities cannot be returning to having no other choice than traditional donor financing, but is instead responsibly and transparently managing new financing choices.

These were the key messages I delivered in Brussels, and from this perspective I will cover five areas in the [40] minutes I will use for my remarks. I will first discuss my experience as a key player in Liberia's debt relief process during 2006-2008, with the view to drawing relevant lessons for current debt challenges, especially for countries already in debt distress. I will then present a brief overview of the evolution of SSA's debt and of its drivers and composition. Following that I'll comment on this debt's contribution to investment. I'll then review the key policies required to reduce debt vulnerabilities while creating fiscal space and tapping other sustainable financing for development spending. And I'll conclude my address by pointing to a number of issues needing more attention from creditors and the international community.

Takeaways from Liberia's HIPC Debt Relief Process

Liberia first, then. When President Ellen Johnson Sirleaf's first administration took office in January 2006 and I joined as Minister of Finance, Liberia was emerging from a decade of economic mismanagement followed by fourteen years of conflict, with a shattered economy and the bleakest social conditions. Given the debt overhang inherited by the new government, a key priority was restoration of Liberia's relationship with the international community, clearance of long-standing external arrears equivalent to some 600 percent of GDP, and debt relief. With no financing having been included for Liberia – nor for other countries long in debt distress like Somalia and Sudan – under HIPC, this proved to be a monumental challenge notwithstanding speedy negotiation of an IMF Staff-Monitored Program (SMP) and two years of good performance under two successive SMPs. The structure of the $4.5 billion stock of arrears was fairly evenly distributed with multilateral arrears of 33 percent, bilateral arrears of about 32 percent, and commercial arrears of close to 35 percent. Close to all of Liberia's debt was in arrears with the total nominal debt stock only some $200 million more than the stock of arrears.

Clearance of arrears to the international financial institutions or IFIs – the IMF, World Bank, and African Development Bank -- was for us the most urgent area of focus since without that no Fund financial program nor normal IDA nor AfDB financing was possible. The World Bank's arrears were cleared in December 2007 through a bridge loan provided by the United States that was repaid with proceeds of a Development Policy Operation (DPO) financed with an exceptional allocation of IDA grant resources. The AfDB's arrears were cleared in the same month through its Post-Conflict Countries' Facility (PCCF), with one-third of the cost covered by bilateral donors and two-thirds by PCCF resources. It was not until March 2008 that U.S. bridge financing was used to clear the Fund arrears, a new Poverty Reduction and Growth Facility (PRGF) and Extended Fund Facility (EFF) program was approved to repay it, and financing assurances were obtained for Liberia to reach the HIPC Decision Point.

There was no established source of exceptional financing at the Fund to finance its portion of HIPC debt relief to Liberia. Instead it took months of "passing the hat" among IMF member countries to contribute a partial distribution of resources they held in the Fund's First Special Contingent Account or SCA-1, the first time such a modality had been used. A month later Liberia received a generous rescheduling of most of its bilateral debt through the Paris Club. Negotiations with the remaining non-Paris Club bilateral creditors then began as did the resolution of Liberia's commercial debt through a cash buy-back scheme under the World Bank's Debt Reduction Facility for IDA-only countries. The buy-back required a very steep discount, and -- with the assistance of first-rate external advisors -- ultimately overcoming most of the jockeying of vulture funds.

In addition to demanding so-called upper credit tranche conditionality under the SMPs, arrears clearance to the IFIs, and the new PRGF/EFF program, Liberia's ability to reach the HIPC Decision Point required that we refrained from any borrowing – including concessional borrowing -- for more than two years at a time when our financing needs were greatest. This in turn required commitment at the highest levels of government to back the ministry of finance in not allowing any sectoral ministry, agency, or state-owned enterprise (SOE) to pursue borrowing – and to be on constant watch out for attempted non-compliance. Let's be clear that SSA Ministers of Finance will always have difficulties maintaining control when incentives for other ministers are to find loans for new projects and if Presidents or Prime Ministers don't hold the line. With very scarce capacity, keeping the SMPs on track, not borrowing, and meeting other HIPC Decision Point conditionality – including an Interim Poverty Reduction Strategy – all of these responsibilities left pretty much no room for anything else in the minister of finance's and sometimes the President's world.

So, with that narrative of the debt relief process, are there lessons or takeaways from the Liberian experience that are relevant to the current debt challenges or debt distress faced by some African countries? I just signaled the need for focus, tenacity, and commitment at the highest political level to prevent torpedoing the debt relief effort or maintenance of debt sustainability. This first lesson applies to all SSA countries. I see other takeaways that are relevant to the two African countries that have been in protracted debt distress and are still hoping to benefit from HIPC debt relief – Somalia and Sudan. I should say parenthetically that Zimbabwe is in a league of its own, having already cleared its arrears to the Fund but struggling to find a solution for its World Bank and AfDB arrears.

In any case the second element that Somalia and Sudan don't yet have but which Liberia fortunately achieved in two years is a strong enough track record of reform, notwithstanding a number of SMPs. The third difference I see is that for different reasons donor support has been absent or uncertain and these two countries don't yet have the full backing of an influential bilateral donor in forging the needed support of others. The fourth takeaway is that if and when the required track record is established, financing of the Fund's portion of debt relief for Somalia and Sudan will also likely confront the challenge of employing the SCA-1 modality. Finally, although we could have benefitted from even higher levels of grant financing while working towards our HIPC Decision Point, it is fair to say that Liberia had more pre-arrears donor financing and consistent support than we've seen in Somalia. The interdependence of state building, security, and development would seem to argue for a more agile solution to debt distress in fragile states like Somalia to facilitate their earlier access to more adequate levels of financing.

But colleagues and fellow participants, a decade on, I must say that all is not entirely well on the debt front in Liberia. Although Liberia was hard-hit by the major twin shocks of Ebola and commodity price decline, the increasing fragility of its debt sustainability also stems from some policy missteps. The last Bank-Fund Debt Sustainability Analysis (DSA) reflected in the June 2018 Article IV Report assessed Liberia to be at moderate risk of debt distress. However, it cautioned the move to a high risk of debt distress if the base case projected financing gap through 2023 was filled with external borrowing in excess of the anticipated $1 billion.

Recent non-transparent contraction and attempted contraction of manifestly non-concessional debt to finance inflated road construction ambitions suggest an eventual transition to high risk of debt distress. Should this materialize, it would illustrate the difficulties of protecting the fruits of reform and debt relief even with strong laws on debt contraction and management – such as the Public Financial Management Act -- when those in charge have very different priorities.

SSA Debt Evolution, Drivers, and Composition

Let me now leave Liberia and turn to the region at large and to the debt challenges currently confronting it. As is by now well-known, debt stocks and interest payments have risen sharply in the region, and especially in oil exporters. Compared to 2013, the median public debt-to-GDP ratio at end-2017 was about 20 percentage points higher while the median interest payments-to-revenue ratio almost doubled. Debt service costs for oil exporters and other natural resource producers in particular have become onerous. In Zambia for example, in 2011 interest payments on debt were about 20 percent of the money spent on health and education, and by 2017 they had risen to 50 percent. Nigeria's debt service increased from 22 percent of revenues in 2016 to more than 60 percent in 2017. With some delayed fiscal consolidation now underway among oil exporters, and with the expected regional growth rebound, debt levels in 2018 should decline slightly. And some improvements in debt servicing capacity are likely in some highly indebted countries with improved revenue performance.

Having said that, it is sobering to note that more than a third of SSA countries are now in debt distress or at high risk of debt distress. From only 7 in 2013, the number of countries in debt distress or at high risk of debt distress more than doubled to 15 in 2017. There are 17 if the two protracted arrears cases of Somalia and Sudan are included. Compared to the period before 2013, the list now contains a variety of countries at high risk of debt distress, ranging from lower middle-income/frontier economies like Cabo Verde, Cameroon, Ghana, Sao Tome and Principe, and Zambia, on the one hand, to fragile states/LICs such as Burundi, Central African Republic, Ethiopia, and the Gambia, on the other hand. Apart from middle-income Republic of Congo and low-income Mozambique, the list of countries in debt distress includes only fragile/conflict-affected states – i.e. Chad, Eritrea, Somalia, South Sudan, Sudan, and Zimbabwe.

The main drivers of the debt sustainability deterioration in oil exporters were large primary deficits, exchange rate depreciation, and delayed adjustment to the 2014 oil price shock. Although still worrisome, the pace of debt accumulation was less rapid in other countries where consistently higher growth in the case of non-resource-intensive countries -- such as Kenya and Senegal -- helped to contain the debt-to-GDP ratio. Debt sustainability deteriorated in some other countries due to negative growth, internal conflict or pandemic, lack of transparency, reporting of previously hidden debt -- as in Mozambique -- and below-the-line operations, e.g. operations of SOEs and incomplete recording of public transactions.

Now, despite the region's increased debt vulnerabilities, investor appetite has remained strong with longer bond terms for some countries this year and differential bond spreads for high versus non-high grade countries. With SSA sovereign bond issuance reaching record levels of $7.6 billion in 2017 and close to $14 billion in the first half of 2018, the expansion in borrowing from China and other non-Paris Club bilateral creditors over a number of years, and increased domestic borrowing in some countries, the composition of SSA's debt has changed significantly. As the share of foreign-currency denominated debt increased, and as the share of bondholder and private bank debt rose, so have debt vulnerabilities increased. These changes have meant more exposure to market, rollover, and foreign exchange risks for some countries and debt resolution challenges in others – as with the Republic of Congo where debt to China dominates and collateralized debt is larger than previously realized. Having said all this, I should stress that not all cases of high risk of debt distress or debt distress are China's "fault" as some increasingly aggressive commentary would have us believe. In some cases, the deterioration is clearly linked to a larger share of commercial borrowing. I found the Jubilee Debt Campaign's analysis of African debt statistics published last month instructive in this connection.

Let me conclude this overview of SSA debt by noting that in some countries contingent liabilities from SOEs and the accumulation of domestic arrears have created additional fiscal uncertainties. And rising domestic public debt in a number of countries has further increased banks' exposure to the sovereign and reduced room for lending to the private sector. This latter disturbing development has resulted in declining credit growth to the private sector. Such crowding out has been evident in Angola, the Central African Economic and Monetary Union, and The Gambia. I look forward to hearing more about SSA's debt dynamics from the first session of the conference this afternoon.

Debt and Investment

Now, fellow participants, has all this debt accumulation actually increased investment? And is this in fact the right or only question to ask? I know from my own time at the IMF that the policy dialogue with SSA countries was dominated by this issue – in particular financing infrastructure investments -- which countries pushed as the rationale for revising the Fund's debt limits policy. The Policy Paper on LIDCs I referred to at the beginning of my remarks finds that increased public investment contributed to debt accumulation between 2010-2014 and 2017 in many countries but was a key driver in only a minority of cases. The finding of a drop in investments in many LIDCs is highlighted, but the story cannot and should not end there, for at least three reasons.

First, physical infrastructural investments are not all that's needed for growth. Indeed, spending on health and education – much of it recurrent -- is critical to the SDGs and necessary to make infrastructure investments beneficial. Recurrent spending on maintenance is clearly essential to keep infrastructure in good shape. Second, where one does see many new roads, ports, etc – as e.g. in Equatorial Guinea – they actually raise questions about the quality of those investments. And third, there are circumstances under which investment could have little impact on aggregate demand in the short-term given its large import content. There are also conditions when investment has limited impact on aggregate supply in the medium term if roads lead to nowhere. And there are cases where investment has limited impact on foreign exchange earnings because roads lead to an expansion of domestic production of goods and services but not to increased exports.

So not all investments are growth-enhancing. Indeed, project selection has been a major shortcoming in financing provided by some non-traditional donors and is not much of a concern for private lenders. In addition to being concerned about countries with expanded debt, at high rate of debt distress, and with little or no high-quality investments, we must also draw lessons from countries with significantly increased debt levels, but at low risk of debt distress and with continuing robust growth – countries like Rwanda.

Addressing Debt Vulnerabilities and Financing Development

I will now turn to corrective policies to contain debt, reduce debt vulnerabilities, and expand more sustainable development financing. SSA's debt – especially those on commercial terms –will clearly need to be contained, and restructured for those countries already in debt distress. While there is good news for containing debt in countries' plans for fiscal consolidation, implementation of such plans is often postponed. After significant delays, some adjustment is now underway in oil exporters but is largely attributable to the revenue impact of the recent uptick in fuel prices and to cutting investment, rather than to a stronger overall revenue effort. And the fuel price increase may unfortunately lead to a relaxation and further delay of adjustment efforts. Policy makers must acknowledge the reality of stronger economic recovery in the region and safeguarding debt sustainability not being possible without steadfast implementation of fiscal consolidation plans.

Significantly improved domestic revenue mobilization is a key aspect of growth-friendly fiscal consolidation, and is in any case critical to increasing fiscal space for development spending. The major attention it has received since the 2015 Addis Ababa Financing for Development Conference reflects the fact that it is an underexploited source of sustainable development finance. Indeed, the average sub-Saharan African country could increase its tax-to-GDP ratio by 3-5 percentage points. This will of course take time, but countries have much to gain in exerting political will to confront vested interests and reap under-exploited low-hanging fruits from e.g. reducing tax exemptions, excise taxes, and property taxes. In what will remain a resource constrained environment for some time, however, two additional urgent policy priorities are to improve investment selection and increase investment efficiency. Public private partnerships or PPPs are possibly a source of infrastructure financing, but only for those countries with strong institutional and legal frameworks and who can mitigate the associated fiscal risks by carefully assessing, disclosing, and budgeting for them.

The current financing constraints underscore the importance of developing capital markets in SSA, with the view to limiting capital outflows and channeling more non-debt creating flows – especially more FDI -- to the region. Strong macroeconomic fundamentals remain a sine qua non for this, as do improvements in the investment climate, better institutional quality, and better governance.

Continued strong investor appetite for SSA sovereign bonds despite debt vulnerabilities suggests room for more risk-sharing by investors, and perhaps through alternative funding vehicles or instruments to cover refinancing risks, e.g. GDP-linked bonds. Some management of expectations is however required with respect to still-untried GDP-linked bonds whose technical details are still being worked out for advanced countries [, and given poor GDP statistics in a number of SSA countries.] I look forward to learning more about potential new financial instruments from colleagues in Session 2 this afternoon.

But ladies and gentlemen, beyond the search for and development of more sustainable sources of financing, some SSA countries will need to reign-in their public investment ambitious in recognition and support of an expanded private sector role in propelling growth. In effect – and as the recent SDG costing exercise makes clear -- the SDGs are simply not achievable with a predominantly public sector focus. While many countries fully recognize this in word and deed, some only pay lip-service while pursuing expensive borrowing for low-quality investments. The move to "blended finance" with a more catalytic role of the MDBs in unleashing private sector financing and the G20's Compact with Africa are welcome developments that could support governments in this connection. It is critical that these initiatives begin to show early results and impact in light of the ticking clock to 2030.

Recent developments in some countries underscore the need for more attention to strengthening transparency and debt data to avert so-called “debt surprises” or “undisclosed debt” as in the Republic of Congo and Mozambique. Despite a tremendous amount of technical assistance over the years, debt data in SSA remain weak with most countries reporting only central government rather than general government data covering SOEs. In many countries, guarantees and extra-budgetary operations are not covered, with a resulting significant risk of contingent liabilities. Some of these issues can be improved by more effective IFI technical assistance and training, but SSA countries will also need to demonstrate strong political will and discipline in curtailing, better managing, and reporting such off-budget operations and contingent liabilities.

Action from Creditors and the International Community

Moving on now to the responsibilities of creditors and the broader international community, I first want to welcome the recent roll out of the revised IMF/World Bank Debt Sustainability Framework (DSF). The revised DSF went into effect in July and its use should support the improvements urged by stakeholders for some time. In particular, the DSF promises to remain balanced in its treatment of risks and borrowing opportunities and to reflect more country specificity. Its adaptation to the evolving financing landscape facing LIDCs – including increased market risks, contingent liabilities, and domestic debt – and adjustments to the methodology should permit a more robust assessment of risks of debt distress.

Significant Bank-Fund support to countries on the implementation of the new DSF is envisaged, including with more guidance on broader debt coverage and assessment of fiscal risks. To better manage challenges around the changed debt structure, more TA and training will be needed on contingent liabilities, domestic debt, and tapping into international financial markets. Such capacity development must focus more squarely on building stronger and more enduring debt management institutions and on facilitating the translation of improved capacity on DSAs and Medium-Term Debt Strategies (MTDS) into actual policy-making and decisions on contracting debt. In this connection weak capacity in the key oversight institution – parliament – is a critical area not yet getting sufficient attention from development partners. The absence of basic capacity in parliament is a significant constraint to maintaining debt sustainability in my own country Liberia, as I’m sure it is in others. I look forward to the discussion of technical assistance and training needs in Session 3 tomorrow morning.

Fellow participants, I think we’d all agree on the need for new lenders to conduct more thorough due diligence in lending, including disciplined use of DSAs based on the new DSF. This will mean battling the prevailing incentives for delivering projects regardless of whether they are needed, efficient, or whether the associated loans can be repaid. Clear modalities for debt restructuring is another critical priority. But there has at times been some overly-optimistic or even unrealistic expectations in some quarters that China will eventually join the Paris Club in its current form, never mind that a central role for the Paris Club in the debt restructuring architecture is at odds with its increasing marginalization as a creditor. There is thus an urgent need to instead focus energies on working with new lenders to design a framework that recognizes their greater debt share and which convinces them that transparent debt restructuring is in their interest. Presumably work towards this end is underway in the IFIs and the Paris Club, but not yet with visible results for outsiders. We’ll I hope be educated on this and hear a lot more about debt restructuring challenges from colleagues in Session 4 tomorrow morning.

There has been much talk of and agreement on the need for greater transparency in lenders' practices. The World Bank and IMF are strengthening their outreach on this and the G20 has been urging lenders to subscribe to the so-called Principles and Operational Guidelines for Sustainable Financing. The Bank and Fund are also supporting steps towards making this initiative effective by requiring regular self-assessment of G20 members. For their part, earlier this year private creditors established an Institute of International Finance (IIF) Debt Transparency Working Group to promote increased transparency in and reporting of their lending. Broad consultation to ensure wide acceptance of the principles being worked on by new and non-bank creditors and their early finalization is necessary. We should learn more about this and other steps to increase transparency in lending from Session 2 this afternoon. I would underscore the need to resist the temptation we've seen in recent gatherings to ascribe non-transparency to China alone, and instead stress that all creditors must enhance transparency. Let's not forget that the non-transparent debt episodes seen in Mozambique had nothing to do with China.

I believe there is also broad consensus on the importance of better monitoring and reporting of public sector debt and guarantees, supported by more effective technical assistance and training from the Bank, Fund, and other donors. I am sure that we'll get commentary on the challenges around this issue and a good update on DMF support in subsequent sessions so I will not address the subject in any detail. Suffice it to say that making such monitoring and debt reporting more effective will require stronger political will to ensure sectoral ministries' and SOE compliance with Ministry of Finance/Debt Management Office requests for data and information. And while this is unquestionably the borrowers' responsibility, partners can provide useful leverage from their support.

I'd like to close my remarks by pointing to three other issues that need more attention going forward. First, in the recent debt acceleration we've seen, debt drivers were fundamentally domestic, but "push" factors – i.e. unconventional monetary policy or UMP in advanced countries and the associated high risk appetite of investors –clearly also played a part. Notwithstanding the resulting welcome expansion in SSA frontier markets' financing choices, the UMP episode illustrates the need for advanced countries to be more attune to potential negative spillovers of their policies on poor countries.

Second, more attention to the volume, instruments, and windows of IFI financing for frontier market economies could potentially limit their recourse to more expensive commercial borrowing and sovereign bond issuances, as I argued in a 2016 essay on IMF financing. Indeed, some of the rules governing access to IFI non-concessional financing could be usefully reviewed. In this connection the 2016 clarification of the IMF's "blending" rules and the World Bank's 2017 capital increase package -- wherein IBRD will prioritize adequate financing for blend countries and IDA graduates -- are to be welcomed. Follow-through, full implementation and concrete results from these important initiatives will be critical.

Finally, development partners must safeguard and indeed increase their financing for the poorest countries. Concessional financing for LICs from OECD Development Assistance Committee members contracted by 20 percent between 2013-2016 at a time when commercial borrowing accelerated. The IFIs and G20 creditor countries cannot credibly continue to insist that LICs at high risk of debt distress rely solely on grants and concessional external borrowing without expanding the volume of such financing, especially for those fragile states whose debt-to-GDP ratio deterioration is largely explained by pandemic and weather-related shocks. The push to do this from the very successful IDA18 replenishment was a much-needed reconfirmation of the international community's commitment to supporting the poorest countries, but more supportive action is necessary from bilateral partners not yet meeting their 0.7 percent of GDP aid commitments.

Fellow participants, colleagues, I've spoken at some length now and will stop here. I look forward to our discussion and thank you very much for your attention.

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