CSIS
AFRICA NOTES
A publication of the African Studies Program of The Georgetown University Center for Strategic and International Studies

No. 9 • March 1, 1983

Africa's Financial Future: Some Constraints and Options

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1. Constraints

During the past two decades, income per capita has risen more slowly in Africa than in any other part of the world, and has actually declined since 1981. Many African countries have also found their export earnings falling dramatically while their import costs—especially oil—were rising. Between 1973 and 1980, the gap between the bill for importing goods and services and the earnings from exporting goods and services widened from $1.8 billion to $10.7 billion.

One way countries finance such deficits is through official development assistance (ODA). Such assistance more than doubled between 1973-1980, and amounted to more than $8 billion in 1980, but it offset only part of the growing balance-of-payments deficits. In addition to utilizing ODA, those countries which could borrow commercially expanded such borrowing substantially, and most countries of the region also depleted their foreign exchange reserves. Meanwhile, another source of foreign exchange, private direct investment, declined by 25 percent between 1973 and 1980.

During the same period, the terms of trade—that is, the relationship between the prices of imports and exports—continuously worsened for African countries. By mid-1982, real prices (prices adjusted for inflation) of primary commodities other than oil were lower than at any other time in the last 30 years, and 21 percent lower than in 1975, a recession year in which prices of primary commodities had fallen by 18 percent. This decline encompassed all the goods that African countries export, ranging from copper to groundnuts. Meanwhile, the prices of oil, manufactured goods, equipment and machinery, and, to a lesser extent, imported foodstuffs, increased dramatically. In addition, weak demand and high unemployment in the industrial countries have brought increasing threats of protectionism.

By 1980, the foreign exchange position of many African countries was precarious. Reserves had fallen below the amount needed to finance two months of imports, and the debt service ratio (i.e. the percentage of foreign exchange annually required to pay principal and interest due on public debt) had reached 13 percent, or more than twice its level in 1973, despite a contraction of imports and a sizeable accumulation of unpaid external obligations in about 20 countries. In fact, in the last several years, 11 countries in the region (the Central African Republic, Gabon, Liberia, Madagascar, Malawi, Senegal, Sierra Leone, Sudan, Togo, Uganda, and Zaire) were forced to renegotiate their external public debts. And, during the past two years, the external financial position of the region has continued to deteriorate.

For the next few years, the economic outlook for Africa depends on the pace and timing of the recovery in the United States and other industrial countries, the prices of commodities exported by African countries, and the degree to which the next expansion in the world economy leads to price increases for key imports of African countries—oil, foodstuffs (rice and wheat), and manufactured goods. The more developed African countries will also be affected by the level of international interest rates, which will significantly affect their debt service ratios.

UNCTAD has estimated that Africa's need for assistance and/or commercial borrowing will more than quadruple during this decade, going from $13 billion in 1981 to $60 billion in 1990. Even with this large inflow of funds, according to World Bank projections, Africa could only expect to avoid further economic decline; there would be no increase in per capita income during the 1980s.

In sum, Africa's medium-term growth is likely to be the lowest of any region in the world. Moreover, Africa will not be in a position to take advantage of

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the growth of world trade once it resumes, because the continent's exports are concentrated in a group of primary commodities for which demand is expected to grow exceptionally slowly even after the end of the global recession.

Thus, the sources and amount of external financing will be critical to African countries. What are the possible forms and prospects of such financing?

2. Prospects from Traditional Sources

Bilateral Concessional Loans. According to the Development Assistance Committee of the OECD, official development assistance worldwide shrank from $36.4 billion in 1980 to $35.5 billion in 1981. And, for the remainder of the decade, no real increases in external assistance are likely. The decrease in aid is a result of economic problems in the industrial countries which have led to a period of general budgetary restraints. In addition, the environment for aid has been affected by the Reagan Administration's belief that private capital should somehow substitute for bilateral assistance and concessional lending. Moreover, with the decline in the real price of oil, it is unlikely that the wealthier OPEC countries can be counted on to fill the gap.

Multilateral Concessional Loans. Multilateral institutions provided funds amounting to $13 billion worldwide in 1981. Of this amount, $8 billion (over 60 percent) was on concessional terms. The prospects for expanded lending by the two multilateral institutions that play the most crucial role in Africa—the International Monetary Fund (IMF) and the World Bank—are cloudy.

The IMF has tightened considerably the conditions it imposes in negotiating loans to finance deficits since May-June 1981. As a result, a number of countries have either failed to agree with the IMF on a stabilization program sufficiently stringent to qualify them for loans or have been unable to carry out the stabilization program they had agreed upon. In any case, the resources of the IMF are insufficient compared to the needs of member countries. Although the United States has recently agreed to an increase of about 50 percent in the IMF resources and to an expansion of the General Arrangements to Borrow (GAB), a special financing fund, to SDR 17 billion, these will most likely not become effective before late 1983 or early 1984 and will mostly benefit countries with large quotas. But compared to the U.S. position as late as mid-1982, when any sizeable increase in IMF resources was opposed, these green lights represent significant progress.

In the fiscal year ending June 1982, the total commitments of the World Bank and its soft-loan window, the International Development Association (IDA), declined by 7.2 percent in real terms. This largely reflects a 20 percent decline of IDA's commitments due to a lack of financing, which in turn resulted mainly from a decision by the United States to spread contributions to multilateral development banks over a longer period of time, and from U.S. delays in enacting legislation concerning these contributions. As for the future, some major shareholders would like to restrict the World Bank's 1982-86 lending program to no more than $60 billion. This compares to needs which in December 1980 had been evaluated by the Bank at $93.8 billion.

IDA's situation is worrisome, because its loans on concessional terms are crucial for most African countries. IDA's lending to the region declined from $954 million in 1981 to $840 million in 1982. This decline occurred even though Africa was allocated an increased percentage of IDA's funds.

The African Development Bank (ADB), established under the auspices of the UN Economic Commission for Africa in 1964, is also experiencing financial difficulties. The ADB has set up a program of activities for the next four years that will require resources well in excess of what is currently expected to be available. Even though the ADB's governors have decided to open capital stock participation to non-regional members, it is not clear how much support will be forthcoming from the international community.

Commercial Loans. After more than a decade of very rapid expansion, international lending by commercial banks is slowing down. Comprehensive data covering all banks in the Bank for International Settlements (BIS) reporting area actually indicate a decline in lending to developing countries in the first nine months of 1982. This decrease is due to the rise in the number of debtor countries encountering difficulties in paying their debts on time. In any event, most countries in Africa cannot rely heavily on borrowing from commercial banks to finance their development requirements. In the first place, the cost of borrowing on commercial terms is well beyond the means of most of the region. Secondly, commercial bankers have traditionally been very cautious in their lending to Africa (except for the notorious cases of Zaire and Sudan), which means that the overall slowdown in international bank lending could be proportionately more pronounced in Africa than elsewhere. Finally, the current difficulties encountered by a number of big debtors in Latin America are likely to divert international attention and resources from the poorer LDCs, the bulk of which are located in Africa.

Private Investment. Africa has always posed problems for private investors. The reasons are partly historical and political as well as economic. They relate to such constraints as the colonial legacy of underdeveloped human resources, lack of infrastructure, and climatic and geographical factors. Business doubts have been exacerbated by governmental policies which have not given many incentives to the private investor.

3. Does Africa Warrant Special Treatment?

Until now, the international community has attempted to deal with the Third World economies more or less as a monolithic bloc. But as Africa falls farther

U.S. Policy Guidelines

The level of international debt, which now stands at nearly $700 billion, increased more than sevenfold from 1972 to 1982. In the same 10-year period, debt to private lenders jumped from 40 to 60 percent of outstanding LDC debt. The conclusion drawn from these facts by those who wish to fix blame is that either banks "over-lent" during the 1970s, or countries "over-borrowed."

The truth is that many bad judgments were made. But it is also true that after the oil price increases of 1973-74, lenders and borrowers acted on a set of assumptions—buoyant export growth and low interest rates—that, though proven false, were thought reasonable at the time. The recycling of petrodollars from the OPEC nations to the non-oil LDCs was highly profitable for the banks. And since the loans were in inflation-depressed dollars, the LDCs assumed that today's loans would be repaid with cheaper dollars tomorrow. In this environment, indebtedness mounted.

It would be wrong, however, to characterize the legacy of the oil shock years as a debt problem. Rather, in its broadest aspect, it is an income-earning problem. True, LDCs borrowed a lot in the 1970s, but our domestic corporations borrow a lot also. The difference is that corporations invest in productive capacity to generate income to repay their debts. Some LDCs, however, tended to invest in consumption rather than production—borrowing to finance internal income transfers. This strategy, although of questionable wisdom, was tolerable as long as LDC export earnings grew fast enough to service their debts. That was indeed the case from 1975 to 1979, when LDC exports grew 22 percent annually, roughly keeping pace with the 25 percent annual growth of LDC debt.

In response to the second oil shock in 1978-1979, however, the major industrialized nations adopted more restrictive monetary policies which slowed inflation, boosted interest rates, and set in motion a retrenchment from the economic excesses of the 1970s. High interest rates and a strong dollar increased LDC debt service costs. Simultaneously, LDC export earnings declined as the recession reduced demand for, and slashed prices of, LDC commodities. Indeed, non-oil commodities prices fell 28 percent between 1980 and 1982, increasing debt service ratios and eroding the terms of trade. As Tanzania's President Julius Nyerere has put it, to buy a heavy truck in 1981, Tanzania had to produce 10 times as much tobacco, or four times as much cotton, or three times as much coffee, as it took to purchase the same truck just five years earlier.

The problem faced now by Tanzania, and other high-debt developing countries, is thus not so much a debt problem as an *income-earning* problem: rising debt service costs consume an ever-increasing proportion of declining export earnings. Many LDCs are now under pressure to increase exports and curb imports. This comes at a time when the industrialized countries face rising unemployment, declining real income and deteriorating trade balances. As a result, the international financial, trade, and monetary systems are under serious strain. . .

The problems currently burdening the international economy—recession, high unemployment, LDC debt—all have a common solution: economic expansion. If growth in the world economy resumes and real interest rates fall, the debt burden of even the most heavily indebted countries will become manageable. . . Our challenge, therefore, is to revitalize the international financial system; preserve and extend the benefits of open trade; improve the monetary system; and ensure political stability in the developing world. This Administration is working hard to achieve these four objectives, all of which contribute to world economic expansion. Our own economy will play a leading role in that expansion. As a result, we have an opportunity to demonstrate the continued viability of our market-oriented economy, and the democratic institutions it supports.

—Excerpted from a statement by Secretary of State George P. Shultz before the Senate Foreign Relations Committee, February 15, 1983.

behind many other LDCs, a case can be made for developing special economic and financial arrangements for this troubled continent. Traditional aid would of course continue to constitute the major source of financing for Africa, but other sources are justifiable. The following three emergency measures, for example, could be implemented relatively quickly and could have a significant and immediate impact:

Debt Restructuring. African countries are not among the biggest LDC debtors. They owe relatively little to commercial banks and their indebtedness stems mainly from foreign aid extended on concessional terms. They do not face the crisis of creditworthiness that confronts many Asian and Latin American countries. For Africa the issue is more simple: how to ensure that more money flows in than out. In this context, all official debt stemming from past aid commitments should be written off and converted to grants. In fact, some donors have already agreed to such a conversion but some (most conspicuously the United States) have not followed suit.

Debt renegotiation for Africa should be considered part of aid rather than a separate issue and should be discussed in the context of World Bank country aid consortiums. In such a framework, creditors might be more open to longer-term solutions—more generous repayment and grace periods. The World Bank country aid consortiums could be enlarged to include senior representatives of commercial banks, holders of public securities, and the Bank for International Settlements (BIS). In present practice, debt restructuring is usually done in a somewhat ad hoc manner,

with each party involved pulling its own way without consideration for the overall long-term interest of debtor and creditors. The advantage of an enlarged and more informal discussion group would be that the more direct and immediate flow of information would facilitate negotiations.

The use of conditional debt repayment schedules should also be given priority consideration. Debt service might be linked, for example, to some objective indicator of the world economic environment or to export receipts and capital flows of the debtor country. It is unrealistic to expect countries to be able to service the same amount of debt during each phase of the commodity price cycle.

At the 1982 IMF-World Bank annual meetings in Toronto, the African governors called for the establishment of an efficient institutional framework for debt renegotiation that would better take into account the internal adjustment problems and the future financing needs of the countries concerned.

Creation of a Multilateral Investment Corporation. A proposal to create a multilateral investment corporation which would be funded mainly by OPEC countries and would concentrate its investment portfolio in Africa was put forward at a conference on African-Arab-OPEC economic partnership in development held in Bellagio, Italy in February 1982 under the sponsorship of the Rockefeller Foundation. The proposal rests on two premises: (1) that investment opportunities exist in Africa but are not developed due to a lack of information and money; (2) that OPEC countries are increasingly looking for investment opportunities in LDCs. In this context, suggestions have often been made that Africa is a natural investment area for Arab countries because of geographical proximity. A feasibility study is currently being conducted to assess whether such a corporation would be viable.

An agency along these lines could also insure investors against any significant changes in the "rules of the game." Such an insurance scheme was advocated by the president of the World Bank at the 1981 IMF-World Bank annual meetings.

New Roles for the IMF. Besides the role the IMF could play if some institutional framework to deal with debt renegotiation issues were created in response to the African governors' request in Toronto, there are three further ways in which the IMF could assist Africa:

The first is to alleviate the burden of interest payments on drawings under the enlarged access fund. The three percent interest subsidy on Supplementary Financing Facility (SFF) borrowing introduced in May 1981 and financed by trust fund repayments and grants from member countries could be extended to other facilities in order to reduce the cost of borrowing from the IMF. This is imperative due to the fact that the cost of borrowing from the IMF has become much less concessional as the IMF itself has been forced to borrow (and will continue to be forced to borrow) because of quotas that will remain inadequate even after implementation of the recent decision for a 50 percent increase. Moreover, those countries that are the most likely to turn to the Fund are precisely those that cannot afford commercial rates.

Second, the Fund could play a more effective counter-cyclical role. The IMF could expand its low conditionality facilities such as the Compensatory Financing Facility (CFF) (which helps member countries finance export shortfalls) and the Cereal Facility (which helps member countries meet increased cereal import costs) to deal with problems generated by such circumstances beyond a country's own control as the world business cycle, protectionism in developed countries, natural disasters, or wars.

Finally, Africa could be assigned a larger share in future SDR allocations than one based on strict proportionality to quotas. The unproportional distribution of SDRs would have to be limited to the poorest countries, using a GDP-per-capita cutoff criterion similar to the one applied by IDA, in order to prevent too much of the additional aid from being channeled to relatively wealthy LDCs. The main advantage of establishing an SDR aid link is that congressional or parliamentary limitations on appropriations of aid funds would be circumvented.

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