The role of regulation in preventing and solving Africa's next debt crisis

Draft paper

Prepared for EUR Conference on the *Dynamics of Inclusive Prosperity*

November 29-30, 2018

Geske Dijkstra

Department of Public Administration and Sociology (DPAS)

Erasmus University Rotterdam

dijkstra@essb.eur.nl

1. Introduction

The previous debt crisis in Sub-Saharan Africa was mainly one of official loans to the region. In the 1980s, when the debt problems became visible, official bilateral and multilateral creditors held most of the debt. Yet it took until 2005 before the crisis was solved. There were many reasons to (also) blame the creditors for the start and the long duration of this crisis. Western governments provided loans or loan guarantees for unrealistic and megalomaniac projects. These loans and loan guarantees were in the interest of their own companies and often benefitted ruthless African dictators. Over time, and when these debts were not serviced (fully), debt stocks exploded due to the high interest rate on accumulated arrears. During the 1990s, these official creditors began to provide debt relief but for a long time this just meant reducing some of the debt service due and did not involve reducing stocks (Daseking & Powell, 1999). In the meantime, new loans, and in particular multilateral loans, continued (Dijkstra, 2008). The debt problems were worsened by high levels of capital flight, mostly in the form of private assets (Ndikumana & Boyce, 2003).

During all these years African debtor countries had to implement structural adjustment programmes with severe consequences for public services, investment, growth and income distribution. It was only with the enhanced Heavily Indebted Poor Countries (HPIC) initiative starting in 1999 and then with the Multilateral Debt Relief Initiative (MDRI) in 2005 that creditors took their responsibility. External public debt stocks came down to below 20% of GDP, on average. Overall, these debt relief measures appear to have had positive impacts on public investment and growth (Ferry & Raffinot, 2018).

After the global crisis in 2008, African countries became attractive for Western *private* creditors. Commodity prices were booming, growth rates were high, and interest rates in OECD countries were much lower than in Africa. Many African government such as Ghana, Rwanda, Kenya, and Zambia began to issue bonds for the first time and these issuances were highly successful. State companies and local and regional governments also borrowed on a large scale at often unclear terms, and sometimes with high risks. China also became an important lender to Africa, thus also changing the creditor landscape. When commodity prices began to fall in 2014, many African governments responded by taking in more loans. So it did not take long for observers to worry about a next African debt crisis. Currently, the median debt in Africa is already above 50% of GDP and some countries like Chad, Mozambique, Kenya, Tanzania and Zambia clearly face problems in servicing their debts (Economist, 2018). Like in the previous crisis, these countries are taking additional loans from multilateral creditors such as IMF and World Bank in order to service the private loans (Dzimwasha, 2017). Many countries are again required to reduce public expenditure, with possible adverse consequences for growth and living standards.

According to many authors, the changed composition of external debt makes it more difficult to achieve debt crisis prevention and resolution as compared to the previous debt crisis in Sub-Sahara Africa (Ellmers, 2016; IMF, 2018).

In this paper I examine to what extent these assumptions are correct. In particular, I analyse what the prospects are for better preventing and solving the new – imminent – debt crisis in Africa, as compared with the previous one. I assess how international creditors and institutions have dealt with the previous debt crisis and to what extent the current situation is different, both regarding types of outstanding debt in Africa and regarding new developments in the international financial architecture. I begin by outlining the origin and the development of the previous debt crisis until its resolution with HIPC and MDRI in 2005. I focus, in particular, on the regulation that was in place in order to prevent and solve the debt crisis. I then discuss the current debt situation in SSA and the changes in the composition of the debt. I will then examine to what extent the current crisis is different and what the possibilities are for more effective prevention and resolution of the current debt problems. This includes a discussion of recent developments in regulation and proposals for further changes in the international financial architecture. A final section concludes.

2. The previous debt crisis in SSA[1]

The previous debt crisis in the developing world had its origin in the oil price hike of 1973. The oil-rich nations deposited their sudden wealth with Western banks. Due to the recession in the Western countries, these banks could hardly invest these petro-dollars in their own countries. They started to give out loans on a large scale to developing countries. The predominant development paradigm at the time was that poor countries should invest in industry and infrastructure, and that governments must play a leading role. Governments and state-owned enterprises began to borrow on a large scale. Due to the high liquidity in the banks, the interest rate was low; so governments and other actors were tempted to borrow even for projects that would not have been profitable under a normal interest rate. In some countries, default risks were exacerbated by irresponsible fiscal policies or overvalued exchange rates.

There was little regulation of bank loans at the time, and banks often had a high concentration of their loans in particular countries. Moreover, the banks charged variable interest rates – rational in a time of high inflation, but also increasing the risk of default as rates rose. This collective irresponsible acting on the part of banks can be attributed to the well-known “herd behaviour” in financial markets: the costs of not going with the flow are far too high for individual banks, which leads them to collectively ignore the risks. The banks assumed that their governments would come to the rescue if they should get into difficulties. After all, they had taken on the task of recycling petro-dollars with the explicit support of their governments by channelling these surplus funds to countries that needed them (Dooley, 1994).

In Sub-Saharan Africa debt also started to grow during the 1970s, but commercial bank loans played a smaller role. The most important source of debt were loans from suppliers in the industrialized countries that were guaranteed by the governments of these suppliers, so-called export credits. A next category were aid loans, which were often also partially or fully spent in the country of origin. These loans helped financing investment plans in Africa, but they were also induced by the desire to promote these countries’ exports. Often, these loans financed unrealistic and megalomaniac projects and benefitted ruthless African dictators.

At the start of the 1980s the high debt levels in many low and middle-income countries quickly became problematic. In 1979 oil prices increased again, but this time the response of the rich countries was different. Staring with the US and the UK, the rich countries began to apply strict monetary policies, which increased interest rates globally. This led to a world-wide recession which greatly reduced demand for developing countries’ exports. In Latin America, higher interest rates formed the most important reason for the rapid debt increase. In Africa, where official creditors usually charged a fixed interest, the main cause was the deteriorating terms of trade. On both continents, the situation was further impaired by capital flight. For every dollar coming in as loan, about 80 cents left the African countries (Ndikumana & Boyce, 2003). The announcement by Mexico in 1982 that it was no longer able to pay its debt service marked the start of the actual crisis. Even before that, however, various African countries had requested that their debts be restructured.

[1] This section is largely based on Dijkstra (2008), chapter 2.

Many African borrowers defaulted on the loans to private suppliers, which meant that governments in the lending countries took over these debts. Hence, the composition of debt in Sub-Saharan African countries changed. While around 1980 a large part of the debts was owed to private creditors, ten years later most debt was owed to official creditors.

The debt problem was called a crisis principally because many major western banks threatened to go bankrupt, and in a few cases they actually did. Initially, until about 1984, it was assumed that debtor countries were suffering temporary payment problems, and that new loans would help them to recover. The IMF attempted to co-ordinate the banks in granting new loans; later, in 1985, the Baker Plan also aimed at mobilizing new funds for debtor countries. Meanwhile, however, the banks had arrived at a different assessment of the situation. They no longer expected that they would get their money back, refused to provide new loans to debtor countries, and started to write off the old loans. This allowed for the coming into being of a secondary market for debt titles with much lower prices than the nominal values. Of course the banks still tried to recover as much money as possible from debtor countries, while making grateful use of the funds that official creditors (multilateral and bilateral) made available to those countries (Dooley 1994). In fact, official creditors to some extent bailed out the private creditors.

In 1989, a new Secretary of the US Treasury, Nicholas Brady, announced a plan for market-based debt reduction in 1989. This plan no longer implied new loans from private creditors. Instead, it allowed debtor countries to buy back private debts at their secondary market price. Official money, mainly from World Bank, IMF, the US and Japan, was provided to help these countries financing the buybacks and to collateralize exit bonds, usually US Treasury bonds (Bowe & Dean, 1997).

The response of official creditors to the payment problems of debtor countries was very different. In general, they adhered much longer to the notion that debtor countries faced only temporary liquidity problems rather than insolvency. During the 1980s, export credit agencies (ECAs) in the rich countries continued to insure commercial loans. Concessional aid loans were also continued. The net flow of bilateral loans to Africa remained positive during the 1980s. In addition, western donors started to provide grants to African countries at a growing rate. At the same time, western creditor governments, united in the Paris Club, dealt with payment problems by means of rescheduling.[2] But this rescheduling implied only a postponement of payment obligations while the interest was capitalized, so the net present value (NPV) of the loan remained unchanged and its nominal value increased rapidly. There was close cooperation between the Paris Club and the IMF; a country needed to have an IMF program before the Paris Club considered a rescheduling.

Starting in 1988, official creditors also began to acknowledge that some of the loans would probably never be repaid, and they started to provide some debt relief. However, this only applied to debt service and only to loans provided before a certain date (the 'cut-off date', usually three years prior to the first agreement). The percentage forgiven on this limited part of the debt service gradually increased from 33 to 50 (1991), to 67 (1994), and to 80 per cent in 1996. The remainder of the debt service due was rescheduled on market terms, so outstanding debts continued to increase. The agreement with the Paris Club only covered debt service obligations falling due during the course of the IMF program. Hence, new Paris Club agreements were usually necessary when a new IMF programme was concluded.

[2] The Paris Club is an informal association of official bilateral creditors who negotiate collectively about debt rescheduling with a debtor country; the debtor country must have an agreement with the IMF. Members are mostly OECD countries.

Multilateral institutions such as IMF, World Bank and African Development Bank (AfDB) strongly expanded their lending during the 1980s and 1990s. In doing so, they fulfilled the role of 'lender of last resort'. The two institutions were preferred creditors, meaning that debtors always had to meet the debt service to these creditors first; failing to do so would deprive them of new multilateral loans, of Paris Club debt restructuring and of a large part of bilateral aid. During the course of the 1990s it became clear that debt service to multilateral creditors was an unsustainable burden for many poor debtor countries. Bilateral donors often had to provide debt relief in order for these countries to service their multilateral debts. It was not until 1996, however, and more extensively in 1999 with the Enhanced HIPC Initiative, that the international community came to acknowledge that structural debt relief was needed for the multilateral debts.

As a result, while for commercial banks and for most Latin American countries the debt crisis was over by 1990, this was by no means the case for the majority of countries in Sub-Sahara Africa. While the average debt/GNI ratio fell in Latin America from 1988 onward, in Africa it continued to rise until 1994 and remained at a high level after that. Debts finally came down in the period between 1999 and 2005.

The first HIPC initiative in 1996 did not have effects yet, but the enhanced HIPC initiative in 1999 began to reduce debts, albeit in different pace for different countries. It was implemented in several steps and each step involved compliance with IMF policy conditions. Countries also had to write a Poverty Reduction Strategy Paper (PRSP). The amount of debt relief was determined such that the debt would become sustainable. For most countries, this sustainability was defined by a debt to exports ratio of at most 150%. In 2005 the relief on multilateral debt was further expanded with the Multilateral Debt Relief Initiative (MDRI). If countries had remained on track with IMF conditions and continued to implement their PRSPs, they received 100% forgiveness on all multilateral loans contracted before 2004 (World Bank) and before 2005 (IMF and AfDB).

This overview leads to several conclusions on the regulation for preventing and resolving this previous debt crisis. A first thing to be noted is that debts from private creditors played a large role in the earlier debt crisis in Sub Sahara Africa, at least at the beginning. Although the share of commercial bank loans was limited, a large part of the contracted loans were export credits provided by private suppliers in industrialized countries. However, these loans were insured against default by official export credit agencies (ECAs). It was only when debtor countries could not service these debts that this debt became official.

Secondly, the origin of the debt problems was on both the demand and the supply side. There was irresponsible borrowing and irresponsible lending. Some of the governments in debtor countries pursued inadequate macro-economic policies. But commercial banks did not properly estimate the risks involved and offered too low rates of interest because they had surplus liquidity. Their international activities were not subject to supervision and regulation and they expected to be bailed out. Creditor *governments* aimed to promote development in recipient countries, but they also wanted to increase their own exports. Later, in the 1980s and 1990s, IMF, World Bank and AfDB increased lending to countries even though they already exhibited debt service problems. In all these cases the decisions to lend were not taken on the basis of an appraisal of expected yields and risks – which can be called a market failure.

Third, and coming to the responses to the debt crisis, it is clear that for a long time, debt relief to African was too little, too late. The fact that by 1990, most of the debt outstanding was in official hands, has hugely postponed the recognition that most countries were not just illiquid but insolvent. There were several reasons why private creditors were much quicker in granting large amounts of debt cancellation. The first is that private creditors, and in particular commercial banks, are subject to regulation that forces them to revalue and (partially) write off bad debts. Official creditors are not subject to this type of oversight. Secondly, private creditors need to make profits and are thus forced to seek alternative and more profitable investments. Such considerations do not apply to official bilateral creditors.

At the same time, official creditors also had an *incentive* for maintaining the fiction that the debtor countries only suffered from temporary liquidity problems. These interests and incentives were different for bilateral and multilateral creditors. The bilateral creditor countries had an interest in continuing promoting private sector exports through their export credit agencies (ECAs), and as donors they preferred to reschedule debts and provide new aid instead of forgiving debts. The recognition that the debts would not be repaid would have raised the difficult question out of which budget the debt cancellation of dubious claims, including those of ECAs, would have to be financed (Daseking & Powell, 1999).

The multilateral creditors had a "natural" interest to stay in business and thus continue lending. But their preferred creditor status also played a role. They could afford to continue lending to countries with serious debt problems, because they knew they would get their money back. During the 1990s, a lot of aid from bilateral donors was debt relief on multilateral loans and went directly to the IMF and the World Bank. In fact, the bilateral donors financed the concessional loans of World Bank and IMF in three different ways: first, by contributing to the funds out of which these concessional loans were financed,[3] second by accepting the preferred creditor status of the multilateral loans which reduced the value of their own claims, and third by paying the debt service on these loans in the form of debt relief on multilateral debt. This was not a very efficient way of using aid money. Furthermore, the bailing out of multilateral creditors created moral hazard (Dijkstra, 2008: 50).[4]

A fourth reason why it took so long before the debt problems were solved can be said to be the failure of policy conditionality. There was a close cooperation between the Paris Club and the IMF, in the sense that the Paris Club could only agree on debt rescheduling once there was an IMF program with the debtor country in place. The idea was that the IMF would set policy conditions that helped the country increase its repayment capacity, and that a program would free the way for new inflows of capital. In this sense, the IMF acted as the "gatekeeper" for both the rescheduling of official claims and for new inflows of loans and grants.[5] But at the same time, the Fund was a creditor itself. This conflict of interest reduced its effectiveness as gatekeeper (Bird & Rowlands, 2007; Dijkstra, 2008; White & Dijkstra, 2003). Policy conditions were seldom complied with,[6] and yet the IMF continued a program or proposed a new program – because it was the only way to get its money back on the previous programs.

Finally, and with regard to the *process* of restructuring debts, there was a high level of coordination but it was not complete. In particular after most debts to private creditors had been written off and sometimes solved by a "debt buyback", the majority of SSA debt was in the hands of official creditors that were members of the Paris Club. And the Paris Club closely worked together with IMF, World Bank and African Development Bank. The HIPC agreements urged other creditors to abide to

[3] The IDA Replenishment Fund at the World Bank, and the ESAF-PRGF Trust at the IMF.
[4] In oral comments to my book, involved officers criticized the use of concepts like moral hazard and bailing out in the context of IMF and World Bank, arguing "we *are* IMF and World Bank".
[5] Empirical research shows, however, that the catalytic effect of IMF programs did not hold for private capital inflows. IMF programs were at most able to free the way for official inflows (Bird & Rowlands, 2000; Bird & Rowlands, 2007).
[6] As shown by multiple authors, for example Collier et al. (1997); Killick et al. (1998).

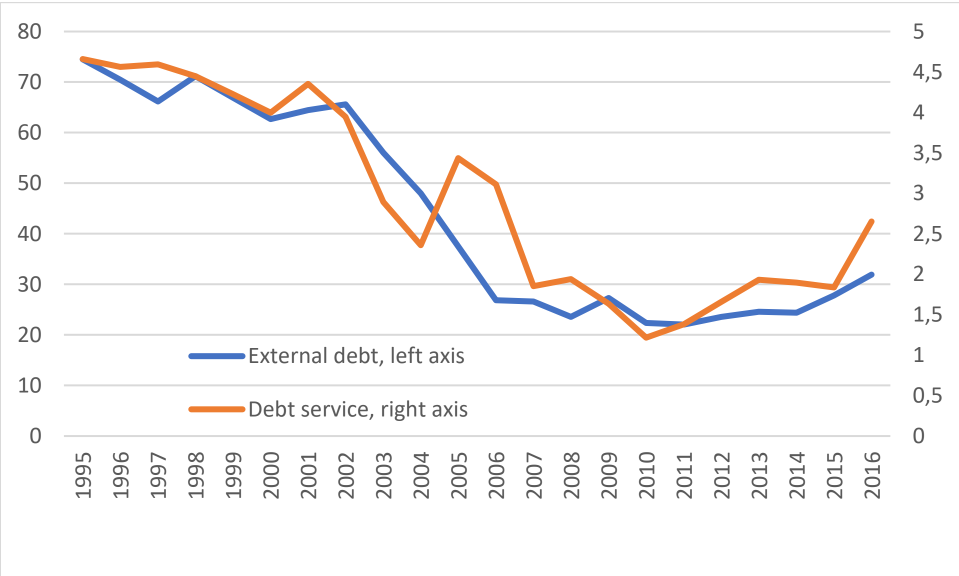
"comparable treatment", i.e., apply the same high debt cancellation percentage, but not all of them did so. Some non-Paris Club official creditors and some commercial creditors did not accept the agreed debt cancellation. A number of them started litigation against the debtor countries with sometimes costly consequences (IEG, 2006).

3. The current imminent debt crisis in Sub-Sahara Africa

Average debt stocks in Sub-Sahara Africa as percent of Gross National Income (GNI) have clearly fallen after the implementation of the HIPC initiative from 1999 onward, and after the introduction of the MDRI in 2005 (Figure 1). The external debt service ratio, also in relation to GNI, started to decline somewhat earlier and follows more or less the same trend. It was more volatile; the peaks in 2005 and 2006 are probably due to the high amounts of debt service paid by Nigeria to its bilateral creditors in order to clear the way for debt relief (Dijkstra, 2013).

However, after a temporary increase in 2009 of the debt/GNI ratio, both ratios began to increase from around 2011 onward, and more steeply from 2014 onward. Figure 1 presents average numbers for Sub-Sahara Africa (excluding high income countries in that region), and for individual countries the numbers are more worrisome. According to the IMF, the number of low income countries in debt distress or with high risk of debt distress increased from 13 in 2014 to 24 in January 2018 (IMF, 2018). All but one of these countries are in Sub Sahara Africa. Two SSA countries, Congo and Mozambique, have already defaulted on their debt service in recent years. The reasons for the increasing debt problems in SSA countries include lower commodity prices (Chad, Congo, Niger, Nigeria, Zambia), civil conflict (Yemen, Burundi), epidemics (Liberia, Sierra Leone), looser fiscal policies (Benin, Ghana, Kenya, Rwanda), and fraud/corruption (Mozambique, Gambia) (IMF, 2018: 33).

Figure 1. Debt and debt service in percent of Gross National Income in Sub-Sahara Africa (excluding high income countries), 1995-2016



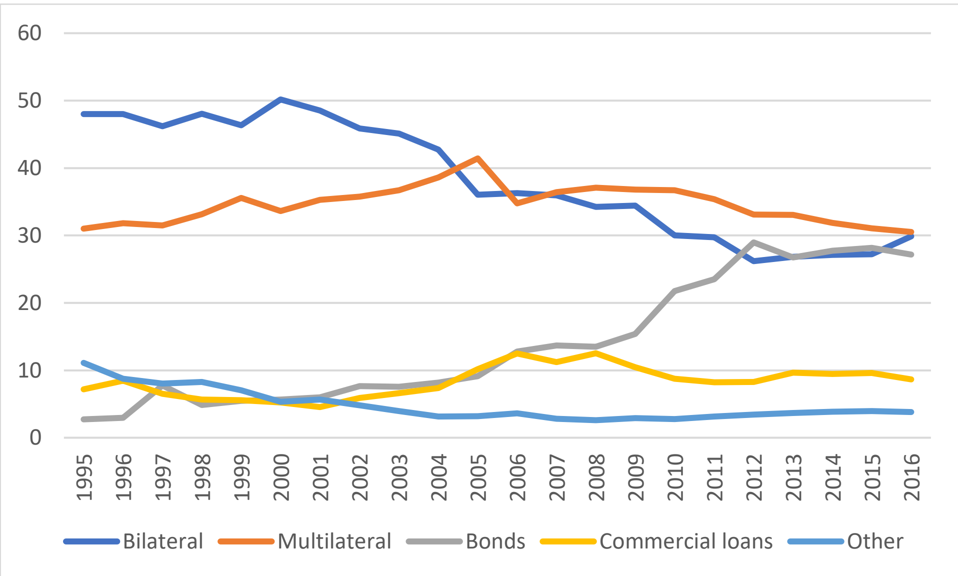
Source: World Bank, World Development Indicators database, accessed 11 November 2018.

The composition of public external debt in SSA has changed as compared to the 1990s (Figure 2). While the share of multilateral debt was about the same in 2016 as in 1995, the share of official bilateral debt decreased and that of private debt (commercial loans and bonds) increased. The category “other” in Figure 2 also belongs to the private debt stock, as it is most held by commodity traders (IMF, 2018).

The most striking development is the increase in bonds. Following Ghana in 2007, many low and middle income SSA countries have issued bonds over the last decade. International bonds are attractive for SSA governments for several reasons years (Tyson, 2015a). First, unlike official loans, they are not accompanied by conditionality in the form of specific projects or policies to be carried out. Second, international bonds are cheaper than domestic bonds and do not lead to crowding out of domestic investment. And third, with an average maturity of ten years, the risks for incumbent politicians appears to be small. On the supply side, financial investors were seeking higher profits than those that can be obtained in the rich countries’ markets. But suppliers also seem to underestimate the risks. For example, coupon rates for bonds to Zambia were much lower than for Spain, while Zambia was rated much lower than Spain by credit rating agencies. Furthermore, western banks have an interest in issuing these bonds because they earn income in the form of underwriting fees, insurance premiums, and creating swaps (Stiglitz & Rashid, 2013).

However, actual risks are high. The coupon rate (average was 7.07 percent) is usually much higher than the interest rate for official loans, which increases servicing risks. Furthermore, the issuing countries bear the exchange rate risk while there is a general trend toward depreciation of their currencies. Most bonds are fully due at the end of the period, which creates high risks of re-financing. By 2013, some bonds were already traded at 20 percent of their original value on the secondary market (Stiglitz & Rashid, 2013).

Figure 2. Shares in public and publicly guaranteed external debt in SSA, 1995-2016



Source: World Bank, World Development Indicators database, accessed 11 November 2018.

The numbers in Figure 2 do no tell the full story on the changed composition of the loans and the effects on possible debt problems. The declining trend in bilateral debt has been accompanied by a change in its composition. While in previous decades most bilateral debt came from creditors associated with the Paris Club, a large part of the bilateral debt is now owed to non-members of the Paris Club, most notably China, but also countries like Brazil and the Persian Gulf states (Ellmers, 2016). The exact amounts of Chinese loans to SSA countries is not known, but reasonable estimates point to 20% of the total debt (Jubilee Debt Campaign, 2018). This would imply that China accounts for two-thirds of the current bilateral debt to SSA countries, leaving the share of Paris Club creditors to lower than 10%. Traditional donors have to a large extent switched from loans to grants, and export credit agencies have become more cautious.

The Chinese loans often finance much-needed large infrastructure projects in SSA countries, and there are no political or policy conditions attached. According to official statements, China's activities in Africa are driven by the search for mutual benefit and complementarity. Countering western hegemony in Africa is another stated objective (Ncube & Fairbanks, 2012). But the size of those projects and the lack of transparency on the terms and conditions may increase risks of debt sustainability (Mustapha & Prizzon, 2018). For example, about one-third of these loans are estimated to be collateralized (Brautigam & Hwang, 2016). The IMF worries about the fact that collateralized debts may have a higher seniority than other debts in case of default.

Within the multilateral debt, the share of IMF and World Bank has decreased. The World Bank has become more cautious in lending to countries with high risks of debt distress. Since 2005, IMF and World Bank examine these risks in so-called Debt Sustainability Analyses (DSA) for low-income countries, in which they analyse the prospects for debt sustainability ratios taking into account expected developments in the net present value of the debt, and in growth, exports, and tax revenues of the country. If the risk of debt distress in low income countries is high, the World Bank provides more grants to this country instead of concessional loans. The IMF used these DSAs for assessing the eligibility of a country for its programs: in order to access a program (and money), countries were not allowed to take loans that would risk their debt sustainability. Congo, for example, had to change the conditions on a loan from China in order to get IMF financing.

More debt in SSA is now owed to other multilateral development banks or new plurilateral development banks like the Asian Infrastructure Investment Bank. A problem with these loans is that if it comes to default, it is not clear whether these plurilateral development banks are at the same status as official bilateral creditors or have a more preferred status like the World Bank and the IMF (IMF, 2018).

Another reason why risks of public debt problems have increased is the fact that domestic debts are also on the rise, often provided by domestic banks. The advantage of domestic loans and bonds is that they do not carry exchange rate risk, they are easier to restructure and the debt service paid at least stays within the country. On the other hand, the costs are higher, and in case of default, banks may become insolvent and need to be rescued – which is obviously impossible for governments if default started with them in the first place (Ellmers, 2016). In addition, an increasing part of these domestic debts is owed to foreign residents, thus leading to the risk of capital outflows (IMF, 2018: 51).

Finally, there are important data gaps in the information on public and publicly guaranteed debt in the region (IMF, 2018). Most countries only report debts by central government while in many countries other public agencies like municipalities or state-owned enterprise also attract loans or bonds. One-third of the countries does not report on public guarantees on debt incurred by private agents. Furthermore, there is hardly any information on external debt by corporate actors or on debt associated with investments in Public-Private Partnerships (PPPs). All this means that actual public and publicly guaranteed debt may be much higher than what is publicly known. The loans for PPPs are often more expensive than other loans. Yet they are promoted by international financial agencies such as the International Finance Corporation (IFC, part of the World Bank Group), which itself is able to make profits on these loans (Ellmers, 2016).

According to many authors, the changed composition of external debt makes it more difficult to achieve debt crisis prevention and resolution as compared to the previous debt crisis in Sub-Sahara Africa (Ellmers, 2016; IMF, 2018). Prevention has become more difficult due to, among other things, the higher share of private debts and the higher interest rate associated with these private debts, the lower transparency involved in Chinese loans and the incomplete information on public debts and publicly guaranteed debts. Debt rescheduling (resolution) has become more difficult because bonds are more difficult to reschedule than loans (Ellmers, 2016) and because there is no creditor coordination mechanism for all official bilateral loans – as China is not a member of the Paris Club.

4. Comparison

To what extent is the current situation indeed different, and what are the consequences? I first examine this for the risk of debt distress, and then for the possibilities for solving a debt crisis.

It is clear from the above that the share of private creditors has increased between 1995 and 2017. However, a large part of the debts registered as official bilateral debts in 1995 also originated from loans from private suppliers in the rich countries. So initially, these were private loans as well. This means that the costs of these loans were not very different from those on current loans, as interest rates on these export loans were market based. What is qualitatively different now is the large component of bonds. This changes the possibilities for solving a debt crisis as will be analysed below, but it does not make much difference for the risks of default.

Irresponsible borrowing and lending is a recurrent feature of both the previous and the current – imminent – crisis. Governments sometimes take loans from China for large investment projects without knowing whether these projects will become profitable, or they issue bonds mainly for election purposes, and under the assumption that they will no longer be in office when repayment is due. On the supply side, the traditional official creditors of SSA, ECAs, traditional donors, World Bank and IMF have become more cautious in lending. However, this does not seem to hold for the private sector arm of the World Bank, the IFC. The IFC makes profits by co-investing in PPPs in developing countries, while at the same time the IMF warns against the risks of these PPPs. And it certainly does not hold for private financial investors or for China. Large investor banks gain from assisting with bond issuance, and financial companies in general search for high profits in these "frontier markets" (Tyson, 2015a), partially ignoring the risks. China has its own interest in investing in Africa, and often insures the risks by using commodities as collateral. Similarly, new plurilateral banks are eager to invest in Africa. Their – real or assumed – preferred creditor status may imply some moral hazard in this eagerness.

The lack of data on the size of indebtedness of the total public sector and of the size of publicly guaranteed debt, and the lack of transparency on the terms and conditions of loans is said to be another qualitative difference with the previous crisis. However, during the previous crisis the size of public and publicly guaranteed loans was also uncertain. State-owned enterprises often borrowed outside the formal central government budget, and the same held for subnational governments, especially in the larger countries such as Nigeria. The terms and conditions of these loans were often also unknown. They became known, or were defined, once the original sub-national or (semi-) private borrowers defaulted and the debt became a claim from one sovereign country on another.

The earlier African debt crisis showed clearly that the creditors recognized too late that substantial debt relief was necessary. During more than two decades, official creditors continued to lend into arrears, and a lot of foreign aid was just used to service debts of multilateral creditors. But this protracted debt crisis in low income countries and the extensive bailing out of one group of official creditors by the other did not raise much attention among the relevant policy makers. This changed when bigger countries suffered from debt crises, and when large amounts of IMF loans, so official money, bailed out private creditors (Mexico 1994, Asian crisis in 1997-1998 and Argentina 2001).[7] In order to examine the prospects for a quicker and more effective solution to an eventual debt crisis in Africa it is important to analyse the changes in this Sovereign Debt Restructuring Regime.

5. Changes in regulation for debt restructuring since 2000.[8]

In response to these debt crises in larger and more important economies, new proposals were made for a sovereign debt workout mechanism, an impartial mechanism that would have authority to decide when to start debt cancelation and on an even distribution of the losses to be taken by all creditors – in a similar way as bankruptcy courts at the national level. In the early 2000s, Ann Krueger, then deputy director of the IMF proposed a Sovereign Debt Restructuring Mechanism (SDRM) under the IMF. For countries that could not repay their debts, the IMF would proclaim a stop on outgoing capital, it would prohibit litigation and it would decide on the amount of cancellation. However, there was a lot of opposition to this proposal. Some governments and NGOs were of the view that a more independent institution was necessary. The IMF was considered heavily dominated by western powers and in addition was a creditor itself. But the most important opposition came from the US government. It was not willing to give up its discretionary power in the current ad hoc system of decision making on the moment of debt restructuring. The US did want to solve the coordination problem among private creditors, but preferred a market based solution. The US then proposed to include Collective Action Clauses (CACs) in all bonds issued. This meant that creditors ex ante agreed to abide by a decision on the size of the haircut, once this decision would be made by a large majority of the bondholders. From February 2003 onward, many new bonds contained CACs.

In the same year, the Executive Board (EB) of the IMF took a decision that would help to reduce the extent to which IMF loans would bail out private creditors in the event of a debt crisis. The IMF would no longer provide loans to countries with unsustainable debts and would instead encourage debt restructuring for these countries. This new rule was first tested during the Greek crisis in 2010. The IMF wanted to lend but according to its own analysis, the debt was not sustainable so restructuring was necessary. However, European countries opposed this idea as it would probably bring their banks, heavily involved in Greece, at risk, with large consequences for government finances if the banks had to be rescued. Under pressure from large European countries, and with support of the US, the EB decided that exemptions to the rule were possible in case of high risk of "systematic international spill-over effects". The IMF provided a record-high loan to Greece, only to

[7] In the same way that the debate on policy conditionality only seriously began after the 1998 Asian crisis and not when conditionality only affected low income countries during the 1970s, 1980s and 1990s.

[8] This is largely based on Brooks & Helleiner (2017).

find that two years later debt restructuring was unavoidable. In the meantime, private creditors had been able to take out US$ 150 billion.

After this new case of bailing out of private creditors, The IMF was heavily criticized for not being impartial and for still being dominated by the traditional western powers. In response, the 2010 exemption was abolished, but at the same time the earlier rule of not lending to countries with unsustainable debt was made more flexible, for example allowing lending if there was some debt "reprofiling", implying just postponements of debt service at market rates.

When it was finally decided that Greek debts would be restructured, the CACs only proved to work partially. They did not work for domestic debts as domestic bonds did not have CACs. Greece could solve this problem by imposing CACs retroactively through a new law. The second problem was that there had to be a majority decision for each bond series, and in the Greek case this occurred in only about half of the series. This created an unfair distribution of the losses. It also meant that Greece still had to pay large amounts to the non-cooperating bond holders. Shortly after, a more serious problem came to the fore. A New York court ruled that Argentina had to pay in full the creditors, often called "vulture funds",[9] that had not accepted the restructuring after the 2001 default. The eurozone countries responded to these problems by proclaiming that from 2013 onward, all bonds, domestic and foreign, had to include CACs, so called euro CACs. They also made it less likely that individual bond series could escape restructuring by deciding on a "two-limb" voting system: for restructuring a bond series, a majority in this series was needed (66.7%) plus a majority of the overall outstanding debt (75%). However, this complicated procedure did not help much to avoid unequal treatment.

The Greek problems and the US court ruling that both created unfairness to creditors that had accepted their losses, brought the US Treasury to install a high-level working group to discuss improvements to the CACs. The working group proposed to have just one voting (one-limb voting system) for the collective of all bond series, and this was quickly implemented. According to a recent IMF report, 85% of new bond issues between October 2014 and October 2016 have these Super CACs – although eurozone countries stick to their earlier, less effective euro CACs (IMF, 2017). In the future, it will therefore be easier to establish equal treatment on all creditors in the event of default. However, the other problem of not having an impartial decision making system for when debt restructuring is necessary, is still present.

Furthermore, the equal treatment will hold for bondholders and it will still be difficult to establish a fair restructuring for other creditors, for example official creditors that are not members of the Paris Club. But the extent of this problem may be smaller than thought. Brazil and Korea are already permanent members of the Paris Club, and other countries have been invited at an ad hoc basis for discussing agreements on specific countries. This has included China but also Persian gulf states like Abu Dhabi and Kuwait. Those countries participating must adhere to the Paris Club Principles on, for example, solidarity (accepting equal treatment). The lack of transparency on terms and conditions of Chinese and possibly other loans, and the lack of clearness on preferred creditor status of plurilateral banks, may indeed complicate orderly restructurings.

[9] Vulture funds buy claims that are already written off at low prices at secondary markets, and then hold on to them and start litigation in order to get fully repaid.

6. Further proposals

Further proposals for preventing debt crises and for more orderly decision making in the process of debt rescheduling have been made. A very important measure to prevent debt crises is improving the debt management capacities in SSA countries. A recent ODI paper shows that debt management capacity in many SSA countries remains weak according to several measures, despite extensive technical assistance from IMF, World Bank and other donors (Mustapha & Prizzon, 2018). Improving debt management may increase insights in costs and risks of different types of borrowing. In addition to debt management, countries also need to adhere to prudent macroeconomic policies and to carefully analyse the profitability of investment projects before borrowing for them.

The latter two recommendations can be considered elements of responsible borrowing. During the Monterrey Conference on Financing for Development it was agreed that both borrowers and lenders bear responsibility for preventing debt crises. Subsequently, UNCTAD has developed 15 Principles on Promoting Responsible Sovereign Lending and Borrowing. They were presented at an UNCTAD Conference in 2012. These principles recognize that it is not only the quantity of debt that matters but also the quality. For example, governments must respect the needs of their citizens, and lenders must check whether borrowers have the right authority for borrowing. The UN General Assembly has approved there principles, but only 13 countries have explicitly endorsed them (Ellmers, 2016). The Principles have also been criticized for not giving explicit attention to odious debts and for not including explicit monitoring mechanisms. Nevertheless, they would be a step forward as compared to the current absence of any regulation.

Another, more market-based solution for preventing debt problems is to issue State-Contingent Debt Instruments (SCDCs). This implies that debt service would be linked to variables with a big influence in government income, for example GDP growth, or changes in prices of main commodities (Mustapha & Prizzon, 2018). So far, they have only been used as part of debt restructuring, and not to prevent such restructuring.

As stated above, there is no impartial supranational mechanism yet for deciding on debt rescheduling. Nevertheless, further proposals have been made. After the 2008 crisis, the UN established a Commission of Experts to rethink the international financial architecture. The committee, named Stiglitz commission after its chair, proposed to set up an International Debt Restructuring Court, that would be able to make binding decisions on losses to be taken by all creditors. This Court would have to be independent of the IMF because the IMF is 1) a creditor itself, and 2) is dominated by western creditor countries (United Nations, 2009). However, advice did not lead to chances in practice.

A few years later, the Group of 77 developing countries (G77) wanted to better protect the interests of defaulting debtor countries. As it was clear that the US would block decision making on this issue in the IMF, the G77 approached the UN. In 2014, the General Assembly approved a resolution that called for a "multilateral legal framework for restructuring sovereign debts" (Brooks & Helleiner, 2017). Although eleven countries, including the US and the UK, opposed it and 41 countries abstained (including many EU countries), an ad hoc committee began to elaborate proposals. Several rich countries including the US and the UK refused to participate, and this was a severe limitation as the overwhelming majority of bonds are issues in these two countries.[10] In view of the lack of support from most rich countries, but also because many developing countries had difficulties in giving up sovereignty to a supranational body, the Committee only came up with soft laws. It defined

[10] 50% in New York, and 46% on London (IMF, 2017)

basic principles on sovereign debt restructuring processes (Brooks & Helleiner, 2017). The principles were adopted, but again, the US, the UK and some other countries voted against them, while most EU countries abstained. A breakthrough in establishing an independent mechanism cannot be expected.

Another way to reduce both the risk of default and to promote an orderly restructuring, is to reduce capital flight. Africa is the continent that relatively suffers most from capital flight. Capital flight seems related to borrowing, in particular. For every dollar borrowed by Sub Sahara African countries between 1970 and 2010, on average between 63 and 73 cents left again within 5 years (Ndikumana, Boyce, & Ndiaye, 2014). Several authors have proposed more regulation of capital outflows, and in particular of short-term outflows (Bassett, 2017; Tyson, 2015b).

7. Conclusion

The dominant opinion is that the current imminent debt crisis in Sub Sahara Africa will be more difficult to prevent and to solve. This is due to the changed composition of the debt. A large part of the debt is in private hands and in particular in the hands of bond holders. In addition, an estimated 20% is represented by loans from China. As China is not a member of the Paris Club, this will make creditor coordination more difficult.

The implicit assumptions in these statements is first, that there are large differences between the previous African debt crisis and the current – imminent – one, and second that that the much larger extent of creditor coordination during the previous debt crises has been able to prevent and solve the debt crises in an agile way. This paper shows that both assumptions can be refuted.

While some African countries already applied for debt restructuring in the 1970s and many more did so in the 1980s, they continued to suffer from unsustainable debts until these were finally solved between 2000 and 2005 with the HIPC and MDRI initiatives. Official creditors were much later than private creditors in recognizing that SSA countries were insolvent and not just illiquid. For a long time, they continued lending and provided far too little debt relief, thus making the situation for these countries worse.

And while there appear to be vast differences between the situations then and now, there are also many similarities. In the previous period, many debts were originally also private loans from western suppliers, they were often not accounted for in formal budgets (taken by subnational entities or sate-owned enterprises) and in many cases terms and conditions were unclear. It was only when the borrowers defaulted that the governments in rich countries took over the claims, and at that moment, the parties had to settle the exact terms and conditions.

Although it is true that restructuring bonds is slightly more difficult than restructuring loans, the Collective Action Clauses (CACs) and, in particular, the super CACs will make it easier to establish coordination among creditors and avoid holdouts by vulture funds. And the previous African debt crisis shows that private creditors tend to accept their losses much quicker than official creditors.

A recurrent feature of the international financial regulatory system is the lack of an independent debt restructuring mechanism. This has proved very damaging in the previous African debt crisis. And although many innovative proposals have been presented, the lack of progress in this area is still a serious problem.

References

Bassett, C. (2017). Africa's next debt crisis: Regulatory dilemmas and radical insights. *Review of African Political Economy, 44*(154), 523-540. doi:10.1080/03056244.2017.1313730

Bird, G., & Rowlands, D. (2000). The catalyzing role of policy-based lending by the IMF and the world bank: Fact or fiction? *Journal of International Development, 12*(7), 951-973.

Bird, G., & Rowlands, D. (2007). The IMF and the mobilisation of foreign aid. *Journal of Development Studies, 43*(5), 856-870.

Bowe, M., & Dean, J. W. (1997). *Has the market solved the sovereign debt crisis?* (Princeton Studies in International Finance No. No. 83). Princeton, NJ: International Finance Section, Princeton University.

Brautigam, D., & Hwang, J. (2016). *Eastern promises: New data on chinese loans in Africa, 2000-2014.* (Working Paper No. 2016/4). Washington: John Hopkins School University School of Advanced International Studies, China-Africa Research Initiative.

Brooks, S., & Helleiner, E. (2017). Debt politics as usual? reforming the sovereign debt restructuring regime after 2008. *International Affairs, 93*(5), 1085-1105. doi:10.1093/ia/iix159

Collier, P., Guillaumont, P., Guillaumont, S., & Gunning, J. W. (1997). Redesigning conditionality. *World Development, 25*(9), 1399-1407.

Daseking, C., & Powell, R. (1999). *From Toronto terms to the HIPC initiative: A brief history of debt relief to low-income countries.* (IMF Working Paper No. 99/142). Washington: IMF.

Dijkstra, G. (2008). *The impact of international debt relief*. London & New York: Routledge.

Dijkstra, G. (2013). What did US$18 billion achieve? the 2005 debt relief to nigeria. *Development Policy Review, 31*(5), 553-574.

Dooley, M. P. (1994). *A retrospective on the debt crisis.* (NBER Working Paper No. 4963). Washington: NBER.

Dzimwasha, T. (2017, May). Africa's debt spree: Precursor to a new debt crisis? *African Business,* , 11-19.

Economist. (2018, March 10). Public debt in Africa: On the rise again. *Economist,* 38.

Ellmers, B. (2016). *The evolving nature of developing country debt and solutions for change.* (Eurodad discussion paper). Brussels: Eurodad.

Ferry, M., & Raffinot, M. (2018). Curse or blessing? has the impact of debt relief lived up to expectations? A review of the effects of the multilateral debt relief initiatives for low-income countries. *The Journal of Development Studies,* doi:10.1080/00220388.2018.1499895

IEG. (2006). *Debt relief for the poorest: An evaluation update of the HIPC initiative.* Washington: The World Bank, Independent Evaluation Group.

IMF. (2017). *Second progress report on inclusion of enhanced contractual provisions in international sovereign bond contracts.* (IMF Policy Paper). Washington: IMF.

IMF. (2018). *Macroeconomic developments and prospects in low-income countries-2018.* (IMF Policy Paper). Washington: International Monetary Fund.

Jubilee Debt Campaign. (2018). *Africa's growing debt crisis: Who is the debt owed to?* (). London: Jubilee Debt Campaign.

Killick, T., Gunatilaka, R., & Marr, A. (1998). *Aid and the political economy of policy change*. London/New York: Routledge.

Mustapha, S., & Prizzon, A. (2018). *Africa's rising debt: How to avoid a new crisis.* (Briefing note). London: Overseas Development Institute (ODI).

Ncube, M., & Fairbanks, M. (2012). China in Africa: Myths, realities, and opportunities. *Harvard International Review, 34*(2), 21-25.

Ndikumana, L., & Boyce, J. K. (2003). Public debts and private assets: Explaining capital flight from Sub-Saharan African countries. *World Development, 31*(1), 107-130.

Ndikumana, L., Boyce, J. K., & Ndiaye, A. S. (2014). *Capital flight: Measurement and drivers.* (Working Paper No. 363). Amherst: Political Economy Research Institute, University of Massachusetts.

Stiglitz, J., & Rashid, H. (2013, 26 June). Sub-saharan africa's eurobond borrowing spree gathers pace. *The Guardian.* Retrieved from https://www.theguardian.com/business/economics-blog/2013/jun/26/subsaharan-africa-eurobond-borrowing-debt

Tyson, J. E. (2015a). *Sub-Saharan Africa international sovereign bonds, part 1, investor and issuer perspectives.* (EPS-PEAKS Helpdesk Request).Overseas Development Institute (ODI).

Tyson, J. E. (2015b). *Sub-Saharan Africa international sovereign bonds, part 2.* (EPS PEAKS Helpdesk Request. January). London: Overseas Development Institute.

United Nations. (2009). *Report of the commission of experts of the president of the united nations general assembly on reforms of the international monetary and financial system.* New York: United Nations.

White, H., & Dijkstra, G. (2003). *Programme aid and development: Beyond conditionality*. London: Routledge.