EURO-MEDITERRANEAN ECONOMISTS ASSOCIATION

EMEA Webinar on "Over-indebtedness, debt relief, restructuring and transparency: Is a debt sustainabilty path for Africa a myth"

Date 18 June 2020, 15:00

Introduction

Prof. Rym Ayadi, President, Euro-Mediterranean Economists Association (EMEA) and Professor CASS Business School, London

This webinar, co-organised with the Centre for European Policy Studies (CEPS), aims at discussing:

- the current challenges and solutions to tackle over-indebtedness of governments in Africa and the Middle East,
- the feasibility and desirability of debt relief and restructuring,
- the role of international organisations (e.g. IMF and the EU) and the private sector, and
- the potential path towards debt sustainability via transparency and conditionality.

There has been a significant growth of debt in Africa and the Middle East during the last few years. This build-up is due to accommodating interest rate policies and an increasing flow of capital from emerging markets. It has led to an increase in financial vulnerabilities. Over-indebtedness increases a country's difficulties in facing up to economic shocks, such as the COVID crisis. The G20 has implemented a Debt Service Suspension Initiative (DSSI) whilst calling for a contribution from the private sector and negotiating with the African Union.

Cinzia Alcidi, Senior Research Fellow and Head of Economic Policy Unit, Centre for European Policy Studies (CEPS) and Member of EMEA Executive Board

The view on the debate looking into the experience of the Greek debt crisis in the EU. It might help to draw lessons from the Greek restructuring. Whilst Greece is an advanced economy, its case is relevant for two main reasons: The large size of external debt and the lack of control of the central bank on the currency. The focus of the talk was on the macroeconomic OSI (Official Sector Involvement) and PSI (Private Sector involvement) impact.

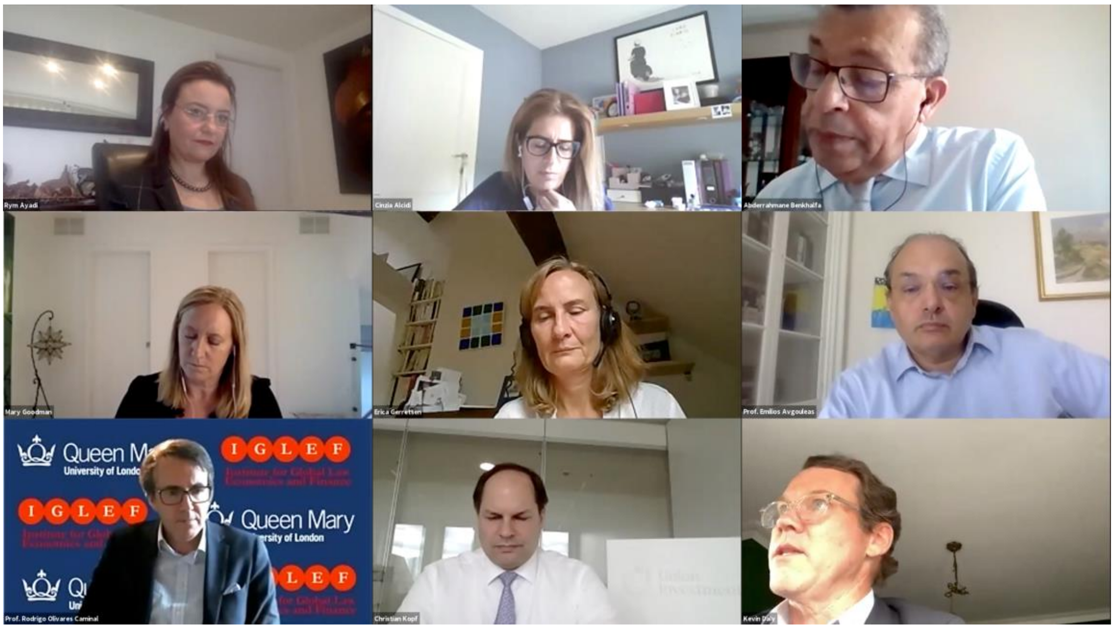
The PSI happened in 2012 with a 55% haircut on debt. The cut in the value of the nominal debt was less than expected. The main problem was that the debt to GDP fell by 4.5% in the year of the event and went back to its previous value the following year. Despite the involvement of the private sector, the level of debt to GDP was not reduced. PSI alone did not allow Greece to go back to the market. In 2017, the Greek debt held by the official sector was re-profiled with a significant reduction in interest rates and maturity extension. It allowed Greece to return to the financial markets in 2018 at reasonable rate. OSI had a significant impact. This was possible due to the huge fall in the risk-free interest rates.

The Macroeconomic performance of Greece remained very weak throughout the years of PSI. And the causality between PSI and the fall in GDP is very difficult to show, but the association remained very large. But in the literature, it has been proven that a debt restructuring is associated with a very large fall in GDP in the early years of the event.

Regarding the link between austerity measures and the fall in GDP: Debt restructuring was a part of a bigger package, along with fiscal consolidation and reform. An important point during the PSI negotiation was its impact on uncertainty and credibility in the context of weak economic performance.

Rapporteur : Sandra Challita – EMEA Research Fellow

EMEA Webinar on over-indebtedness, debt relief, restructuring and transparency: Is a debt sustainability path for Africa a myth?



Speaker(s):

Mary Goodman, Assistant Director, International Monetary Fund
Role of the IMF in COVID mitigation and the way forward
The fund’s engagement with Sub-Saharan Africa has the following objectives: To foster high economic growth, fight fragility and help countries to strike the balance between development and debt sustainability.

The debt challenges: An increasing number of countries are at high risk of debt distress or are facing unsustainable debt. For many countries, their access to new sources of financing has led to significant changes in the structure of the debt, in particular more private creditors and official creditors that are outside of the Paris Club.

With this, comes the COVID crisis that threatens progress and future growth, at a time of limited budgetary space which is complicating policy response. There is a need to boost external assistance.

The main focus of the IMF is to enable members to meet the health challenges by working with development partners and international institutions. The response has two key points: Financing and debt relief. They have worked on emergency financing, rapid expanding facilities and doubling capacities. 40 countries in sub-Saharan Africa requested emergency financing and 28 countries received 9.9 billion USD. Reform of the Catastrophe, Containment and Relief Trust (CCRT) for service relief on the debt service owed to the IMF. By working with donors under the CCRT, 20 countries received relief under the CCRT framework. Launch of a fundraising effort to relieve the CCRT, in order to provide relief on debt service for a two-year period whilst requiring financial commitments from the members.

Regarding the DSSI, the IMF and its partners called for the suspension of official bilateral debt payments, supported by the G20 and the Paris Club until the end of 2020. This initiative requires a lot of detailed work, such as terms, developing MOF between countries, work on debt data reconciliation, and the amendment of bilateral individual loan agreements. Policy requirements include the use of the freed-up resources from the debt service relief to respond to the crisis, limiting the contracting of new debt and the requirement for disclosure of existing debt obligations, whilst providing support from the IMF. Private sector engagement in the DSSI initiative is encouraged by the IMF and WB, on the basis of voluntarily participation.

Erica Gerretsen, Head of Unit, Budget Support, Public Finance Management, Domestic Revenue Mobilisation, DG Devco, European Commission
Role of the EU on linking investment and debt to SDGs

The current context has created an unprecedented triple shock composed of the pandemic, the collapse of oil and commodity prices and the financial market turmoil. Half of the countries were assessed as being ‘high risk’ or already in debt distress before the crisis, with a high level of debt service. The crisis only served to aggravate the situation. And it is raising the political dimension of the debt. The EU has been strongly supportive of the DSSI initiative, whilst closely monitoring the level of ownership and interest.

The European Union is lending support to the countries most in need from this crisis, even though the EU is having its own problems. The EU (EC, EIB, EBRD and EU member states) have mobilised a 36 Billion euro financing package (grants, loans, guarantees to loans). One specific tool is the EU’s contribution in the form of a grant budget support programme for 90 countries (3.5 billion euros). This budget support is an important part of the response because it contributes directly to national budgets in terms of liquidity and increases fiscal space, it allows the EU to provide rapid response, comes with dialogue on policies, macroeconomic stability, public finances and transparency, and is an important entry point for economic policy reform discussions and for the effective use of funds. To benefit from this support, some pre-conditions

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should be met, but for monitoring they rely on the institutions of the countries themselves.

Looking forward, the DSSI is a breakthrough and a first step and there is a need to look into the details and reflect on a country-specific analysis and approach. Debt restructuring needed to take place before the crisis, and there is a need to think proactively about it.

The way forward can be via a DSSI policy dimension and the UN agenda for better principles, to link the efforts to the quality of investments and to bring the SDG agenda on board. Also, the green deal can find its external dimension as well as the digital transformation in building resilient and inclusive economies. There is also a need for more transparency on debt and more efforts at a political level to put pressure on debt transparency. We need to reflect on the concessional lending, if applicable.

The global recovery initiative: debt relief, the quality of investment, and SDGs. Some concrete steps are needed to go further: Extension of the DSSI and to find a way to include the private sector, a strong push for more debt transparency, the potential of debt swaps and support for a multilateral solution.

Abderrahmane Benkhalfa, Special Envoy, African Union
The position of the African union

The Covid-19 crisis is an opportunity to plead for the adjustment African debt. The debt stock is high - 365 Billion US (145 to China). Negotiation is being held with the G8 and G20, the IMF and the WB. The debt to GDP ratio is 60% for African countries; the amount of debt is not very high, but the GDP is very low. The pandemic further deteriorates the debt quality of African countries, to the point of becoming unsustainable. From the African level, the position is to include debt as part of a financial support package that includes: (1) addressing immediate needs to respond to the health crisis (100 Billion USD), (2) mobilising additional resources in a format other than traditional loans (such as additional assistance from the IDA : World Bank; Catastrophe, Containment and Relief Trust: IMF and assignment to Africa of the non-used SDR (Special Drawing Rights)) (3) requesting a special immediate contribution from China to buy medical supplies and equipment and acting for a quick disbursement of funds.

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Regarding the debt delay that is for now being implemented for 2020, this is not sufficient. The African Union's view is a need for an extension for a two year duration, with targetted debt relief for low income countries. This, whilst ensuring the participation of multilateral institutions and private investors under similar rules. Since the debt delay is an exceptional measure, it should ensure that beneficiary countries are able to go back to financial markets whilst being engaged in transparent processes and reforms.

Kevin Daly, Senior Portfolio Manager, Aberdeen Standard Investments, Africa Private Creditor Working Group
Reaction on the extension of the DSSI

The ASI group is engaged with 16 countries in Eurobonds of over 180 billion. The DSSI prompted a lot of confusion amongst private creditors. They considered that it was not a well- thought out plan which disregarded several stakeholders. The concern of private creditors is that it would trigger rating downgrades and forced selling at a time where markets are very fragile. They cannot provide public support for the initiative without consulting with their clients.

If countries seek PSI, this will forego their access to private capital. Several African countries were looking for alternative and cheaper financing tools and are not in favour of PSI. There is a need to reach out to the rating agencies in the DSSI framework and to keep in mind the importance of market access.

The Africa working group was designed to respond to the DSSI. The group is seeking ways to be part of the solution and not the problem - such as providing cheaper financing instruments for African countries, for instance partial guarantees and including SDG bonds.

Prof. Rodrigo Olivares Caminal, Queen Mary University of London
On the implementation of DSSI from a legal point of view via 4 steps **(Diagnosis, First Aid, Cure and Surgery)**

Diagnosis by identifying the real problem - is it a temporary liquidity problem or a structural problem? And a single approach for the whole of Africa is not viable.
First aid: Need for opening the proper channels of communication, reaching out to different creditors, seeing how to maintain the current situation without encountering any legal problems. Transparency is the essence.

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Cure: What should be done? Interest holidays? Re-profiling and restructuring? NPV issues?
Perform surgery: Great participation from the different types of creditors and dealing with the different tools. It is a complex issue, since different types of lenders and regimes are more or less willing to assist.
To be able to deal properly with a country in financial distress, it needs to happen under an IMF programme and with transparency, good faith and fair treatment.

Prof. Emilios Avgouleas, Edinburgh Law School
To what extent transparency is part of the solution?
Transparency is a key obstacle. The Greek PSI came late because it was difficult to locate where the debt was and who were the different types of creditors. It seems comparable with the case of Africa. It is not just about the willingness of the private sector to provide relief, it is about to whom this relief is given. Transparency is exacerbating the dilemma of liquidity and solvency and the question is: are they solvent? There is a need for a global public-private initiative partnership for transparency via electronic platforms, and project funding from bilateral loans. It is necessary to have transparency in order to be rid of the cycle of corruption, over-indebtedness and debt relief and back to square one. You do not really know who you are really helping, if they are solvent … Private organisations should be moving towards a global recording/depositary system for information on government debt.

Discussant(s):

Moritz Kraemer, Chief Economic Advisor, Acreditus
His perspective on the crisis is that it's not a COVID crisis, it's a sub-Saharan Africa debt crisis. What we see currently is a solvency crisis and not a liquidity crisis. Countries are vulnerable and external debt has gone up massively. Some of the countries are already in CCC rating, and private sector investors have been warned. And requiring debt relief now is a way to bail out. Forced selling is not the critical point here. What is the critical point is the debt capacity that has been crossed by several African countries. Given the high level of commercial debt in African countries, the PSI has to happen. Half of the countries in sub-Saharan Africa have an official debt that is less than half of the global debt. The official sector cannot do this alone (need for a NPV relief). In the end, what needs to be considered is the ratings of the multilateral development banks, based on preferred credit treatment. But the role of rating should not be exaggerated.

We must resist the temptation to pin the debt sustainability of African countries on COVID.

Christian Kopf, Managing Director, Union Investment
It is important to frame this situation: How do we think of Africa? Aid? Or through highest growth rates? It is a growth story and a continent that is developing. And the private sector has a role in developing Africa.

The scope of DSSI: 39 African IDA countries are eligible, 11 of them have requested, none of them have any bond outstanding and only 4 countries are in need.

The dichotomy is not between the official sector and private sector, it is the one between loans and bonds (bonds are more difficult and costlier to restructure). Loans should be restructured, they are easy to restructure. When it comes to bonds, there should be a cost benefit analysis per country.

The way forward is to link debt relief with the SDG agenda. One suggestion can be to offer a market-based exchange, to transform existing bonds into sustainable bonds (SDG bonds) carrying debt relief. This implies a need for an SDG monitoring and a partial guarantee for new securities by multilateral institutions.

Concluding remarks

- Multilateral organisations are keen to find a solution that includes the private sector
- To the private sector: what is the root of the problem?
- There is a need to look at the different situations in Africa
- There is a need for different solutions for different types of lenders (to whom we are providing relief)
- Modalities: loan or bonds. Bonds ratings could be affected, impacting future access to the markets.
- The solutions we are looking for are for a longer horizon. One instrument can be by including the SDGs. This is an opportunity to find a constructive solution for the private sector, which can also involve the external dimension of the green deal.
- Transparency is important, disaggregation is needed and there is a need to have current and timely data.