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Preventing the scenario of 'lost' economic decades: African Debt Crisis and the needed reform of the International Financial Architecture *(provisional title)*

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For many observers, the current circumstances are dangerously reminiscent of the late 1970s. Back then, as the US Federal Reserve raised its key interest rates - the so-called "Volcker shock" and commodity prices plummeted - most African countries found themselves unable to service their foreign debt. As their export earnings declined and debt servicing costs rose, their refinancing opportunities on financial markets closed while the depreciation of their exchange rates increased the domestic currency burden of servicing foreign-currency-denominated sovereign debt. In such conditions, many African countries had to knock on the doors of the Bretton Woods institutions. The International Monetary Fund (IMF), in return for its loans, demanded the implementation of macroeconomic stabilization policies – exchange rate devaluation and reduced public spending - while the World Bank's role was to facilitate medium- and long-term "structural adjustment" through privatization and liberalization policies in the domains of foreign trade, finance and labour relations.

For the continent, the application of the "Washington Consensus" precepts resulted in a loss of sovereignty in the design and implementation of public policies, increased control by foreign investors of strategic sectors, halted nascent industrialisation efforts and the general impoverishment of African countries, most of which lost one or two decades in terms of real income growth.

Four decades later, a similar scenario is taking shape. The African continent is once again mired in a debt crisis. The COVID-19 pandemic has led to economic contractions of varying magnitude everywhere. While it preceded and exacerbated the economic crisis in Northern countries, in Africa the health crisis deepened and accelerated economic and social crisis already well on the way. The COVID-19 pandemic drove down raw material prices, disrupted essential imports, led to a drop in foreign earnings from tourism and accelerated capital flight, particularly in the case of countries strongly integrated with the global economy through financial globalization such as South Africa. An ECA report (2020) projected that 27 million more Africans will fall into extreme poverty. Suddenly, for many countries, coping with the health and socio-economic consequences of the pandemic proved incompatible with servicing their foreign debt.

To address their international liquidity needs, African finance ministers called for an injection of external assistance of $100 billion each year for the next three years, including a waiver of all interest payments, estimated at US$44 billion in 2020, the extension of the waiver to the medium term, to middle income countries and to include sovereign bonds. For fragile states the waiver should include both principal and interest payments. The African Union set up a high-level panel to pursue these goals.

The results were disappointing. Initiatives by the IMF to enable the poorest countries tackle their debt problems yielded limited and short-term results. The allocation of new SDRs has not matched the international liquidity needs of African countries. With a quota of 5%, the continent received just $33 billion in SDRs, less than Germany. Although new loans granted by multilateral development banks made African economies more resilient, this has been at the cost of increased indebtedness. Although the IMF's "people first" agenda, called on countries "to do whatever it takes to ramp up public health expenditures to contain the virus outbreak, regardless of fiscal space and debt positions" and the World Bank Chief Economist Carmen Reinhart advising countries to borrow more: "First fight the war, then figure out how to pay for it", no sooner had public deficits and debt ratios began to rise than the same IMF promptly reverted to "fiscal orthodoxy". Zambia, in November 2020, and Ghana, in December 2022, were the first African countries to default on their debts. According to the IMF, with which they negotiated agreements, they should each achieve primary surpluses between 2023 and 2028. In the case of Chad, another country in crisis, these primary surpluses should amount to between 5% and 8% of GDP over the same period. For a poor economy plagued by the threat of jihadism, this represents an extremely drastic austerity "cure".

For most of the continent, the pandemic shock has been amplified by the consequences of the Russian-Ukrainian war. Speculation-driven global inflation has been accentuated at the domestic level by the depreciation of their exchange rates, triggered in part by the capital flight induced by the hikes in key interest rates by the US Federal Reserve and other developed economy central banks. With the rising cost of capital, refinancing options have also become more problematic for African countries classified as "frontier markets", which have to service a debt burden of around $30 billion a year.

In the 1980s, most of the external debt of African countries was held by bilateral and multilateral partners. Private debt, though limited, was largely confined to loans from commercial banks in Northern countries. Three decades later, two new global creditors have emerged. For a number of African countries, China has become the leading bilateral partner in terms of trade and investment. According to the China Africa Research Initiative, China has granted African governments and state-owned enterprises cumulative loans worth about $160 billion between 2000 and 2020. In addition to Chinese loans, African governments have tried to diversify their funding sources by issuing foreign currency-denominated bonds (Eurobonds) in international financial

markets and even in domestic markets, e.g. in the case of Ghana. Prior to the 2007-8 North Atlantic Financial Crisis, only countries such as South Africa and Mauritius had access to the Eurobond market.

Since then, the pursuit of zero-interest rate and quantitative easing policies by central banks in the North has stimulated a prodigious growth in international liquidity, part of which has been invested in sovereign bonds issued by countries in the South. Between 2007 and 2021, 21 African countries issued Eurobonds, often offering relatively high yields, reflecting the negative "perception premium" from which the continent suffers. Between 2010 and 2022, the continent's public debt/GDP ratio doubled from 32.7% to 65% (debt denominated in domestic currency represented 30% of GDP in 2020, versus 15% a decade earlier).

Against this backdrop, the "traditional" forums for negotiating the restructuring of bilateral debts (Paris Club) and commercial debts (London Club) have lost much of their relevance. In any case, earlier restructuring efforts, which included debt write offs under the Highly Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative, left unaddressed the structural problems delivered by colonialism and the unequal world order that resulted in chronic deficits in the underdeveloped world. What was achieved was part clearance of legacy debt that postponed the problem of countering the repeated cycles of debt accumulation, stress and crises.

But this time around even temporary resolution is proving to be a problem. Despite the changes in the composition of holders of lower and middle income country (LMIC) debt, the IMF, dominated by the US and its allies, remains the lead interlocutor in debt restructuring negotiations. It sets the benchmarks for debt write-offs by different types of creditors present in individual countries, and implicitly (before agreement to provide a credit line to facilitate restructuring) as well as explicitly (in Letters of Intent, which are ostensibly owned by government of the debtor countries), defines the set of policies to be adopted by countries to restore debt sustainability.

This process is taking too long, worsening the crisis in many countries. Without China and private creditors - Eurobond holders - at the table, countries in urgent need of debt restructuring face a fragmented process. The lack of coordination between the various creditors is compounded by geopolitical rivalries between China and the West - each side being discouraged from granting concessions that might benefit the other. China, in particular, senses that it is being called upon to carry a disproportionate share of the burden of restructuring in a process that is driven by other players and appears to favour private creditors located in the developed market economies. And the IMF is willing to hold out till a country is desperate enough to accept the intense austerity that it recommends. The process is delayed. The median duration of defaults for Fitch-rated sovereigns since 2020 was 107 days (and five were still unresolved by March 2023) compared with 35 days for all defaults since 2000. Moreover, the austerity package

inevitaby fails to deliver growth and debt sustainability. Recently, the instruments to impose austerity have been substantially widened (in Ghana and Sri Lanka) through the inclusion of domestic debt restructuring as an element of the policy package required to be adopted as a prelude to external debt restructuring negotiations. This not only damages the domestic commercial banking sector, with adverse implications for the level of economic activity, but also the pension fund industry, wiping out a part of the savings of sections of salaried and wage workers.

The changed debt environment also explains the failure of G20 measures such as the Debt Service Suspension Initiative (between May 2020 and December 2021), which only involved one private creditor. A number of African countries, despite their real financial difficulties, have preferred to refrain from using the DSSI, for fear of compromising their access to international financial markets. As for its successor, the Common Framework for Debt Treatments, its mixed results for Chad, Zambia, Ethiopia and Ghana, the four countries that used it, and the fact that it excluded a number of middle income distressed countries, encouraged the setting up of the Global Sovereign Debt Roundtable, a platform that brings together the Bretton Woods institutions, the Paris Club and other bilateral creditors such as China, private creditors and debtor countries.

At a time when 24 of 55 African countries are in or at risk of debt distress, it is important to prevent a repeat of the 1980s scenario. African economies weakened by the COVID-19 pandemic and the consequences of Russia's invasion of Ukraine, cannot accept the prospect of further lost decades. Such a course of events would not only lead to potentially destabilizing socio-political turmoil but would also risk wiping out the continent's efforts to date on the climate front and towards achieving the Sustainable Development Goals (SDGs).

The current stalemate raises the issue whether the structurally unwarranted central role for the IMF in debt restructuring negotiations and the template it uses is fit for purpose. Evidence clearly suggests it is not. This raises the issue of what alternative platforms, new laws and new policy templates are needed to offer not only workable and viable restructuring solutions, but those that are more just given the global inequalities that precipitate debt crises and are more reasonable given the changes in shares of different creditors.

Several questions arise. How to restructure the debts of African countries that have become insolvent in a way that circumvent counterproductive austerity policies? How to prevent the scenario of sovereign insolvency for countries at risk? What are the alternatives to the IMF's approach to debt sustainability? What reforms to the global financial system could be envisaged to facilitate the continent's access to adequate financing, including for climate-related spending, and to protect the countries from the negative consequences of the various exogenous shocks to which they are exposed?

To explore these pressing issues, IDEAs is planning an international conference from **March 27 to 29**, 2024 in Accra. The event will be attended by experts, policy-makers, members of civil society and other invited guests. As 2024 will mark the 50th anniversary of the launch of the G77 New International Economic Order agenda (NIEO), this gathering will provide the opportunity to discuss its legacy as well as current proposals along the same lines aiming to reshuffle the international financial architecture.