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**THE ECONOMIC AND ETHICAL AMBIGUITIES OF AFRICAN DEBT
FORGIVENESS**

By

Christopher B. Barrett

**DEPARTMENT OF ECONOMICS
UTAH STATE UNIVERSITY
LOGAN, UTAH**

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Christopher B. Barrett
Associate Professor
Department of Agricultural, Resource, and Managerial Economics
351 Warren Hall
Cornell University
Ithaca, NY 14853-7801 USA
tel: (607) 255-4489
fax: (607) 255-9984
email: cbb2@cornell.edu

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The Economic and Ethical Ambiguities of African Debt Forgiveness

Abstract

Subsaharan African states clearly labor under an extraordinary weight of external debt. A strong groundswell of opinion has formed behind debt forgiveness efforts and the international financial institutions have announced steps in this direction. The plight of Africa's poor demands serious response from creditors and donors, not to mention their own governments. Yet the common economic arguments for debt relief find little empirical support in SSA. In particular, there is no solid empirical evidence of debt overhang serving as a tax on investment or GDP growth. The real problem of external debt in SSA appears to be the heavy marginal tax it levies on current account receipts. Surely this contributes to persistent balance of payments crises, and the related need to negotiate adjustment loans which appear to degrade regimes' legitimacy. The most important dimension of debt relief for SSA states may thus be not stock reduction so much as release from the foreign exchange demands of repayment.

The Economic and Ethical Ambiguities of African Debt Forgiveness

While the declining severity of Latin American debt has reduced global concerns about the Third World debt crisis, external debt continues to bedevil most of the economies of Sub-Saharan Africa (SSA). SSA accounted for only 10.1% of developing country external debt at the end of 1994, yet the almost \$200 billion owed by SSA countries was one-third greater than their GNP and almost four times their export earnings.¹ Several international leaders and nongovernmental organizations (NGOs) have advanced major proposals for debt remission for severely indebted, low-income and middle-income countries (SILICs and SIMICs, respectively), most of which are in SSA.

Unlike debt reduction efforts elsewhere in the developing world, where private creditors hold 46.1% of total long-term debt outstanding and multilateral development banks (including the IMF) account for only 15.1%, SSA's long-term debt is owed primarily (80.4%) to official creditors, with almost one-third to multilateral agencies. Thus the focus in SSA is on official debt forgiveness. There have been some small steps in this direction by bilateral official creditors, beginning with agreements reached at the 1988 G-7 summit in Toronto and most recently extended by the Paris Club's Naples terms in December 1994. More recently, the Bretton Woods institutions (the International Monetary Fund and the World Bank) announced limited debt forgiveness measures in October 1996. Most analysts nonetheless seem to believe that these measures come up short² and have only postponed more substantial remission by official creditors.

This paper analyzes the issue of African debt forgiveness. While many believe that SSA cannot grow out of its external debt, this does not mean debt has caused African economic

decline. Indeed, a central point of confusion in the debate about African debt forgiveness is the amount of growth stimulus one can reasonably expect. This point gets complicated by all-too-common indiscriminate borrowing from the literature on commercial debt problems in Latin America, despite the substantial structural differences between the African and Latin American cases. The debt crisis is part of Africa's prolonged economic malaise and social and environmental crises, and it is not axiomatic that substantial debt forgiveness is central to the resolution of these challenges. Nor do ethical arguments unambiguously favor debt remission. The evidence I present in this paper favors highly differentiated debt relief structured to relieve the balance of payments burdens associated with African debt and to benefit most and directly vulnerable subpopulations. The ambiguous economic and ethical merits of African debt forgiveness necessitate hard political choices, similar in important respects to contemporaneous choices regarding democratization, food aid or the safeguarding of tropical ecosystems.

The Case For Debt Forgiveness

Most SSA governments have run arrears on principal and interest payments in the past decade. Prolonged recession in SSA has convinced many observers that arrearages signal an excessive debt burden that must be reduced for both economic and ethical reasons. The primary economic arguments advanced for debt remission follow from the presumed existence of a “debt overhang”, which Krugman (1988) defines as debt in excess of the expected present value of future resource transfers. Debt overhang suggests the existence of a debt Laffer curve, in which expected repayments rise with debt stocks up to some point, then decrease thereafter as the probability of repayment falls. The central argument of the debt overhang hypothesis is that since

increased future output increases repayment expectations, debt service may act as an *ad valorem* tax on investment, thereby depressing investment demand.³ An external debt overhang may also increase the riskiness of a debtor country's domestic debt, thereby reducing investment funds and increasing local interest rates (Cline, 1995; de Aghion and de Hineirosa, 1995). Investment rates in SSA were low and falling from 1980 to 1993: gross domestic investment (GDI) fell 2.8% per year to 16% of GDP. By comparison, annual GDI growth over the same period was positive 2.4% in all low- and middle-income countries, reaching 24% of GDP (World Bank, 1995). Given strong linkages from investment to GDP growth (Levine and Renelt, 1991), any investment dampening effects of debt are potentially quite serious for SSA economies. The question nonetheless remains as to whether SSA has exhibited the macroeconomic drag posited by the debt overhang hypothesis. Evidence from other regions is mixed (Bulow and Rogoff, 1990; Claessens, 1990; Cohen, 1993; Cline, 1995) and to the best of my knowledge there is no published empirical study of this issue as it applies to SSA.

The notion of debt overhang leads directly to widespread claims that debt reduction may benefit creditors as well as debtors. This occurs directly by increasing expected receipts, either by reducing the probability of default or by reducing macroeconomic distortions. It can also occur indirectly, by fostering macroeconomic growth in debtor nations and thereby stimulating demand for creditor country exports, providing creditors with new investment opportunities offering high yields and portfolio diversification opportunities, or (still more speculatively) reducing international emigration and environmental degradation.

A related issue is that external debt servicing absorbs a substantial share of scarce foreign exchange receipts, thereby reducing SSA's ability to import necessary food, medicines, fuel, spare

parts and capital equipment. This argument harkens back to the "two-gap" models popular in the World Bank in the 1960s, which posited foreign exchange was a binding constraint on development. As I show in the penultimate section, data from SSA support the hypothesis that debt servicing has heavily taxed current account receipts.

A rather different economic argument for debt forgiveness focuses on the notion of “loan pushing,” wherein lenders supply more credit to borrowers than the latter would voluntarily contract under the prevailing terms⁴ (Basu, 1991). Essentially, loan-pushing is the excess-supply equilibria counterpart to more familiar excess-demand equilibria models of credit rationing. It turns on the ability of lenders to make credible “take-it-or-leave-it” credit offers. If loans fail to generate the returns necessary to finance repayment for reasons other than borrower misconduct (i.e., due to external shocks), then in equilibrium a lender will not punish the borrower’s nonpayment.⁵ Loan pushing necessarily exposes the borrower to greater risk, and debt forgiveness is thus a means of risk sharing among borrowers and lenders. There is widespread evidence of such loan pushing in SSA by commercial lenders in the 1970s, by bilateral official lenders from the 1970s through the early-to-mid 1980s, and by the multilateral development banks since the early 1980s (Gordon, 1993; Nafziger, 1993).

Fafchamps (forthcoming) offers a similar but distinct argument concerning a “conditionality trap.” Conditionality of the sort required by the IMF — and thus *de facto* prerequisite to any SSA debt rescheduling or reduction by the London or Paris Clubs — helps borrowers *ex ante* to get additional loans by committing them to policies that enhance repayment prospects. *Ex post*, however, conditionality haunts the debtor by inducing excessive borrowing and periodic rescheduling and increases creditors’ leverage over debtor nations. Moreover,

empirical evidence from SSA suggests that conditionality is associated with not only loss of economic sovereignty but also with increased political instability in borrowing countries (van de Walle and Bratton 1997), which appears to degrade macroeconomic performance (Alesina and Perotti 1994).

The common denominator of the loan-pushing and conditionality trap arguments is that borrowers take on predictably excessive debt volumes and that efficient risk-sharing favors some limited form of debt reduction. The extent of optional write-downs will necessarily vary according to the borrower's circumstances. Creditors have implicitly recognized they should bear more of the risk by increasing the grant element of recent development finance. But the approach of highly differentiated debt reduction⁶ runs counter to the uniform approaches adopted thus far by the Paris Club (e.g., Toronto or Naples terms) or those proposed by leading NGOs in the debate (e.g., OXFAM).

These economic arguments about "conditionality traps" and "loan pushing" lead directly to the various ethical arguments in favor of debt forgiveness for SSA states: infringement on sovereignty and the regressive distribution of repayment burdens and risk-bearing. The need to roll over principal repayments and the mechanics of debt renegotiations have given foreign creditors and donors unprecedented influence over domestic economic policy and the internal politics of borrowing nations (Mosley, Harrigan and Toyé, 1991; Helleiner, 1992; Callaghy and Ravenhill, 1993; van de Walle and Bratton, 1997). African leaders and their subjects justifiably object to the power exercised by international actors. But it is probably misguided to believe that debt remission would substantially relieve the power imbalance between poor African states and their bilateral and multilateral benefactors. Broader economic, environmental and political crises

in Africa will continue to draw in foreign creditors, donors and technical assistants who will exert considerable influence over the course of near-term African development. While it is true that external debt burdens are associated with some infringement on sovereignty, the condition would surely exist in SSA even in the absence of any significant debt. Debt forgiveness is unlikely to have any impact on this unbalanced relationship.

More compellingly, advocates for African debt forgiveness appeal to compassion and justice for marginalized subpopulations, observing that the burdens of external debt servicing seem to fall disproportionately on marginalized populations, who rarely benefitted initially from borrowed funds. While the social impact of the debt crisis cannot be separated convincingly from the broader problems of deep, prolonged recession and halting, often ineffective efforts at structural economic reform, the vulnerable of SSA have undeniably suffered considerably over the past decade. Providing durable relief to the poor is of paramount concern to all parties serious about development. While SSA debt forgiveness represents a modest amount to creditors, it seems a vast sum to poor Africans whose standards of living have declined with macroeconomic stabilization efforts based on expenditure reduction. Toward this end many NGOs are calling for an unrepeatably debt forgiveness. For example, the UK's Jubilee 2000 movement invokes the pentateuchal concept of rare acts of grace to clear unpayable debts to motivate a call for one-off, concerted debt remission (Peters, 1995). In biblical times, such jubilee years were seen as necessary to ameliorate economic inequalities that were seen as both unjust and socially dangerous. Conditions seem reasonably similar today.⁷ The rub, of course, is that debt forgiveness accrues to the very states that neglected the vulnerable in imprudent borrowing and kleptocratic spending programs and later in sometimes-harsh adjustment measures. Unless one

believes that the current generation of SSA leaders are markedly more effective and trustworthy stewards of their subjects, creative approaches to debt forgiveness will be necessary to circumvent the governance problems that are partly to blame for the real hardships of the past decade plus.

Development is an inherently risky endeavor; many try but not all succeed. Loans are extended to finance uncertain ventures. Most industrial nations have bankruptcy laws governing the settlement of debts made unserviceable by the failure of the borrowing enterprise, but there are no analogous rules governing sovereign debt. Without debt forgiveness, the full burden of the risks of debt-financed development falls on the shoulders of low-income states although responsibility for identical projects would not rest with recipients were they financed by grants nor with private borrowers who could declare bankruptcy. The problem of failed development projects is particularly serious in SSA. Creditors, including the MDBs, could bear more of this cost, as has been implicitly recognized by the movement in recent years to a higher proportion of grant financing (Sanford, 1993).

The Case Against Substantial Debt Forgiveness

Opponents of substantial African debt forgiveness likewise invoke concerns regarding economic efficiency and long-term growth, compassion, and justice. Cline (1995, p.368) perhaps sums up this perspective best when he writes, "the key issue [in SSA debt] is policy reform, not debt forgiveness." Most of the arguments against substantial debt forgiveness — and the modifier "substantial" is crucial, if evasive — center on the consequences of forgiveness for governments' incentives and capacity to implement assiduous economic policy and on the impact of debt forgiveness on equally (or more) deserving third parties.

Many powerful participants in the debt forgiveness debate (e.g., Germany, Japan and the IMF) express grave concerns over the moral hazard effects of debt forgiveness. It seems manifestly unfair to penalize prudent states that maintained sustainable fiscal and external payments balances in favor of those who squandered borrowed funds. Because it is impossible to distinguish clearly between the unlucky and the unscrupulous, *ex post* debt forgiveness will almost surely reward excessively those who have eschewed the hard but necessary policy choices of macroeconomic adjustment. A minority of African states have implemented the sorts of broad-based macroeconomic reforms essential to sustainable economic growth (World Bank, 1994), but within SSA there have been marked differences in the intensity of adjustment efforts. Countries such as Burkina Faso, the Gambia, Ghana and Uganda have made considerable sacrifices to adjust to the external shocks and internal policy errors that made external debt servicing particularly onerous. Yet those nations will receive less for their pains than those who delayed or refused to adjust, and nations that behaved assiduously in the face of volatile external conditions (e.g., Botswana, Mauritius) would be denied entirely. Not only does debt forgiveness inversely related to a nation's previous sacrifices discourage the sort of prompt and prudent macroeconomic response to exogenous economic shocks that must surely be a central lesson of the present debt crisis, but it goes against the principle that rewards ought to be commensurate with effort.

Even with a favorable policy environment, African development will take a long time (Helleiner, 1992). Long-term development requires financing, whether by foreign aid, direct investment, portfolio equity investment or borrowing. Sustained access to international finance therefore appears crucial to the broader objectives of economic growth and poverty alleviation in SSA. The region has not participated in the portfolio equity investment and direct foreign

investment booms of the early 1990s, and aid to most SSA states has been flat or falling. Recourse to credit thus remains important to the financing of imports of consumer products and intermediate inputs essential to improving living standards and GDP in SSA economies. The burgeoning theoretical literature on sovereign debt highlights how access to credit hinges on a borrower's reputation and on creditors' commitment to punish borrowers who fail to repay, either by restricting capital access or through trade sanctions (Eaton and Fernandez, 1995). Debt forgiveness may ameliorate the reputational costs of default, but this is a matter of degree not kind. The formal models notwithstanding, the empirical literature offers no clear evidence as to whether failure to pay in fact harms recalcitrant borrowers' future trade or credit market access (Eichengreen and Portes, 1989; Ozler 1989, 1993). It is widely believed that failure to repay debts cuts sovereign borrowers off from capital markets: "myopic borrowers default on loans, while nonmyopic borrowers do not" (English, 1996, p. 272).

While capital markets access might not concern SSA governments much since so little financing comes from private creditors, the effect of debt forgiveness on official financing flows matters enormously. In the face of limited — and shrinking — foreign aid budgets, it is important to remember that a certain amount of debt forgiveness will almost surely be "paid for" out of funds that would otherwise flow as aid. Certainly not all, and probably not most debt forgiveness would be "additional" financing. For example, funds for bilateral debt forgiveness must be appropriated by the national legislature in many creditor nations (Sanford, 1993, 1995). In claiming that debt is the primary obstacle to African economic and human recovery, the most vociferous proponents of debt forgiveness risk convincing donor country legislatures that debt relief should suffice and aid programs can be ended. This is akin to the argument advanced by

Bulow and Rogoff (1990) against the establishment of an international debt discount facility, and it applies equally to the case of official debts owed by African states. Note that while Japan has been notably reluctant to forgive debts owed it by African states it has nonetheless become the leading provider of development assistance funds over the past decade. Indeed, the Japanese position has long been that deep or widespread debt forgiveness is misguided (Hecht, 1995).⁸ In a similar spirit, the IMF has been staunchly opposed to the use of aid money for one-off debt write-downs, claiming that forgiveness is not the highest return use of scarce development funds. Perhaps surprisingly, some African governments (e.g., Côte d'Ivoire) agree. It is an extremely difficult matter to establish what is the best expected use of funds for Africa. If the additionality of debt forgiveness proves modest, there is no getting around the hard calculus of the relative rates of return to different uses of the funds. In some settings this would probably not favor debt forgiveness, especially of concessional loans not presently being serviced.

Moreover, even if African debt forgiveness is additional for SSA, it might not be for the rest of the world. There is a real prospect that African debt forgiveness may deprive the equally-deserving poor in nonbeneficiary nations of access to low-cost funds by reducing the aggregate flow of new aid money (and less likely by raising the costs of borrowing from MDBs). Fearing that African debt relief might be paid for indirectly by nonbeneficiaries in other regions, IDA borrowing nations such as Bolivia, China and India have voiced opposition to forgiveness.

Next to bilateral official creditors, the multilateral development banks (MDBs) are the largest creditors to SSA and now the dominant source of new disbursements. Until very recently, the MDBs had resisted debt rescheduling or reduction, in part on the claim that it could jeopardize development banks' bond ratings, and thereby raise their costs of borrowing and the

interest rates they pass on to borrowing states, notably those not benefitting from debt forgiveness. As the new multilateral debt relief initiative announced in October 1996 implicitly concedes, this is a somewhat disingenuous claim, since SSA debtors represent a small portion of MDBs' market-financed loans. For instance, SSA obligations to the IBRD — the arm of the World Bank financed through capital markets — amounted to only \$8.2 billion at end-1993, less than 8% of total IBRD claims: twice its existing loan-loss provisions and less than the half of the Bank's reserves. Even a total write-off of SSA obligations to the IBRD needn't impact its borrowing on international capital markets. Moreover, if the recent experience of U.S. money center banks is any indication, reducing exposure to nonperforming sovereign loans can reduce financial institutions' cost of funds. The bulk of SSA debt owed MDBs derives from concessional facilities (e.g., ADF, IDA) and the IMF, all of which are funded directly by member governments and not at all through borrowing on capital markets. Of course the corollary to this is that remission of concessional loans gives scant real relief — as official bilateral debt forgiveness episodes of the past decade clearly demonstrate⁹ — returning one to the earlier question of whether funds are best used to write down debts or as new grants or concessional financing.

Debt forgiveness that might increase net financial flows to African nations in any significant volume would raise the possibility of “Dutch disease” effects. It is well known that a sharp exogenous increase in net foreign exchange revenues can stimulate inflation and real exchange rate appreciation, thereby hurting the competitiveness of exportables sectors in the economy. Paradoxically, debt relief of any substantial volume thus has the potential to harm longer-run current account balances by causing endogenous currency revaluation and reducing export competitiveness. Given that poor macroeconomic management of exogenous shocks (both

good and bad) helped precipitate the African debt crisis, as well as the broader economic crisis of which it is a part, there are grounds for concern on this point. Hence a conundrum: if debt forgiveness comes in any substantial volume, it could destabilize still-poorly-managed SSA macroeconomies, but if not it offers no real relief. This suggests that maybe debt is not the appropriate focus of attention, but merely a symptom of the larger development challenge.

There is, moreover, an eminently practical question: what is the point of debt forgiveness in countries that do not service their debt? Efforts to forgive African debts largely seek to transform the present *de facto* forgiveness, wherein creditors and borrowers both recognize that African external debts will never be paid off in full, into *de jure* remission. But this is not costless. In domestic debt work-outs bankruptcy settlement laws obviate the problems of creditor heterogeneity and coordination problems that have bedeviled commercial bank sovereign debt renegotiations. No such mechanisms are available for resolving sovereign debt. If anything, the official creditors to whom SSA states owe most of their debt have more diverse interests and agendas than the commercial banks, while the distribution of burdens among official creditors is proving an enormously sensitive issue. What is the point of costly, protracted negotiations over the issue, especially given that debtors' scarce technocrats' time might be better used managing their economies instead of negotiating debt relief?¹⁰ There are huge political obstacles to radical African debt reduction (Gordon, 1993), so perhaps it would be wisest to let those who are so motivated forgive debts, but not to invest much in negotiating concerted remission.

Finally, consider the realpolitik argument: creditors don't forgive debts for humanitarian reasons. The past decade's experience of bilateral official debt forgiveness for SSA has been of limited remission of concessional debts for humanitarian purposes, ultimately providing scant

relief. Meanwhile, serious debt relief has been reserved for countries serving primary geopolitical goals: Egypt, Jordan, Poland. As Sanford (1995, p. 381) points out in his analysis of U.S. claims, "the debt forgiveness provided to a few countries for strategic purposes thus accounts for much more money than all the debt relief provided to poor countries for general humanitarian ends."

The Empirical Evidence on Sub-Saharan African Debt

Some of the economic arguments surrounding debt forgiveness can be tested econometrically, although to the best of my knowledge no one has yet done so in the SSA case. The empirical findings I report should thus be understood as a first cut at trying to isolate the effects of external debt on SSA economies, not as the final say on the matter. Using 1983-92 data on 23 SSA nations commonly identified as in need of debt forgiveness, I regressed net external transfers (disbursement less repayments and interest payments) on GDP, GDI, exports of goods and nonfactor services, aid flows and debt stocks. Table 1 presents the results.

The empirical evidence indicates that GDP and investment are positively related to net transfers on debt in SSA, not negatively as the traditional debt overhang argument suggests. Each extra dollar of GDP brings the country three extra cents in external finance, half of it from official creditors. Gross domestic investment shows greater effects, with 15% coming from net external transfers, 5% from official creditors. Rather than being a drag on growth and investment in SSA, financial flows associated with external debt appear to support it.¹¹

The biggest effects are not in the national income and product accounts but in the balance of payments, where net external transfers are negatively related to both exports and aid flows. Nearly half of each extra dollar's export earnings exits the continent in the form of debt servicing,

roughly one-third to official creditors. The tax is thus not on domestic production or investment, but on export expansion. No wonder African governments question whether they stand to benefit from export promotion policies strongly advocated by foreign creditors; much of the gains are handed over to foreign creditors. Moreover, 20 cents of each extra dollar's overseas development assistance leaves the country as net transfers, almost all of it paying off private creditors. This sharply diminishes the effectiveness of aid funds extended to support infrastructure rehabilitation, environmental protection, institutional reforms, human capital investments and other development activities.

Contrary to the conventional wisdom (e.g., Helleiner, 1992; Nafziger, 1993; World Bank, 1994b), the empirical evidence suggests that a reduction in debt stock and servicing would likely provide little in the way of investment or growth stimulus to SSA economies. It would nonetheless seem to yield immediate, significant balance of payments benefits. Arguments focusing on debt as a tax on investment and output thus seem inappropriate in the SSA case. Rather, attention should be focused on the strong relationship between net transfers on debt and nonfactor current account flows. Export expansion and aid inflows have been heavily taxed for the servicing of external debt. Insofar as continued balance of payments crises fuel capital flight and limit imports of necessary inputs to manufacturing, marketing and the provision of basic human services, releasing this yoke appears the primary economic argument for debt forgiveness in SSA.

The traditional claims of the macroeconomic drag associated with debt overhang don't appear to stand up to empirical scrutiny in the SSA case. Does the opposing claim, that debt forgiveness will induce punishment of nonpaying borrowers by international capital markets,

thereby choking off future development finance opportunities, fare any better in the data from SSA? The question cannot be answered convincingly because there are too few SSA states that have retained access to private loans to do any careful multivariate econometric analysis.¹² There are nonetheless some basic findings worth reporting.

The severely- or moderately-indebted SSA countries who borrowed from private creditors in 1994 had outstanding principal and interest arrears averaging 22% of end-1993 total debt stock. Substantial delinquency in payments clearly does not blockade even poor nations from access to loans from private creditors. Moreover, naive univariate regressions show no evidence of a relationship between the terms of private loans and a SSA borrower's previous repayment difficulties. In a cross-section of SSA countries, when one regresses the weighted average interest rate or maturity of new private loans to SSA in 1994 on either end-1993 outstanding arrears or the number of times the country rescheduled debt in the preceding decade, the coefficient estimates are statistically insignificantly different from zero. This is clearly a weak test¹³, but it is nonetheless suggests that the theoretical arguments against debt forgiveness, like those in favor, may be empirically unfounded.

Conclusions

Subsaharan African states clearly labor under an extraordinary weight of external debt. Resolution of this situation remains difficult. A strong groundswell of opinion has formed behind debt forgiveness efforts, several bilateral official creditors have moved in this direction, and the multilateral official creditors have taken first steps toward reducing their own claims on SSA

debtors. The plight of Africa's poor demands serious response from creditors and donors, not to mention their own governments. Yet the common economic arguments for debt relief find little empirical support in SSA. In particular, there is no published evidence of debt overhang serving as a tax on investment or GDP growth in SSA and such a relationship does not appear in the regression results I report. Widespread expectations that debt relief might "engineer" economic recovery thus seem misplaced, as do related expectations that debt relief might benefit creditors through the economic recovery associated with the relief of a debt overhang. SSA's debt crisis appears more a symptom of prolonged economic crisis than its cause.

The real problem of external debt in SSA is not its effect on growth or investment, but the heavy tax it levies on current account receipts. The empirical evidence indicates that debt servicing does not create disincentives to invest or produce in SSA, but at the margin external debt servicing deprives SSA of almost half its hard currency earnings. Surely this high marginal tax rate contributes to persistent balance of payments crises. The most important dimension of debt relief for SSA states is thus less stock reduction than release from the foreign exchange demands of repayment. Indeed, if debt stock writedowns cause a reduction of more than 20% in aid flows to SSA — and 20% is probably an optimistic assumption about the degree of additionality to expect in any significant stock relief — then the regression results in Table 1 suggest debt stock reduction would likely aggravate rather than relieve foreign exchange shortages in SSA, without any direct positive effects on investment or growth.

These empirical findings support Basu's (1991, p.35) suggestion that "it will be necessary to separate the issue of repayment from repayment in hard currency. ... The large U.S. debt is not as worrisome as third-world debt precisely because the United States can repay it in its own

currency.” The manifest debt servicing tax paid on export earnings cannot help but retard export expansion. Cross-country macroeconomic evidence indicates that trade volume has a strong, positive relationship to investment rates (Levine and Renelt, 1992). Since most analysts suggest that the fundamental development task for SSA economies is to enhance export performance and improve investment productivity (which depends fundamentally on access to imported inputs), reducing the tax on export earnings by permitting local currency servicing of external debt may be the most important step toward fruitful African debt relief.

While debt stock reduction deserves less emphasis than it receives in discussions of SSA debt, there is a sound economic and ethical argument for partial and highly differentiated debt forgiveness to provide a more efficient and equitable sharing of debt burdens associated with loan pushing and conditionality traps. Given the history of MDB lending to SSA, this clearly implies the need for multilateral debt reduction, as has been recognized for some time (e.g., Mistry, 1989; Sanford, 1993).

Probably the greatest concern about SSA debt is that funds used to repay external creditors could instead address severe and widespread human hardship on the continent. The poor of SSA appear to have borne a disproportionate share of the adjustment and repayment burden of the past decade (Gibbon, Havnevik and Hermele, 1993; Barrett and Dorosh, 1996). Many would like to use debt relief to accelerate poverty alleviation. As most governments and NGOs advocating forgiveness recognize, debt renegotiation or remission would require continued conditionality. Future conditionality could involve demonstrable commitments to poverty reduction and environmental protection in the form of verifiable increases in outlays on primary health care, primary education and rural infrastructure rehabilitation. Keep in mind that increased

real expenditures to care for the poor and the environment must be reconciled with the continued need for reduced fiscal deficits in SSA, which is difficult given a thin tax base and limited collection capabilities. External debt relief could help in the form of local currency servicing with payments dedicated to financing poverty alleviation and environmental protection programs.¹⁴ The principle of subsidiarity should govern these efforts, devolving authority for project design, implementation and evaluation from central governments to communities.

The concentration of Sub-Saharan Africa's external debt in the hands of official creditors and the ambiguous nature of the economics and ethics of African debt forgiveness make this an inherently political question. The vigor of the contemporary debate is thus a blessing in that it subjects sloppy ideological and myopic technical arguments to careful scrutiny. There is a strong ethical case to be made for bold economic policies to combat widespread African poverty. The appropriate way to do this, however, depends on where available funds will have the greatest expected impact. It is by no means clear that a write-down of African external debt stocks will have much impact, either on the national income and product accounts or the poor of Africa. Local currency conversion of debt servicing streams may be far more effective in relieving binding financial constraints to African development.

**Table 1: Net Transfers on External Debt
Subsaharan African Countries, 1983-92**
(positive net transfers indicate inflows to SSA)

| Independent Variables (all measured in US\$) | Dependent Variables | |
|---|--------------------------------|--|
| | Total Net Transfers | Net Transfers to Official Creditors |
| Gross domestic product | 0.027 ^a (0.006) | 0.015 ^a (0.005) |
| Gross domestic investment | 0.151 ^a (0.040) | 0.046 ^a (0.023) |
| Exports of goods and nonfactor services | -0.457 ^a (0.030) | -0.173 ^a (0.021) |
| ODA flows | -0.188 ^b (0.107) | -0.023 (0.060) |
| Total external debt | 0.058 ^a (0.016) | |
| Official external debt | | 0.003 (0.013) |
| n | 230 | 230 |
| r ² | 0.81 | 0.65 |

Standard errors are in parentheses. Regressions include unreported country and year-specific dummy variables.

^a = statistically significant at 1-percent level

^b = statistically significant at 10-percent level

Countries: Benin, Burundi, Cameroon, Central African Republic, Congo, Côte d'Ivoire, Ethiopia, Guinea-Bissau, Kenya, Madagascar, Malawi, Mozambique, Niger, Nigeria, Rwanda, Sao Tome and Principe, Senegal, Sierra Leone, Tanzania, Togo, Uganda, Zambia, Zimbabwe.

Data source: World Bank, African Development Indicators 1994-95

Notes

1. These and other debt statistics reported in the paper come from the World Bank's *World Debt Tables*, adjusted to remove Namibia and South Africa, which have been included in the SSA data since 1994. I thank Jon Sanford for making the adjusted data available.
2. The Toronto terms were nonetheless significant for establishing a precedent in forgiving export credits as well as development loans.
3. It may also be true that the foreign exchange burden of debt servicing tempts governments to devalue their currencies, prompting inflation and preemptive capital flight, both of which discourage domestic investment.
4. These include interest rates, maturities, renegotiation provisions, etc.
5. This is Basu's (1991) monotonicity postulate.
6. Cline (1995) also advocates this, albeit following a very different approach.
7. The need for prudent mercy is likewise invoked by debt forgiveness advocates who invoke the specter of German debts "insufficiently forgiven" in the interwar period (Sonko, 1994).
8. The Korean and Turkish cases come up frequently in discussions with Japanese about debt forgiveness. Recall that both were major debtors in the 1970s and early 1980s, about which many lenders were quite concerned, but they maintained debt servicing and have largely grown out of their debt problems.
9. Debt reduction programs in the context of Brady Plan agreements and IDA Debt Reduction Facility initiatives reduced the affected countries' debt by only 9.8% as of end-1994. Debt forgiveness over the past decade or so has been of a similar magnitude.
10. The growth consequences of the debt renegotiation treadmill have been (surprisingly) overlooked in the literature and are the subject of current research by the author.
11. Of course, this likewise suggests that net outflows of funds (i.e., negative net transfers) reduce growth and investment.
12. The concern about degrees of freedom is compounded by selectivity and censoring problems in estimation since many sovereign SSA borrowers have self-selected out of private capital markets and capital flight suggests that there is instead considerable (unobservable) private lending from SSA to the rest of the world.
13. For instance, perhaps private financing flows are affected only by arrears to private creditors, although the commercial creditors with whom I worked in the 1980's on SSA were deeply concerned about any arrears.

14. The U.S. government ran a scheme similar to this in El Salvador, in which the government auctioned the foreign exchange it was scheduled to repay to the U.S. to domestic businesses who needed it to buy imports. The government's local currency receipts were then used for human capital programs, with apparent success. I thank Jon Sanford for calling this program to my attention.

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