Revisiting Debt Sustainability in Africa

Background Paper
for UNCTAD’s
2016 Economic Development in Africa Report:
“Debt Dynamics and Development Finance in Africa”

Bernhard G. Gunter
American University and Bangladesh Development Research Center¹
2508 Fowler Street, Falls Church, VA 22046-2012
president@bangladeshstudies.org; Tel: (+1) 571-461-3005

August 11, 2016

Abstract
This paper assesses the financing needs of African countries in the context of the recently adopted 2030 Agenda for Sustainable Development. It assesses the various options for African countries to finance their development, in the context of the current international economic environment and the Addis Ababa Action Agenda (FFD). It critically reviews the main debt relief initiatives established by the international community. It also reviews and evaluates existing debt sustainability frameworks (DSFs) as operated by the World Bank and the International Monetary Fund (IMF). It analyzes the opportunities and pitfalls posed by Africa’s increased access to international private capital markets. Finally, the paper provides some conclusions, lessons learnt from previous debt relief initiatives, and policy proposals for an SDG consistent debt sustainability framework.

¹ The views expressed in this paper are those of the author and should not be reported as representing the views of any organization/institution.
I. Introduction

At the United Nations Summit on Sustainable Development in September 2015, the world leaders adopted the 2030 Agenda for Sustainable Development. The agenda includes a set of 17 sustainable development goals (SDGs) to end poverty, fight inequality and injustice, and tackle climate change by 2030. The SDGs build on the Millennium Development Goals (MDGs), which were adopted in 2000 to achieve specific objectives that include reducing poverty, hunger, disease, gender inequality. Enormous results were achieved, including in Africa, the world’s poorest continent. “Over the past decade, Africa has recorded sustained and impressive economic growth rates. In 2013, growth rates averaged 4 per cent, almost double the global average. One quarter of countries in the region grew at about 7 per cent or more, and a number of African countries are among the fastest growing economies in the world.”

However, despite success, the indignity of poverty has not been ended for all and inequality continues to grow. Notwithstanding the glowing gross domestic product (GDP) figures, Africa continues to have the lowest levels of human and social development with a large part of the population trapped in poverty, facing rampant unemployment and inequality. “To translate rapid economic growth into sustained and inclusive development, Africa must put in place development strategies that foster economic diversification, create jobs, reduce inequality and poverty and boost access to basic services. This can only be done through structural transformation.”

The SDGs go much further than the MDGs, addressing the root causes of poverty and the universal need for development that is not only sustainable, but also inclusive. They reflect the key features of the Common African Position (CAP) on the Post-2015 Development Agenda, which was the consensus of African leaders, civil society and the private sector adopted by the Heads of State and Government of the African Union in January 2014.

This paper examines the priorities, options and challenges for financing Africa’s development in the light of preventing another debt crisis. Following this Introduction, the next section (Section II) assesses the financing needs of African countries in the context of national and regional development plans to accelerate structural transformation, foster inclusive growth with job creation and deepen regional integration. It focuses specifically on the financing needs related to the recently adopted Sustainable Development Goals (SDGs). It also assesses the various options for African countries to finance their development, in the context of the current international economic environment and the Addis Ababa Action Agenda (FFD). The subsequent section (Section III) critically reviews the key debt relief initiatives established by the international community to achieve debt sustainability. Section III also examines the successes and failures of such initiatives. Section IV reviews and evaluates existing debt sustainability frameworks (DSFs) as operated by the World Bank and the IMF. Section V analyzes the opportunities and pitfalls posed by Africa's increased access to international private capital markets. Finally, the last section (Section VI) provides some conclusions, lessons learnt from previous debt relief initiatives, and some policy proposals on how the tension between maintaining debt sustainability and debt-financing SDG investments can be reduced, as well as some policy proposals on how international private capital markets and the international community can promote debt sustainability in Africa.

---

3 UNECA (2015).
II. Africa’s Financing Needs

This section assesses the financing needs of African countries, in the context of national and regional development plans related to the adoption of the SDGs to accelerate structural transformation, foster inclusive growth with job creation and deepen regional integration. It also summarizes the various options for African countries to finance their development, in the context of the current international economic environment and the Addis Ababa Action Agenda (FFD).

II.1. SDG Financing Needs

According to the Rockefeller Foundation (2015), the UN estimated that it will cost $3.9 trillion a year to achieve the SDGs in developing countries alone. “Current levels of both public and private funding cover only $1.4 trillion, leaving an annual shortfall of an estimated $2.5 trillion.”

A more recent, but still preliminary analysis of available sector studies by Schmidt-Traub (2015) shows that incremental spending needs in low income countries (LICs) and lower-middle income countries (LMIC) may amount to at least $1.3 trillion per year ($342-$355 billion for LICs and $903-$938 billion for LMICs). Over the 2015-2030 period this corresponds to some 4 percent of these countries’ GDP measured in purchasing power parity (PPP) dollar or 11 percent of GDP measured using market exchange rates. The World Bank (2015b) has stated that investment needs in infrastructure alone reach up to $1.5 trillion a year in emerging and developing countries.

According to Schmidt-Traub (2015), “approximately half of these investments in the SDGs can be privately financed. Domestic resource mobilization can increase significantly leaving an external financing gap of perhaps $133-$161 billion per year (equivalent to 0.23 percent of high income countries’ GDP) that must be met through international public finance, including official development assistance (ODA). Globally an incremental 1.3-2.0 percent of world GDP needs to be invested each year by the public and private sectors to achieve the SDG in every country.”

Though Schmidt-Traub (2015) does not provide estimates by region, we can use the estimates for all LICs and LMICs to estimate the incremental costs for the SDGs in Africa based on the share of African countries’ GDP. Given that the percentage of African LICs constitute 78.5 percent of all LICs’ GDP, the incremental costs for all African LICs amounts to 269-279 billion US dollar a year. Similarly, using the estimates for all LMICs, we can estimate the incremental SDG financing needs for the non-LIC African countries to amount to 345-359 billion US dollar a year. Hence, in total, the incremental costs to finance the SDGs in Africa can be estimated to amount to 614-637 billion US dollar per year. Similarly, using Schmidt-Traub’s total financing gap for all LICs and all LMICs (which were estimated at $133- $161 billion per year), we can estimate Africa’s total financing gap to be $65-$80 billion per year.

II.2. SDG Financing Options

Keeping in mind that many industrialized countries did not keep up with their promise to provide 0.7 percent of their GNI as ODA (a promise that was already made in form of a UN Resolution in 1970, and reconfirmed at the first International Conference on Financing for Development in March 2002 in Monterrey), the question may be asked if the SDGs are doomed due to their staggering costs? While it will not be easy to finance the SDGs, the world clearly has the resources,

---

5 Rockefeller Foundation (2015).
as the following example, comparing the SDG financing needs to the global foreign exchange transactions, shows.

As reported by Reuters, according to the Bank for International Settlement (BIS), the volume of global foreign exchange transactions reached $5.3 trillion a day in 2013. This implies that a tiny tax of one tenth of a percent on foreign exchange transactions would yield an annual tax revenue of $1.93 trillion a year. That is, a foreign currency transaction tax of 0.1 percent would easily finance the SDGs in all LICs and all LMICs. Independent on if a foreign currency transaction tax is politically feasible, these numbers illustrate that we clearly have the resources to finance the SDGs if there is sufficient will to tap into new resources. In any case, as emphasized in the European Report on Development (2015), we need a completely new approach towards finance for development, see Box 1.

A joined Press Release by the major multilateral development banks and the IMF (see African Development Bank et. al, 2015) stated that “ODA, estimated at $135 billion a year, provides a fundamental source of financing, especially in the poorest and most fragile countries. But more is needed. Meeting the staggering but achievable needs of the SDG agenda requires everyone to make the best use of each dollar from every source, and draw in and increase public and private investment."

“The large scale of incremental SDG investment needs will make it difficult for low-income country governments to take on additional debt. For this reason ODA will need to play an important role in closing the public financing deficit.” However, as stated by Wall (2014), Africa’s position as privileged beneficiary of aid may already be slipping. “According to the Organization for Economic Co-operation and Development (OECD), official bilateral aid to Africa fell by 10% in real terms in 2012, and by about 5% in 2013, despite an increase in ODA to all developing countries for an all-time-high in the latter year. In Africa, incoming foreign direct investment now surpasses ODA. A simple substitution of private resources for public funds may not be the best way to characterize African options.”

The Common African Position (CAP) suggested a blend of financial resources, including improving domestic tax collections, staunching the flow of illicit flight capital and recovering stolen assets, tapping into global financial markets, and stepping up intra-African trade, South-South cooperation and public-private partnerships.

The Addis Ababa Action Agenda has emphasized similar financing sources. It emphasized actions to be taken in the following seven areas: (a) domestic public resources, (b) domestic and international private business and finance, (c) international development cooperation, (d) international trade as an engine for development, (e) debt and debt sustainability, (f) addressing systemic issues, and (g) science, technology, innovation and capacity-building.

---

6 http://www.reuters.com/article/2013/09/05/bis-survey-volumes-idUSL6N0GZ34R20130905.
8 Wall (2014).
Box 1: Summary of the European Report on Development (2015)

We need a completely new approach towards finance for development - this is what follows from the lessons learned from the implementation of the Millennium Development Goals (MDGs), the changes in the Financing for Development (FFD) landscape and practical analyses of key enablers of transformative development which combines economic, social and environmental dimensions.

This report analyses the considerable changes in the FFD landscape since the 2002 Monterrey Consensus. It notes that the implementation of the Consensus came to focus largely on the role of Official Development Assistance (ODA) and paid insufficient attention to the importance of increasing domestic tax revenue and encouraging private finance. Yet in some of the countries that were achieving the greatest progress in reducing poverty, domestic tax revenue carried the main burden. This calls for adopting a more comprehensive view of FFD that takes fully into account the crucial role of public finance and private finance, both domestic and international. This will set the scene for international public finance to be a valuable complement to other flows of FFD.

The European Report on Development 2015’s main message is that finance alone will not be sufficient to promote and achieve the post-2015 development agenda. Policies also matter. Indeed, they are fundamental. Appropriate and coherent policies will ensure that finance is used effectively to achieve results and that it is not wasted or underused. Good policies will also help to ensure that more finance is mobilised as success breeds further success.

The Report identifies many examples of governments that are making effective policy choices in mobilising and using finance for major enablers of transformative development, including local governance, infrastructure, green energy technology, biodiversity, human capital and trade. Given the challenges encountered in the follow-up of the Monterrey Conference, it is crucial to develop an appropriate system of monitoring and accountability that covers as many flows of finance as possible and that stimulates the right actions in the finance and policy framework, nationally and internationally. This accountability system must cover both the Sustainable Development Goals (SDGs) and their targets and the finance and policies required to achieve them. It can then guide implementation of the post-2015 agenda in a way that covers finance, policies and partnerships.

Overall our analysis suggests that it is not an overall shortage of funds that will be the constraining factor in achieving a transformative post-2015 development agenda. Rather, it is the way finance is mobilised and used that will determine success in achieving the goals that the agenda enshrines. This in turn will require efforts to improve the effectiveness of each category of financing by drawing on its unique characteristics in support of particular enablers of development, to expand the range of possible sources of finance through appropriate policies and also to combine different flows as effectively as possible. This will call for reform of national finance and policy frameworks (including for example a more efficient tax system and improved procurement policies), as well as concerted efforts at the international level.


All seven areas of actions were detailed, resulting in nearly 30 pages of descriptions of actions. For example, within the area of domestic public resources, the agenda stressed that public policies and the mobilization and effective use of domestic resources are central. It recognized that significant additional domestic public resources, supplemented by international assistance, will be critical to realizing the SDGs. The Addis Ababa Action Agenda also emphasized efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminating them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation. It urged all countries that have not yet done so to ratify and accede to the United Nations Convention against Corruption, and encouraged all parties to review its implementation. It also encouraged the international community to develop good practices on stolen asset recovery.
III. Review of Debt Relief Initiatives

This section critically reviews in a historical perspective the initiatives established by the international community to assist Africa and other developing countries in reducing their debt. It starts with some comments on the Third World Debt Crisis of the 1980s, some important clarifications on the impact of so-called traditional debt relief (i.e., debt relief provided by the Paris Club until 1996), and then reviews the HIPC Initiative and Multilateral Debt Relief Initiative (MDRI). Given that only HIPCs were eligible for MDRI debt relief, we then compare the trends for various debt ratios in African HIPCs and African non-HIPCs from 2000-2013. This analysis is limited to mostly external debt as there is still no sufficient data readily available on domestic debt to compare a significant number of countries for an extended period of time. It also summarizes the key successes and failures of such initiatives.

III.1. Third World Debt Crisis of the 1980s

The so-called Third World Debt Crisis erupted in August 1982, after Mexico declared that it was unable to pay its external debt service, and some 25 mostly middle-income countries followed Mexico’s example. The crisis refers to debts owed mostly by Latin American governments to mostly industrialized countries’ commercial banks. Given the significant impact on industrialized countries’ commercial banks, it caused the most serious international financial crisis since the 1930s.

However, it took until 1989 that the crisis was formally resolved with the adoption of the Brady Plan, in which market-based debt reductions were implemented, that is, the indebted countries engaged in buying up their own debt at a discount in the secondary market using mostly debt buybacks and debt-equity swaps. It then took another few years before the developing economies would recover and the creditor banks would clear their books of bad loans.

While a wide-scale banking crisis in industrialized countries was avoided, the crisis and the programs adopted in debtor countries entailed high social costs in terms of rising unemployment, falling incomes, and increased poverty. Though only a few African countries followed Mexico’s example of declaring bankruptcy in the early 1980s, most African countries still suffered from the negative side effects of so-called structural adjustment programs, which were more or less forced on them as a pre-condition for restructuring African debt and for receiving development aid.\(^9\)


Though there were a variety of initiatives that provided some debt reduction, especially the so-called Baker and Brady plans dealing with the systematic provision of debt relief on bilateral debt of low-income countries began only after the Group of Seven (G-7) Economic Summit in Toronto in 1988, when it was realized that a non-concessional rescheduling of debts does not solve the debt problems of many LICs.

Based on the agreement reached in Toronto, the Paris Club began with a menu-based provision of concessional debt relief for low-income countries in October 1988, providing a 20-33 percent debt reduction in net present value (NPV) terms on eligible debt service flows due between October 1996.

---

\(^9\) See, for example, Sahn, Dorosh and Younger (1997).
Eligible debt is defined as any public or publicly guaranteed (PPG) bilateral debt that has been contracted before the date of the first rescheduling was agreed with the Paris Club (which is called the pre-cutoff date) and that is not considered to be official development assistance (ODA), see Box 2.

**Box 2: Eligible Debt under Traditional Debt Relief**

Traditional debt relief provided by the Paris Club only covers external bilateral debt that:

- is public or publicly guaranteed (PPG) by the debtor country,
- is unofficial development assistance (non-ODA,) and
- has been contracted before the cut-off date (COD), which is usually the date a debtor country has been granted Paris Club debt relief for the first time.

All three conditions (PPG, non-ODA, and pre-COD) are usually summarized and referred to as “eligible” debt. In other words, debt contracted after the cut-off date (post COD debt) is not eligible, neither are ODA debts (though ODA debts are usually rescheduled at the originally agreed interest rate over 20 to 30 years, including a grace period). All private debt that is not publicly guaranteed and all multilateral debt is always excluded from traditional debt relief.

Though a Paris Club agreement covers formally only eligible bilateral debt of Paris Club creditors, it is expected that non-Paris Club bilateral creditors also provide debt relief. Formally, Paris Club debt relief is conditional on non-Paris Club bilateral creditors providing the same (or higher) percentage of NPV debt reduction. However, this condition has never been strictly enforced.


In any case, given the restrictions on eligible debt and that debt relief was provided only via a flow rescheduling of debt service due within the next three years, the amount of debt relief provided was far too marginal for African countries to regain solvency. Hence, three years after the Toronto Summit, debt relief under London terms (named after the G-7 Summit in London in 1991, where these terms were adopted), provided a 50 percent NPV debt reduction on eligible debt service flows due between December 1991-December 1994.

Another three years later, following the G-7 summit in Naples in 1994, debt relief under Naples terms provided (i) a 50 percent NPV debt reduction on eligible debt service flows and/or debt stocks for developing countries with a GDP per capita above US$500 and (ii) a 67 percent NPV debt reduction on eligible debt service flows and/or debt stocks for developing countries with a GDP per capita below US$500. The significance of extending debt relief on debt stocks (not just on debt flows due during the next three years) is that debt relief on debt stocks provides much more relief than the debt relief on debt flows;¹¹ though it was still insufficient to solve the debt

---

¹⁰ The NPV of a debt is the sum of debt service, whereby each future debt service payment is discounted at the market interest rate. A loan with an interest rate below the discount or market interest rate has a NPV below its nominal value; while a loan with an interest rate at the market interest rate would imply that the face value of the loan is identical to the NPV of the loan.

¹¹ For example, consider an interest rate free loan in the amount of US$10 million, repayable over ten years. A rescheduling of debt service flows due in the next three years would imply that US$3 million would be rescheduled to be paid over a longer time period. However, a debt stock reduction would imply that the whole debt stock of US$10 million will be eligible for debt relief.
problem of many low-income countries. Debt relief under Toronto, London, and Naples terms are referred to as traditional debt relief.

Anyway, there are some serious misconceptions on the impact Paris Club NPV debt reductions had effectively on the debt sustainability of LICs. In order to understand why traditional debt relief did not resolve the debt problems of most LICs it is important to recall that (a) many low-income countries had accumulated large amounts of multilateral debt, (b) a considerable amount of low-income countries’ debt was ODA, (c) much bilateral debt had been contracted after the date of the first rescheduling was agreed with the PC (hence, was non-eligible post cutoff date debt); and (d) that NPV debt reductions, even on debt stocks, are unlikely to be suitable to solve long-term debt solvency problems, for reasons as they become clear when understanding how the PC provides its debt relief.

One important point to keep in mind is that the actual amount of debt service in nominal terms can actually increase due to the provision of NPV debt relief, especially if a debtor country had been charged interest on arrears because interest charges will continue to accrue until the debt is fully repaid. In other words, a rescheduling of debt service due, which implies a reduction in NPV terms lowers the short-term debt service payments due to the rescheduling, but increases the total debt service payments of a loan, and hence, decreases the likelihood for a country to regain long-term debt sustainability. A related point is that the repeated rescheduling of debt service payments has led to the situation that the African continent has already paid more in terms of cumulative debt service (US$549 billion) from 1970-2002 than it has received in terms of cumulative disbursements from 1970-2002 (US$539 billion).12

Finally, it should be kept in mind that some of the debt African countries repaid was what is called odious debt (see Box 3), that is debt incurred by previous rulers who borrowed without the people’s consent and used the funds either to repress the people or for personal gain.

III.3. Original HIPC Initiative, Enhanced HIPC Initiative, and MDRI

Following the insufficient amount of debt relief provided under traditional debt relief mechanisms, and the mounting evidence of the existence of a debt overhang in low-income countries, the IMF and World Bank launched the HIPC Initiative in fall 1996. It was the first comprehensive approach to reduce the external debt of the world's poorest, most heavily indebted countries, and represented an important step forward in placing debt relief within an overall framework of poverty reduction. HIPC debt relief is available for the group of heavily indebted poor countries (HIPCs), defined as countries that satisfy both of the following two conditions. First, countries rely on highly concessional financing from the World Bank’s concessional lending-arm (IDA). Second, countries face an unsustainable external debt situation after the full application of traditional debt relief mechanisms (the 67 percent NPV reduction on eligible debt stock).

---

Box 3: Odious Debt

The legal doctrine of odious debt argues that sovereign debt incurred without the consent of the people and not benefiting the people is odious and should not be transferable to a successor government, especially if creditors are aware of these facts in advance.

According to Howse (2007), the concept of “odious debt” regroups a particular set of equitable considerations that have often been raised to adjust or sever debt obligations in the context of political transitions. A survey of such transitional situations indicates that the way in which the “odiousness” is argued as a ground for limiting obligations, which varies from one transitional context to another, and may differ depending on whether the transition involved, is for instance a secession, whether it arises from war or decolonization or simply a political revolution.

However, dealing with odious debt from the prior regime usually involves political as well as legal considerations. Even where a strong legal argument exists for repudiation of some or all debt based on considerations of odiousness, a transitional regime may well prefer to negotiate a voluntary adjustment in obligations with its creditors or even to continue to repay the debt. South Africa is a case in point.

Indeed, as pointed out by Kremer and Jayachandran (2002), in most cases, countries repaid debt even if it is odious because, if they failed to do so, their assets abroad could be seized and their reputations would be tarnished, making it more difficult for them to borrow again or attract foreign investment. However, if there were an institution that assessed, and announced, whether regimes were odious, this could create a new market outcome in which countries’ reputations would not be hurt by refusal to repay illegitimate debts, just as individuals’ credit ratings are not hurt by refusal to pay debts that others fraudulently incur in their name. For example, if the world’s leading powers, international organizations, and financial institutions declared a regime odious and announced that they would consider successor governments justified in repudiating any new loans the odious regime incurred, a private bank—even an unscrupulous one—would think twice before lending to the regime.

Kremer and Jayachandran (2002) suggested two mechanisms to ensure that lending to odious regimes is eliminated. First, laws in creditor countries could be changed to disallow seizure of a country’s assets for nonrepayment of odious debt. That is, odious debt contracts could be made legally unenforceable. Second, foreign aid to successor regimes could be made contingent on non-repayment of odious debt. In other words, donors could refuse to aid a country that, in effect, was handing the funds over to banks with illegitimate claims. More recently Ndikumana and Boyce (2011) proposed a strategy of selective repudiation of public external debts, whereby African countries would repudiate debts for which it cannot be established that they were used for bona fide development purposes. They also claim that capital flight and external borrowings are intertwined phenomena, with external borrowing fueling capital flight, and capital flight then inducing further external borrowings. They estimated that over half of the money borrowed every year is siphoned out of Africa as capital flight.

Though not addressed in the FdD action plan, the FfD-CSO forum (2015) had stressed that the debt problem is inextricably linked to illegitimate and odious debts and that decisive actions to address them toward the objective of putting an end to their re-accumulation, including through independent debt audits are urgently needed.

Source: Adapted mostly from Kremer and Jayachandran (2002) and Howse (2007).
III.3.a. Debt sustainability criteria of the original HIPC framework

Under the original framework of the HIPC Initiative (1996-1999), sustainable debt-to-export levels were defined at a ratio ranging from 200 to 250 percent (on a net present value basis) at the completion point. For very open economies, where the exclusive reliance on external indicators may not adequately reflect the fiscal burden of external debt, an NPV debt-to-export target below the 200-250 percentage range could be recommended if the country concerned met two criteria: an export-to-GDP ratio of at least 40 percent and a minimum threshold of fiscal revenue in relation to GDP of 20 percent. For countries meeting these thresholds, the NPV debt-to-export target was set at a level that achieves a 280 percent of the NPV debt-to-revenue ratio at the completion point.

Consistent with the HIPC Initiative, the Paris Club has extended its previous agreements for HIPCs through the adoption of Lyon terms (1996). While the original framework of the HIPC Initiative yielded some progress, multilateral organizations, bilateral creditors, HIPC governments, and civil society had engaged in an intensive dialogue since the inception of the Initiative about its strengths and weaknesses. A major review in 1999 has resulted in an enhancement of the original framework that aimed at providing deeper, broader and faster debt relief, adopted at the joint IMF-World Bank annual meeting in September 1999.

III.3.b. Debt sustainability criteria of the enhanced HIPC framework

Under the enhanced framework, sustainable debt-to-export levels are defined at a fixed ratio of 150 percent (on a net present value basis) at the decision point. For very open economies, an NPV debt-to-export target below 150 percent can be recommended if the country concerned meets two criteria at the decision point: an export-to-GDP ratio of at least 30 percent and a minimum threshold of fiscal revenue in relation to GDP of 15 percent. For countries meeting these thresholds, the NPV debt-to-export target will be set at a level which achieves a 250 percent of the NPV debt-to-revenue ratio at the decision point. Consistent with the enhanced HIPC Initiative, the Paris Club had once again extended its previous agreements for HIPCs through the adoption of Cologne terms (1999). Furthermore, the enhanced framework provides the option to consider additional assistance at the completion point beyond that committed at the decision point if there has been a fundamental change in a country’s economic circumstances at the completion point, and the change was clearly due to exogenous developments. The HIPC stages, especially Decision and Completion Points, are explained in more details in Box 4.

III.3.c. Multilateral Debt Relief Initiative (MDRI)

At the 2005 Gleneagles Summit of the Group of Eight (G8) major industrial countries, the G8 leaders backed a proposal to cancel 100 percent of the outstanding obligations of the Heavily Indebted Poor Countries (HIPCs) to the African Development Fund (AfDF), the International Development Association (IDA), and the IMF. The G8 proposal was subsequently endorsed by the Development Committee at the joint IMF-World Bank Annual Meetings in September 2005 as well as by the AfDB. The proposal has since then been detailed and is now known as the Multilateral Debt Relief Initiative (MDRI).

13 See IMF and IDA (2001).
Box 4: The HIPC Stages: Decision and Completion Points

The HIPC Initiative involves two stages. Under the original HIPC framework (1996-99), the first stage was a fixed three-year period during which a HIPC works in coordination with the support of the World Bank and the IMF to establish a record of good economic policies and sustained poverty reduction. At the end of this three-year period the World Bank and the IMF determine whether a country’s debt level is sustainable. For those countries whose debt burden remains unsustainable after full use of traditional debt relief mechanisms, a package of debt relief is identified. This is known as the Decision Point. While full HIPC debt relief will be provided at the Completion Point, some creditors might provide interim debt relief (the period between the Decision Point and the floating Completion Point). Under the enhanced framework, the completion point is “floating” as it is tied to the implementation of key structural reforms and poverty reduction policies. As detailed in Table 2, as of December 2015, 30 African and 6 non-African countries have reached the enhanced HIPC decision point.

The MDRI implies a 100 percent irrevocable debt cancellation of all AfDF, IDA, and IMF debt owed by eligible HIPCs. HIPCs will need to reach the completion point under the enhanced HIPC Initiative in order to be eligible for the MDRI. The implementation approach and even the country coverage vary slightly across creditor institution. However, all three institutions cover the outstanding debt as of December 31, 2004, after taking HIPC debt relief into account. In March 2007, the Inter-American Development Bank (IDB) confirmed that it would write-off US$4.4 billion in debt owed by the five Latin American HIPCs (see IDB, 2007).

The financial implications of the MDRI via debt service savings are not linearly distributed over time. Current estimates indicate that the direct financial impacts are increasing from 2006 to 2025 and then decreasing until they end in 2054. Concerns have been expressed with regards to the long time period during which debt relief is provided, especially if one believes that the poorest countries’ development challenge is due to a multidimensional poverty trap that can only be overcome with a big push now rather than in the future in order to break various interrelated vicious circles.

Before addressing some of the successes and failures of the HIPC Initiative and MDRI, the next two sections provide first some empirical background on the trends in debt and debt service payments of African HIPCs and African non-HIPCs from 2000-2013.

III.4. Trends in Debts of African HIPCs and African Non-HIPCs

For the following analysis of Africa’s 54 nations, the group of African HIPCs include all 29 African HIPCs that reached the HIPC Completion Point December 2012.14 Chad, which reached the Completion Point in April 2015 has been put into the group of non-HIPCs as the Interim Assistance provided since its Decision Point in 2001 has been limited. Furthermore, among the three potential HIPCs (Eritrea, Somalia and Sudan), Eritrea and Sudan have been placed in the group of non-HIPCs as they have not even reached the HIPC Decision Point. Including Chad and Eritrea in the group of HIPCs would distort the picture with regards to the impact of HIPC debt relief, which is analyzed from 2000-2013.

Somalia is, due to lack of reliable data, excluded from both groups. Furthermore, due to a lack of reliable data, we also had to exclude Equatorial Guinea, Libya, Namibia and South Sudan. Hence, the African non-HIPCs included in the analysis are Algeria, Angola, Botswana, Cabo Verde, Chad, Djibouti, Egypt, Eritrea, Gabon, Kenya, Lesotho, Mauritius, Morocco, Nigeria, Seychelles, South Africa, Sudan, Swaziland, Tunisia, and Zimbabwe. Among the 49 African countries with sufficient data, the 29 HIPCs had 18.0 percent of Africa’s GDP in 2013, 24.2 percent of Africa’s nominal debt in 2013, and 26.1 percent of Africa’s debt in NPV terms in 2013.

While we will provide a few figures for a variety of debt indicators comparing the African HIPCs with the African non-HIPCs, it is important to stress that there is always a lot of variation in debt levels in either group. For example, given that Nigeria is not only the most populous and largest economy in Africa, but also reduced its NPV debt-to-exports ratio from 135.0 percent in 2001 to 3.0 percent in 2012, the inclusion of Nigeria in the group of non-HIPCs paints a far more favorable picture than is truly the case for the non-HIPCs if excluding Nigeria. We have nevertheless included Nigeria in the group of non-HIPCs as similar arguments could be made for some HIPCs. However, we will provide some figures for some specific countries to better understand the evolution of debt indicators for the HIPCs and non-HIPCs.

The three debt categories we will examine are nominal debt outstanding, NPV debt, and debt service. For each of these three indicators, we will show the evolution in terms of current US dollar, relative to GDP, relative to exports, and relative to government revenues. The figures for debt in current US$, NPV debt in current US$, and debt service in current US$ are provided solely as reference points, they should not be looked at without also looking at these indicators relative to GDP, exports, and government revenues.

III.4.a. Trends in External Public Debt Stocks and NPV Debt

As Figure 1 shows, while the external debt stocks of the African non-HIPCs remained relatively stable at around current US$200 billion from 2000-2006, it increased significantly in the subsequent years, reaching nearly $400 billion in 2013, which as some of the country cases below show, is partly due to considerable new borrowing, including commercial new borrowing.

For the African HIPCs, the level of external debt stocks has remained much more stable at around US$100 billion. This is partly the result of more and more HIPCs receiving HIPC and MDRI debt relief as well as moderate increases in new borrowing after having reached debt sustainability, and hence, creditworthiness, after reaching the HIPC completion point. While debt relief reduced the debt, this was overall compensated by increases in new borrowing.

15 For example, the Republic of Congo’s NPV debt-to-exports ratio stood at 219.8 percent in 2001 but then dropped to 14.5 percent in 2011, partly due to HIPC and MDRI debt relief and high commodity prices increasing the Congo’s exports.
Despite the distortions resulting from changes in discount rates over time, given the large differences in loan periods and interest rates, the better comparison is to look at the evolution of debts in net present value (NPV) terms. As figure 2 shows, the NPV debts of both HIPC and non-HIPC declined slightly until 2006. It then increased significantly for the African non-HIPC in 2007, mostly due to lower discount rates and new borrowing. In the case of the African HIPC, the lower discount rates of 2007 are largely compensated by the impact of the MDRI, hence, the evolution of the NPV debt of the HIPC remains relatively stable until 2012 and 2013.

**III.4.b. Trends in External Public Debt to GDP Ratios**

Looking at the evolution of Debt to GDP ratios (Figure 3), we see a very drastic decline for the HIPC from 2001 to 2006, and a more moderate decline from 2006 to 2008, and finally
stabilization at around 30 percent from 2008 to 2013. For the non-HIPCs, the decline in debt-to-GDP ratios began in 2002 and ended in 2006, with the decline far more moderate, but still significant, than for the HIPCs. Since 2006, the debt-to-GDP ratios has remained stable at about 20 percent. The same picture emerges if looking at the NPV debt-to-GDP ratios (see Figure 4), except that the HIPCs and non-HIPCs reach about the same level of stabilization within a range of 10-20 percent of NPV debt-to-GDP ratios from 2008 to 2013. The main reason for why the debt levels are similar towards this later period for both HIPCs and non-HIPCs is mostly due to the more concessional debt of the HIPCs than the non-HIPCs. In 2012, the NPV debt-to-GDP ratio of the HIPCs was actually below that of the non-HIPCs.

Figures 3 and 4: Nominal and NPV debt to GDP ratios (percent), 2000-2013

Illustrating some of the heterogeneity within both, the African HIPCs as well as the African non-HIPCs, the left hand panel of Figure 5 shows the evolution of the NPV external debt to GDP ratios for the two African non-HIPCs with the lowest debt ratios in 2013 and two African non-HIPCs with some of the highest ratios in 2013. Algeria and Nigeria have been able to reduce their debt levels to below 2 percent, while Mauritius and Zimbabwe were not so successful, having NPV debt to GDP ratios in 2013 of 79 percent and 68 percent, respectively.

We can get similar success and less-success stories within the group of HIPCs. As the right hand panel of figure 5 shows, Chad was able to reduce its NPV debt to GDP ratio to below 2 percent by 2012 and Cameroon was able to reduce its NPV debt to GDP ratio to below 10 percent by 2012. On the other hand, Guinea-Bissau’s and Malawi’s 2013 NPV debt to GDP ratios stood at 82 percent and 67 percent, respectively. There are some external factors, like the different impact of commodity prices on commodity importers and exporters, which have contributed to these different developments, but country-specific debt policies also had a major impact on the heterogeneous evolution of debt levels in African countries.

Source: Calculations by the author based on GDF/WDI databases.
III.4.c. Trends in Domestic Public Debt to GDP

Though we do not have sufficient time series data to plot developments in domestic debt, Table 1 provides at some information for a selected group of early HIPCs\textsuperscript{16} on the shares of public domestic debt in total public debt as well as the ratios of public domestic debt to GDP (in percent).

Table 1: Levels and Trends of Domestic Debt in Some Early HIPCs

<table>
<thead>
<tr>
<th>Share of Public Domestic Debt in Total Public Debt</th>
<th>Change (percentage points)</th>
<th>Domestic debt (as percent of GDP)</th>
<th>Change (percentage points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2013</td>
<td>2007</td>
<td>2013</td>
</tr>
<tr>
<td>Benin</td>
<td>40.1</td>
<td>36.2</td>
<td>8.5</td>
</tr>
<tr>
<td>Cameroon</td>
<td>51.7</td>
<td>37.6</td>
<td>6.2</td>
</tr>
<tr>
<td>Ghana</td>
<td>53.2</td>
<td>57.4</td>
<td>16.5</td>
</tr>
<tr>
<td>Malawi</td>
<td>51.2</td>
<td>56.5</td>
<td>16.6</td>
</tr>
<tr>
<td>Mali</td>
<td>14.2</td>
<td>15.6</td>
<td>3.0</td>
</tr>
<tr>
<td>Senegal</td>
<td>19.1</td>
<td>23.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Uganda</td>
<td>45.2</td>
<td>44.5</td>
<td>9.9</td>
</tr>
<tr>
<td>Zambia</td>
<td>61.4</td>
<td>56.1</td>
<td>16.4</td>
</tr>
<tr>
<td>Unweighted Average</td>
<td>42.0</td>
<td>41.0</td>
<td>10.2</td>
</tr>
</tbody>
</table>

Source: Calculations by author based on IMF (2014), Appendix Table 2, p. 34.

\textsuperscript{16} Early HIPCs refers to HIPCs that reached the completion point before January 1, 2007.

Source: Calculations by the author based on GDF/WDI databases.
Based on Table 1, there seems to be some indication that at least for the group of selected early HIPCs the share of public domestic debt in total public debt has not changed significantly between 2007 (42 percent) and 2013 (41 percent). It increased in four of those countries (Ghana, Malawi, Mali and Senegal) and decreased in the other four countries (Benin, Cameroon, Uganda and Zambia). However, the percentage of public domestic debt to GDP increased in all eight countries, with the largest increase experienced by Ghana and Malawi (18.0 percentage points and 17.4 percentage points, respectively), and the smallest increase experienced by Cameroon and Mali (0.8 percentage points and 1.9 percentage points, respectively).

III.4.d. Trends in External Public Debt to Export Ratios

Looking at the trends in nominal debt-to-export and NPV debt-to-export ratios, we can see the same evolutions as for the debt-to-GDP indicators, except that the declines until 2006 are even more drastic for the HIPCs, while they are less drastic for the non-HIPCs. For the HIPCs, the nominal debt-to-export ratio declined from 424 percent in 2000 to 104 percent in 2008, while it decreased from 129 percent to 73 percent for the non-HIPCs during the same time period. Still, the debt levels of HIPCs and non-HIPCs approached each other during 2009-2013, and in the case of NPV debt-to-exports, the HIPCs had a slightly lower ratio than the non-HIPCs in 2012 (as was the case for the NPV debt-to-GDP ratio).

![Figures 6 and 7: Nominal and NPV debt to Exports ratios (percent), 2000-2013](image)

Source: Calculations by the author based on GDF/WDI databases.

Given that the NPV external debt to exports ratio is a key debt indicator in general and specifically for the HIPC Initiative, the left hand panel of Figure 8 shows the evolution of the NPV external debt to exports ratios for the two African non-HIPCs with the lowest ratios in 2013 and two African non-HIPCs with some of the highest ratios in 2013. Algeria and Nigeria have been able to reduce their debt levels to very low levels (four and three percent, respectively), while the Seychelles and Zimbabwe were not so successful. We can get similar success and less-success stories within the group of HIPCs. As the right hand panel of figure 8 shows, Chad and the Republic of Congo have been able to reduce their NPV external debt to exports ratios to below 20 percent, while Burundi and Sao Tome and Principe had NPV external debt to exports ratios above 500 percent in 2013.

While there are severe data constraints on reliable data for government revenues, we are still able to show the trends in nominal and NPV debts to government revenues for a sub-group of African HIPCs and non-HIPCs. The African HIPCs with complete annual data for 2003-2012 are the following 10 countries: Benin, Burkina Faso, Cote d’Ivoire, Ethiopia, Ghana, Madagascar, Mali, Sao Tome and Principe, Sierra Leone, and Uganda. The African non-HIPCs with complete annual data for 2003-2012 are Angola, Egypt, Kenya, Morocco, Nigeria, Seychelles, South Africa, and Tunisia.

The debt-to-revenue ratios for the selected African HIPCs declined from 561 percent in 2003 to 167 percent in 2008, while it deceased from 153 percent to 71 percent over the same time period for the selected non-HIPCs. The debt-to-revenue ratios then remained relatively stable at their 2008 levels for both the selected HIPCs and non-HIPCs. The overall same picture emerges for the NPV debt-to-revenue ratios, except that there is a sharp decline from 2011 to 2012 for the selected HIPCs, which implied that the NPV debt-to-revenue ratio of 2012 was slightly lower for the selected HIPCs than the selected non-HIPCs. The lower NPV debt-to-revenue debt levels for the HIPCs in 2012 is consistent with the lower debt levels of the HIPCs than the non-HIPCs with regards to NPV debt-to-GDP and NPV debt-to-exports, which we had pointed out above.

Ncube and Brixiova (2015) examined Africa’s public debt sustainability, which included an informative analysis of the key drivers for the trends in Africa’s public debt dynamics from 2007 to 2012. This section summarizes their main results. In addition to debt dynamics of all African countries, Ncube and Brixiova (2015) also disaggregate their analysis for three African country groups:

a) oil exporters (Algeria, Angola, Cameroon, DRC, Republic of Congo, Cote d’Ivoire, Equatorial Guinea, Gabon, Libya, Nigeria, and Sudan);

b) frontier markets (Benin, Botswana, Burkina Faso, Cabo Verde, Egypt, Ghana, Kenya, Lesotho, Mauritius, Morocco, Mozambique, Namibia, Rwanda, Senegal, Seychelles, South Africa, Tanzania, Tunisia, Uganda, and Zambia); and

c) other countries (Comoros, Djibouti, Ethiopia, Gambia, Madagascar, Malawi, Mauritania, Niger, Sao Tome & Principe, and Swaziland.

As Figure 11 shows, for the whole of Africa, primary balance deficits were the key driver for deteriorating debt dynamics, while growth, real interest rates, and other factors (including debt relief and exchange rate changes) improved debt dynamics. The impact of these four drivers are however very different across the three country groups. For the oil exporters, primary balances, growth and real interest rates improved debt dynamics, while other factors had a negative impact. For the frontier markets, growth and real interest rates improved the debt dynamics, while primary balances and other factors deteriorated debt dynamics. Finally, for the group of other countries, which actually saw the largest decrease in debt to GDP ratios, only primary balances had a negative impact, while growth, real interest rates and other factors lowered the debt to GDP ratios.

III.5.a. Trends in Debt Service Payments on External Public Debt

While it is not very useful to compare the levels of nominal debt service payments of the African HIPCs and African non-HIPCs, we still provide Figure 12 for the purpose of comparing the trends for both country groups. The figure shows that there was a spike in nominal debt service payments for the African HIPCs in 2008, as well as for the African non-HIPCs in 2006. There is no simple explanation for these spikes and they are not due to spikes in only a few countries. There has been a wide range of growth rates across countries. 

Anyway, Figure 12 clearly shows that there has been a relative sharp increase in nominal debt service payments since 2010. The debt service payments for the HIPCs increased from 3.3 billion in 2010 to 5.7 billion in 2013. Similarly, debt service payments increased from 20.1 billion in 2010 to 35.4 billion in 2013 for the non-HIPCs. Projections based on a few countries with more up to date data indicate that this trend of sharply increasing debt service payments has continued in 2014 and 2015.

17 Togo’s debt service payment increased from 15 billion in 2007 to 195 billion in 2008, but given Togo’s small share (less than 4 percent) in debt service payments within the group of HIPCs, excluding Togo from the analysis does not really lower the spike.
III.5.b. Trends in Debt Service Payments relative to GDP and Exports

While debt service payments have been rising in nominal terms, they have overall been declining as a percent of GDP and exports until about 2011. Excluding the spike for the non-HIPCs in 2006, Figure 13 shows that the levels and trends in debt service to GDP have been similar for both groups, though it cannot be stressed enough that there are huge differences within each group. Though we still see some increase in debt-to-GDP ratios since 2012 for the HIPCs and since 2010 for the non-HIPCs, the magnitude of these increases are far less than in nominal debt service payments. What is also comforting is that the 2008/2009 world economic crisis did not have a major impact on debt service to GDP ratios at the group levels.

Figures 13 and 14: Debt Service relative to GDP and Exports, 2000-2013 (percent)

Source: Calculations by the author based on GDF/WDI databases.
Looking at the levels as well as trends of debt service-to-exports, the two groups are even closer to each other than in terms of debt service-to-GDP. Both groups had debt service to export ratios of slightly above 14 percent in 2000. Excluding the temporary spike for the non-HIPCs in 2006, both groups’ ratios declined relatively sharply over the next decade, until they were again increasing for the HIPCs since 2012 and for the non-HIPCs since 2010.


Looking at the sub-group of HIPCs and non-HIPCs for which we have a full set of annual data for government revenues from 2003 to 2012, Figure 15 shows that the levels and trends of debt service to government revenues have overall been very similar for the group of HIPCs and non-HIPCs. Despite some volatility and huge differences within each country group, the ratios of debt service to government revenues declined relatively sharply from 18 percent in 2000 to 7 percent in 2007 for the HIPCs, and from 16 percent in 2000 to 9 percent in 2007 for the non-HIPCs. They then stabilized at these respective levels until 2012 (the last year we have data for this group of countries).

**Figure 15: Debt Service to Government Revenues (percent), 2003-2012**

![Graph showing debt service to government revenues from 2003 to 2012 for HIPCs and non-HIPCs.]

Source: Calculations by the author based on GDF/WDI databases.

Finally, as Figure 16 shows, within the group of African countries with sufficient data to calculate debt service to revenues from 2003 to 2012, Uganda has been the African HIPC with the lowest debt service to revenue ratio in 2012, while Egypt has been the African non-HIPC with the lowest debt service to revenue ratio in 2012. On the other hand, as Figure 17 shows, neither Cote d’Ivoire (a HIPC) nor Tunisia (a non-HIPC) were able to substantially lower their debt service to revenue ratio during 2003 to 2012.
III.6. Success and Failure of Debt Relief Initiatives

Given that a variety of problems of the HIPC Initiative are well-known as they were already discussed widely in the debt relief literature of the early 2000s,\(^{18}\) this section summarizes first the relatively successful alleviation of debt burdens for the eligible HIPCs. It then provides some critical comments on the time it took for some countries to reach the HIPC completion point and the fact that three African HIPCs (Eritrea, Somalia and Sudan) have not even reached the Decision Point under the HIPC Initiative. The third sub-section will examine to which degree these initiatives have provided long-term debt sustainability, while a fourth sub-section reviews some key issues related eligibility criteria, and the related questions of additionality and burden sharing of debt relief. To the degree that other problems remain relevant, they will be discussed in the subsequent section (Section IV), which reviews and evaluates the existing debt sustainability frameworks (DSFs).

III.6.a. Successful Alleviation of Debt Burdens for most HIPCs

With 36 countries having reached the completion point under the HIPC Initiative and hence, these countries also receiving MDRI debt relief, these two initiatives are nearly complete. There are only three countries (Eritrea, Somalia, and Sudan) that could eventually be considered for future HIPC debt relief, though the political situation in Eritrea and the protracted arrears of Somalia and Sudan make it unlikely for these countries to reach the HIPC Decision Point within the next few years.

According to the HIPC progress report of December 2014 (see IMF, 2014), debt relief under the HIPC Initiative and MDRI has substantially alleviated debt burdens in recipient countries and has enabled them to increase their poverty-reducing expenditure by two and a half percentage points between 2001 and 2013. Creditor participation in the Initiative has been strong amongst the multilateral and Paris Club creditors; however participation from the other creditor groups still needs to be strengthened. Based on the latest IMF update provided on September 17, 2015:

---

“Smaller multilateral institutions, non-Paris Club official bilateral creditors, and commercial creditors, which together account for about 26 percent of total HIPC Initiative costs, have only delivered a small share of their expected relief so far.”

Anyway, as Table 2 shows, the total cost of debt relief provided under the HIPC Initiative (that is, cumulative since the Initiative was adopted in 1996 and enhanced in 1999) to all creditors amounts to US$76.4 billion (of which about US$66 billion were provided to 30 African HIPCs). The largest amount of HIPC debt relief went to the Democratic Republic of Congo (US$15.2 billion), followed by Cameroon (US$4.9 billion) and Liberia (US$4.6 billion). That is, nearly one third of the debt relief provided went to three African HIPCs, while the remaining 27 African HIPCs received about US$46 billion. For comparison purpose: world GDP in just one year (2014) is estimated at US$78 trillion. That is, all the costs of total HIPC debt relief accumulated since 1996 amounted to slightly less than 0.1 percent of world GDP in 2014. Another comparison: net official development assistance (ODA) from DAC members totaled US$135.2 billion in 2014, which is about the same as it was in 2013 (US$135.1 billion), though marking a 0.5 percent decline in real terms. Net ODA as a share of gross national income (GNI) was 0.29 percent. The total assistance provided under the MDRI amounts to about US$50 billion, of which about US$41 billion were provided to 30 African HIPCs.

### III.6.b. Time Period for Reaching Decision and Completion Points

Though there are some good arguments for not allowing Eritrea, Somalia and Sudan to reach the Decision Point under the HIPC Initiative, the fact that nearly 20 years since the adoption of the original HIPC Initiative the people of Somalia and Sudan are still waiting for debt relief does not speak for a timely resolution. As is well-known, there is a vicious cycle of facing a debt overhang and not making progress in qualifying for debt relief.

Furthermore, when the international community agreed in 1999 to enhance the initial HIPC Initiative by providing deeper, broader and faster debt relief, few would have expected that the average interim period for the 30 African HIPCs having reached the Completion Point would be four years and three months. Uganda, which already had reached the Completion Point under the Original HIPC Initiative in April 1998, was the country with the shortest interim period under the enhanced HIPC initiative (3 months). Chad was the country with the longest interim period of 13 years and 11 months. Even if excluding Chad, the average interim period was still about 4 years.

---

19 See IMF (2015).
20 Calculations based on HIPC 2014 Progress Report and HIPC Completion Point document for Chad (see respectively, IMF (2014) and IMF (2015).
21 For further details, please see Table AIII.4 of the 2014 HIPC Progress Report (IMF, 2014) and HIPC Completion Point Document for Chad (IMF, 2015).
23 The largest amount of MDRI debt relief went to Ghana (US$3.9 billion), followed by Tanzania (US$3.8 billion) and Ethiopia (US$3.3 billion). For further details, please see Table AIII.4 of the 2014 HIPC Progress Report (IMF, 2014) and HIPC Completion Point Document for Chad (IMF, 2015).
### Table 2: Committed Debt Relief under HIPC Initiative and MDRI

(In millions of U.S. dollars; status as of end-April 2015)

<table>
<thead>
<tr>
<th>36 Completion Point HIPCs</th>
<th>Decision Point Date</th>
<th>Completion Point Date</th>
<th>Assistance under the HIPC Initiative</th>
<th>Assistance Delivered under MDRI (^2/)</th>
<th>Total HIPC and MDRI Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>In NPV Terms as of Decision Point (^3/)</td>
<td>In Nominal Terms (^4/)</td>
<td>In Nominal Terms (^4/)</td>
</tr>
<tr>
<td>Benin</td>
<td>Jul-00</td>
<td>Mar-03</td>
<td>262</td>
<td>460</td>
<td>1,128</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>Jul-00</td>
<td>Apr-02</td>
<td>553</td>
<td>930</td>
<td>1,196</td>
</tr>
<tr>
<td>Burundi</td>
<td>Aug-05</td>
<td>Jan-09</td>
<td>833</td>
<td>1,366</td>
<td>103</td>
</tr>
<tr>
<td>Cameroon</td>
<td>Oct-00</td>
<td>Apr-06</td>
<td>1,267</td>
<td>4,917</td>
<td>1,288</td>
</tr>
<tr>
<td>Central African Republic</td>
<td>Sep-07</td>
<td>Jun-09</td>
<td>578</td>
<td>804</td>
<td>294</td>
</tr>
<tr>
<td>Chad</td>
<td>May-01</td>
<td>Apr-15</td>
<td>170</td>
<td>260</td>
<td>745</td>
</tr>
<tr>
<td>Comoros</td>
<td>Jun-10</td>
<td>Dec-12</td>
<td>146</td>
<td>136</td>
<td>78</td>
</tr>
<tr>
<td>Congo, Dem. Rep. of the</td>
<td>Jul-03</td>
<td>Jul-10</td>
<td>7,252</td>
<td>15,222</td>
<td>1,050</td>
</tr>
<tr>
<td>Congo, Rep. of</td>
<td>Mar-06</td>
<td>Jan-10</td>
<td>1,575</td>
<td>1,738</td>
<td>196</td>
</tr>
<tr>
<td>Cote d'Ivoire</td>
<td>Mar-09</td>
<td>Jun-12</td>
<td>1,576</td>
<td>3,415</td>
<td>1,844</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Nov-01</td>
<td>Apr-04</td>
<td>1,935</td>
<td>3,275</td>
<td>3,291</td>
</tr>
<tr>
<td>Gambia, The</td>
<td>Dec-00</td>
<td>Dec-07</td>
<td>67</td>
<td>112</td>
<td>377</td>
</tr>
<tr>
<td>Ghana</td>
<td>Feb-02</td>
<td>Jul-04</td>
<td>2,187</td>
<td>3,500</td>
<td>3,891</td>
</tr>
<tr>
<td>Guinea</td>
<td>Dec-00</td>
<td>Sep-12</td>
<td>639</td>
<td>800</td>
<td>975</td>
</tr>
<tr>
<td>Guinea-Bissau</td>
<td>Dec-00</td>
<td>Dec-10</td>
<td>489</td>
<td>790</td>
<td>129</td>
</tr>
<tr>
<td>Liberia (^5/)</td>
<td>Mar-08</td>
<td>Jun-10</td>
<td>2,739</td>
<td>4,600</td>
<td>260</td>
</tr>
<tr>
<td>Madagascar</td>
<td>Dec-00</td>
<td>Oct-04</td>
<td>836</td>
<td>1,900</td>
<td>2,384</td>
</tr>
<tr>
<td>Malawi</td>
<td>Dec-00</td>
<td>Aug-06</td>
<td>939</td>
<td>1,628</td>
<td>1,577</td>
</tr>
<tr>
<td>Mali</td>
<td>Sep-00</td>
<td>Mar-03</td>
<td>539</td>
<td>895</td>
<td>1,968</td>
</tr>
<tr>
<td>Mauritania</td>
<td>Feb-00</td>
<td>Jun-02</td>
<td>622</td>
<td>1,100</td>
<td>877</td>
</tr>
<tr>
<td>Mozambique</td>
<td>Apr-00</td>
<td>Sep-01</td>
<td>2,143</td>
<td>4,300</td>
<td>2,022</td>
</tr>
<tr>
<td>Niger</td>
<td>Dec-00</td>
<td>Apr-04</td>
<td>644</td>
<td>1,190</td>
<td>1,053</td>
</tr>
<tr>
<td>Rwanda</td>
<td>Dec-00</td>
<td>Apr-05</td>
<td>651</td>
<td>1,316</td>
<td>513</td>
</tr>
<tr>
<td>São Tomé and Príncipe</td>
<td>Dec-00</td>
<td>Mar-07</td>
<td>117</td>
<td>263</td>
<td>66</td>
</tr>
<tr>
<td>Senegal</td>
<td>Jun-00</td>
<td>Apr-04</td>
<td>488</td>
<td>850</td>
<td>2,460</td>
</tr>
<tr>
<td>Sierra Leone</td>
<td>Mar-02</td>
<td>Dec-06</td>
<td>675</td>
<td>994</td>
<td>663</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Apr-00</td>
<td>Nov-01</td>
<td>2,026</td>
<td>3,000</td>
<td>3,816</td>
</tr>
<tr>
<td>Togo</td>
<td>Nov-08</td>
<td>Dec-10</td>
<td>282</td>
<td>360</td>
<td>713</td>
</tr>
<tr>
<td>Uganda</td>
<td>Feb-00</td>
<td>May-00</td>
<td>1,027</td>
<td>1,950</td>
<td>3,501</td>
</tr>
<tr>
<td>Zambia</td>
<td>Dec-00</td>
<td>Apr-05</td>
<td>2,499</td>
<td>3,900</td>
<td>2,757</td>
</tr>
<tr>
<td><strong>Total African HIPCs</strong></td>
<td></td>
<td></td>
<td>35,756 (^4/)</td>
<td>65,971</td>
<td>41,215</td>
</tr>
<tr>
<td>Afghanistan</td>
<td>Jul-07</td>
<td>Jan-10</td>
<td>582</td>
<td>1,280</td>
<td>39</td>
</tr>
<tr>
<td>Bolivia</td>
<td>Feb-00</td>
<td>Jun-01</td>
<td>1,330</td>
<td>2,060</td>
<td>2,833</td>
</tr>
<tr>
<td>Guyana</td>
<td>Nov-00</td>
<td>Dec-03</td>
<td>610</td>
<td>1,354</td>
<td>710</td>
</tr>
<tr>
<td>Haiti</td>
<td>Nov-06</td>
<td>Jun-09</td>
<td>140</td>
<td>213</td>
<td>964</td>
</tr>
<tr>
<td>Honduras</td>
<td>Jun-00</td>
<td>Apr-05</td>
<td>556</td>
<td>1,000</td>
<td>2,726</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>Dec-00</td>
<td>Jan-04</td>
<td>3,308</td>
<td>4,500</td>
<td>1,916</td>
</tr>
<tr>
<td><strong>Total Non-African HIPCs</strong></td>
<td></td>
<td></td>
<td>6,526 (^4/)</td>
<td>10,407</td>
<td>9,188</td>
</tr>
<tr>
<td><strong>Total Debt Relief Committed</strong></td>
<td></td>
<td></td>
<td>42,282 (^4/)</td>
<td>76,378</td>
<td>50,403</td>
</tr>
</tbody>
</table>

Sources: Calculated based on 2014 HIPC Progress Report and World Bank (2015a).

1/ Committed debt relief under the assumption of full participation of creditors, including debt relief under the original HIPC Initiative and any topping up at the completion point, but excluding IMF MDRI debt relief of nominal US$182 million to non-HIPCs Cambodia and Tajikistan.

2/ Nominal MDRI costs include principal and interest foregone for all multilaterals participating in the Initiative, except IMF, which only include principal. The estimated costs for IMF reflect the stock of debt eligible for MDRI relief, which is the debt outstanding (principal only) as of end-2004 and that has not been repaid by the member and is not covered by HIPC assistance.

3/ Topping-up assistance and assistance provided under the original HIPC Initiative are expressed in NPV-terms as of the decision point.

4/ Given that these amounts are in different NPV terms (according to the date of the decision point), the sums are only indicative.

5/ Liberia received MDRI-type (beyond-HIPC) debt relief at end-June 2010, which was financed from the Liberia Administered Account.
III.6.c. Reaching Long-term Debt Sustainability

While it was always doubted by some sceptics if the HIPC Initiative would imply a permanent exit from debt rescheduling and provide long-term debt sustainability, after the adoption of the MDRI most observers expected that debt sustainability will not be an issue for a long time for MDRI-eligible countries, especially as most industrialized countries also canceled most of their bilateral debts to MDRI countries.

However, as Table 3 shows, as of November 29, 2015, sixteen African Completion Point HIPCs were classified as having moderate debt levels, while six HIPCs were classified as having high debt levels. The time period between reaching the completion point under the enhanced HIPC Initiative and being classified as having high debt levels amounted to about 13 years for Mauritania, about 11 years for Ghana, less than 8 years for Sao Tome and Principe, less than 5 years for Burundi and the Central African Republic, and Chad, which reached the HIPC completion point in April 2015 was still classified as having high debt levels in May 2015 (the last DSA available for Chad).

III.6.d. Eligibility and Additionality of Debt Relief

Though both HIPC and MDRI were targeted at the poorest and most heavily indebted countries, it has been argued that some equally poor and equally indebted countries were excluded due to shortcomings in eligibility criteria, using a) IDA eligibility (which is mostly based on nominal GDP per capita) as the only criterion to determine the poverty level of a country, and b) mostly focusing on the NPV debt-to-export ratio to define indebtedness. For example, as was shown by Gunter (2006), at least 30 non-HIPC low-income countries were actually poorer than some of the eligible HIPCs when measuring poverty by human poverty indicators instead of IDA eligibility. Hence, there have been doubts if HIPC and MDRI have been a fair and efficient allocation of scarce development resources.

Bird and Milne (2003, p. 57) have pointed out that “there could be undesirable distributional effects with some poor countries losing out.” Killick (2001) has pointed out that countries that have taken better care of their debts might be left in a relatively worse status when debts are nullified. Killick (2004) has stated that the distributional implications of the enhanced HIPC Initiative without additionality raise concerns about the initiative’s poverty reduction objective. Sanford (2004b) has provided an outstanding analysis of the effectiveness and impact of IDA grants and HIPC debt relief on IDA resources. He has shown (p. 1579) that unless the money to pay for IDA grants and HIPC debt relief is additional, IDA’s funding problem will not be solved: “Rather, money will simply be shifted from one foreign aid purpose to another and the cost of the shortfall in IDA resources will be borne ultimately by the poor countries, which are supposedly its intended beneficiaries.” The same problem applies principally to the other HIPC creditors, and it also applies to debt relief provided under the MDRI as MDRI debt relief is in no way guaranteed to be additional.
### Table 3: Debt Ratings of African Countries as of November 29, 2015

Countries that reached the HIPC completion point are listed in red font, all others are listed in blue font.

<table>
<thead>
<tr>
<th>Country</th>
<th>Date last DSA was published</th>
<th>Country</th>
<th>Date last DSA was published</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Low</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benin</td>
<td>1/11/2013</td>
<td>Nigeria</td>
<td>3/30/2015</td>
</tr>
<tr>
<td>Liberia</td>
<td>2/27/2015</td>
<td>Tanzania</td>
<td>7/10/2015</td>
</tr>
<tr>
<td>Madagascar</td>
<td>7/2/2014</td>
<td>Uganda</td>
<td>7/7/2015</td>
</tr>
<tr>
<td><strong>Moderate</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Angola</td>
<td>11/6/2009</td>
<td>Guinea-Bissau</td>
<td>7/21/2015</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>7/24/2015</td>
<td>Lesotho</td>
<td>7/11/2014</td>
</tr>
<tr>
<td>Cabo Verde</td>
<td>9/25/2014</td>
<td>Malawi</td>
<td>3/30/2015</td>
</tr>
<tr>
<td>Cameroon</td>
<td>7/17/2014</td>
<td>Mali</td>
<td>12/11/2014</td>
</tr>
<tr>
<td>Comoros</td>
<td>2/13/2015</td>
<td>Mozambique</td>
<td>8/4/2015</td>
</tr>
<tr>
<td>Congo, Republic of</td>
<td>9/16/2015</td>
<td>Sierra Leone</td>
<td>3/24/2015</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>12/22/2014</td>
<td>South Sudan</td>
<td>12/17/2014</td>
</tr>
<tr>
<td>Gambia, The</td>
<td>4/22/2015</td>
<td>Togo</td>
<td>2/7/2014</td>
</tr>
<tr>
<td>Guinea</td>
<td>9/29/2014</td>
<td>Zambia</td>
<td>6/16/2015</td>
</tr>
<tr>
<td><strong>High</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central African Republic</td>
<td>6/16/2014</td>
<td>Mauritania</td>
<td>2/12/2015</td>
</tr>
<tr>
<td>Chad</td>
<td>5/13/2015</td>
<td>São Tomé &amp; Príncipe</td>
<td>7/21/2015</td>
</tr>
<tr>
<td>Djibouti</td>
<td>3/21/2013</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>In Debt Distress</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sudan</td>
<td>12/30/2014</td>
<td>Zimbabwe</td>
<td>7/7/2014</td>
</tr>
</tbody>
</table>

Source: Compiled by author based on IMF Country Reports/DSAs available as of Nov. 29, 2015.  
1/ There is no IMF/World Bank DSA available for Algeria, Botswana, Egypt, Equatorial Guinea, Eritrea, Gabon, Libya, Mauritius, Morocco, Namibia, Seychelles, Somalia, South Africa, Swaziland, and Tunisia.
The degree to which non-HIPC low-income countries might suffer (or potentially benefit) from the recent debt relief initiatives depends mostly on two factors:

- the degree of additionality of debt relief to donors’ traditional aid (that is, to what degree traditional aid is increasing to pay for debt relief provided by the donors), and
- the degree to which donors will make reallocations in their traditional aid (which is supposed to be based on the donors’ assessment of aid recipients’ policies and institutions).

While the two issues are obviously related to each other, it makes sense to first focus on the additionality issue at the creditors’ aggregated level of ODA, and then at the reallocation issue of traditional aid.

The Group of Eight (G8) Finance Ministers’ Communiqué states that donors would provide additional contributions to the AfDF and IDA to offset dollar for dollar the forgone principal and interest repayments of the debt cancelled, with an immediate provision of additional funds to cover the full costs for the next three years, namely the AfDF-X and IDA-14 periods. For the subsequent period, donors would commit to cover the full costs for the duration of the cancelled loans, by making contributions additional to regular replenishments of the AfDF and IDA. The Communiqué suggests that the donor’s MDRI contributions will be based on agreed AfDF-X and IDA-13 burden shares. Following these suggestions, the AfDF and IDA donors have indeed adopted such a pay-as-you-go approach for the reimbursement of these organizations’ debt relief. Hence, this implies that there will be direct budgetary implications for (i) IDA’s donors until 2049 and (ii) AfDF’s donors until 2054.

A World Bank (2006) press release, issued on the occasion of IDA’s approval of its MDRI package, states that: “Donors have agreed to a financing package that calls for additional donor contributions over time to ensure delivery of fresh resources for poverty reduction. Compensatory financing over the duration of the cancelled loans will be based on strong indicative pledges already made, and donors are undertaking the necessary steps in their home countries to provide their financing commitments.” Despite all these donor assurances and detailed financing plans by the AfDF and IDA, the risk for some shortfall is—due to the long time horizon—a serious issue. As Sanford (2004a, p. 35) has pointed out “governments may sign agreements requiring their successors to make certain future payments. However, there is really no way a current government can bind a future government to honour that pledge, particularly if future exigencies intervene.”

History provides little insight on how much additionality we may expect. The most elaborate review of the additionality of past debt relief initiatives has been provided by Li (2001). She concludes that traditional debt relief provided in the 1980s and 1990s were not additional. On the other hand, the most recent independent review of the HIPC Initiative (see World Bank, 2006b, p. 34) concludes that “HIPC has channeled additional development resources to its qualifying countries” with this assessment based on the fact that “net transfers to HIPC countries doubled from $8.8 billion in 1999 to $17.5 billion in 2004, while transfers to other developing countries grew by only one third.” The problem with such assessments however is that they are made without knowing what aid levels would have been without debt relief. As is well known (see for example, Dollar and Levin, 2006), there has been an increase in the selectivity of aid in recent years to

---

countries with good policies and sound institutions. Given that nearly all countries that reached the HIPC completion point are typically such countries (otherwise they would not have been the first countries reaching the HIPC completion point), it is logical that the increase in aid has been higher to the group of HIPCs than the group of non-HIPCs.

The necessity to know what aid levels would have been without debt relief is close to what Cline (1997) referred to when stressing the importance of truth in accounting for debt relief. The World Bank (2006b, p. 34) evaluation report states: “to demonstrate that future debt relief initiatives are additional, donors will need to establish what net transfers—both multilateral and bilateral—would be in the absence of debt relief.” While some progress has been made in this regards by adopting a long-term contribution baseline of the real SDR value of donor contributions under IDA-14 as a means of assessing additionality (see Press Release of the U.S. Treasury of September 23, 2005, p. 2), the same Press Release also concludes that “funding for IDA will continue to depend on donors’ conviction of IDA’s effectiveness in delivering development assistance; IDA reflows; and the performance, financing needs, and absorptive capacity of poor countries.”

Hence, it is unclear how long the established contribution baseline may hold. The established contribution baseline fixed at the SDR’s real value seems inconsistent with the recent promises made by the G8 to substantially increase aid budgets, except if the G8 allocates the increased aid budgets solely through bilateral aid. The later might not be optimal given recent efforts to increase the effectiveness and harmonization of aid. Furthermore, there are additional complexities arising from the emergence of new donors which lend under other financial terms and modalities, like for example, China.

This second question, if donors will or have made changes in their traditional aid allocations is even more difficult to answer than the question about additionality. However, we can get some answers based on the benchmarks provided by Gunter, Rahman and Wodon (2008). They calculated how much the recent debt relief initiatives (including HIPC, post-HIPC Paris Club, and the Multilateral Debt Relief Initiative) will cost and then allocated these costs to each country based on four benchmark scenarios. The four benchmark scenarios reflect the four possible combinations derived from the two extreme cases for the question about how much debt relief is additional, and the two extreme cases for the question if donors will make reallocations of their traditional aid budgets to HIPCs due to debt relief provided to them.  


26 With regards to the first question (if debt relief is additional to donors’ traditional aid budgets), it is important to stress that these two cases of additionality should not be confused with the question about the additionality of debt relief for a debt relief-receiving-country. The question of the additionality of debt relief for a receiving country can only be addressed properly after taking possible reallocations in traditional aid into account. The cases of zero and full additionality of resources by creditors determine the total aid envelope, of which a part will be provided in terms of debt relief and the other part in terms of traditional aid.

27 With regards to the second question (if donors will make reallocations of their traditional aid budgets to HIPCs due to debt relief provided to them), there are two extremes: zero and full reallocation. Zero reallocation of the HIPCs’ traditional aid is defined as donors continuing to give the same amount (not necessarily the same share) of traditional aid to HIPCs as before providing debt relief, independently of whether debt relief is additional or not. Full reallocation of the HIPCs’ traditional aid is the opposite of zero reallocation. When fully reallocating the HIPCs’ traditional aid, donors would subtract the exact amount of debt relief from the HIPCs’ traditional aid. Hence, in this case, debt relief cannot be additional for the group of HIPCs; it may however be additional at the aggregate level (in terms of aid and debt relief to all aid recipients). The case of full reallocation of the HIPCs’ traditional aid does not necessarily imply that the aid provision to non-HIPCs will increase as that depends on the degree of additionality at the creditors’ level.
As shown in Table 4, based on these four benchmark scenarios, Gunter, Rahman and Wodon (2008) then calculate the net benefits for four country groups: (i) the 30 HIPCs that reached the enhanced decision point by end-2006, (ii) 48 other IDA-eligible countries, (iii) the group of 88 non-IDA developing countries, and (iv) the group of 21 industrialized countries. Table 5 provides a numerical example for the net benefits of debt relief provided under HIPC, additional Paris Club and MDRI, based on the 30 HIPCs that reached the enhanced HIPC Decision Point by end December 2006. It shows, the higher the degree of additionality, the higher are the costs of the creditors, and the higher the reallocation of the HIPCs’ traditional aid, the lower are the benefits to the HIPCs.

Table 4: Four Benchmark Cases for the Distribution of the Costs of Debt Relief

<table>
<thead>
<tr>
<th>Question One: Is debt relief additional to donors’ traditional aid budgets?</th>
<th>Full additionality in creditors’ resources</th>
<th>Benchmark Case 1</th>
<th>Benchmark Case 2</th>
<th>Benchmark Case 3</th>
<th>Benchmark Case 4</th>
<th>Full reallocation of the HIPCs’ traditional aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Zero reallocation of the HIPCs’ traditional aid</td>
<td>HIPCs gain, while there is no significant impact on the non-HIPCs</td>
<td>Non-HIPCs gain, while there is no significant impact on the HIPCs</td>
<td>HIPCs gain, while the non-HIPCs lose</td>
<td>No impact on either HIPCs or non-HIPCs</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Gunter, Rahman and Wodon (2008), Table 3.

The largest uncertainty about countries either benefiting or bearing the costs of debt relief provided under the HIPC Initiative and MDRI applies to the non-HIPC IDA-eligible countries. In the benchmark case of full additionality and a proportional reallocation of traditional aid budgets to HIPCs (which is somewhere in between zero and full reallocation), the non-HIPC eligible, though IDA eligible countries would have a net benefit of about 59 percent of the total costs of these initiatives. However, in the benchmark case of zero additionality and zero reallocation of traditional aid budgets to HIPCs, the non-HIPCs would effectively carry all the costs of these debt relief initiatives.
### Table 5: Net Benefits of Debt Relief Provided under HIPC, additional Paris Club and MDRI, depending on Additionality of Debt Relief and Reallocations of Traditional Aid

(in billions of US$, 2004 NPV terms, based on the 30 countries that reached the enhanced HIPC Decision Point by end-December 2006)

<table>
<thead>
<tr>
<th>Net Benefits to:</th>
<th>Full additionality of debt relief in creditors’ resources</th>
<th>Zero additionality of debt relief in creditors’ resources</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Zero reallocation of the HIPCs’ traditional aid</td>
<td>Full reallocation of the HIPCs’ traditional aid</td>
</tr>
<tr>
<td>30 Eligible HIPCs</td>
<td>86.2</td>
<td>-0.4</td>
</tr>
<tr>
<td>30 Eligible HIPCs</td>
<td>86.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Non-HIPC eligible, though IDA eligible countries</td>
<td>-0.8</td>
<td>82.8</td>
</tr>
<tr>
<td>Non-HIPC eligible, though IDA eligible countries</td>
<td>-83.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Non-IDA eligible developing countries</td>
<td>-14.8</td>
<td>-11.7</td>
</tr>
<tr>
<td>Non-IDA eligible developing countries</td>
<td>-3.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Industrialized countries</td>
<td>-70.6</td>
<td>-70.6</td>
</tr>
<tr>
<td>Industrialized countries</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Source: Adapted from Gunter, Rahman and Wodon (2008), Table 9.

### IV. Review and Evaluation of Existing DSFs

This section reviews and evaluates the existing debt sustainability frameworks (DSFs) as operated by World Bank and IMF, focusing specifically on the DSF for LICs. The WB/IMF debt burden indicators depend on a country’s policy and institutional capacity, as measured by the World Bank’s country policy and institutional assessment (CPIA) index. This section critically evaluates these measures, empirically assess the WB/IMF debt indicators methodology and the impacts on debt sustainability in Africa. It also uses some case study information to inform the analysis.

Although the analysis of a country’s debt sustainability is far from a homogenous concept or approach, one of the key definitions is whether a country can meet its current and future debt service obligations in full, without recourse to debt relief, rescheduling or accumulation of arrears. It is now also widely recognized that a sustainable debt is a precondition for sustainable development. Unsustainable debt has significant negative implications on investment, growth and the reduction of poverty. The importance of achieving debt sustainability is also reflected by including ‘deal comprehensively with developing countries’ debt’ as the third target of the eighth MDG. While the Millennium Declaration gives some indicators on how to measure progress towards this target, it does not—for good reasons—determine any specific level at which debt sustainability will have been achieved.

Most of the theoretical debt sustainability literature looks at debt dynamics over an infinite horizon and then derives some kind of solvency conditions according to which debt sustainability can be...
determined. The best-known such solvency condition is the so-called no-Ponzi scheme condition, which comes in many versions, ranging from relatively simple to highly sophisticated mathematical equations. The basic implication of any no-Ponzi scheme condition is that the present value of future revenues has to be higher than the present value of future debt service. If the present value of future revenues is smaller than the present value of future debt service, debt is not sustainable, even though the debtor might be able to finance the debt service temporarily. Hence the no-Ponzi scheme condition pays critical attention to the fact that a country may face an unsustainable debt in the long run, even though it is able to pay its debt service currently due. Yet, given the practical limitations of such infinite horizon solvency conditions, practitioners have suggested a variety of more specific debt sustainability indicators like debt-to-exports or debt-to-GDP ratios. While theoretical aspects related to debt sustainability have been analyzed since the 1920s, the systematic analysis of developing countries’ debt sustainability surfaced only after the emergence of the so-called Third World debt crises in the early 1980s.

There are currently two separate debt sustainability frameworks (DSFs): one for countries that do not normally rely on concessional external financing, and one for countries that normally rely on official concessional financing. For the countries that do not normally rely on concessional external financing, judgments on the extent of debt vulnerabilities are informed by a set of tools provided within the debt sustainability framework for market access countries (MAC-DSA). For countries that normally rely on official concessional financing, the assessment of debt vulnerabilities is informed by the low-income countries debt sustainability framework (LIC-DSF). The subsequent analysis focuses on the DSF for LICs.

The joint World Bank–IMF Debt Sustainability Framework (DSF) for LICs was introduced in April 2005. It seeks to ease the debt-sustainability challenge by providing guidance on new lending to LICs whose main source of financing is official loans. The framework has been developed with the intention of better monitoring and preventing the accumulation of unsustainable debt. It also guides the grant allocation and lending decisions of IDA, IMF, and some other donors by providing a systematic basis for analyzing debt sustainability prospects, including individual countries’ current and prospective ability to service debt. By providing guidance to both lenders and borrowers on new lending/borrowing decisions, the new framework aims to help LICs achieve their development objectives while maintaining sustainable levels of debt.

The DSF is also important for the IMF’s assessment of macroeconomic stability, the long-term sustainability of fiscal policy, and overall debt sustainability. Furthermore, the debt sustainability assessments are taken into account to design the debt limits in Fund-supported programs while the World Bank uses it to determine the share of grants and loans in its assistance to each LIC.

---

IV.1. Rationale and Description of LIC-DSF

Officially, the framework is designed to guide the borrowing decisions of LICs in a way that matches their financing needs with their current and prospective repayment ability, taking into account each country’s circumstances. Within the framework, debt sustainability analyses (DSAs) are conducted regularly and consist of:

- an analysis of a country’s projected debt burden over the next 20 years and its vulnerability to external and policy shocks—baseline and stress tests are calculated;
- an assessment of the risk of external debt distress in that time, based on indicative debt burden thresholds that depend on the quality of the country’s policies and institutions (see Table 6); and
- recommendations for a borrowing (and lending) strategy that limits the risk of debt distress.

Table 6: Debt Burden Thresholds under the LIC-DSF

<table>
<thead>
<tr>
<th></th>
<th>NPV of debt in percent of</th>
<th>Debt service in percent of</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exports</td>
<td>GDP</td>
</tr>
<tr>
<td>Weak Policy</td>
<td>100</td>
<td>30</td>
</tr>
<tr>
<td>Medium Policy</td>
<td>150</td>
<td>40</td>
</tr>
<tr>
<td>Strong Policy</td>
<td>200</td>
<td>50</td>
</tr>
</tbody>
</table>


The main rationale for the framework is to assess the sustainability of debt to avoid risks related to debt distress. The DSF analyzes both external and public sector debt. Given that loans to LICs vary considerably in their interest rates and length of repayment, the framework focuses on the NPV of debt obligations. This is supposed to ensure comparability over time and across countries. In reality, the use of short-term and currency specific discount rates distorted the comparability over time and across countries. The reform adopted by the IMF and World Bank in October 2013 to replace the previous discount rate system based on currency-specific commercial interest reference rates (CIRRs) with a unified discount rate of 5 percent per annum is a big step forward, but does not solve the comparability problem entirely.

To assess debt sustainability, debt burden indicators are compared to indicative thresholds over a 20-year projection period. A debt-burden indicator that exceeds its indicative threshold suggests a risk of experiencing some form of debt distress. There are four ratings for the risk of external public debt distress:

- low risk, when all the debt burden indicators are well below the thresholds;
- moderate risk, when debt burden indicators are below the thresholds in the baseline scenario, but stress tests indicate that thresholds could be breached if there are external shocks or abrupt changes in macroeconomic policies;
- high risk, when the baseline scenario and stress tests indicate a protracted breach of debt or debt-service thresholds, but the country does not currently face any repayment difficulties; or
- in debt distress, when the country is already having repayment difficulties.

---

29 This section is mostly based on the IMF’s and World Bank’s official description of September 17, 2015, see: [https://www.imf.org/external/np/exr/facts/jdsf.htm](https://www.imf.org/external/np/exr/facts/jdsf.htm).

Countries with significant vulnerabilities related to public domestic debt or private external debt, or both, are assigned an overall risk of debt distress that flags these risks. This assessment of overall debt vulnerability complements the rating on the risk of external public debt distress.

LICs with weaker policies and institutions tend to face repayment problems at lower levels of debt than countries with stronger policies and institutions. The DSF, therefore, classifies countries into one of three policy performance categories (strong, medium, and poor) using the World Bank's Country Policy and Institutional Assessment (CPIA) index, and uses different indicative thresholds for debt burdens depending on the performance category. Thresholds corresponding to strong policy performers are highest, indicating that in countries with good policies debt accumulation is less risky.

IV.2. Revisions in the DSF for LICs

The framework was reviewed in 2006, 2009, and 2012. The next review is set for 2016.

- The 2006 review assessed the initial experience with the framework and examined the implications of debt relief under the Multilateral Debt Relief Initiative.
- The 2009 review, which came in the wake of wide-ranging reforms of the IMF’s financial facilities for LICs, focused on options to enhance the flexibility of the DSF, especially with regards to taking the link between debt-financed investment and growth into account.
- The main changes based on the 2012 review were a modest revision in some debt thresholds, a strengthening of the analysis of total public debt and fiscal vulnerabilities, an additional risk rating related to domestic public debt and private external debt, a better assessment of the link between debt-financed investment and growth, and a refinement in stress tests to better reflect dynamic linkages between macroeconomic variables.

IV.3. Critical Assessment

Despite various improvements in the DSF and especially in DSAs, many still consider the framework to be too mechanical, too much backward looking, and excessively restrictive by not differentiating sufficiently between capital and recurrent public spending.  

IV.3.a. How Restrictive are the Debt Burden Thresholds?

Despite the good intentions by the donors to restrict debt flows to developing countries in order to avoid LICs facing soon again debt distress, there have been concerns among LICs that the Bank-Fund DSF will lock LICs into a so-called ‘low debt-low growth’ scenario. Most LICs faced severe financing gaps for MDG investments in the early 2000s.

---

31 The CPIA is an index compiled annually by the World Bank for all IDA-eligible countries, including blend countries, ranging from 1 (lowest) to 6 (highest). The DSF uses the CPIA index to classify countries into one of three policy performance categories according to the strength of their policies and institutions. Countries with a CPIA score less than or equal to 3.25 are considered to have weak policies and institutions. Those with a CPIA score greater than 3.25 and less than 3.75 have medium policies and institutions. Countries with a CPIA score greater than or equal to 3.75 have strong policies and institutions. For further details, see http://www.imf.org/external/np/pp/eng/2013/110513.pdf.

For most LDCs, there is an inherent tension between (a) debt-financing national development strategies to achieve the MDGs and even more so the SDGs, and (b) maintaining debt sustainability. The concerns about being locked into a ‘low debt-low growth’ scenario have been aggravated by the emerging consensus among the main donors in the mid-2000s that countries that received debt relief under the MDRI were not supposed to accumulate new debt in the near future, even if their debt levels were below the new framework’s thresholds. As will be detailed below, restrictions on concessional financing have been a key factor for many African LICs to borrow domestically, and some African LICs have also started to borrow from non-concessional international capital markets.

In order to get a better idea on how restrictive these debt burden thresholds have been for an average African HIPC, Table 7 compares the debt burden thresholds to the actual debt burden values of the average African HIPCs between 2000 and 2013 (or the average of the group of African HIPCs with available data from 2003-2012 in the case of debt or debt service to government revenues). The table also shows the average value for 2012 and 2013, to get a better idea on the more recent situation. The evolution of average values for these five debt indicators are also provided in Figure 18. Even though there is wide variety of debt levels within the group of African HIPCs, these averages still provide some information on how restrictive these thresholds were.

<table>
<thead>
<tr>
<th></th>
<th>NPV of debt in percent of Export</th>
<th>Debt service in percent of Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exports</td>
<td>GDP</td>
</tr>
<tr>
<td>Weak Policy</td>
<td>100</td>
<td>30</td>
</tr>
<tr>
<td>Medium Policy</td>
<td>150</td>
<td>40</td>
</tr>
<tr>
<td>Strong Policy</td>
<td>200</td>
<td>50</td>
</tr>
<tr>
<td>Average Policy</td>
<td>150</td>
<td>40</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2012 Average</th>
<th>2013 Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Export</td>
<td>Revenue</td>
</tr>
<tr>
<td>Actual Average</td>
<td>32.9</td>
<td>52.7</td>
</tr>
<tr>
<td>Actual Average Range</td>
<td>10.6</td>
<td>7.6</td>
</tr>
</tbody>
</table>

Source: Table 6 and calculations by author based on previously presented data.

Looking at the last two columns, which contain the data for debt service indicators, we can see that none of the averages, none of the ranges and none of the 2012 or 2013 averages ever surpassed the debt thresholds, not even for the weak policy case. This is however not the case for the NPV debt indicators. Looking at the first row below the thick black line, we can see that the average debt indicators were always below the thresholds for medium and strong policy countries, but they were all above the weak policy thresholds.

Furthermore, looking at the actual range of debt indicators during the 2000-2013 (or 2003-2012 for the government revenue indicators), we can see that the maximum range of the average African HIPC exceeds or approaches the thresholds for strong policy. This indicates that it is likely that most HIPCs reached or surpassed the thresholds at some point, even if they would have had strong policies. Finally, looking at last two rows, none of the averages for 2012 and 2013 came close to
the thresholds for weak policy. This seems to indicate that the thresholds became less binding in the early 2010s. In other words, HIPCs were able to borrow more as they were below the debt thresholds. The rising debt indicators reviewed above and the fact that some countries have more recently been categorized as having high debt, seem to indicate that many of these countries have borrowed more aggressively in the last few years.

**Figure 18: Debt Burden Thresholds and Actual Averages of African HIPCs**

Source: Calculations by the author based on GDF/WDI databases.

**IV.3.b. How Objective are the CPIAs?**

The World Bank’s CPIA provides a useful tool to assess the progress countries make in terms of policies and institutions. There also is substantial empirical evidence that economic growth, and therefore the likelihood of reducing income poverty, is strongly influenced by the quality of policies and institutions. Those in favor of the CPIA might also argue that there is some long-term relationship between high CPIA scores and achieving the MDGs.

However, the analysis by Gunter, Rahman and Shi (2009) has shown that there are considerable differences across countries between the CPIA score and actual MDG achievements. There were
some countries that had high CPIA scores without having made satisfactory progress in achieving the MDGs (like for example Uganda). Similarly, there are some countries that had low CPIA scores for decades but have made significant progress in achieving the MDGs (like for example Bangladesh). Indeed, for the sample of 59 LICs analyzed by Gunter, Rahman and Shi (2009), the correlation coefficients between the CPIA index and five MDG indices were low, ranging between 0.12 and 0.22.33

Those in favor of the CPIA might argue that low correlation coefficients are an argument against replacing the CPIA index by the MDG index. On the other hand, critics of the CPIA index might argue that low correlation coefficients between the two indices are resulting from (i) the CPIA’s subjective measuring34 and (ii) an inadequate/biased definition of what constitutes good policies.35

IV.3.c. Not Restrictive Enough Thresholds or Weak DSAs?

The fact that various African HIPCs face once again high debt levels (see Table 3 above) after having received HIPC and MDRI debt relief may indicate to some that the Bretton Woods institutions’ debt thresholds are actually not restrictive enough. While arguments and explanations can be found for either side, the more fundamental problem is that even the most sophisticated DSAs are ultimately misleading with regards to the true long-term sustainability of any country. Box 5 illustrates how wrong and misleading DSAs can be based on the experience of Sao Tome and Principe. The fact that Sao Tome and Principe’s decision point DSA was so far off from the actual situation within a relative short period of time (less than seven years) seems to indicate that DSAs are simply not able to accurately predict the longer-term sustainability of a country’s debt.

33 Given the lack of time series data for all MDGs, Gunter, Rahman and Shi (2009) created five alternative MDG-indices based on the following five social variables for which there exists reasonable time series data:
   (i) the percentage of gross primary school enrolment;
   (ii) the percentage of female gross primary school enrolment;
   (iii) the percentage of children (ages 12-23 months) immunized against measles;
   (iv) the percentage change in life expectancy at birth; and
   (v) the percentage change in under-five mortality rates.

34 While significant improvements have been made over recent years in the CPIA exercise (for example, by publishing CPIAs for the first time in 2006 and by adding World Bank internal checks across countries), it remains the case that CPIAs are the outcome of subjective evaluations by World Bank economists. Compared to the subjective CPIA, the MDG progress index is an objective measure based on facts not opinions.

35 CPIA critics also argue that the CPIA is biased by the Bank’s institutional guidelines on what constitutes good policies. They argue that countries should not be penalized for having different views on what good policies are, especially if their policies result in sustained poverty reduction. The MDG progress index seems to be less sensitive to alternative definitions/compositions as the correlation coefficients between the five MDG indices suggested by Gunter, Rahman and Shi (2009) were relatively high, ranging between 0.897 and 0.997.
Box 5: Can DSAs Accurately Determine a Country’s Longer-term Debt Sustainability?

Sao Tome and Principe reached the decision point under the HIPC Initiative in December 2000. Based on the DSA undertaken at the Decision Point, it was projected that the country’s NPV debt-to-export ratio of 2005 would be 140 percent. However, about six years later, when Sao Tome and Principe reached the completion point in February 2007, the completion points DSA based on end-2005 data indicated that the NPV debt-to-exports ratio at the end of 2005, after full delivery of HIPC assistance, stood at 299 percent.

An initial assumption for the cause of this massive increase in NPV debt to exports may be that Sao Tome and Principe borrowed heavily after reaching the HIPC decision point. However, as Table 8 shows, new loan disbursements were actually less than anticipated in December 2000. The main factors for the far higher NPV debt to export ratios are due to far lower exports (both in export prices and export volumes), changes in discount rates, changes in the timing and mechanisms of debt relief, and a lower concessionality of new loans.

Table 8: Breakdown of Sao Tome and Principe’s Increase of NPV Debt-to-Export Ratio

<table>
<thead>
<tr>
<th></th>
<th>Percentage Points</th>
<th>Percent of Total Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPV of debt-to-export ratio (as projected at decision point)</td>
<td>139.7</td>
<td></td>
</tr>
<tr>
<td>NPV of debt-to-export ratio (actual)</td>
<td>298.7</td>
<td></td>
</tr>
<tr>
<td>Total increase</td>
<td>159.0</td>
<td>100.0</td>
</tr>
<tr>
<td>1. Due to changes in the parameters</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which: due to changes in the discount rates</td>
<td>45.1</td>
<td>28.4</td>
</tr>
<tr>
<td>Of which: due to changes in the exchange rates</td>
<td>10.3</td>
<td>6.5</td>
</tr>
<tr>
<td>2. Due to unanticipated new borrowing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which: due to higher than expected disbursements</td>
<td>-11.2</td>
<td>-7.0</td>
</tr>
<tr>
<td>Of which: due to lower concessionality of the loans</td>
<td>10.9</td>
<td>6.9</td>
</tr>
<tr>
<td>Of which: due to other factors 3/</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which: due to prices</td>
<td>40.6</td>
<td>25.5</td>
</tr>
<tr>
<td>Of which: due to volumes</td>
<td>33.7</td>
<td>21.2</td>
</tr>
<tr>
<td>5. Other factors 4/</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which:</td>
<td>22.1</td>
<td>13.9</td>
</tr>
</tbody>
</table>

Sources: World Bank and IMF staff estimates.
1/ NPV of debt-to-export ratio after enhanced HIPC assistance.
2/ After full delivery as of end-2005.
3/ Refers to incorrect use, at the decision point, of U.S. dollar discount rates and terms of new borrowing.
4/ Due to revisions in the end-1999 database and changes in the timing and mechanisms of delivery of assistance compared to the assumptions in the decision point projections (mainly due to delays in reaching the completion point).

Data and Table Source: Sao Tome and Principe HIPC completion point document, p. 27.

The view that DSAs are simply not able to accurately predict the longer-term sustainability of a country’s debt is not new. There are several publications arguing that DSAs are impossible missions. The systematically wrong predictions of most DSAs have contributed to the suggestion in the late 1990s to adopt a human development approach to debt sustainability, which implicitly implies that LICs should only get grants.

36 See for example, Wyplosz (2011).
A related view is that DSAs cannot deal with any real shock, and should therefore be part of a contingency debt sustainability framework (see Ferrarini, 2008). Ferrarini also argues that the IMF and World Bank’s DSF is centered on the CPIA to suit the aid allocation mechanism of IDA, but fails to deal effectively with the economic vulnerability of LICs. Instead of using the Bank-Fund DSA, Ferrarini proposes a Contingency Debt Sustainability Framework (CDSF), which identifies the sources of vulnerability and compensates for exogenous shocks and trend factors. He argues that without giving rise to significant moral hazard implications, the CDSF is suitable to effectively shield LICs from the main external causes undermining their achievement of debt sustainability.

“The Contingency Debt Sustainability Framework (CDSF) aims at providing effective protection against the disruptive effects of exogenous shocks on LICs’ balance of payments (BOP) and debt sustainability.” 37 This approach is grounded on the evidence that external shocks have played a central role in undermining LICs’ debt sustainability. The proposals entails an array of closely inter-related instruments, which are outlined in Figure 19, though the main point is that a country experiencing an external shock will have access to a contingent credit line that can prevent the country from facing unsustainable debt.

V. Opportunities and Pitfalls posed by Africa’s Increased Access to International Private Capital Markets

This section analyzes the opportunities and pitfalls posed by Africa’s increased access to international private capital markets on debt sustainability in Africa. It also examines the risks and opportunities for debt sustainability in HIPC/MDRI countries associated with less traditional flows of development finance.

V.1. Recent Developments

A decade ago, most African countries, excluding South Africa and some Northern African countries, were unable to raise money through bond sales because their economies were considered too risky by international investors. Most African countries were not even rated by credit companies. Until the recent drop in commodity prices, the quest for profitable investments in Africa has been powered by a variety of factors, including a) an optimistic narrative of Africa’s economic prospects dubbed “Africa Rising”, b) high commodity prices, c) sound economic policies, d) improved governance, e) low or negative real interest rates and low growth prospects in high-income countries. As a consequence, several SSA countries found themselves eligible to raise money by issuing bonds. 38

After South Africa, the Seychelles were the first Sub-Saharan African (SSA) sovereign issuing a $200 million Eurobond in 2006. Ghana was the next SSA sovereign, launching its debut $750 million Eurobond with an interest rate of 8.5 percent in 2007. Several other SSA countries, including Côte d’Ivoire, Nigeria, Rwanda, Namibia, and Zambia followed Ghana and the Seychelles during the subsequent years. Excluding South Africa, there were twelve SSA Eurobonds issues in 2012, nine in 2013, and ten in 2014. 39 According to Tyson (2015a), sub-Saharan Africa has significantly increased its borrowing through bond sales from $6 billion in

38 Tafirenyika (2015).
2012 to a record $11 billion in 2014. “Most recently, first-time issuers led by Ethiopia and Kenya, which in 2014 raised $1.5 billion and $2 billion respectively. Kenya’s entry into the bond market in June 2014 was one of the largest ever debut deals from an African country, according to the Wall Street Journal. Virtually all the bond sales were hugely over-subscribed, a testimony to the investors’ appetite for risk in frontier markets.”

V.2. Opportunities

The post-2008 SSA bond issues had positive characteristics relative to other market-based sources of financing. The maturity period of African bonds, typically ranging between five to ten years has been good, and interest rates have been reasonable in most cases. Beyond these positive characteristics, “[t]here are several advantages attached to government borrowing through bond sales: they offer an alternative source of finance; the money is not subject to the conditions usually attached to loans from rich countries or multilateral organizations; critical infrastructure can be financed at cheap rates generated by relaxed monetary policies pursued by developed countries; and bonds carry less stringent terms with reasonable periods of repayment.”

---

40 Tafirenyika (2015).
41 Tafirenyika (2015).
While African Eurobonds came with far lower interest rates than domestic financing, the interest rates and maturities are far less favorable than those offered by concessional debt issuers. “African sovereigns have long-standing relationships with concessional debt issuers, which are framed by lengthy discussions over borrowing requirements, project viability, development impact, and debt sustainability (largely driven by donors).”

While the previous commodity boom and Africa’s high GDP growth rates have led to exponential growth in the African Eurobond market, mostly from oil exporting countries, the more recent collapse in global oil prices could, as Tafirenyika (2015) has pointed out, halt the recent boom in issuance, though Africa still ranks as the second fastest-growing region in the world after Asia.

V.3. Pitfalls

As Tafirenyika (2015) has put it clearly: “Despite the current positive economic outlook for Africa, its debt could pose acute challenges in the face of economic headwinds turned negative from falling commodity prices, a slowing Chinese economy that has been gobbling African commodities, and declining global demand for exports. There is growing concern that the countries likely to be hit hardest by soaring debt repayments are those that cashed in on low interest rates by issuing bonds. Already, Ghana and Zambia have appealed to the IMF for help in repaying debts acquired through sovereign bonds.”

Another potentially disastrous pitfall is the currency risk Eurobonds (and any external debt) carry. As detailed in Tyson (2015a, p. 17), African Eurobonds have been exclusively denominated in US dollars, creating significant foreign exchange risks for issuing countries: The exchange rate risk of sovereign bonds issued by governments in SSA in 2013 and 2014 is threatening losses of $10.8 billion - a value equivalent 1.1 percent of the region’s GDP. Though the exchange rate risk applies equally to concessional lending, the shorter maturity of Eurobonds, hence, the potential need to refinance them at a time when the market does not favor it, imply a bigger risk for Eurobonds. The various opportunities and pitfalls are illustrated for the case of Ghana in Box 6.
Box 6: The Case of Ghana

Following South Africa and the Seychelles, Ghana was the third sovereign in SSA to go to the international markets to finance its government deficit. In 2007, it launched a debut $750 million Eurobond, with an interest rate of 8.5 percent. On July 25, 2013, Ghana issued another $1 billion Eurobond at 8.0 percent interest rate, and on September 11, 2014, Ghana issued a third bond in the amount of US$1 billion, which has a twelve year maturity and a coupon rate of 8.125 percent. About six weeks later (on October 24, 2014), Standard & Poor’s (2014) Ratings Services lowered its long-term foreign and local currency sovereign credit ratings on Ghana from B to B minus. Still, on October 7, 2015, Ghana launched a 15-year $1 billion Eurobond at a 10.75 percent coupon rate, which was 100 percent oversubscribed after the World Bank provided a partial bond guarantee of $400 million.

Comparing these Eurobonds to Ghana’s traditional concessional external borrowing at far lower interest rates, these bonds constitute a significant change in the way Ghana finances its government deficit. For example, while the 2007 Eurobond constituted 14.7 percent of Ghana’s total external debt outstanding of that year, the 8.5 percent interest payments on the debut bond constituted 39.1 percent of Ghana’s total interest payments on external debt of 2008.

As the right hand panel of Figure 20 shows, in addition to the sharp increase in external borrowing, domestic borrowing also increased at about the same rate during 2011 to 2015. A considerable problem of all external borrowing (concessional as well as non-concessional) is that Ghana’s currency depreciated significantly. When Ghana launched its debut bond in 2007, the cedi was virtually at parity with the dollar. As of October 21, 2015, one cedi was only 26.1 U.S. cents. In other words, the US$750 million debut bond of 2007, which was at that time equivalent to about 750 million Ghanaian cedi, is now equivalent to a fiscal burden of about 3 billion cedi.

Though Eurobonds come with far higher interest rates than traditional concessional borrowing, the advantage of Eurobonds are that they are still much cheaper in terms of interest rates than domestic borrowing. According to Standard & Poor (2014), the weighted average interest rates on the government’s cedi-denominated debt stood at 24 percent and 23 percent per year, respectively, on the government’s 91-day and 182-day treasury bills as of October 2014. The high interest rate payments on domestic debt can be seen clearly in the right hand panel of Figure 20.

Figure 20: Ghana’s Domestic and External Debt

Source: Left figure: Ghana (2015), right figure; created and calculated by author based on data provided in various fiscal reports by the Ministry of Finance of Ghana, posted at: http://www.mofep.gov.gh/.

“Declining prices for gold and cocoa, rising trade and fiscal deficits and a burgeoning debt forced Ghana to reach an agreement with the IMF in February 2015 for a $1 billion loan. The money is expected to shore up an economy saddled with unsustainable debt levels of more than 60% of gross domestic product. While Ghana’s misfortunes underscore the risks associated with borrowing in dollars, the deal with the IMF was expected to restore investor confidence in what was until recently one of Africa’s high-flying economies.” Tafirenyika (2015).

As pointed out by Tafirenyika (2015), debt acquired through bond sales is a double-edged sword. To attract international investors, African bonds are typically issued in U.S. dollars, sometimes in euros. This makes the debt vulnerable to currency risks whenever the value of the dollar or euro strengthens. According to Tyson (2015a), SSA could face more than $10 billion in losses, or 1.1 percent of its GDP, servicing debt acquired in 2013 and 2014 should exchange rates take a hit from a strong dollar. To the degree that the hit is temporary, more emphasis should be placed on stabilizing the exchange rate according to their long-run equilibrium.

Furthermore, the interest in African bonds is threatened by the prospects of normalization of monetary policy in advanced economies (Velde, 2014). Rising interest rates in the United States and other industrialized countries raise the risks of a damaging reversal of capital flows. (Tyson, 2015a). Moreover, as pointed out by Saigal (2015), the fall in oil prices has already led to stresses in African bond financing: “Since June 2014, the price of Brent crude oil has more than halved, dipping below $50 per barrel in January – the lowest level since May 2009. In response, leading oil exporters in Africa, in particular Nigeria, Gabon and Angola, have experienced weaker current accounts, budgetary stress and rising exchange-rate pressures. Yields on Eurobonds across SSA have risen.” Finally, as the case of South Africa (illustrated in Box 7) shows, debts can destabilize economies if investors decide to reduce their exposure. Furthermore, as we know from history, investor’s behavior is not always rational, following what is called herding, and can then lead to contagion to debtors who’s economic fundamentals do not warrant an outflow of capital.

### Box 7: Bond Financing in South Africa

South Africa’s debt levels and bond sales are set to climb as the government struggles to meet its revenue-collection targets. Gross government debt will probably increase to 49 percent of GDP by end 2015 (which is 1.7 percentage points higher than was previously forecasted in February 2015). The National Treasury projects the ratio will stabilize at below 50 percent of GDP over the next three fiscal years.

Rising debt-service payments are already crowding out spending on social and economic priorities. The government is set to borrow 519.5 billion rand (US$39 billion) in the three years through March 2018, or 47 billion rand more than was targeted in February 2015. The Treasury cut projected tax revenue for the period by 35 billion rand as power shortages and an anemic global economic expansion constrain growth.

Domestic bond sales are projected to increase to 175 billion rand in the year through March 2016 and 180.5 billion rand next year, up from a February 2015 projection of 172.5 billion rand for each of the two years. The government plans to raise $1.5 billion from international markets in each of the next three fiscal years, after raising $1 billion in 2015. The projections imply an exchange rate of about 12.6 per dollar next year. Net debt is seen to be increasing to 45.4 percent of GDP in 2018, up from 43.5 percent in 2015.

South Africa’s debt is rated at one level above junk by Standard & Poor’s. Moody’s Investors Service and Fitch Ratings rate the nation one level higher. Fitch has a negative outlook on the rating and plans a review its rating in December 2015. Further rating downgrades “could induce a sudden outflow of foreign capital and sharply higher interest rates,” the Treasury said. “Given South Africa’s reliance on foreign lending to finance investment, such a development would compromise the country’s ability to sustain growth and social progress.”

Source: Based on Cohen (2015).
“Given the potential risks from bonds, the current enthusiasm has prompted analysts to start questioning the wisdom of piling up dollar-denominated debt. A downturn in the global economy or market volatility could have a negative effect on African debt, as evidenced by (…) the plunge in oil prices. The U.S. Federal Reserve has also signalled it might end the era of rock-bottom interest rates, which could also spell problems for African bond issuers who will be faced with rising debt repayments. Countries like Angola and Nigeria, for instance, which depend heavily on oil revenues, are already feeling the pinch.”

Though a temporary confidence crisis into the Chinese economy in early October 2015 prevented the Fed from increasing interest rates at its meeting on October 26, 2015, there actually were requests by nine (of the 12) regional reserve banks to increase the primary credit rate.

IMF managing director Christine Lagarde warned African countries in 2014 against accruing high debt. “Governments should be attentive and they should be cautious about not overloading their countries with too much debt,” she told the Financial Times.

“A Thanks to previous measures that rescheduled or cancelled Africa’s debt, robust economic growth and concessional interest rates, Africa’s debt burden today is still within manageable range and relatively low compared with the strength of its economies. Hence, it’s not yet crunch time for African debtors who have taken advantage of current low interest rates and favourable markets conditions to issue bonds. Prudent use of the borrowed funds backed by sound economic policies will see them weather the storm from declining commodity prices and future interest rate hikes.”

A stronger warning has been stated by French Ivorian businessman Tidjane Thiam, who said that it is madness for African nations to rely on loans in foreign currencies to fund vital infrastructure, including roads, power and clean water (see Clark, 2015).

VI. Conclusions, Lessons Learnt, and Policy Proposals

Many African countries have made impressive progress in achieving sustainable growth and substantially reducing poverty. Some of these countries, reflecting what has been dubbed “Africa Rising”, have achieved this progress while also reducing their debt ratios. However, some countries have achieved growth and reduced poverty while seeing sharply rising debt ratios that may ultimately threaten the progress made during the last decade. Some other African countries, though being a clear minority, have neither made much progress with substantially reducing poverty nor with reducing their debt ratios.

Arica is at the crossroads. Will the huge SDG financing needs, which are unlikely to be covered by aid, put Africa on the road towards facing another debt crisis in the near future? Or will African governments be cautious with using debt, hence maintain debt sustainability but fail to achieve the SDGs? Clearly, everybody would like to achieve the SDGs as well as maintain debt sustainability.

48 Tafirenyika (2015).
50 Tafirenyika (2015).
51 Tafirenyika (2015).
52 Thiam is currently the Chief Executive of Credit Suisse Group AG; in the 1990s, he worked on infrastructure and privatization projects for the government of Cote d’Ivoire, where his final job was minister of planning and development.
The difficult question is if and how this can be done. The remainder of this section focuses first on some lessons that can be learnt from the past and then some policy proposals.

VI.1. Lessons Learnt

A first important lesson from experiences throughout history is that debt sustainability is never guaranteed. Any severe shock may push even the most conservative country over the limits of sustainable debt. It would not make sense to restrict new borrowing so drastically to virtually guarantee long-term debt sustainability. A better balance must be reached between a) the benefits of new concessional and non-concessional borrowing from domestic and external sources and b) the benefits of restricting any such borrowing to achieve debt sustainability. Furthermore, we should expect “unpredictable” shocks, and hence, be prepared to deal with them, for example by adopting something like a Contingency Debt Sustainability Framework (CDSF) outlined above. To some degree, debt sustainability is not an oasis, but a mirage. This should however not be interpreted as that the whole of Africa is close to facing another debt crisis.

Second, it takes typically many years to resolve a debt crisis. It took about seven years (from 1982 until the adoption of the Brady Plan in 1989) until the Third World Debt Crisis was at least officially resolved for mostly MICs. It also took about seven years from the time Krugman (1988) and Sachs (1989) suggested the debt overhang concept in the late 1980s until the adoption of the HIPC Initiative in 1996, and another three years until the adoption of the enhanced HIPC Initiative, and finally another six years until the adoption of the MDRI.

Third, not only does it take many years to resolve a debt crisis, “too little, too late” makes the situation worse. During the years of inaction, the impacts of the debt overhang on growth and development are severe. Figure 21 is a simple but useful illustration on the overall inverse relationship between debt levels (as percent of GDP) and GDP per capita, aggregated for the African continent, from 1970-2013.

Figure 21: Relationship between Debt and GDP per capita, 1970-2013

Source: Created by the author based on World Bank (2015c).
Fourth, expect holdouts of non-participating creditors and the emergence of vulture funds.\textsuperscript{53} Even though intended, none of the past initiatives implied a fair burden sharing as some commercial creditors have initiated law suits against HIPCs and been awarded multiples of the original claim. The emergence of vulture funds can and should be prevented before the next crisis, like via using collective action clauses. In accordance with the treaty establishing the European Stability Mechanism, all bonds issued by Eurozone member states with maturities exceeding one year, issued after January 1, 2013, have a mandatory collective action clause.\textsuperscript{54} African countries should adopt the same regulation. Furthermore, on September 9, 2014, the United Nations General Assembly passed a resolution to create new legal rules to stop financial speculators like vulture funds from undermining debt restructurings.\textsuperscript{55}

Fifth, though the official numbers on debt relief provided may look impressive, without knowing the degree of additionality, there is no way to know how much of debt relief has actually benefitted African countries. This is even more the case taking into account that most of the debt canceled under the HIPC Initiative would likely never have been repaid.

Sixth, as the analysis of Section III has shown, there is a huge heterogeneity across both HIPCs and non-HIPCs in the evolution of debt, and while some exogenous factors have played a role, national economic policies, especially debt policies, have also been critical. Given the tremendous negative implications of falling in debt distress, especially in the post-HIPC and post MDRI era, national debt management policies are critical to achieve the SDGs.

\textbf{VI.2. Policy Proposals}

More than 10 years ago, the Report of the UN Secretary General (UN, 2005, p. 18) proposed to ‘redefine debt sustainability as the level of debt that allows a country to achieve the Millennium Development Goals and reach 2015 without an increase in debt ratios’. Today, as the world leaders have adopted the SDGs, there is a similar call to outline a SDG-consistent DSF. Before defining some elements of such a SDG-consistent DSF, two important points need to be stressed from the very beginning to avoid any misunderstanding about the suggested new concept.

First, given that the world’s poorest countries will remain with large portions of their populations in poverty for decades to come, the applicability of any traditional debt-sustainability concept remains doubtful, as these countries will continue to have more urgent development expenditures than making debt-service payments. Hence, as is more detailed in EURODAD (2001) and Sachs et al. (1999), if debt sustainability is approached

\textsuperscript{53} As defined in IMF and IDA (2002, p. 74), [t]he term “vulture fund” is typically applied only to small arbitrage-seeking operators that specialize in buying and selling distressed debt.” Vulture funds specialize in obtaining distressed debt in the secondary debt market at a price far below its face value with a view to recovering the original value of the debt through litigation (or in the shadow of litigation). For example, as detailed on a Jubilee USA Network website with vulture fund case studies (see: http://www.jubileeusa.org/vulturefunds/vulture-fund-country-studies.html#sthash.sSbXkD8V.dpuf): “Beginning in the summer of 2008, Themis Capital and Des Moines Investments Ltd. acquired roughly $18 million of Congolese debt from Citibank and various other creditors. This debt dates back to the early 1980’s and the corrupt regime of former dictator Mobutu Sese Seko. In February 2009, Themis and Des Moines filed a lawsuit against the DRC, suing the nation for the principal $18 million plus decades of interest. In July 2014, after unsuccessful settlement negotiations, US District Judge Judge Paul A. Engelmayer ruled the DRC must pay the hedge funds roughly $70 million in principal and interest.”

\textsuperscript{54} See http://europa.eu/efc/sub_committee/cac/index_en.htm.

from a human and social development perspective, most of the poorest countries will have an unsustainable debt as soon as they borrow.

Second, it is not possible to increase the debt-financing of national development strategies without also increasing a country’s indebtedness. While the recent progress many African countries have made provides some options for new financing methods for investments needed to achieve the SDGs, the fundamental challenge of maintaining debt sustainability remains the same, which is that any substantial increase in debt financing has earlier or later a negative impact on debt sustainability. Furthermore, as was already pointed out above, most of the investments needed for reaching the SDGs cannot be financed via debt as it would blow any concept of debt sustainability.

The conclusion based on these two important points as well as based on actual experience with regards to the significant costs for developing countries due to delays in providing debt relief is that maintaining debt sustainability may ultimately have priority over debt financing SDG investments because a sustainable debt is a precondition for sustainable development.\footnote{There are a variety of other conclusions which will be detailed in the next section as they go beyond the focus of this section.} Still, there are some options to improve the current DSF to allow a limited increase in the debt-financing of countries that make progress with achieving the SDGs without creating a debt overhang. The following proposals reflect a variety of partly complementary and partly alternative options that should be discussed among donors as well as debtors.

\textit{VI.2.a. Making Adjustments for SDG Investments}

There is very broad agreement within the literature as well as among practitioners that the sustainability of a country’s debt depends critically on the way the funds borrowed are used. As Tyson (2015a, p. 17) has stressed: “Debt sustainability is dependent on retaining strong GDP growth and whether funds being raised have a “growth dividend” or are frittered away will be an important factor in differentiating those countries that repay and those that default. Investors would be well advised to differentiate more closely between responsible and irresponsible issuers.”

Unfortunately, there is currently no effective system that monitors and prevents LICs from incurring debt for expenditures that will not provide the growth dividend needed to guarantee the repayment of the debt. While donors have imposed conditions for concessional borrowing for decades and the IMF’s debt limits policy has been in place since the 1960s,\footnote{See IMF (2015) \url{http://www.imf.org/external/np/spr/2015/conc/index.htm}.} recent experiences have shown the system is either not enforced or broken.

For example, as detailed in Tafirenyika (2015), after Zambia has opened loan negotiations with the IMF after it was stung by declining prices for copper (its main export commodity, which accounts for more than two-thirds of total export earnings), “Zambia had unwisely spent a big chunk of the money from the sovereign debt on salary increases for its public servants.” Another example is Mozambique. “Mozambique borrowed US$ 850 million for their national fishing industry but instead spent the money on military boats and equipment.”\footnote{http://www.odi.org/news/741-repayment-sub-saharan-africas-bonds-threatened-by-escalating-risks-new-report.}
The case of Ghana is illustrative on how much the system is broken even within the Bretton Woods institutions. After “Ghana has frittered away funds on public sector pay increases,” the IMF disapproved of Ghana issuing another sovereign bond in fall 2015. However, Ghana nevertheless launched a 15-year $1 billion Eurobond at a 10.75 percent coupon rate on October 7, 2015, which was 100 percent oversubscribed after having gained a partial bond guarantee from the World Bank in the amount of $400 million.

Despite these negative examples, “acquiring debt is not inherently a bad policy; what matters is how the money is spent. Most African countries that raised money from sovereign bonds have used it to pay for infrastructure investment like transport and energy in Ethiopia, Rwanda, Nigeria, Senegal and Zambia. Others, like Côte d’Ivoire and Zambia, used the money to pay for development-related current expenditures such as health and education.”

VI.2.b. Building on Actual Progress instead of Hopes

While there has been a push among development practitioners to make more adjustments in the Bank-Fund DSF to take debt incurred for SDG-investments in account, one problem related to these suggestions is that the benefits of such investments typically accrue over the long-term, beyond the time at which repayments on these loans have to be made.

Another problem is that many of these investments may not provide a sufficient increase in government revenues with which the repayments will have to be made. Eliminating poverty has tremendous benefits to the people, but may not generate the government revenues to repay the loans. Furthermore, there are a variety of external factors, including shocks and natural disasters, that may hamper the achievements of these investments. Hence, instead of hoping that such SDG-investments will achieve their intended goals, a better approach would be to base debt sustainability on actual achievements of MDGs and now SDGs, as was detailed above.

VI.2.c. More Emphasis on Public Debt Service to Government Revenues

Another problem is that there is too much emphasis on broad debt indicators like debt-to-GDP or debt-to-exports, instead of focusing on debt service on domestic and external debt to government revenues. Mainly due to the commodity boom in the early 2000s and recent resource discoveries all over Africa, many African countries experienced double-digit growth rates in exports. These let to low debt-to-export ratios, which may not properly reflect these countries’ longer-term payment capacities, especially in cases where the resources extracted by mostly MNCs provided very little revenues to the government.

There is far too much emphasis of the impact of loans on GDP growth instead of on poverty reduction. As a recent Jubilee (2015) report points out: Bhutan, Ethiopia, Ghana, Lao PDR, Mongolia, Mozambique, Senegal, Tanzania and Uganda have been growing faster than the average LIC. However, they are making less progress in reducing poverty than the average LIC and inequality is increasing. “For example, in Ethiopia between 2005 and 2011 GDP grew by 60% per person, but the number of people living on less than $2 a day increased by 5.4 million.” Finally, DSAs will need to take better account of contingent liabilities by the public sector based on public-private partnerships.

60 Tafirenyika (2015).
In May 2003, the United States adopted legislation requiring the U.S. Administration to seek agreement with other countries to implement limit debt service payment of HIPCs to 10 percent of the revenue their governments receive from internal sources. For HIPCs experiencing major public health emergencies (like HIV/AIDS), the suggested limits were reduced to five percent of government revenues. Though the U.S. Administration never succeeded in establishing an international initiative to cap debt service payments, it has been argued that the adoption of the MDRI and the subsequent cancelations of bilateral debts to eligible HIPCs more than substituted for the debt service payment proposal, at least in the short-run.

**Arguments in Favor of Capping Debt Service Payments**

It has been argued (mostly by civil society and religious groups related to Jubilee 2000) that the remaining high and highly uneven debt burden constitute a challenge to the central objective of sustainable development. Furthermore, a cap on debt payments would protect all eligible countries against situations where their export income falls or their economy shrinks because of changes in export prices or international recessions. In that situation, their debt payment obligations would remain the same but their ability to pay would decline. A debtor government would then need to spend a larger share of its revenue to service its foreign debt. Likewise, LICs remain highly vulnerable to currency depreciations, as they would need to spend more of their revenues to purchase the foreign exchange necessary to make payments on external debt service. The proponents of payment caps worry that, without some sort of mechanism to automatically reduce countries’ debt payment obligations, LICs could find themselves in a situation where their debt burdens were once again unsustainable, even after full debt relief from the HIPC initiative and MDRI.

**Do Payment Caps Reward Low-Revenue HIPCs?**

The proponents of debt payment caps believe that steps should be taken to put all HIPCs on a more equal footing. Proponents of payment caps want limits on payments so no LIC will need to spend a major share of their government budgets for external debt service as is currently the case for some LICs, including HIPCs and non-HIPCs.

The opponents of payment caps (mostly the creditors, including the World Bank and IMF) maintain, however, that the difference among the outcomes for HIPCs can be attributed at least as much to differences in the level of government revenues as to any variation in their treatment by the HIPC framework. Thus, critiques of payment caps argue that a cap on debt service based on government revenue will benefit most the HIPCs whose governments have the smallest flow of revenues (relative to GDP) drawn from domestic sources. However, the actual data of the early 2000s did not support the critiques of payment caps.61

In conclusion, a cap limiting the LICs’ debt payments could be a useful firebreak protecting them against future deterioration in their economic situation.

---

61 Sanford and Gunter (2005).

**VI.2.d. More Emphasis on Payment Caps on Debt Service**

One significant improvement would be to refocus debt sustainability for LICs on public debt service payments to government revenues and to implement payment caps on debt service payments for LICs, with a proportional reduction in debt service payments to all creditors, including commercial creditors. Box 8 provides further background on the proposal to cap payments on debt services. These debt service limits would need to be part of binding collective action clauses. As long as it is uncertain if the debt problem reflects a temporary illiquidity or a
more permanent debt overhang situation, debt service caps could be implemented on a temporary basis without reducing total debt stocks. Once it becomes clear that a country faces a longer-term debt overhang, a debt stock reduction would need to be implemented.

VI.2.e. A Fair and Efficient Debt Workout Mechanism

The Addis agenda stressed that borrowing is an important tool for financing investment critical to achieving sustainable development, including the sustainable development goals. It recognized the need to assist developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief, debt restructuring and sound debt management. It also stressed that the monitoring and prudent management of liabilities is an important element of comprehensive national financing strategies as well as for reducing vulnerabilities. It also reiterated that debtors and creditors must work together to prevent and resolve unsustainable debt situations. It affirmed the importance of debt restructurings being timely, orderly, effective, fair and negotiated in good faith. In the same vein, the UN General Assembly voted on September 28, 2015 to call for an independent debt crisis response mechanism outside the IMF.62

VI.2.f. Grant Financing and Keeping the Promise to Increase ODA to 0.7 percent of GNI

Instead of providing scarce funds for debt relief after a country has fallen in debt distress, it would obviously be much better to reduce the risk of piling up potentially unsustainable debt in the first place. The theoretically easiest way to avoid ever facing unsustainable debt is not to borrow. While this would not make sense for most African countries, it should be considered more seriously for some of the poorest African countries. This would require substantially higher grant financing, and hence, all industrialized countries should increase their grant financing for SDG investments and make finally good on the long-standing promise to provide 0.7 percent of their GNP as aid. All countries also need to adopt longer-term expenditure frameworks, while donors will need to adopt longer-term aid commitments.

VI.2.g. New Creative Financing Sources

In addition to pressure industrialized and some upper-middle income countries to increase their grant allocation, taking into account that the SDGs are globally agreed goals, more emphasis should be put on finding new global financing sources. For example, given the large amount of daily currency transactions, some of which are actually destabilizing the international financial system, more efforts should be undertaken on making use of an international tax on foreign currency transactions (a so-called Tobin tax). At the proper level, such a tax would reduce the risk of financial crises, which typically have a negative impact on any country’s debt sustainability.

VI.2.h. Innovative Financing of Infrastructure Financing

More efforts need also to be undertaken to attract more foreign direct investment (FDI) and make use of new innovative ways to finance infrastructure investments without building up hidden risks for the public sector. Governments and development agencies also need to be held more

responsible for using debt to finance SDG investments instead of using debt to pay for non-critical current expenditures.

VI.2.i. African Commodity Price Stabilization Fund

African countries can and will need to work closer together to make better use of the opportunities and challenges they face. For example, more thought should be given to adopting some kind of African Commodity Price Stabilization Fund. As Figure 22 shows, there are various winners and losers from lower and higher oil prices which should allow for some kind of cooperation between some countries. This could reduce the reliability on debt financing whenever there is a significant change in commodity prices.

Figure 22: Winners and Losers of Lower Oil Prices


VI.2.j. Overcoming Debt Data Limitations

Finally, there are still considerable problems related to data availability. After many initiatives, especially related to African countries’ debt management, it is surprising how little data there is still publicly available on domestic debt and government revenues. While the IMF and World Bank actually have such data for most countries, especially for the African HIPCs they monitor on a regular basis, most of this data is not readily available to the public. For example, the World Development Indicators/Global Development Finance (WDI/GDF) database, which is the primary World Bank database for development and debt data, contains no data on domestic debt and has considerable gaps on government revenues. The unavailability of such data then contributes to the use of less useful debt indicators like debt-to-GDP and debt-to-export ratios. It also subdues the emergence of better research to analyze the real issues related to debt sustainability.
References


International Monetary Fund (IMF) and International Development Association (IDA) (2002).


