Reconciling Debt Sustainability and Development in Sub-Saharan Africa

Duke CID Conference on Development, November 2018

Brian Pinto
Former Senior Adviser, The World Bank

Source of Presentation

- Presentation draws upon two papers:
  - A critique of the 2017 version of the IMF-WB Low-Income Country Debt Sustainability Framework (LIC DSF) being applied to SSA in spite of being obsolete (Pinto 2018a)
  - An exploration of policy options to better align debt sustainability and development in Ethiopia in the light of its downgrade to high risk of debt distress by the IMF/WB (Pinto 2018b)
    - The Ethiopia case study illustrates the obsolescence of the IMF-WB LIC DSF.

Clash between debt sustainability and development in SSA

- This clash has two aspects:
  1. Massive remaining SDG investment needs cannot be met from own resources => need to borrow => debt sustainability problems even in the better-governed SSA countries, e.g., Kenya, Rwanda, Ethiopia
  2. Initial conditions not good with widespread existing public debt sustainability problems in SSA (Felino and Pinto 2017, IMF 2018a)
     - Therefore, continued focus of the 2017 version of the IMF-WB LIC DSF on *external debt* distress (IMF 2017) counterproductive. Problem lies with *public debt* as Ethiopia cogently illustrates.

Four Obstacles to Resolving Clash

1. Governance, leadership and institutions in SSA
   - Rwanda is SSA's star performer. It's CPIA is 4 out of 6. Sovereign credit rating is B (S&P), 5 levels below investment grade. Very high CAD a key factor.
   - Time for Africa to take charge of its own destiny.
2. Failure to accept that present system of ODA not delivering either on debt sustainability or long-run growth just 10 years after HIPC-MDRI
   - Need better early warning and analytical frameworks. LIC DSF (even the 2017 revision) is hopelessly obsolete.
3. Development financing needs remain vast and immediate while ODA is shrinking.
   - Need better framework for ODA and stronger coordination across donors and IMF/WB/AfdB.
4. Not much appetite for overhauling even a system that is clearly not working among donors or IMF/WB/AfDB.

Approach to Resolving Clash

1. Vast upfront SDG investment needs while ODA is shrinking=>need for front-loading ODA while pricing it better. Market debt increasingly defines marginal cost of borrowing in SSA=>less concessional, more front-loaded ODA
2. Concerns about widespread misuse of public resources especially in NR rich countries (Felino and Pinto 2017, IMF 2018b)=> raise bar for access to ODA, institute a tougher policy dialogue
   a. Ghana, Mozambique, Zambia: obvious public debt sustainability problems worsened by weak PFM systems
   b. Ethiopia, Kenya, Rwanda: constant tension between infrastructure investments and macroeconomic sustainability=>allow for heterogeneity, move away from templates like the LIC DSF
3. Shift focus in LIC DSF from external debt distress to public debt
   a. This would shift attention from symptom (external debt distress) to malady (unsustainable public debt dynamics spilling over into CADs and external debt)
4. Donors and IMF/WB/AfDB need to speak with one voice based on collaboration rather than competition/condescension/turf-mindedness.

See High Level Panel (2017) report on more innovative approaches to SSA development finance.

Ethiopia's January 2018 downgrade to red (high risk of *external* debt distress)

- Macroeconomic data from IMF January 2018 Ethiopia Country Report (IMF 2018b) make it abundantly clear that CADs and external debt dynamics being driven by public sector deficits-**-in turn driven by massive public investments in infrastructure**
- Yet IMF (2018b) notes that public debt does not "flag additional risks". Indeed, ratio of public debt to GDP falls by 7 percentage points during 2015/16 and 2016/17 in spite of large primary deficits, superficially supporting IMF position
- But composite **real** interest rate was -5% (2015/16) and -14% (2016/17) as a result of financial repression and overvalued real exchange rates.
  - If composite real interest rate had been just 3% instead, public debt/GDP would have *risen* by 4 pp instead of *falling* by 7 pp over these two years.

Ethiopia (continued)

- Two crucial questions for Ethiopia:
  1. What would public debt dynamics look like without financial repression and real overvaluation?
  2. Will the country's massive infrastructure investments pay off in terms of future growth and taxes?
     - If "yes" Ethiopia could benefit from more front-loaded, long-maturity ODA and could approach both China and other donors for this **supported by the IMF/WB/AfDB**
- Both questions are crucial as Government seeks to hand over the growth baton to FDI and the private sector in line with its growth strategy**. BUT neither is raised in the IMF/WB DSA or in the broader policy analysis.**
- Nor are such questions likely to be raised in the context of the "significant overhaul" claimed by the obsolete 2017 LIC DSF.

References

- IMF. 2017. Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reforms. Published October 2, 2017.
- IMF. 2018a. “Macroeconomic Developments and Prospects in Low-Income Developing Countries—2018.” IMF Policy Paper. March.
- IMF. 2018b. “The Federal Democratic Republic of Ethiopia: Staff Report for the 2017 Article IV Consultation--Press Release; Staff Report; and Statement by the Executive Director for The Federal Democratic Republic of Ethiopia.” IMF Country Report No. 18/18.
- Felino, Luisa Teixeira and Brian Pinto. 2017. Debt Sustainability and Development Implications of Moderately Concessional Lending Terms for ADF Countries. ADF Lab WP 3, June.
- High Level Panel. 2017. Reinvigorating African Concessional Finance. Report of the High Level Panel on Transforming Trust in the AfDB Group Into Influence.
- Pinto, Brian. 2018a. “The 2017 Version of the IMF and World Bank’s LIC Debt Sustainability Framework: ‘Significant Overhaul’ or Obsolete?” June 1 2018.
- Pinto, Brian. 2018b. “Ethiopia’s Downgrade to High Risk of Debt Distress: A Policy Framework for the Government.” October.