The dark side of infrastructure investment in Africa: How the Compact with Africa pushes Africa towards its next debt crisis

With its Compact with Africa the German G20 presidency is actively promoting private loans and investment as solutions to infrastructure deficiencies on the African continent. The Compact aims at using public resources in order to improve the investment climate and mobilize private capital to finance investment critical to achieving sustainable development.

The need to invest in infrastructure is very much consensus among all parties concerned with African development. There is also broad consensus that conditions to actually implement development efforts need to improve. However, the discussion about potential risks of such an investment initiative is limited to the risks for the investors and therefore only the improvement of investment conditions in African countries are discussed, so that (institutional) investors from industrial countries feel save to invest. There is no discussion about the risks to the debt sustainability of receiving countries. The German G20 presidency entirely ignores that rising debt levels are the inevitable downside of any loan push into the Global South.

This is, although the initiative comes in a context of an already deteriorating global debt situation. Since the global financial crisis, there has been a steady rise in debt levels in African countries. The debt sustainability assessments of the IMF show that currently, out of 37 African low-income countries, only 6 have a low risk of debt distress. 19 will get into trouble if external shocks materialize. 9 countries are classified as having a high risk of debt distress, three countries already are in debt distress. Research by Jubilee Germany shows that the debt situation deteriorated heavily between 2014 and 2015 and that currently, 43 countries in Africa have debt indicators above critical thresholds.

In such a situation, promoting a massive expansion of commercial borrowing is only responsible if reliable resolution mechanisms for debt distress situations are in place. Historical data prove that capital boom episodes are often followed by a wave of sovereign debt crises, especially in developing countries. According to Reinhart, Reinhart and Trebesch, all the major spikes in sovereign defaults in the last 200 years “came in the heels of surges in capital inflows, especially those followed by ‘double busts’ in capital and commodity markets”.

The last such default wave, often called the “Third World Debt Crisis”, took place in the 1980ies and 1990ies. The crisis was preceded by massive capital exports in the form of commercial bank lending to developing countries, a reaction to the investment plight caused by a low-interest environment in the Western economies. However, debt crises soon followed as the global economic environment changed and international interest rates rose, commodity prices collapsed and capital flows

reversed. Due to a lack of mechanisms that could provide for timely, orderly and effective debt restructurings, it took more than 20 years to resolve the crisis, in many cases with catastrophic economic and social costs.

Given this historical evidence and past experiences of protracted and costly crisis resolution, the Compact with Africa should only be promoted if the downside of resource mobilisation will be as much considered as the positive side. This means that countries that are hit by debt crises need to be able to receive timely and effective debt relief.

In March 2017, the G20 finance ministers adopted the position that for restoring long-term debt sustainability, it is important that debt restructurings are “conducted in good faith in a timely, orderly and effective manner, facilitating appropriate burden-sharing”\(^2\). Present debt relief schemes are neither timely, nor orderly, nor do they facilitate appropriate burden-sharing, which is why debt restructurings were and still are in many cases ineffective. As a consequence, it is imperative that the discussion in the context of the Compact with Africa includes how to improve the current debt crisis resolution architecture.

However, such discussions are entirely missing. In the Compact with Africa, the term “debt sustainability” only appears in relation to a better IMF monitoring of potential debt distress risks. While a more thorough monitoring makes sense, this does not mean that an eventual crisis can be better resolved. In the past, even when the IMF criticized individual investments or pointed to broader debt sustainability risks, this usually neither had substantial influence on the respective borrowing or lending decision, nor did the IMF manage to create a more timely and efficient debt crisis resolution framework.

This means that besides better risk monitoring, it is absolutely essential that the G20 promote the establishment of a fair and comprehensive sovereign debt workout mechanism if the Compact is not to become the starting point of the next African debt crisis.

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