An Inside-Out Perspective: Impact of Non-Paris Club Countries' Lending on Selected African Countries

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Balancing the Financing Needs to Achieve SDGs for African Countries and the Fiscal and Debt Sustainability

アフリカにおけるSDGs達成に向けた資金ニーズの充足と財政・債務持続性の確保

MOTIVATION

- MDRI, HIPC initiative & associated macroeconomic adjustment process led to faster growth and opened up space for sub-Saharan African (SSA) countries to acquire additional public debt
- Infrastructure gaps, new access to capital markets & increased bilateral cooperation enabled them to implement expansionary fiscal policies
- In resource-based countries, this was compounded by their slow reaction and adjustment to the 2014 deterioration in terms-of-trade
- These policies have resulted in growing public debts (especially external) and thus to debt sustainability concerns (including in 5 of 6 countries studied)
- Debt relief mechanisms like the Paris Club are unlikely to help deal with these problems, as many emerging bilateral lenders are not members

MOTIVATION

- Debt is most linked to SDG #9 (infrastructure)
  - Other SDGs funded mainly by domestic fiscal allocations
- Focus on lending by non-Paris Club (NPC) creditors
  - These creditors don't coordinate debt relief activities with legacy bilateral lenders under the Paris Club framework
- This study:
  - Provides inside-out reviews of NPC lending for all infrastructure sectors in Cameroon, Djibouti, Ethiopia, Ghana, Kenya and Zambia
  - Offers deeper analysis of one NPC-financed infrastructure project in each country
  - Assesses the fiscal/debt effects of NPC lending for these countries
  - Draws policy implications from these findings

COUNTRY REVIEWS: FINDINGS AND CONCLUSIONS

- Following HIPC and MDRI, access to NPC lending and capital markets enabled SSA countries to embark on very expansionary fiscal policies, which have given rise to debt sustainability concerns
- Debt financing of large infrastructure projects initially raised growth but over time contributed to large macroeconomic imbalances, lower growth and debt overhang
- Lack of transparency and non-adherence to best practices in project selection and execution may have given rise to overpricing, environmental damage, allegations of corruption, rumors of repossession clauses
  - As in the case of the power plant in Zambia, NPC-financed projects co-financed with multilateral institutions largely adhered to best practice
- Lack of ex-ante project appraisal/selection procedures may have given rise to unproductive projects and consequent debt repayment challenges.

EFFECTS OF PROJECTS

- **Macroeconomics and growth**: projects initially raised growth, but over time contributed to large macroeconomic imbalances, lower growth and debt overhang
  - Evidence of a relationship between public investment and economic growth is mixed (i.e. Zambia's declining growth rate despite large investments)
  - This shows that for rising or sustained growth, infrastructure investments need to be supported by increased productivity induced by sound macroeconomic and structural policies
- **Fiscal policy and public debt**: large budget deficits in all six countries due to public investment and infrastructure projects, weak revenue mobilization, growing debt service
- Need to ensure net real rate of return on a project exceeds debt service (at least interest); project financing should reflect the net returns of each project

LESSONS LEARNED

- Well-formulated sector strategies (incl. sector policies) can help raise standards across all projects
- Countries should give priority to preparation of detailed feasibility studies with high standards & input from development partners
- Transparency in procurement and data sharing can improve public confidence in project agreements
- Pairing NPC and PC/MDB financing leads to higher project standards

ADDITIONAL ISSUES RAISED IN COUNTRY REVIEWS

- **Governance**: lack of structures to assess, prioritize projects; shortcomings in project identification, feasibility studies, M&E
- **Local employment**: Chinese companies often prefer Chinese workers to locals, despite reportedly similar qualifications in some cases
  - When locals are hired, their wages are very low
- **Knowledge transfer**: limited; projects are carried out almost to the exclusion of local workers/firms
- **Environment**: mining runoff, deforestation, water pollution, loss of agricultural land
- **Local communities**: conflicts caused by poor consultation and follow-through
- **Speculation on guarantees**: lack of transparency fuels concern that China could repossess assets in case of default (Kenya, Zambia)

G20 PRINCIPLES FOR QUALITY INFRASTRUCTURE INVESTMENT

- 6.1: “Openness and transparency of procurement should be secured to ensure that infrastructure projects are value for money, safe and effective and so that investment is not diverted from its intended use.”
- 6.2: “Well-designed and well-functioning governance institutions should be in place to assess financial sustainability of individual projects and prioritize among potential infrastructure projects subject to available overall financing.”
- G20 members should help SSA partners achieve these principles through:
  - Capacity building, training, scholarships; and
  - Voluntarily incorporating the principles into their own work with SSA economies

IMPROVEMENTS ANNOUNCED BY THE CHINESE AT THE 2ND BRI SUMMIT, 2019

- China will:
  - Conduct and take into account the results of debt sustainability analyses (DSA) in its future lending decisions and encourage recipient countries to publish the results
  - Ensure economic/financial viability of future BRI projects through rigorous due diligence
  - Ensure that BRI projects are environmentally and socially sustainable
  - Increase consultations with local communities to ensure they benefit from BRI projects
  - Share more project information and not tolerate any corruption in BRI projects
  - Partner with IFIs to multilateralize the BRI
  - Encourage its companies and banks to co-finance projects with IFIs and the international private sector
- These improvements should help allay the problems and concerns raised by the study

RECOMMENDATIONS

- Leverage Chinese FDI flows and project financing to diversify local economies
- Rein in the pace of debt accumulation and bring down risk of debt distress
- Assess the macroeconomic and debt implications of large infrastructure projects
- Align projects with national strategies and priorities; implement a system for project appraisals prior to project selection
- Improve information sharing and dissemination and enhance transparency
- Develop a formal code of conduct for business and a guide to doing business in the country

ATTAINMENT OF THE SUSTAINABLE DEVELOPMENT GOALS

- Focus on infrastructure and other policy priorities may have limited resources for other SDGs in SSA
  - Need for careful balancing of allocation of limited fiscal resources to various SDGs
- Growing public debts and debt sustainability concerns will require fiscal adjustment in some countries
  - This will require cutbacks in infrastructure investment
  - Adjustment will take place in a challenging global environment with heavy downside risks to growth
- Fiscal adjustment will open space to invest in attaining the SDGs, though little time left to mobilize resources
  - Considerable grant assistance from traditional donors & NPCs, as well as private sector involvement will be needed

ANNEX: ANALYSES OF NPC-FINANCED PROJECTS

SELECTION OF NPC-FINANCED PROJECTS

- Nairobi-Mombasa SGR & Addis Ababa-Djibouti Railway
  - Selected at the recommendation of JICA
  - These projects showcase Chinese infrastructure lending and contracting practices without multilateral participation
- Criteria for selecting other projects:
  - Financial involvement of NPC creditors other than China
  - Large infrastructure projects completed relatively recently
  - Possible to analyze their fiscal implications post-completion

BASIC FACTS

Nairobi-Mombasa SGR (Kenya)

- 472km, operational since 2017
- Cost: US$3.3 bn.
  - US$2.9 bn. loan from China EXIM to GoK
  - GoK to pay 10% of total project cost
  - GoK to pay for land acquisition
- 120km Nairobi-Naivasha extension:
  - Estimated 90% complete
  - Cost: US$1.5 bn.
- Naivasha-Kisumu extension stopped due to financial viability concerns

Addis Ababa-Djibouti Railway (Ethiopia/Djibouti)

- 718km (91% in Ethiopia), operational since 2018
  - 2 freight trains daily in each direction
  - 1 passenger train every other day
- Cost: US$4.5 bn.
  - Ethiopian section: US$3.4 bn., 70% from China EXIM loan, 30% from Ethiopian Government
  - US$878 mn. contributed by Government of Djibouti
- Chinese construction contractors will operate & train local staff until 2024
  - Local staff will take over at that point

Itezhi Tezhi Power Project (Zambia)

- Commissioned in 2016, operating at 94% capacity
- Owned by Tata Africa (50%) & ZESCO (50%), Zambia's state energy company
- Cost: US$240 mn.
- Debt: 70% of financing
  - Four US$34.57 mn. loans from AfDB, DBSA, FMO, PROPARCO
  - US$29 mn. India EXIM loan on-lent to SPV; tied to 85% Indian equipment
- Equity: 30% of financing
  - Evenly split between TATA & ZESCO
- Project positively appraised by AfDB

POSITIVE ACHIEVEMENTS

Nairobi-Mombasa SGR

- Started operations almost 3 yrs. ahead of target in feasibility study
- Supply of trains & equipment achieved ahead of schedule
- Had capacity to handle 20 trains daily in each direction by June 2019
- Punctuality estimated at 98%

Addis Ababa-Djibouti Railway

- 1st fully electrified cross-border railway in Africa
- Cuts journey time from 2 days by road to 13 hours
- Chinese contractors built 400+ km of roads for underserved villages near rail line
- Chinese contractors also dug 19 wells, established 20+ water distribution sites for local villages

Itezhi Tezhi Power Project

- Financing procedures resembled Paris Club standards
- Despite India EXIM's tied financing, procurement process was competitive
- Environmental/social impact assessment & public consultations carried out

COMPARATIVE ASSESSMENT

	Nairobi-Mombasa SGR	Addis Ababa-Djibouti Railway	Itezhi Tezhi Power Project
Tied financing?	✓	✓	✓
Multilateral involvement?	✖	✖	AfDB, DBSA, FMO, PROPARCO
Private sector involvement?	✖	✖	✓
Competitive procurement?	✖	✖	✓
Transparency?	✖	✖	✓