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MANAGING AFRICA'S RISING DEBT: TIME FOR A MULTI-PRONGED APPROACH

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EXECUTIVE SUMMARY

Debt sustainability in Africa has emerged as a key concern among policymakers and development finance institutions (DFIs). Currently, 19 out of 54 countries in Africa exceed the 60% debt-to-gross domestic product (GDP) threshold prescribed by the African Monetary Co-operation Programme (AMCP) and 24 countries have surpassed the 55% debt-to-GDP ratio suggested by the International Monetary Fund (IMF).[2] Of concern is the changing structure of Africa's debt: countries are tilting towards non-concessional and domestic debt with higher interest rates. Governments' ease of access to and control over the domestic debt market is leading to excessive public debt accumulation and macroeconomic instability.[3] Aside from the high interest rate and debt-servicing burden, excessive domestic debt also stifles credit to the private sector, the main engine of growth and job creation.

This policy briefing analyses the drivers of Africa's debt, and evaluates debt sustainability levels and current debt management strategies amid the changing structure of debt in Africa. It concludes that better debt management approaches focused on enhancing macro-economic stability, combined with stronger support by international DFIs, can improve debt sustainability in the region.

INTRODUCTION

The IMF's 'Regional Economic Outlook for Sub-Saharan Africa 2018' warned that 'the median level of public debt in Sub-Saharan Africa at the end of 2017 exceeded 50% of GDP'.[4] While 24 countries have exceeded the IMF debt-to-GDP threshold, at which additional debt leads to output volatility or weak economic growth, of the 16 countries in this group facing a high risk of debt distress, only two have the capacity to pay it off. The debt increase has raised concerns among bilateral creditors and international financial institutions (IFIs), as several countries continue to take on more debt to manage debt burdens and poor macroeconomic conditions. This is taking place on the back of two prominent debt relief initiatives, the Heavily Indebted Poor Country (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), which offered $99 billion in debt relief, addressing about 40% of Africa's total public debt.

Several factors are driving Africa's rising debt, including deteriorating macroeconomic conditions and rising fiscal deficits on the back of poor growth, exchange rate volatility, adverse climatic conditions, political instability (in some countries) and the 2014 commodity price shock. Over the last decade, the structure of Africa's debt profile has also changed considerably. There has been a shift to market-based loans and a decline in concessional loans as a share of external loans from 66% in 2005 to 54% in 2016.[5]

While the current debt situation cannot be compared with the 116% debt-to-gross national income ratio of 1995, the rapid accumulation of debt is raising concerns that Africa is heading towards an unsustainable debt scenario.

WHY IS AFRICA'S DEBT RISING?

To uncover the drivers of debt, this policy briefing dissected the evolution of the key components of debt. A change in the debt equation can be written as:

$$\Delta\frac{D}{Y} = \frac{P}{Y} + (r - g)\frac{D}{Y}$$

where D/Y = ratio of past debt to GDP; P/Y = ratio of primary deficit to GDP; r = real interest rate; and g = growth rate of real GDP.[6]

Over the past decade, most indicators have moved in a direction that has increased Africa's debt. For instance, deficit financing (P) increased significantly following the 2007/2008 global financial crisis. Between 2004 and 2008 the overall fiscal balance as a share of GDP in sub-Saharan Africa stood at 0.4%, declining severely to -5.6% in 2009 and remaining in negative territory following the financial crisis, reaching -5.5% in 2016. In broad terms, the 2014 commodity price shock, low global demand and underlying structural defects in African economies have cumulatively contributed to the low earning position of governments. In addition, some countries have accessed international capital markets to finance infrastructure investment as a countercyclical fiscal measure to compensate for the fall in private sector spending.[7] The interest rate (r) has not had a significant impact on the change in debt during the period under consideration. While domestic interest rates are relatively high, their impact on debt has been insignificant, as only a few African countries (such as South Africa, Nigeria, Uganda and Ghana) have developed debt markets capable of absorbing large transactions.

Over this period, the continent also experienced tepid economic growth (g), which adversely affected debt levels. Sub-Saharan Africa's real GDP growth declined from 5.3% in 2013 to 2.8% in 2016. Declining revenues due to low growth have affected the debt-servicing capacity of several countries. As a result, the fiscal fragility of countries has worsened, with a higher share of the budget going to debt-servicing payments.

HOW MANY COUNTRIES ARE ABLE TO PAY OFF THEIR DEBT?

The IMF's debt sustainability framework (see Table 1), which uses the World Bank's (WB) Country Policy and Institutional Assessment (CPIA) score in addition to a set of threshold levels for selected debt burden indicators, enables an assessment of the debt-carrying capacity of individual countries and their ability to service their debt.[8] The results show that only eight African countries are at low risk of debt distress. These countries fall within the strong and medium CPIA. Nonetheless, Uganda, Tanzania, Kenya and Senegal have breached their debt service-to-revenue thresholds[9] (undermining their capacity to pay off debts). It is likely that they may enter into medium debt risk if non-concessional debt refinancing becomes the preferred option. Of the 21 countries that are at moderate risk of debt distress, Togo, Guinea, Madagascar, Benin, Nigeria, Niger, Burkina Faso and Tunisia have breached their debt service-to-revenue thresholds. Togo, Guinea and Madagascar are likely to slip into high risk of debt distress owing to their weak policies and institutions. Furthermore, the Central African Republic, Angola, Burundi, Djibouti, São Tomé and Príncipe, Cameroon, Zambia, Mauritania, Ethiopia, Ghana and Cabo Verde are at high risk of debt distress. In fact, of these countries, only Djibouti and São Tomé and Príncipe (despite their weak policies) have the capacity to pay off their debt, owing to the higher portion of concessional debt in their total debt portfolios.

More worrisome, Sudan, The Gambia, Mozambique, Chad and Zimbabwe have surpassed all debt sustainability thresholds and are experiencing debt distress. Sudan's debt distress (with a total public debt

TABLE 1 DEBT SUSTAINABILITY INDICATORS AT A GLANCE

SN	COUNTRIES	QUALITY OF POLICIES & INSTITUTIONS	PV DEBT/GDP 2017	PV OF EXTERNAL DEBT TO EXPORT	DEPT SERVICE TO EXPORT	DEBT SERVICE TO REVENUE	SOVEREIGN RATINGS 2018			CAPACITY TO PAY OFF	RISK OF DEBT DISTRESS
							MOODY'S RATING (+)	S&P RATINGS (+)	FITCH RATINGS (+)		
1	Angola	Weak	65.3	103.3934	26.5	42.84	B3	B-	B	Low	High
2	Benin	Medium	54.6	88.1	5.1	19.40		NR	B	Low	Moderate
3	Burkina Faso	Medium	38.3	NA	4.39	30.8		B		Low	Moderate
4	Burundi	Weak	56.7	186.034	16.73	19.3				Low	High
5	Cape Verde	Medium	126	140	10	30.8		B	B	Low	High
6	Cameroon	Weak	33.8	77	6.2	15.8		B	B	Low	High
7	Central African Republic	Weak	53.4	120	9.3	21,8				Low	High
8	Chad	Weak	52.5	89	NA	54.4				Low	In distress
9	Dem Rep of Congo	Weak	23.1	111	1.5	4.7		CCC+		High	Moderate
10	Congo Brazzaville	Weak	119.1	43	NA	9.6		CCC+	CC	High	Moderate
11	Cote d'Ivoire	Medium	46.4	84	6.3	12.9			B+	High	Moderate
12	Djibouti	Weak	30.6	235	7.14	13.4				High	High
13	Egypt	Strong	103.3	206.4	18.94	NA	B3	B-	B	NA	Moderate
14	Equatorial Guinea	Weak	42.7	20.7	NA	NA				NA	Moderate
15	Eritrea	Weak	131.2	NA	NA	NA				NA	Moderate
16	Ethiopia	Medium	56.2	272	21.01	20.7			B	Low	High
17	Gabon	Medium	61.1	98.4	1.4	2.95		NR	B	High	Low
18	Gambia, The	Weak	123.2	181.2	15.17	50.2			CCC	Low	In distress
19	Ghana	Medium	71.8	120	10.49	76.5		B-	B	Low	High
20	Guinea	Weak	39.7	54.9	3.6	26.3				Low	Moderate
21	Guinea-Bissau	Weak	42	26	2.57	11.9				High	Moderate
22	Kenya	Strong	55.6	137	10.62	32.8		B+	B+	Low	Low
23	Lesotho	Medium	34.7	NA	4.19	5.8				High	Low
24	Liberia	Weak	34.4	77	2.94	3.1				High	Moderate
25	Madagascar	Weak	37.3	52	3.66	27.6				Low	Moderate
26	Malawi	Weak	59.3	72	5.03	NA			B-	NA	Moderate
27	Mali	Medium	35.6	67	4.23	10.5			B-	High	Moderate
28	Mauritania	Medium	91.1	181	13.16	23.3				Low	High
29	Mauritius	Strong	60.2	49.9	18.21	NA	Baa1			NA	Moderate
30	Morocco	Strong	64.4	NA	10.87	0.013	Ba1	BBB-	BBB-	High	Moderate
31	Mozambique	Weak	102.2	171	12.65	28.8	Caa3	SD	RD	Low	In distress
32	Namibia	Strong	46.1	161.5	NA	NA	Ba1		BB+	NA	Moderate
33	Nigeria	Medium	16.3	46.5	2.2	44.9		B	B+	Low	Moderate
34	Niger	Medium	37.4	298.8	6.34	40.8				Low	Moderate
35	Rwanda	Strong	34.6	153.8	8.29	7.9		B	B+	High	Low
36	Senegal	Strong	52.8	63.3	10.49	32.6	Ba3	B+		Low	Low
37	Sierra Leone	Weak	35.3	125	6.65	13.9				High	Moderate
38	South Africa	Strong	52.7	159.8	13.17	NA	Baa3	BB	BB+	NA	Low
39	Sudan	Weak	126	1538	33.5	43.7				Low	In distress
40	São Tomé and Príncipe	Weak	83.3	115	2.99	6.6				High	High
41	Tanzania	Medium	38.2	88	5.4	22.2				Low	Low
42	Togo	Weak	78.6	51	3.2	85.9				Low	Moderate
43	Tunisia	Strong	71.3	NA	10.7	24.82	B2	NR	B+	Low	Moderate
44	Uganda	Medium	39	85	18.8	39.6		B	B+	Low	Low
45	Zambia	Medium	62.2	105	8.6	26.6		B	B	Low	High
46	Zimbabwe	Weak	78.4	175	13.4	9.2				Low	In distress

Note: PV debt/GDP, PV of external debt to export, Debt service to export and debt service to revenue that breached their thresholds are in red, while those within thresholds are in green.

Source: Authors based on data from World Bank World Development Indicators, 2018; International Monetary Fund Country Economies Sovereign Ratings list, 2017; World Bank Group Open Knowledge Repository, CPIA Africa, July 2018: Assessing Africa's Policies and Institutions.

of over 116% of GDP) results from fiscal and external imbalances because of political unrest, South Sudan's secession, sanctions, weakened oil revenues, exchange rate depreciation and rising prices. Mozambique's debt distress stems from weaker commodity prices, limited control over borrowing by state-owned enterprises and real exchange rate depreciation. In the case of The Gambia, the country has slipped from a moderate to a weak policy CPIA performer, narrowing its sustainability thresholds following collapsed agricultural output, foreign exchange scarcity and macroeconomic instability. Zimbabwe's distress results from fast-rising domestic debt owing to increased external arrears, limited access to external resources and large fiscal deficits. Of the five countries, only Chad, with ongoing debt restructuring and HIPC debt relief, is on its way out of distress – if it can sustain this path.[10]

Overall, the results show a rising debt burden in Africa, especially in weak and medium CPIAs. Only 11 countries have high capacity to pay off accumulated debt and are still within low or moderate debt stress levels. Countries in debt distress or with a high risk of debt distress spend a significant portion of their yearly government budget on recurring expenditure and have more non-concessional debt. Because of the limited external sources available to these countries, many turn to the domestic market, thereby also increasing the chances of crowding out investors in the credit market and fuelling inflation.

HOW ARE COUNTRIES COPING WITH RISING DEBT?

For DFIs it is important to note that the graduation of several African countries away from low-income to middle-income status has supported the drive towards alternative financing instruments, given the constrained access to concessional loans.[11]

One of the core debt management strategies employed by countries is to increase the maturity of their debt profile by issuing long-term bonds in the international capital market. In recent times, Kenya, Côte d'Ivoire, Egypt, Morocco, South Africa and Nigeria have issued Eurobonds at the long end of the maturity spectrum, typically 30 years. In addition, countries with fairly developed debt markets such as Kenya and Nigeria are also issuing longer-term bonds in their domestic debt market. The Nigerian Debt Management Office, for instance, issued its maiden 20-year instrument at the beginning of 2018. The expected outcome of this strategy is that the capital projects for which the debt has been issued will eventually contribute significantly towards debt servicing and debt sustainability. This approach has several advantages, including reducing roll-overs, interest rates, refinancing and cost-of-debt servicing risks.

Switching from domestic to external borrowing is another debt management strategy being deployed by debt management agencies. With external creditors offering a relatively lower interest rate and few domestic markets capable of offering the scale of development financing required, countries are turning to external financing. The number of external bond issuances has accelerated as countries such as Kenya, Nigeria, Senegal, Ghana, Côte d'Ivoire, South Africa and Egypt turn to external financing. The expected outcome of this strategy is to mitigate the crowding out of the private sector and circumvent high domestic interest rates. However, this increases exposure to foreign exchange rate volatility.

Furthermore, countries are introducing novel products to capture a wider and more diverse set of investors with a view to ensuring a sustainable debt portfolio. Inflation-linked bonds, which are indexed to inflation, have recently been issued in Zambia, Namibia and South Africa. Since the principal interest on these bonds follows the inflation rate, investors are protected from inflation volatility. Nigeria has issued diaspora bonds for international investors and also plans to list its first green bond in 2018 for environmentally friendly projects. Issuing new products is expected to boost financial inclusion and deepen domestic debt markets. In addition, de-risking loans through currency conversion flexibilities and allowing countries to fix, unfix and re-fix the base interest rate is another debt management strategy that has been deployed.

WHAT ELSE ARE COUNTRIES DOING TO IMPROVE THEIR FISCAL POSITIONS?

Some actors, such as multilateral development banks (MDBs) and especially the African Development Bank, refrain from extending grant and other budget support facilities to countries with weak fiscal positions to counter unsustainable debt accumulation. This is prompting African countries to explore debt management strategies other than the traditional modalities offered by multilateral lenders. These include strategies that target the underlying causes of accelerated borrowing in Africa. For instance, weak domestic revenue capacity is a major reason most countries rely on deficit financing for development. With huge development and infrastructural gaps in Africa, it is crucial to strengthen domestic capacity to ensure repayment and diversity of financing options, prompting several countries to concentrate on improving tax revenues. The most recent estimate of the average tax revenue-to-GDP (excluding resource royalties) ratio in Africa – about 15% – is far below the 25% benchmark required to finance development.[12]

To address this problem, tax reforms have been implemented in many countries. Value added tax and voluntary tax compliance schemes have been introduced in Nigeria and Rwanda to increase the tax base. Eliminating loopholes for tax avoidance, especially by multinationals, is another important policy intervention prompting Nigeria, recently, to introduce new tax policies geared towards international companies. However, key challenges remain in terms of inefficient tax administration and the lack of implementation of tax and revenue management policies for resource-rich countries.

Formalisation of the economy is another major reform initiative. After Latin America and the Caribbean, sub-Saharan Africa's economy has the largest informal sector, estimated at about 38% of GDP (ranging from 25% in South Africa to about 65% in Nigeria).[13] Policymakers are targeting regulations to incentivise the transition to the formal sector. In 2017, 36 sub-Saharan African countries implemented reforms to improve ease of doing business, the largest number recorded in a single year.[14] In general, reducing informality can directly benefit economic growth by mobilising domestic savings for investment.

Improving the efficiency of government expenditure is another strategy to indirectly enhance debt management. Crucially, one of Africa's biggest challenges remains the mismanagement of scarce development resources. The huge debt incurred in recent years has not yielded the expected development outcomes. Corruption by public officials and the poor prioritisation of resource allocation, as evident in high recurrent expenditure, are major contributory factors to lower development outcomes. Key reforms in this area have targeted debt use. Specifically, borrowing is more directly linked to specific critical projects. Sukuk bonds follow this modality, as do multilateral and bilateral creditors who similarly link borrowed funds to specific projects.

Finally, after the creation of the HIPC and MDRI, a number of African countries strengthened their legal frameworks for debt management, improved debt recording and reporting, and prepared debt management strategies supported by the WB and IMF. In 2008 the WB established the Debt Management Facility (DMF) for lower-income countries (LICs), which provides resource tools, technical assistance and debt management training with the goal of formalising debt management operations and building the debt management capacity of LICs.[15] In 2014 the WB partnered with the IMF to launch DMF II, the second phase of the DMF, to build on the achievements of the programme and broaden its reach. Debt management capacities are developed using a demand-driven approach reliant on four resource tools: debt management performance assessment, medium-term debt management strategy, debt management reform plans and domestic debt market development.[16] This work should continue to strengthen the debt management capacities of LICs, especially as a lack of transparency[17] and effective reporting of debt at national and sub-national levels make it difficult to provide guidance on debt sustainability.[18] The presence of multiple actors also makes coordination and uniform reporting difficult, as especially bilateral loans are often linked to development assistance and trade.

CONCLUSION

The rising debt burden across the continent is a clear source of concern for local authorities, creditors and the wider international community. It is particularly worrisome considering that, in the past, the rapid accumulation of debt by African countries resulted in a debt crisis that required extensive debt relief initiatives. While the current public debt as a percentage of GDP in sub-Saharan Africa is still relatively low, the trends point to the need for concerted action by countries, lenders and DFIs to counter unsustainable debt in the region. This is critical given the insufficient budgetary resources of African countries to finance the region's vast development agenda.

POLICY RECOMMENDATIONS

To achieve debt sustainability while working towards meeting development goals and achieving macroeconomic stability, African countries should:

1 **Maintain and promote prudent macroeconomic principles to curb and closely manage rising debt-servicing costs.**

Generally, achieving sound economic fundamentals – that is, a stable exchange rate and low inflation – is critical in curbing rising debt-servicing costs, especially for those countries wishing to draw on their domestic debt market. At the same time, governments should prioritise capital expenditure in the productive sector while carefully keeping recurrent expenditure in check.

2 **Promote economic diversification and expand revenue generation to reduce the effect of commodity price shocks on fiscal stability.**

Economic reforms geared towards diversification are key to ensuring debt sustainability in countries that are overly dependent on commodity exports. Historically, commodity exporters are more vulnerable to debt crises owing to the impact of commodity price shocks on local currencies and public revenue. Consequently, expanding the fiscal space by growing a range of revenue sources is necessary to reduce the effect of commodity price shocks on a country's fiscal balance. Countries should support African initiatives such as the newly launched African Continental Free Trade Agreement to facilitate diversification of domestic economies.

3 **Develop and deepen domestic debt markets to curtail the dependence on external loans and avoid exchange rate risks, while carefully managing the structure of debt.**

Exchange rate risks are increasing as developed countries begin to raise interest rates. Accordingly, developing and deepening domestic markets could provide a sound alternative to local authorities, although care should be taken not to crowd out the private sector and a careful assessment should be made of the advantages of external loans through bilateral creditors and DFIs, such as low interest rates and long maturities (especially for LICs).

4 **Explore other domestic financing options, such as expanding the tax base through efficient tax collection, leveraging private sector capital through public–private partner-ships and using various debt instruments.**

Apart from drawing on domestic debt, using other domestic financing options such as expanding the tax base through efficient tax collection and leveraging capital from the private sector through public–private partnerships could widen the sources and scope of financing. Several novel financing options increase the sources and scope of financing and ensures better debt use, such as Sukuk bonds, which are asset-linked to ensure that debt is deployed towards projects that curb corruption and theft.

5 **Establish autonomous, well-resourced and functional debt management offices, enhance debt-recording systems, improve data transparency and invest in debt management and risk strategies.**

African governments should establish autonomous, well-resourced and functional debt management offices that enable optimal borrowing strategies and provide credibility to local bond issuances. Furthermore, as more non-traditional lenders play a dominant role in debt financing, there is a need for a comprehensive debt recording system, regular updating of information on debt, greater data transparency and more robust risk analysis.

6 **Explore the capacity-building and technical assistance offered by MDBs to develop sound debt management institutions.**

Major MDBs already contribute to debt sustainability in African countries through a combination of technical assistance and capacity-building support programmes. These efforts should be continued to support proper debt management strategies in African countries. In addition to assisting African countries in developing domestic debt markets, DFIs should assist governments to monitor the risks that emerge from the changing characteristics of debt, as African countries become increasingly vulnerable to risks such as investment arbitration. This is to avoid debt default owing to the poor use of debt. Finally, MDBs should scale up the volumes of concessional lending to the continent for key social and economic projects (ie, infrastructure, renewable energy, water and transport) that support productive and sustainable economic development and avoid corruption. They should also explore more closely with LICs their reluctance to utilise concessional loans despite the long maturity and low interest rates on offer.

ENDNOTES

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