CHAPTER 7

FISCAL AND PUBLIC DEBT SUSTAINABILITY

Public debt rose in Africa in 2017, reaching 59.1 per cent of GDP. The high and rising debt created debt vulnerabilities for many African countries. About 40 per cent of low-income countries now face debt servicing challenges, and an increasing number of countries are at high risk of debt distress or in debt distress. Five countries are in debt distress today (Chad, Mozambique, South Sudan, Sudan and Zimbabwe) compared with none in 2014.

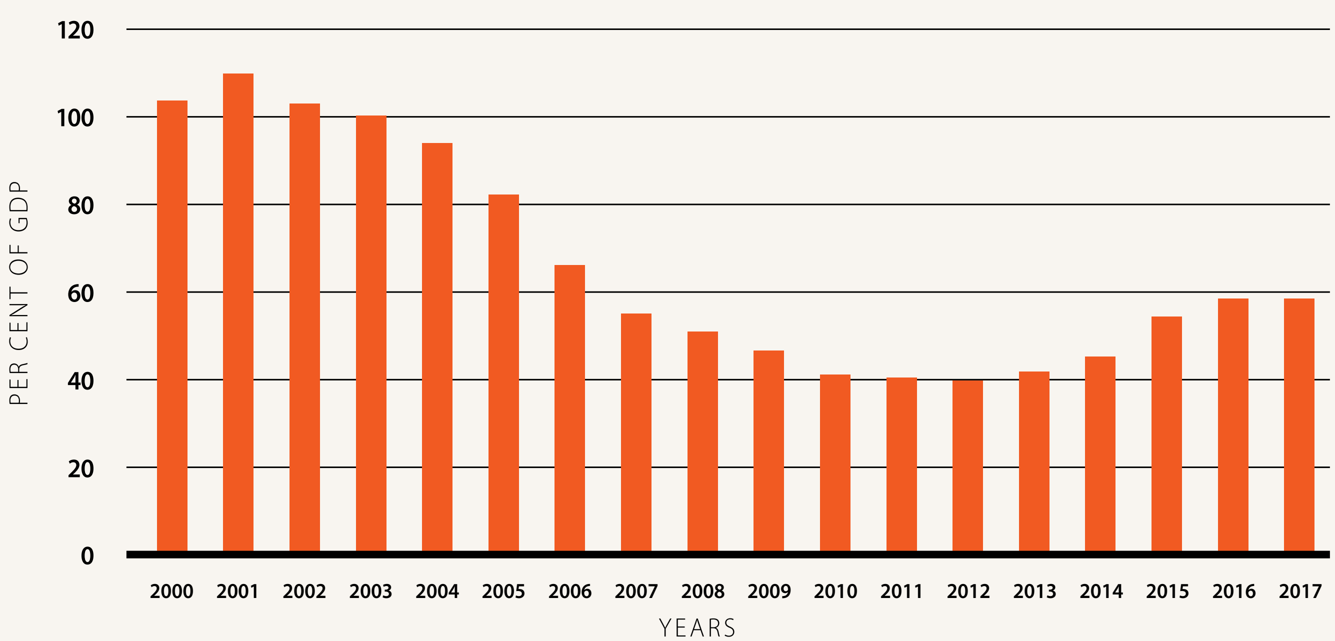
With 16 African countries in debt distress or high risk of debt distress, low government revenue is the most common factor. To ensure debt sustainability, countries need to increase the mobilization of tax and non-tax revenue and deepen the domestic capital market with increased reliance on local currency—denominated loans.

INTRODUCTION

With the slowdown in economic growth and low commodity prices, Africa's fiscal deficit peaked at 11.3 per cent of GDP in 2015 before declining to 5.0 per cent in 2018 (see figure 1.6 in chapter 1). As one of the instruments used by many African countries to partly finance their fiscal deficit, total public debt (general government gross debt) also increased, from 40 per cent of GDP in 2012 to 59 per cent in 2017 (figure 7.1).

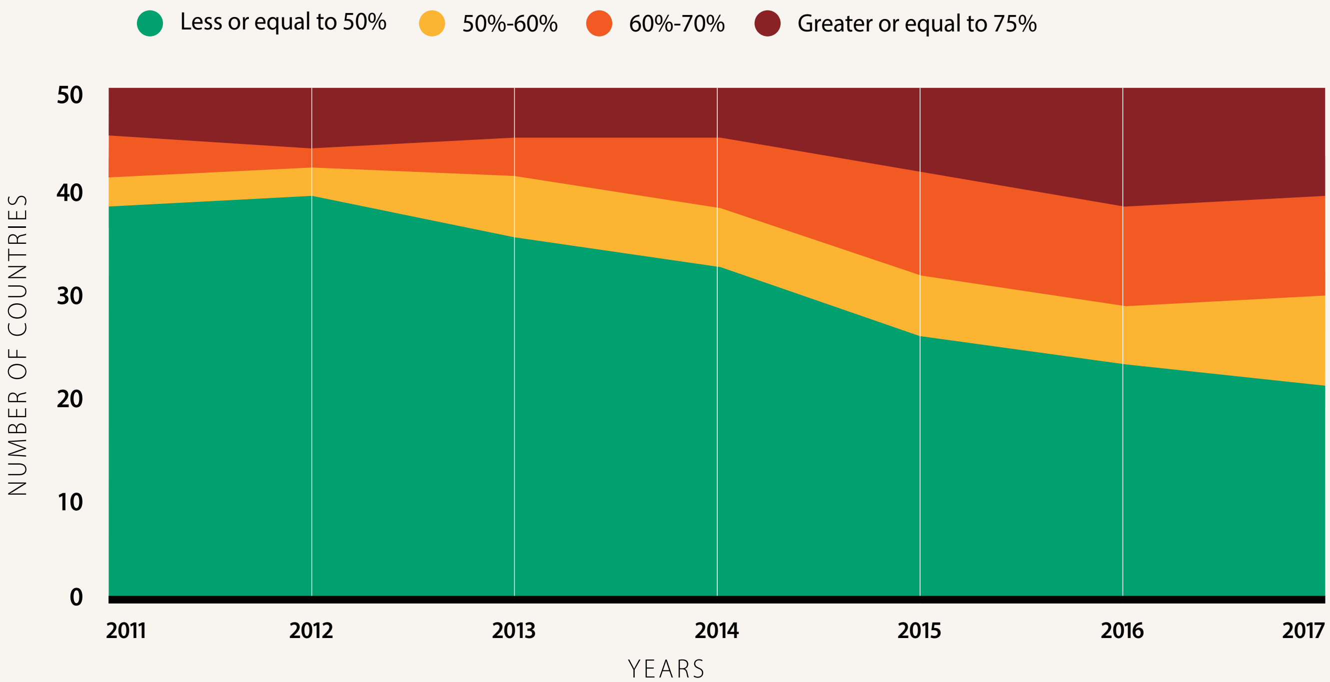
However, Africa's average debt to GDP ratio conceals widely different experiences, in part reflecting different resource endowments. The median public debt increased most noticeably among oil-exporting countries. Public and publicly guaranteed debt soared from an average of just over 20 per cent of GDP in 2011–2013 to 57 per cent in 2017. A similar level of public indebtedness was recorded in non-resource-rich economies with a history of government borrowing.

FIGURE 7.1. GROSS PUBLIC DEBT IN AFRICA, 2000–2017



Source: Based on data from IMF (2018e).

FIGURE 7.2. DEBT TO GDP RATIOS IN AFRICA, 2011–2017



Source: Based on data from IMF (2018e).

Although domestic revenue mobilization has improved in many countries in Africa, government revenue as a share of GDP remains fairly low by international comparisons (see chapter 2). In the run-up to the 2008–2009 global financial and economic crisis, African countries recorded fiscal surpluses, with a peak of 4.2 per cent of GDP in 2006, due partly to the commodity price boom. But as the global financial crisis hit, governments responded with countercyclical fiscal policy measures. As a consequence, Africa's median fiscal balance shifted from a surplus of 0.6 per cent of GDP in 2008 to a deficit of 3.8 per cent in 2009.

The post-crisis countercyclical expansion was financed through a combination of increased revenue collection (especially in resource-rich countries), domestic debt (bond issuances) and external borrowing, which led to a rising public debt burden (discussed in detail below). The fiscal balance deteriorated further after 2013 (reaching its worst level of –8.4 per cent of GDP in 2015), as government spending rose unsupported by similar increases in revenue.

This chapter examines public debt dynamics in African countries and disaggregates external and domestic debt by instrument, creditor and debtor. It discusses the relationship between fiscal policy and debt sustainability, emphasizing the need for increased revenue mobilization and prudent debt policies for African countries to address vulnerability, particularly to debt denominated in foreign currencies.

PUBLIC SECTOR DEBT

The number of countries with a debt ratio of more than 75 per cent of GDP has doubled since 2011, although there are signs that the number is stabilizing (figure 7.2). A much more dramatic increase has occurred in the number of countries with a debt ratio of 60–75 per cent of GDP (from 2 in 2012 to 10 in 2017), while the number of countries whose public debt is less than half of GDP has declined, from just below 40 to 23 The International Monetary Fund (IMF, 2018e) projects public debt across the continent to level out in the coming

Africa's stock of public external debt averaged about $309 billion over 2000–2006 and then rose further to $707 billion in 2017, with a 15.5 per cent increase from 2016 alone.

years and even decrease. Nevertheless, as Songwe (2018) argues, there are many reasons to be worried about African debt. These include potential adverse impacts on growth and job creation.

In 2017 debt rose to the highest levels in Eritrea (131 per cent of GDP), Cabo Verde (126 per cent), Sudan (126 per cent), Gambia (123 per cent), Congo (119 per cent), Egypt (103 per cent) and Mozambique (102 per cent). At the same time, ratios of public debt to GDP have been rising steadily, giving rise to worries about sovereign defaults and fiscal vulnerabilities.

Cabo Verde's high public debt reflects the government's fiscal policy focus since 2005 on expanding the tax base and increasing public investment. These policies reduced the fiscal deficit (from 5.6 per cent in 2015 to 4 per cent in 2017), but domestic resource mobilization fell short of spending targets. Government borrowing increased, aimed at addressing the public expenditure challenges, declining productivity and restructuring of public enterprises, as well as the negative effects of external shocks (including weak economic growth in Europe, which reduced tourism).

In Gambia the main driver of public debt was the adverse effect of bad weather on subsistence rain-fed agriculture, which resulted in higher government spending and a widening budget deficit (reaching a peak of 9.5 per cent in 2016 before settling at 2.5 per cent in 2017). To finance the budget deficit, the government borrowed extensively from the domestic debt market. The high public debt in the other countries (Congo, Egypt, Eritrea, Mozambique and Sudan) resulted largely from fiscal imbalances due to external shocks (declining commodity prices and poor weather conditions).

Public debt has varied by subregion and country. In Central Africa Chad's debt rose from 25.8 per cent of GDP in 2004–2008 to 52.5 per cent in 2017. In East Africa Ethiopia reduced its borrowing from nearly 68 per cent of GDP in 2004–2008 to 37.8 per cent in 2009 before steadily increasing it to 56.2 per cent in 2017 while pioneering financing innovations such as diaspora bonds and bond issues in the Eurobond market (foreign currency bonds registered outside their country of issue; ECA, 2018f). In Kenya public borrowing held steady at just over 40 per cent of GDP through the first decade of the century but then began to rise, reaching 55.6 per cent in 2017.

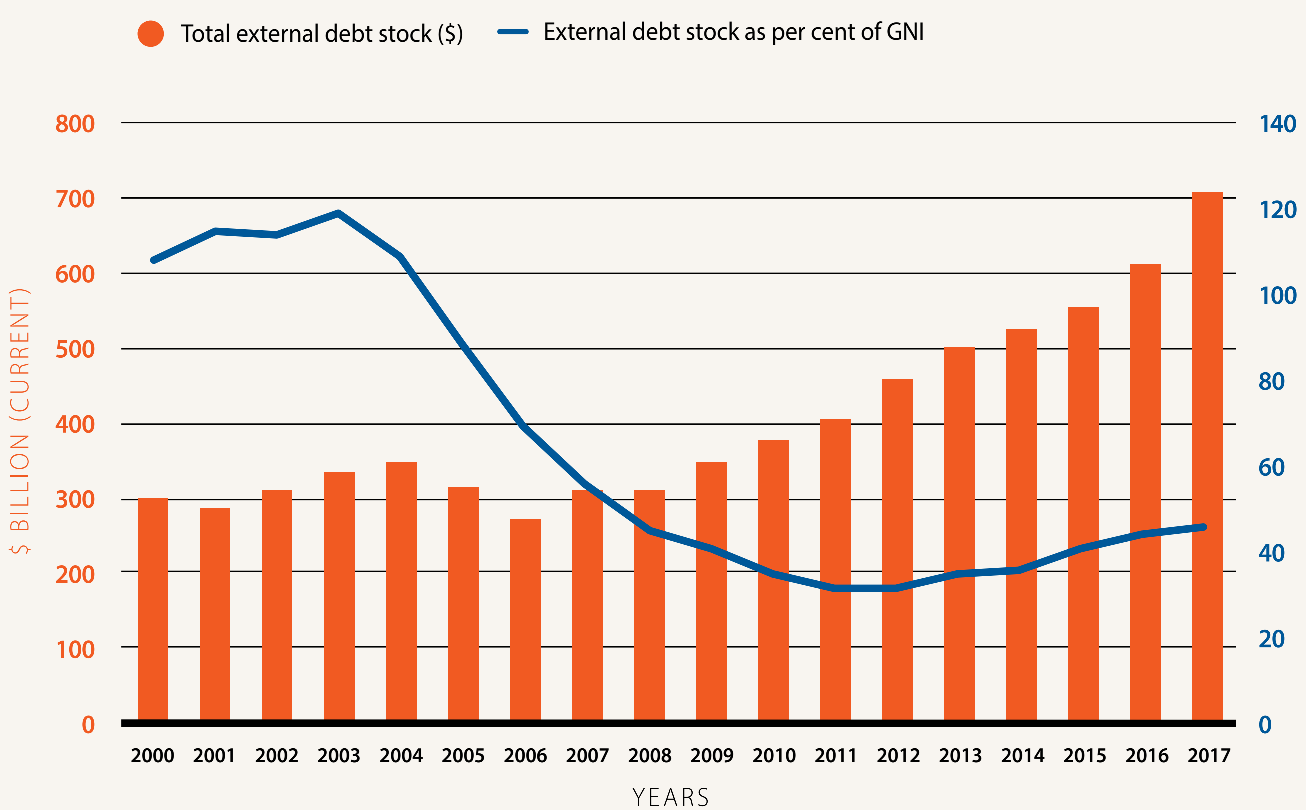
In North Africa, where social spending is still increasing, government debt is expected to continue to rise, at least in the short term. Striking examples include Sudan, where government borrowing exceeded 120 per cent of GDP in 2017, a sharp rise from 77 per cent in 2011–2013, and Egypt, where government borrowing rose from similar levels in 2011–2013 to more than 100 per cent in 2017. In Southern Africa Angola's borrowing rose sharply after 2013, reaching 79.8 per cent of GDP in 2016. Public borrowing in Mauritius rose from 47.3 per cent of GDP in 2004–2008 to more than 60 per cent in 2017. In South Africa public borrowing has been much lower, but also rising, going from 30.5 per cent of GDP in 2004–2008 to 52.7 per cent in 2017. Zimbabwe's borrowing was much higher in 2004–2008, at 51.5 per cent of GDP, and more volatile, with a sharp increase since 2015, rising to 78.4 per cent of GDP in 2017. In West Africa, Benin's public debt exceeded 50 per cent of GDP, while Ghana's borrowing rose even higher, from 39.2 per cent of GDP in 2004–2008 to 71.8 per cent in 2017.

PUBLIC EXTERNAL DEBT

Africa's stock of public external debt averaged about $309 billion over 2000–2006 and then rose further to $707 billion in 2017 (figure 7.3), with a 15.5 per cent increase from 2016 alone. Most of the rise reflects increased external borrowing by middle-income countries, with five of the six largest economies on the continent accounting for more than half of public external borrowing in 2017. South Africa borrowed $176 billion externally, followed by Egypt at $82 billion, Morocco at $49 billion, Nigeria at $40 billion and Angola at $37 billion. The total debt stock was lower in some of the frontier markets than in middle-income countries, but the increase over the past few years was nonetheless considerable. For instance, Ethiopia's external debt stock rose more than 250 per cent, from $7.3 billion in 2010 to $26.5 billion in 2017. Kenya's pace of external debt accumulation was similar, with external debt stocks rising from $8.8 billion in 2010 to $26.4 billion in 2017 (nearly a 200 per cent rise). Ghana's public debt rise was close to 145 per cent between 2010 and 2017 (from $9 billion to $22 billion).

The increase in external debt accumulation raises concerns about debt sustainability in many African countries, especially as external debt stocks have risen much faster than economic growth owing

FIGURE 7.3. TOTAL EXTERNAL DEBT STOCKS IN AFRICA, 2000–2017



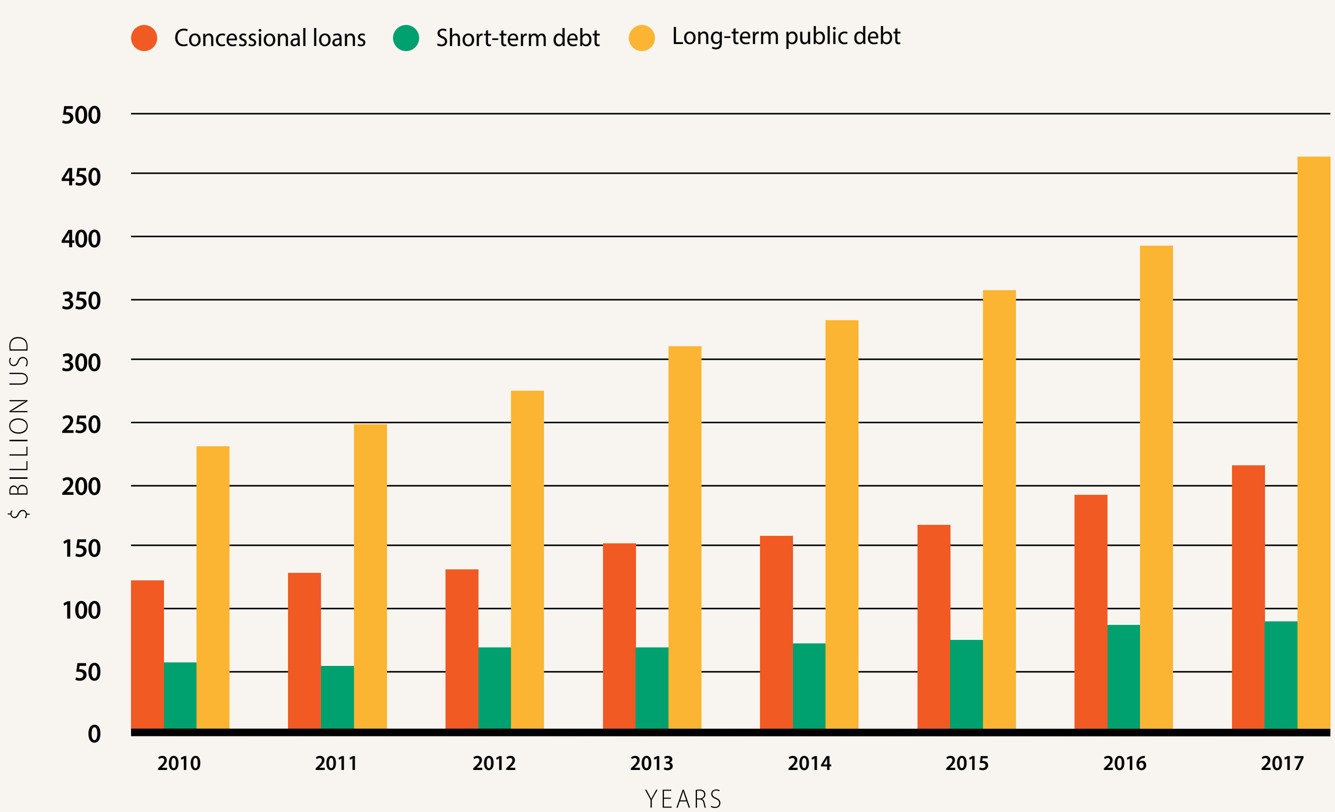
Source: Based on data from World Bank (2019).

to rising interest rates in international capital markets. While the average ratio of external debt to GNI[1] in Africa declined from 119 per cent of GNI in 2003 to 32 per cent in 2012 before rising in 2013 and stabilizing at 46 per cent in 2017, debt ratios are still very high in some countries, mostly low-income economies. Debt ratios in 2017 were high in Djibouti (112 per cent), Mauritius (156 per cent), Mozambique (101 per cent), Mauritania (89 per cent), São Tomé and Príncipe (67 per cent) and Zambia (65 per cent). With the high share of external debt to GNI, debt servicing costs have increased. About a third of African countries had debt servicing costs of more than 10–15 per cent of exports in 2017 (World Bank, 2018), including Côte d'Ivoire, with $2.2 billion in external debt; Ghana, with $2.1 billion; and Kenya and Zambia, both with $1.6 billion; and Ethiopia, with $1.4 billion.

1 Data on the ratio of external debt to GNI were available for all African countries up to 2017 while data on the ratio of external debt to GDP were available for only 14 countries. Thus, the discussion here uses the debt to GNI ratio instead of the debt to GDP ratio.

The changing patterns of external borrowing help to explain Africa's rising external debt. In recent years African countries began to diversity the source and composition of their external debt (figure 7.4). They have increased their share of external borrowing from non-traditional creditors (non-Paris Club official bilateral creditors, foreign and domestic commercial creditors and other financial institutions) and reduced the share of concessional borrowing. Countries have been relying more on non-concessional sources (both bilateral and commercial creditors) and are

FIGURE 7.4. COMPOSITION AND TREND IN AFRICA'S EXTERNAL PUBLIC DEBT, 2010–2017



Note: Concessional debt is debt with an original grant element of 25 per cent or more. Short-term debt is debt with an original maturity of one year or less. Long-term debt is debt with an original or extended maturity of more than one year.

Source: Based on data from World Bank (2019).

increasingly tapping international bond markets. The expansion of non-concessional debt with longer maturity was due partly to enhanced IMF guidelines providing more flexibility in external debt sustainability limits and partly to progress by some countries in developing and deepening their financial sector, enabling them to issue dollar-denominated sovereign bonds in international capital markets.

While most African countries still rely heavily on financing from official bilateral and multilateral creditors (which together account for about 60 per cent of Africa's long-term external debt stock), non-traditional partners are emerging. These include the BRICS[2] countries as well as private creditors, commercial banks and other private entities. The increasing role of China among non-traditional bilateral lenders is especially noteworthy, particularly in external financing for large-scale infrastructure projects.

PUBLIC DOMESTIC DEBT

The recent expansion in domestic borrowing in Africa reflects efforts in middle-income countries such as Egypt, Ghana, Kenya, Morocco, Nigeria and South Africa to develop domestic debt markets to mobilize resources through bond issuance, improve financial sector development and deepen financial markets. Governments introduced securitized instruments (treasury bonds and bills) in the late 1990s and early 2000s to mobilize domestic resources and finance their fiscal deficit in the face of declining external assistance (concessional loans and grants).

In 2017 the stock of international sovereign bonds issued by African governments rose to more than $30 billion, driven mainly by bond issues in South Africa (estimated at $19 billion). Other countries that issued international bonds in 2017 include Nigeria ($4.8 billion), Côte d'Ivoire ($2 billion) and Senegal ($1.1 billion). The rise in bond issuance reflects improved borrowing conditions, increased investor confidence and a search for higher yields in the face of falling yield spreads in advanced economies.

There has also been a rise in local currency–denominated bond issuance, in part driven by the desire of some African governments and public sector entities to develop their domestic bond markets and meet demand from investors for low-volatility government, municipal, corporate and diaspora bonds. The rise has also been due partly to the need to address some of the financial vulnerability linked to foreign currency borrowing. For instance, in 2016 the stock of treasury bonds and treasury bills issued in local currency in Africa totalled close to $220 billion, or about 9 per cent of GDP. Some countries that find it difficult to borrow at long maturities have been issuing medium- to long-term bonds in local currency, with 5–10 year maturities (for example, Mozambique, Niger and Uganda) or tenor of more than 10 years (for example, Benin, Burkina Faso, Kenya, Mali, Tanzania and Zambia).

Domestic bonds are usually oversubscribed. In Nigeria's government bond auction for June 2018, investors' bids reached 66.7 billion naira ($183.4 million), well above the initial offer of 60 billion ($165 million). In Kenya bond trading was 21 per cent higher over the same period in 2018 than in 2017, with a turnover of 232 billion Kenyan shillings ($2.3 billion) in the five months to May 2018.

African governments view local currency bond markets as an effective means to mobilize alternative sources of finance for development, reduce dependence on foreign currency debt and mitigate the risks of external shocks and currency mismatches. However, to ensure sustainable development and the deepening of local currency bond markets, countries must address a range of challenges, such as weak legal, regulatory and institutional frameworks; underdeveloped

2 Brazil, Russian Federation, India, China and South Africa.

secondary markets; illiquid debt instruments; short maturities and a restricted and undifferentiated investor base (DIE, 2015). Thus, countries need to create a sound macroeconomic environment, develop appropriate financial infrastructure, deepen the banking sector and promote trade openness. Moreover, harmonizing the legal and regulatory framework, improving the rule of law and facilitating the cross-listing of bonds on several exchanges will help create scale economies and deepen local currency bond markets.

Many analysts argue that domestic borrowing has advantages over external borrowing as a source of credit for governments. For instance, local currency—denominated loans can be serviced by tax revenue in the same currency, and governments have greater control over the conditions on which they can borrow, including the rate of interest and loan maturity. Moreover, advances to governments in the form of loans or bonds held by commercial banks in their asset portfolios serve as a form of liquid reserve, allowing banks to expand their lending to the private sector.

COSTS OF RISING PUBLIC DEBT

Rising public debt in Africa has led to increased government spending on interest payments. Strikingly, the largest increases have been among non-resource-rich countries, whose governments devoted nearly 10 per cent of total spending to interest payments in 2016, more than double the 4 per cent in 2011. Oil-exporting countries devoted close to 13 per cent of fiscal spending on interest payments in 2008, less than 4 per cent in 2012 as interest rates fell and then nearly 7 per cent in 2015.

A key part of public debt financing is the cost of servicing debt. Servicing domestic debt issued in the local currency is easier than servicing external debt, particularly if debt service payments lead to a rise in private sector incomes and expenditures that may be taxed or are subject to central bank management of interest rates. Servicing external debt, by contrast, imposes pressures on government cash flow. External debt service rose overall, with some disparities among subregions. For instance, in oil-producing countries south of the Sahara, external debt service jumped from 1.2 per cent of GDP in 2011–2013 to 2.2 per cent in 2016 (a 1 percentage point increase) while in North Africa, external debt service was highest but rose 0.3 percentage point, from 2.4 per cent of GDP in 2011–2013 to 2.7 per cent in 2016, reflecting the subregion's greater integration in international financial markets.

The rise in total external debt service reflects increasing external borrowing by the private sector in African countries. As private economic activity stabilized in recent decades, and as African economies became more integrated into international financial markets, use of short-term trade credits expanded (Bonizzi and Toporowski, 2018). A typical example is Mauritania, which stands out for its very high levels of external debt. External trade plays a disproportionately large part in economic activity in Mauritania, a country with rich mineral resources and off-shore gas reserves. Mauritania's external borrowing has exceeded 100 per cent of GDP since 2014. Its public external debt is owed mainly to bilateral and multilateral official lenders, including Kuwaiti development lenders. But the scale of the government's external borrowing has placed Mauritania among countries with a high risk of debt distress (ECA, 2018a). The IMF expects the Mauritanian government to restructure its debt and, with appropriate fiscal management, to reduce the level of its borrowing to 73.2 per cent of GDP by 2019 and to fall below the 56 per cent benchmark from 2020 onward (IMF, 2017b).

Rising public debt in Africa has led to increased government spending on interest payments.

The experience of Ghana, in West Africa, has been different. Its total external debt rose from 19.3 per cent of GDP in 2009 to 42.8 per cent in 2016. Since 2007 the government has tapped the Eurobond market, with an initial issuance of a $750 million Eurobond that matured in 2017. A further $750 million bond was issued in 2013, partly to repay an earlier bond at a lower rate of interest. When the earlier bond matured, Ghana issued new bonds, with assistance from the World Bank, to refinance the outstanding amounts, culminating in a planned $2.5 billion bond, $1.75 billion of which is to be used to refinance earlier borrowing at a lower coupon rate (IMF, 2018d). This refinancing aims to facilitate the management of public external debt in Ghana in the short term (ECA, 2018d).

Within East Africa Ethiopia benefited from write-downs of its government's external borrowing at the turn of the century, lowering total external borrowing to 14.7 per cent of GDP by 2009. Since then the government has borrowed heavily to finance a large infrastructure investment programme, boosting total external borrowing to 37.9 per cent of GDP ($18 billion) in 2015, most of it official debt owed to multilateral agencies. However, at the end of 2014 the government issued a $1 billion Eurobond maturing in 2024 (IMF, 2017b). In Kenya the government managed to bring total external borrowing down to 19.3 per cent of GDP by 2012, assisted by the positive effects of high commodity prices on agricultural commodity exports. Since then, total private and public sector foreign debt crept up to 28.3 per cent in 2017, and it is expected to exceed 30 per cent in 2018. The Kenyan government tapped the Eurobond market, borrowing some $2 billion. However, Kenya has kept external borrowing low by leveraging internal borrowing (ECA, 2018e).

The high and increasing debt levels have resulted in debt vulnerabilities for many countries, with an increasing number of countries falling into high risk of debt distress or into debt distress.

In the Southern African subregion a large financial sector coupled with controls on private sector external borrowing kept total external debt low for South Africa. Nonetheless, as commodity prices fell and economic activity slowed, external borrowing crept up, reaching 18.9 per cent of GDP in 2016. A much larger debtor in Southern Africa is Mozambique. The country benefited from a reduction in its public debt in the early 2000s, and in 2013 the government issued an $850 million Eurobond to support the development of fisheries and liquefied natural gas. Total external borrowing rapidly mounted to 89 per cent of GDP in 2017. The Eurobond issue was refinanced in April 2016, but the government defaulted on a $60 million coupon payment in January 2017. The IMF's latest Debt Sustainability Analysis (as part of its Article IV Consultation) put the Mozambique government's public debt at 112 per cent of GDP in 2017, down from 128 per cent in 2016 (IMF, 2018c).

RISING DEBT DISTRESS

Several factors have made debt servicing by African governments more difficult, including slowing economic growth, deteriorating terms of trade (as commodity prices fell), loosening fiscal policies and re-evaluation of cross-border risks in international financial markets[3]. The high and increasing debt levels have resulted in debt vulnerabilities for

3 Central banks in Europe and North America move away from the loose monetary policies implemented after the 2008 financial crisis many countries, with an increasing number of countries falling into high risk of debt distress or into debt distress. By 2016, 14 African countries were in arrears. In many cases, the problems were political. Governance is the main problem in Sudan and Zimbabwe. Mozambique and Zambia are experiencing more purely financial difficulties for governments that only recently were able to access the Eurobond market.

About 40 per cent of low-income countries in Africa that are eligible to borrow at zero rates of interest from the Poverty Reduction and Growth Trust are now in debt distress or high risk of debt distress (IMF, 2018b). "While the causes of sliding into debt distress are country-specific, most of the countries in debt distress are those in fragile situations or those facing a large shock to the price of their major export commodity" (IMF 2018a: 12).

DEBT DISTRESS AND DOMESTIC RESOURCE MOBILISATION

With 16 African countries in debt distress or high risk of debt distress, low government revenue is the most common factor among them. Mozambique has the highest average government revenue to GDP ratio (23.5 per cent) among this group of countries, which is low compared with developing and emerging economies. Government revenue is below 20 per cent in most countries including Sudan, Chad, Zimbabwe, Ghana, and Ethiopia. Those countries will remain in the debt trap unless something is done to raise revenue through tax reforms, non-tax revenue, enhanced tax administration and reduced tax evasion and avoidance particularly in the natural resources sector. As the earlier chapters indicated, the potential to boost

BOX 7.1. RISK OF DEBT DISTRESS AMONG GOVERNMENTS IN AFRICA, 2014–2018

RISK OF DEFAULT ON DEBT	*2014*	*2017*	*2018*[a]
In debt distress	**0**	**2:** Chad, Gambia	**5:** Chad, Mozambique, South Sudan, Sudan, Zimbabwe
High risk of debt distress	**5:** Burundi, Chad, Comoros, Democratic Republic of Congo, São Tomé and Príncipe	**6:** Burundi, Cameroon, Central African Republic, Ghana, Mauritania, São Tomé and Príncipe	**11:** Burundi, Cameroon, Cabo Verde, Central African Republic, Djibouti, Ethiopia, Gambia, Ghana, Mauritania, São Tomé and Príncipe, Zambia
Moderate risk	**14:** Burkina Faso, Central African Republic, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Malawi, Mali, Mauritania, Mozambique, Niger, Sierra Leone, Togo	**18:** Benin, Burkina Faso, Comoros, Congo, Democratic Republic of Congo, Côte d'Ivoire, Ethiopia, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Mozambique, Niger, Sierra Leone, Togo, Zambia	**14:** Benin, Burkina Faso, Congo, Democratic Republic of Congo, Côte d'Ivoire, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Niger, Sierra Leone, Togo
Low risk	**11:** Benin, Cameroon, Congo, Ethiopia, Liberia, Madagascar, Rwanda, Senegal, Tanzania, Uganda, Zambia	**4:** Rwanda, Senegal, Tanzania, Uganda	**6:** Kenya, Lesotho, Rwanda, Senegal, Tanzania, Uganda

a. Data for 2018 are as of June.

Source: Based on data from IMF (2018b).

government revenue is huge, ranging from 12 to 20 per cent. Such an increase is sufficient to pull the 16 countries out of the debt trap.

To finance infrastructure and promote sustainable development, African countries should continue to borrow from the market to finance their growth (Songwe, 2018). However, noting that about 70 per cent of Africa's external debt is denominated in foreign currencies and that interest rates and debt servicing burden are rising[4] due to tightening financial conditions in global markets, Songwe (2018) argues that African countries should increase borrowing in local currency in both domestic and international markets. This is important for countries to lower exposure and exchange risks. In this regard, prudent macroeconomic policies supported by development and better regulation of local capital markets are essential for countries to attract capital and manage their debt. At the same time, international financial institutions are urged to find means to hedge against exchange risks related to lending in local currency.

CONCLUSIONS AND POLICY RECOMMENDATIONS

The rise in government debt and the vulnerability of fiscal policy in Africa have exposed governments on the margins of solvency to debt difficulties, such as arrears to the IMF and other difficulties servicing debt. African countries are increasingly diversifying their sources of finance to mobilize both domestic and external resources. Today, around a third of African governments have taken advantage of financial markets and low interest rates in Europe and the United States to issue Eurobonds. But these bonds have caused difficulties for some governments as interest rates in developed countries rose. With slower economic growth, little immediate prospect of rising commodity prices and intensifying pressure on government finances, debt difficulties are likely to spread in the near future.

To prevent fiscal and debt positions from deteriorating, African governments need to rebalance their policy framework to maintain stable income and expenditure flows for achieving the Sustainable Development Goals. Countries need to strengthen their capacity (especially human and institutional skills in national public budget agencies) to conduct more effective assessments of risks to public debt sustainability and to public borrowing for long-term development infrastructure projects (the capacity to design bankable projects and ensure cost-effective means of repaying debt).

African governments should finance their deficits in local currency markets by issuing financial obligations with the longest possible maturity. Local currency—denominated debt—has the advantage that it is "hedged" by the government's assets and income in that same currency, in contrast to government assets in foreign currencies, which consist overwhelmingly of their foreign currency reserves.

The deterioration in the finances of African governments and the squeeze on international financial liquidity threaten the fiscal balance and debt sustainability of those governments. To avoid this, governments need to rebalance fiscal policy to maintain government spending while increasing revenue to reduce fiscal deficits without austerity.

4 For example, the nominal value of Ghana's Eurobonds of $750 million in 2007 was $3.4 billion in 2017 (Songwe, 2018).

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