Is Africa Facing a New Debt Crisis?

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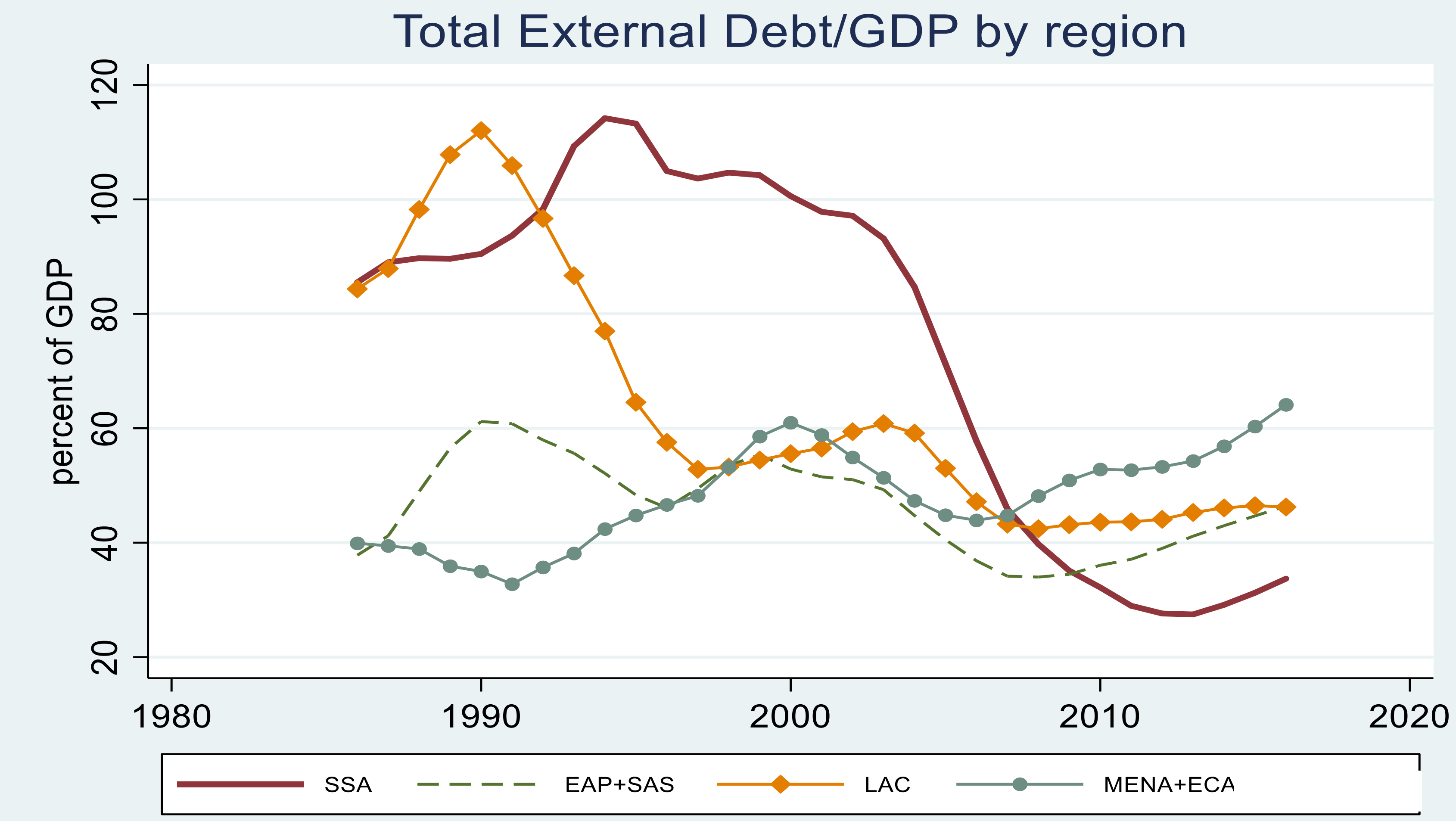
Outline

- Is there a new African debt crisis?   Some Evidence
- Borrowing, investment and growth…and why things go wrong.
- Getting debt under control -- one simple rule
- The new landscape of debt and lessons for economic policy

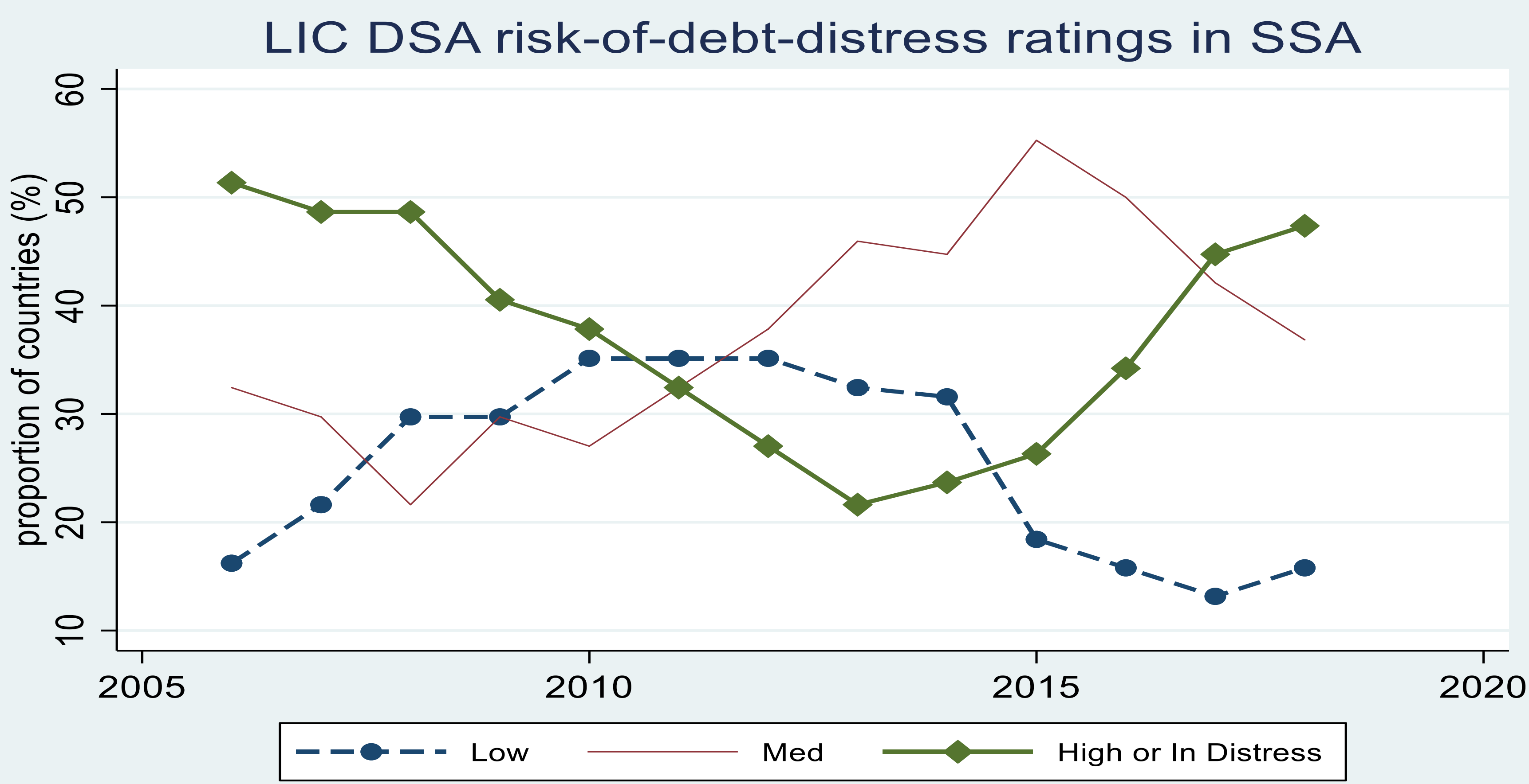
Is there a new African debt crisis? Some Evidence

Following an extended period of falling debt, is SSA returning to a path of rapidly rising external indebtedness?



Source: World Bank, WDI. 3-yr MAs of estimated time effects in unbalanced samples.
The dot shows the average ratio of the present value of debt to GDP in SSA in 2017.

…and behind the aggregates, more countries are classified as either 'in distress' or at high risk of falling into distress



Source: Joint IMF/WB debt sustainability analyses, 38 low-income countries in SSA.
South Sudan enters the sample in 2014.

The evolution of debt distress 2013-2019
EAC 'Six' in red

		2019			
		Low	Medium	High	In Distress
2013	Low	SEN, TZA, UGA	BEN, CONGO, KEN, LIB, MAD, NGA	CAM, ETH,ZAM	
	Medium	RWA	BFA,CDI, GIN,GNB,LES, MWI, MAL, NIG, TOG	CPV, CAR, GHA,MAU, SLE	GAM, MOZ, SSD
	High		COM, DRC	BUR, CHD,DJI, ERT	STP, SDN, ZWE

Borrowing, investment and growth…and why things go wrong.

Why would a government borrow?

"Never a borrower nor a lender be…"

Wise for the household, but not obvious for a nation.

- Public infrastructure designed to boost growth and the trade balance.
- Sums involved are too great to be met solely from taxation.
  - Could be infrastructure projects (standard gauge railway) or 'human capital' (investment in schools and hospitals
- New resource discovery that requires exploratory investment (e.g. offshore gas).
- Change in trade or regional policy that makes investment more lucrative.

So, what could go wrong?
The simple arithmetic of debt

Foreign Debt 'fills the gap' between investment needs and domestic savings

(i) Debt finance the difference between the total cost of **imports** (used in consumption and investment) and all other sources of financing (**exports, aid flows, remittances, reserves, FDI**

(ii) What matters is not the absolute amount of debt that matters to an economy but its level relative to the income of the country (GDP) and whether the economy as a whole can generate the resources to service the debt (i.e. interest and principal repayments).

How debt evolves in any country

$$\Delta d_t = (r - g)d_t - b_t$$

:

Growth in the debt-to-GDP ratio

Cost of borrowing

Growth in GDP

Trade surplus to GDP

Managing Debt I:
Debt dynamics are unstable…there is no automatic stabilizer!

$$\boxed{\Delta d_t = (r-g)d_t - b_t}$$

Notice that if $b_t < (r-g)d_t$ then $\Delta d_t > 0$ and debt-to-GDP will grow….

…but this means that next period the trade balance will have to be *even higher* to stabilize the debt ratio (because $(r-g)d_{t+1} > (r-g)d_t$)

Unless some adjustment occurs (raising b_t or lowering $(r-g)d_t$) then the ratio of foreign debt to GDP is set to ***grow without limit***

What could go wrong?

Debt will continue to build and become unsustainable if there is no response if:

1. The cost of borrowing increases $(r \uparrow)$
2. The growth rate of the economy slows down $(g \downarrow)$
3. The balance of trade deteriorates $(b \downarrow)$

If creditors believe that debt is not sustainable (or is at risk of being unsustainable):

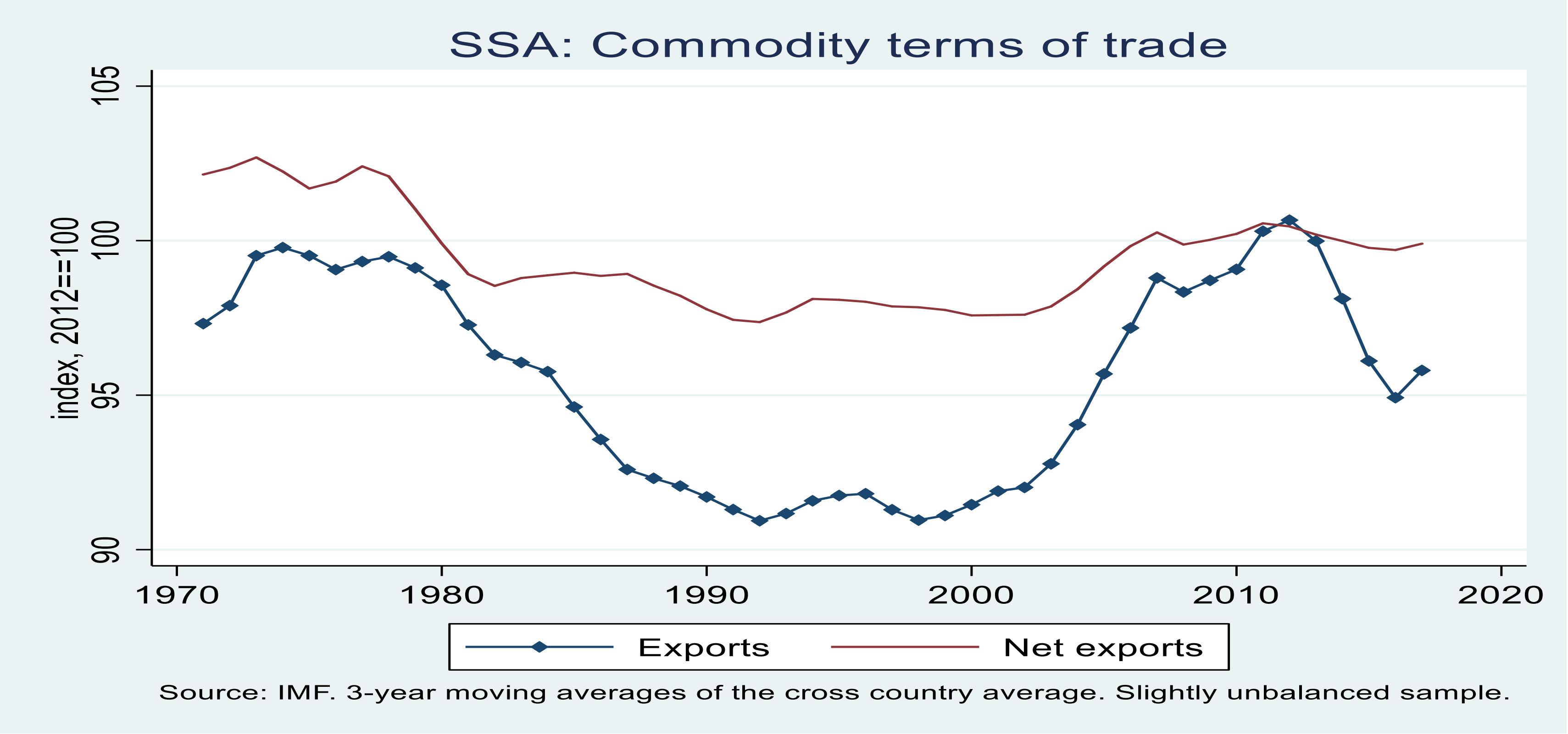
They will demand a higher return on their debt

Stop lending and call-in debt where they can ➔ ***'sudden stop'***

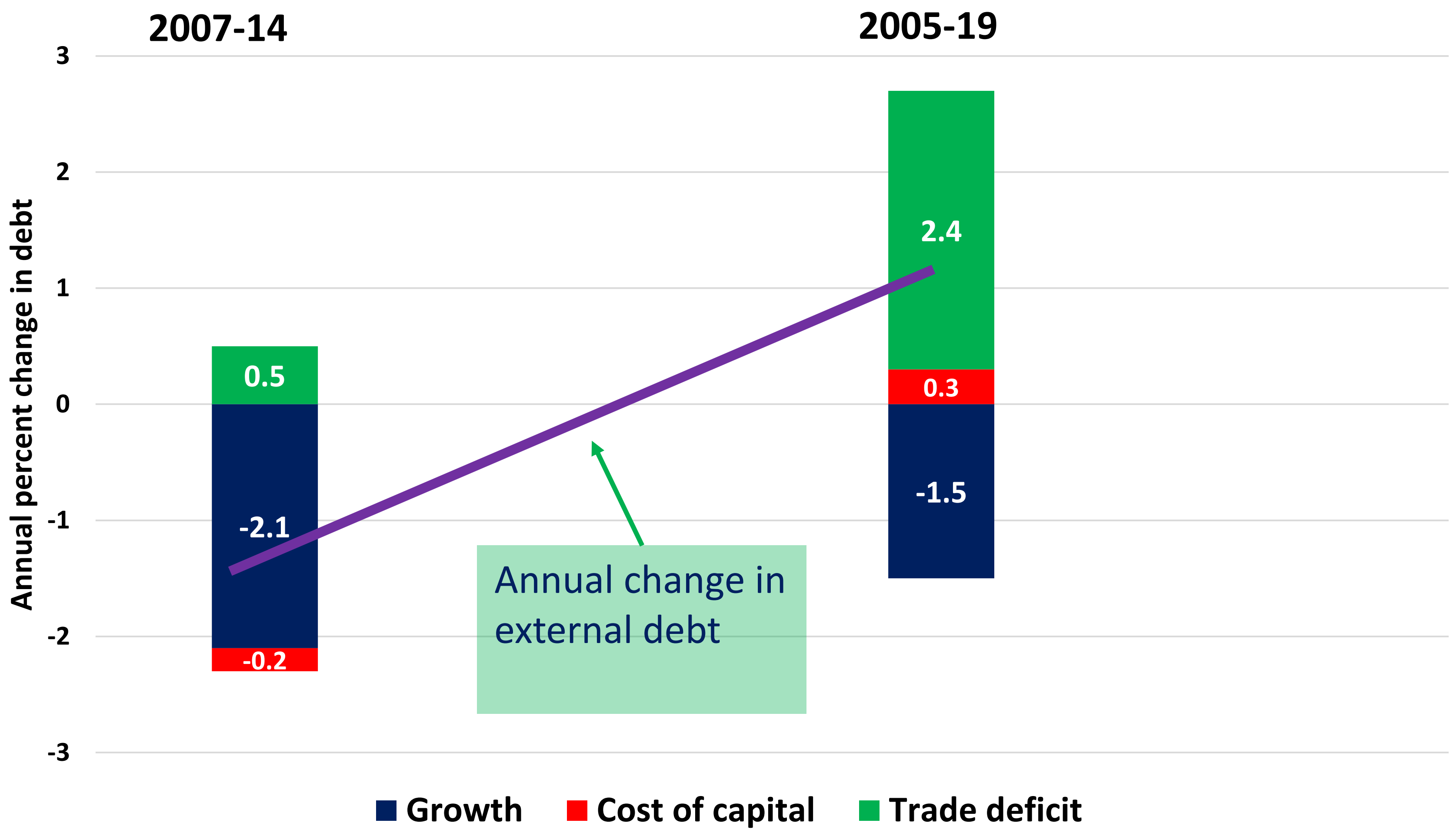
Sub Saharan Africa: From Tailwinds to Headwinds

UNIVERSITY OF OXFORD

After a long spell of rising commodity prices, the ‘super cycle’ came to an end in 2015; trade balances started to deteriorate quite sharply



Sub Saharan Africa: From Tailwinds to Headwinds
Decomposition of Sources of Growth of Indebtedness



Getting debt under control -- one simple rule

Getting back on track

- To re-stabilize (or reduce) external debt-to-GDP

- GDP growth must increase

and/or

- The cost of borrowing must fall

Not under the direct control of government, at least in the short-to medium term

and/or

- The trade balance needs to increase

The focus of policy

Getting back on track

- How quickly can the trade balance recover?

- If investment contracted to improve export capacity, there may be a lag between incurring the debt and exports responding.

- Very often the debtor (the public sector) is not the same party as the one able to generate the trade surplus required to service the loan (the private sector).

- This creates an **internal transfer problem** how can the government secure the resources from the private sector – by taxing them – without creating a disincentive on produces / investors etc.

The new landscape of debt and lessons for economic policy

A changing borrowing landscape

SSA countries have typically borrowed from…

Multilaterals (the World Bank, African Development Bank etc)

Paris Club Creditors (traditional, mostly 'Western' donors – e.g. UK, France, Germany, US, Canada and Japan).

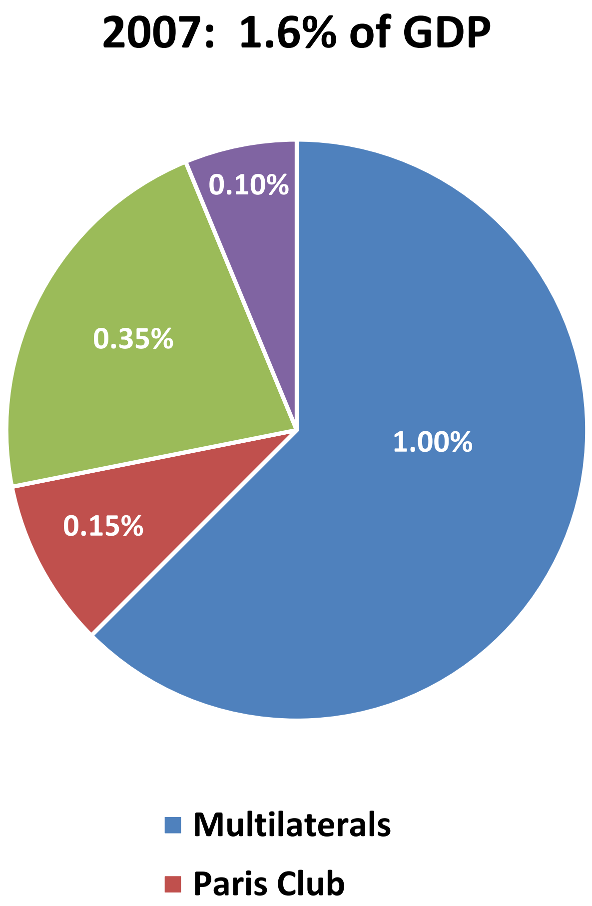
Called the **Paris Club** since these lenders meet and coordinate their activities at the OECD in Paris.

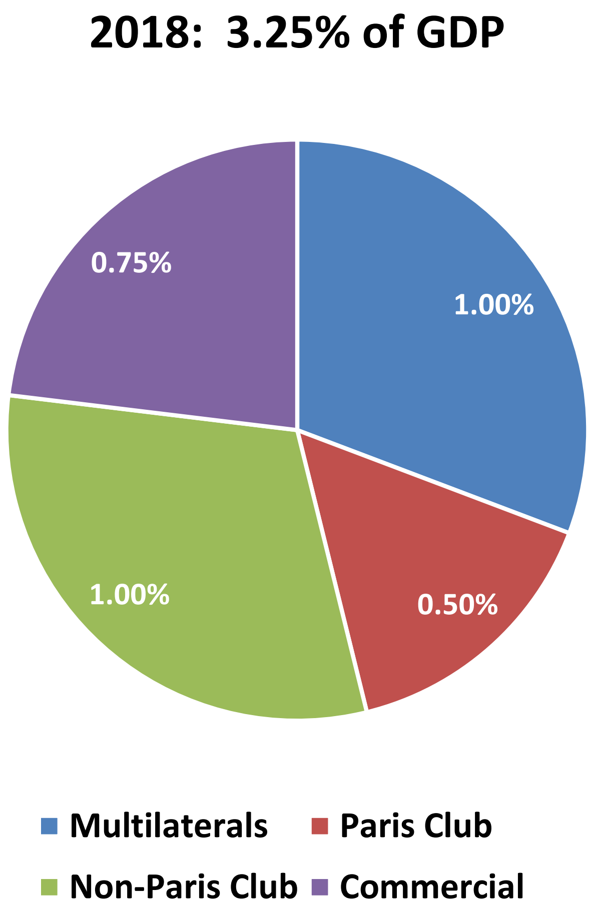
Since around 2005, SSA countries have increased their borrowing from…

Non-Paris Club Creditors (especially China and Gulf nations)

Commercial Creditors (the Eurobond market).

Low income countries: more borrowing, different creditors





The new landscape

- Erosion of Paris Club and rise of Chin makes coordination and debt re-scheduling more difficult

- Greater access to commercial Eurobond market is enticing but may be expensive and difficult to manage (Tz has not entered this market).

- But in all cases, the centrepiece of effective debt management strategies is government's ability to strengthen its revenue mobilization

- Ultimately domestic taxation is what finances public investment and the more robust is the tax system, the lower the risk of debt crises and more effective public investment programs can be in driving growth and poverty reduction.

THANK YOU!