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Emerging public debt challenges in sub-Saharan Africa

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Abstract: Sub-Saharan Africa (SSA)'s public debt burden remains a challenge to development. Key drivers of public debt include large-scale financing of infrastructure development, adverse impact of multiple shocks including COVID-19 pandemic, maturity mismatches, and high vulnerability to exchange rate and interest rate volatility. The tight financial conditions following interest rate hikes in advanced economies have exacerbated the debt burden and heightened debt sustainability risks. Half of the SSA low-income countries are either in debt distress or at high risk of it. Countries in debt distress include middle-income economies. Given the high cost of debt servicing and lack of fiscal space, achievement of sustainable development goals is in jeopardy. A long-term sustainable solution requires a multi-pronged approach. The G20 Common Framework for debt treatment remains limited in scope, coverage, and impact. More needs to be done including consideration for debt relief. Other strategies include access to long-term concessional finance, domestic resource mobilization, and improved efficiency in public spending and fiscal management.

Key words: public debt, debt sustainability, sub-Saharan Africa

JEL classification: H63, H68, E60

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1 Introduction

Sub-Saharan Africa (SSA)'s rising public debt burden amid limited fiscal space and multiple shocks remains a key challenge to development. Public debt in SSA has increased steadily over the last two decades. Unlike the debt crisis of the 1980s that was mainly due to debt owed to multilateral institutions, the current debt burden is mainly linked to commercial and bilateral borrowing following increased access to international financial markets and China's emergence as a significant creditor. Additionally, the COVID-19 pandemic that emerged in March 2020 had an adverse impact on the economies, thereby exacerbating public debt challenges as COVID-related spending increased while revenues and economic growth plummeted. Consequently, SSA's public debt as a ratio of Gross Domestic Product (GDP) increased notably from an average of about 50% in 2019 before the pandemic to 57.1% (63.3% excluding Nigeria and South Africa) in 2020 (IMF 2023b).

On average, SSA economies contracted by 1.7% in 2020, compared with a 3.1% growth recorded in 2019. Before the economies could fully recover, the Russian–Ukraine war kicked in early 2022, leading to a disruption of supply chains and a surge in international oil and food prices. Meanwhile, global inflation rose from historically low levels of less than 2% before 2020 to 8.7% in 2022, leading to aggressive monetary policy tightening in advanced economies. The latter has led to higher interest rates, tightening of financing conditions in the global markets and depreciation of domestic currencies, thus further increasing debt vulnerabilities and the cost of borrowing. After a lengthy period of low interest rates and low inflation, the global economy entered a new phase characterized by elevated inflation, a rise in interest rates, high debt levels and subdued growth.

The multiple shocks have not only complicated SSA's economic recovery efforts but have also heightened macroeconomic vulnerabilities and made sustainable management of public debt difficult, amid limited finances and other pressing challenges such as climate change and food insecurity.¹ From the last quarter of 2020 to early 2023, the horn of Africa experienced one of the worst droughts in over 40 years, placing millions of people at the risk of starvation. It is estimated that about 132 million people were acutely food-insecure in 2022, at a time when half of the countries in the region reported double-digit inflation, thus contributing to the high cost of living (IMF 2023a). By end of 2022, nearly one-third of the SSA economies had debt levels above 70% of GDP.² One-half of the low-income countries in SSA are either in debt distress or at high risk of distress. Moreover, even if countries do not default, the heightened public debt distress or risk of default drive market sentiments and credit ratings negatively. Following the lower credit rating and interest rate hikes in advanced countries, SSA's sovereign spreads increased three-times the emerging markets average since the global tightening cycle started (IMF 2023a). This, coupled with the depreciation pressures of domestic currencies and high cost of borrowing in the global and domestic financial markets could lead to a vicious cycle of debt.

In light of the above, the rising public debt burden is not only a threat to debt sustainability and macroeconomic stability but also a key constraint to sustainable development in SSA. The opportunity costs associated with the high costs of debt servicing in low-income countries are huge, given the high unemployment, widespread poverty and limited access to basic public utilities such water and electricity. Ndulu and O'Connell (2021) note that development assets, including

¹ The dry weather conditions that started in the last quarter of 2020 until March 2023 adversely affected agricultural activity in the most affected countries such as Kenya and Ethiopia.

² Based on data in the IMF Regional Economic Outlook for SSA October 2023.

major public infrastructure projects that were nearing fruition and improvements in human capital formation are at stake. While domestic savings play a crucial role in providing the necessary resources needed for financial independence and sustainable development, saving rates in SSA have remained generally low. To supplement the low levels of savings and limited tax revenues, governments mainly rely on domestic and external borrowing to finance public spending including public investment. Thus, given the increased debt burden, lack of fiscal space and multiple challenges in the context of a global environment that has become more uncertain, the achievement of sustainable development goals (SDGs) is in jeopardy. Against this background, this paper provides an assessment of the SSA's public debt, drivers, and the implications for debt sustainability, mainly focusing on external debt.

The rest of the paper is organized as follows. Trends and composition of public debt is given in section 2, while drivers of public debt accumulation are discussed in section 3. Section 4 provides an overview of approaches to debt sustainability assessment. Implications of public debt accumulation on debt sustainability are discussed in section 5, while section 6 provides an overview of international debt related initiatives. Conclusion and policy insights are summarized in section 7.

2 Trends and composition of public debt

Public debt has generally been on the rise in developing economies and globally, especially after the 2009 global financial crisis (GFC). However, it edged up sharply in 2020 following the increased spending and fiscal interventions occasioned by the impact COVID-19 pandemic (Figure 1). On average, SSA's public debt to GDP ratio has increased steadily over the past two or so decades. It nearly doubled from 27% in 2010 to about 52% in 2019, before increasing notably to 57.1% in 2020 following the adverse socioeconomic impact of COVID-19 pandemic. SSA's public debt to GDP ratio averaged 56.6% (60.1% excluding Nigeria and South Africa) in 2021 and 57.1 percent in 2022 (IMF 2023b). However, the ratios were much higher for middle-income countries (excluding South Africa and Nigeria) at 74.1%, 68.4% and 67.3% in 2020, 2021 and 2022, respectively.³ Moreover, public debt to GDP ratio for the region is estimated to have increased further to 60.1% in 2023.⁴

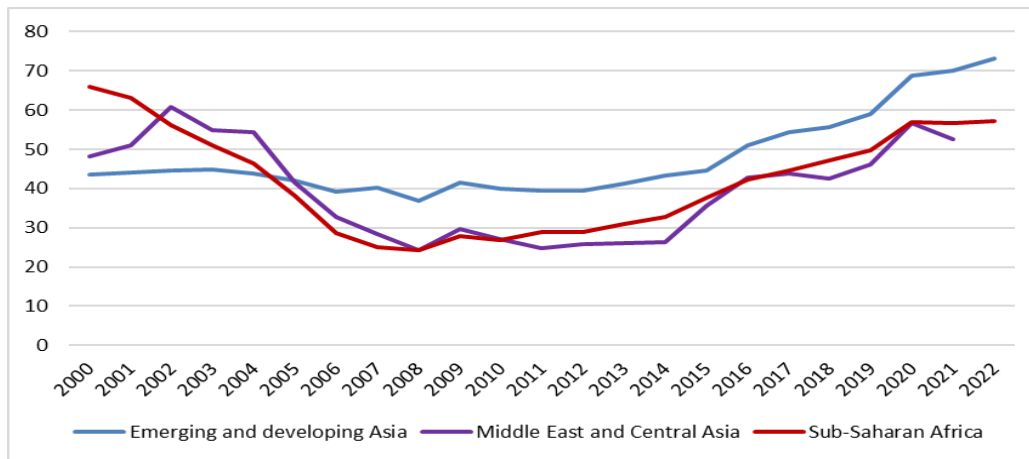
The public debt accumulation was preceded by a period of decline in the debt-to-GDP ratios from about 66% to 24% between 2000–08. This was largely on account of the debt relief programmes initiated in the early 2000; the Highly Indebted Poor Countries (HIPC) initiative that was later complemented by the Multilateral Debt Relief Initiative (MDRI).

Following increased debt accumulation, over three quarters (76%) of SSA countries had public debt to GDP ratio of above 50% in 2021 (Figure 2). One-third had debt levels of above 70% of GDP. These include Eritrea (176.2%), Cabo Verde (142.3%), Zambia (119.1%), Mozambique (106.4%), Congo Republic (103.6%), Mauritius (93.5%), Angola (86.4%), Gambia (83.8%) and Ghana (82.1%) (IMF 2022). Of these, Mozambique, Congo Republic, Zambia, and Ghana already slid into debt distress as of June 2023.

³ Based on the IMF-World Bank classification middle income countries are those whose per capita gross national income averaged US\$1085 or more over the period 2019-2021. These are Angola, Benin, Botswana, Cabo Verde, Cameroon, Comoros, Republic of Congo, Cote d'Ivoire, Equatorial Guinea, Eswatini, Gabon, Ghana, Kenya, Lesotho, Mauritius, Namibia, Nigeria, São Tomé and Príncipe, Senegal, Seychelles, South Africa, and Zambia.

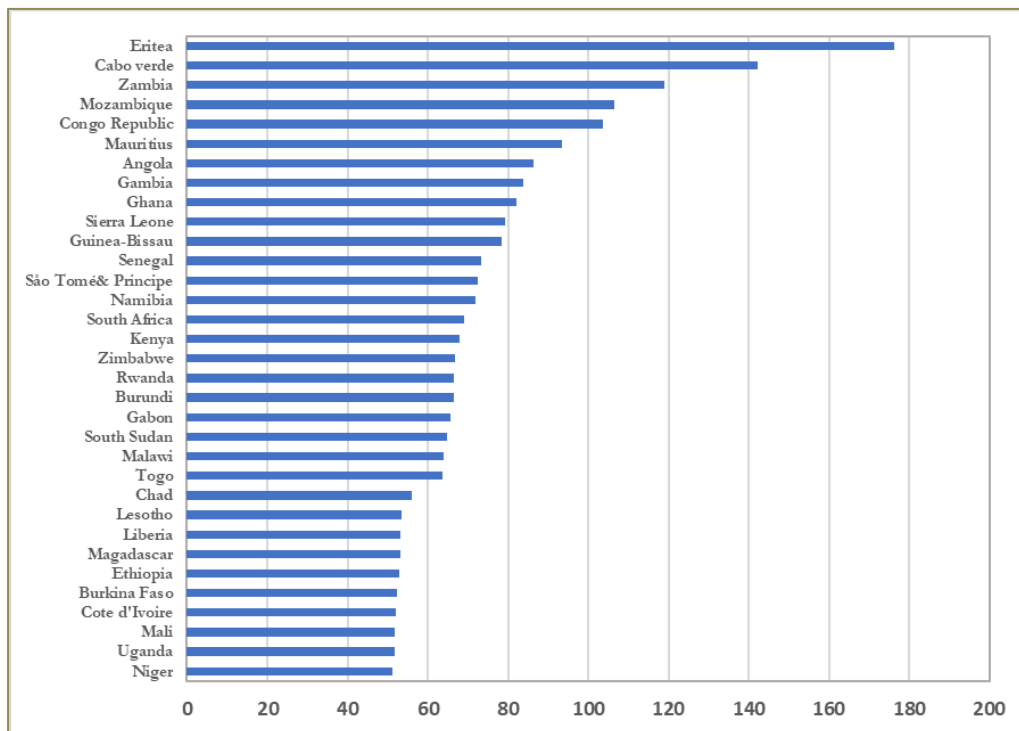
⁴ Based on IMF Regional Economic Outlook: Sub-Saharan Africa for April 2024 (IMF 2024).

Figure 1: Trends in public debt to GDP ratio in developing economies



Source: World Economic Outlook (IMF 2023c) database.

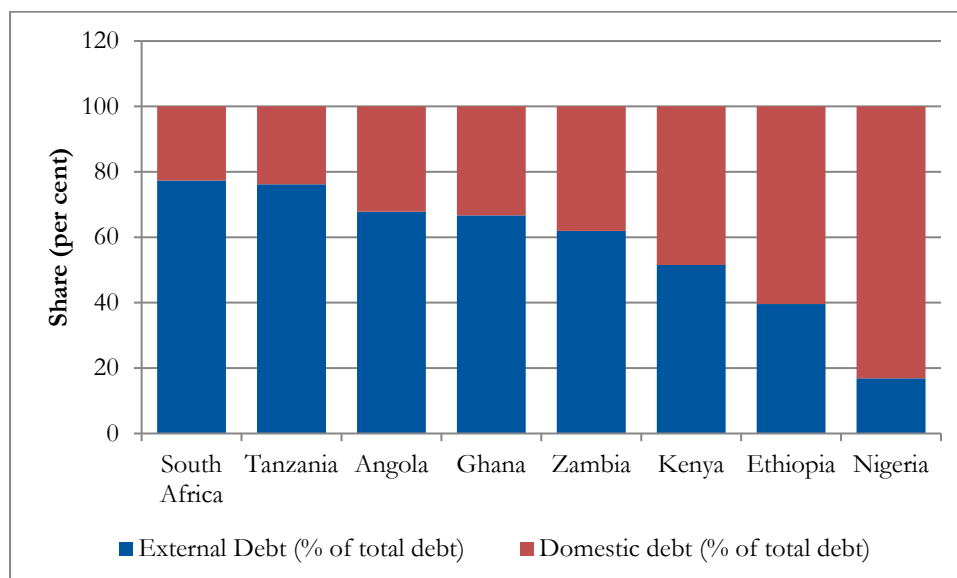
Figure 2: SSA Countries with government debt-to-GDP >50% in 2021



Source: author's illustration based on IMF (2022) data.

The composition of public debt is varied. For example, South Africa, Tanzania, Angola, Ghana and Zambia's public debt is largely comprised of external debt, which account for over 60% on average (Figure 3). As of Dec 2020, Tanzania's external debt as a percentage of total public debt was 72% compared to Kenya's at 52%. In contrast, Nigeria's public debt is largely domestic debt. As of 2021, about 40% of SSA's debt was external (IMF 2023a). The risks associated with the domestic and external debt are not necessarily the same. Whereas increased appetite for domestic borrowing can put pressure on local interest rates in economies with thin or under-developed financial markets, it is arguably easier to deal with in terms of roll-over, and there is less exposure to interest rate and exchange rate volatility given borrowing is in local currency. Domestic borrowing is considered as a form of transfer of resources within the country. Nonetheless, it accounts for a significant amount of interest payments.

Figure 3: Composition of total public debt in select SSA countries (average 2015–19)



Source: author's illustration based on various countries' central bank reports

In general, the share of multilateral debt has declined, including for HIPC countries such as Tanzania and Ethiopia that traditionally had a significant share of multilateral debt. For most countries, the share is below 40%. This is mainly due to change in creditor composition, as exemplified by the rise in bilateral and private debt (which includes commercial debt and bonds). For instance, the proportion of commercial debt as a share of Kenya's external debt increased notably from just about 4% in 2010 to 31% in 2020.

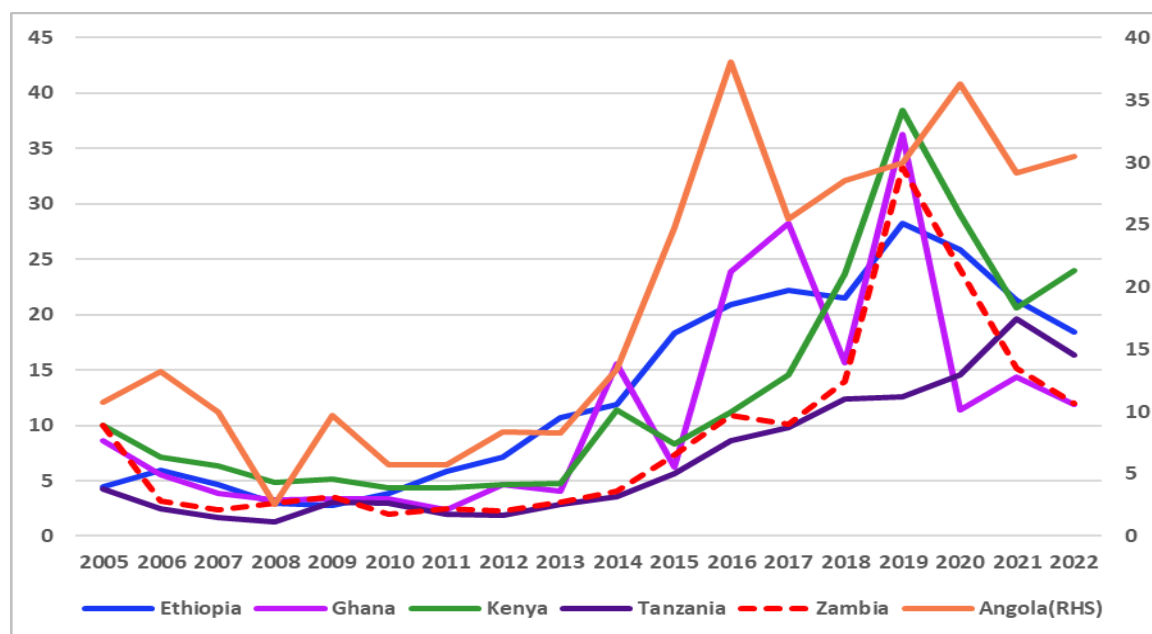
In terms of bilateral lending, China has emerged as the largest bilateral lender to African governments through its network of state-owned banks. Over the period 2000–20, the top ten recipients of loans from China were Angola, Ethiopia, Zambia, Kenya, Egypt, Nigeria, Cameroon, South Africa, Republic of Congo and Ghana. According to Global China Initiative researchers at Boston University Global Development Policy Center (BUGDPC), these countries accounted for 71% of all commitments between 2000–20, with loans to Angola constituting 27% (BUGDPC 2022). Over the same period, loan commitments estimated at US\$160 billion were signed with 49 African governments, their state-owned enterprises and five regional multilateral organizations (BUGDPC 2022b). The lending has largely been geared towards infrastructure projects in the transport, energy and mining sectors.

The surge in Chinese loans has not been without criticism, especially with regard to the terms and conditions, leading to calls for more transparency particularly by international financial organizations and the West. However, after a rapid growth that peaked in 2016 (2013 excluding Angola), China's lending to Africa has generally declined. The decline was more drastic in 2020, with a reduction in new loan commitments to US\$1.9 billion, down from US\$8.2 billion recorded in 2019, possibly due to COVID-19 pandemic challenges (BUGDPC 2022b).

The increase in the share of private debt is attributable to sovereign financing. Since 2006, several SSA countries including Kenya, Nigeria, Senegal, Zambia, Rwanda, Ghana and Tanzania issued foreign currency bonds in international debt markets following a period of favourable global financing conditions characterized by low interest rates. As of July 2021, twenty-one SSA countries were holding one or more outstanding Eurobonds (Icyeza 2021). Compared to the multilateral official debt with relatively long maturity, the tenor for bonds tend to be shorter and the interest rates are higher. Unlike concessional multilateral lending, commercial debt is more costly and subject to interest rate fluctuations, and hence higher exposure to vulnerabilities in financing

conditions. It is, therefore, not surprising that the increase in public debt has been accompanied by a remarkable rise in debt servicing burden. Debt service to exports ratios had already risen sharply by 2019 before COVID-19 pandemic, especially for middle-income countries such as Kenya, Angola, Zambia and Ghana, as well as low-income countries that have had comparatively low public-debt to GDP ratios such as Tanzania (Figure 4). The decline of the ratios in 2020 and 2021 is partly attributable to the temporary suspension of debt servicing during the COVID period. SSA governments are grappling with the high costs of debt servicing. Most are spending over 30 percent of domestic revenue on debt servicing, some as high as 50 percent or more.

Figure 4: Debt service as a share of exports of goods, services and primary income



Source: author's illustration based on World Development Indicators (2023).

3 Drivers of public debt accumulation

The rapid accumulation of public debt is attributable to various factors. These include pursuit of development objectives especially infrastructure development, costly financing sources, negative shocks, interest rate and exchange rate volatilities, maturity and currency mismatches, among others. The key drivers are briefly discussed below.

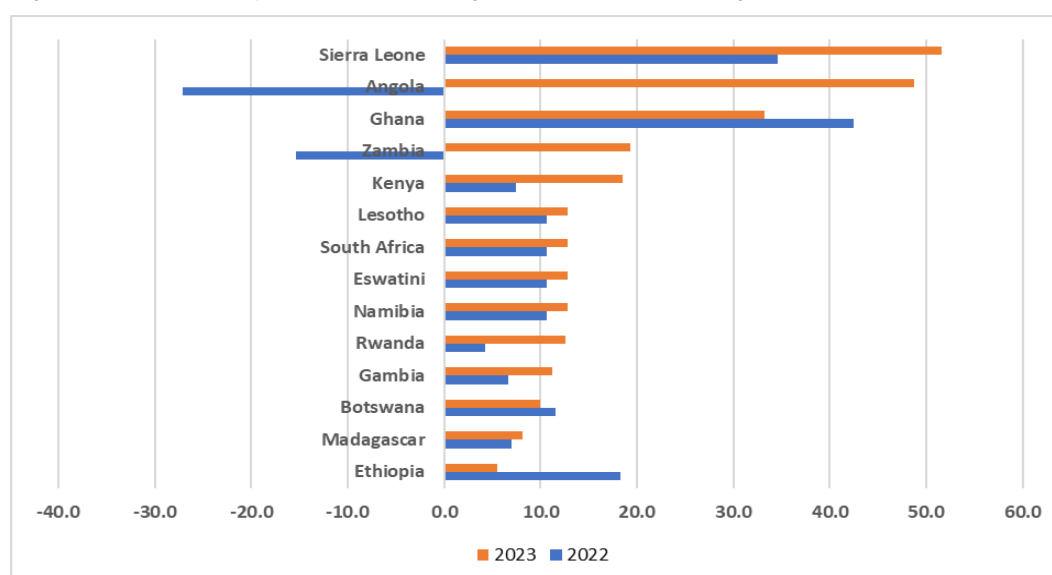
- i. Increased investment demand for infrastructure development to fill the huge infrastructure gap and promote development has led to large-scale financing mainly through loans from China. The Africa-wide infrastructure gap is relatively huge — based on estimates by the African Development Bank (AfDB), Africa’s infrastructure investment needs are about US\$130–170 billion annually (AfDB 2018). Investment in infrastructure and public utilities is deemed to promote growth and job creation by enhancing productivity and competitiveness. However, former has led to widening of fiscal deficits and increased borrowing, especially in the absence of long-term infrastructure finance. Melina et al. (2016) note that frontloading of public investment through increased borrowing can induce debt sustainability risks, especially with lower investment efficiency or when future resource revenues turn out to be lower than expected.
- ii. The outbreak of COVID-19 pandemic in March 2020 had an adverse impact economic activities and domestic revenues. Although public debt was already rising, debt

vulnerabilities became more elevated as borrowing to fund COVID-related expenditures increased, leading to a sharp increase in SSA's debt-to-GDP ratio to about 57.1% in 2020, the highest in nearly 20 years.

- iii. A general improvement in macroeconomic management, the fiscal space availed by the debt relief under the HIPC initiative and the fairly strong economic performance driven by the commodity boom during the period 2000–14 expanded the borrowing ability and capacity. Ndulu and O'Connell (2021) observe that the Debt Sustainability Assessments (DSAs) that became integral to the post-2005 lending and surveillance activities of the IMF and World Bank also played a role in 'certifying improvements in borrowing capacity and reducing the cost of screening for private and bilateral official creditors including China' (pg. i59).
- iv. Whereas the debt crisis of the 1970s and 1980s was mainly characterized by debt owed to multilateral institutions, the current debt burden is notably due to commercial and bilateral borrowing. The later was particularly occasioned by the significant interest rate cuts witnessed in advanced economies in response to the 2008/09 global financial crisis. Following a period of low global interest rates, bond issuances in Africa expanded eight times from an average of US\$10 billion annually in the early 2000s, to about US\$80 billion annually by 2016–20. While the access to international financial markets has increased the financing options, it has exposed the economies to increased risks associated with volatility in interest rates and capital flows. The financing conditions tightened drastically following the policy rate hikes by leading central banks in response to elevated inflation in advanced economies. Consequently, most African countries are facing rollover risks as their sovereign bonds mature. Primary spreads for sovereign bonds for an average SSA issuer are on average higher than in other regions (Presbitero et al. 2016). A study by Brauning and Ivashina (2018) found that changes in US bond rates feed through more than point-for-point to emerging-market sovereign bond rates. Moreover, the heightened debt vulnerabilities have led to poor credit ranking, thus exacerbating the sovereign spreads. The high interest rates have increased the cost of borrowing and debt servicing, thus leading to a vicious cycle.
- v. Dependency on commodity exports which are subject to volatile prices in the global market (e.g., Angola, Nigeria, South Sudan on oil; Ghana on cocoa and Zambia on copper). A collapse in international prices as it happened to oil prices during the pandemic implies a drastic loss of revenue. For instance, the sharp decline in the price of copper exacerbated Zambia's financial challenges that contributed to the country's default in November 2020; the first African country to default on its debt during the COVID-19 period. Zambia is Africa's second largest exporter of copper after the Democratic Republic of the Congo.
- vi. The risk of debt distress is heightened by maturity and currency mismatches, as well as coordination challenges in debt restructuring, particularly in view of the plurality of creditors (Ndulu and O'Connell 2021). The relatively short loan maturity structure does not match the life of some of development infrastructure projects with much longer gestation periods of investment returns (Coulibaly, Gandhi, and Senbet 2019).
- vii. Exchange rate volatility: Most of the debt is denominated in foreign currency, especially in US\$, hence making countries vulnerable to exchange rate risks. Emerging market economies such as Zambia, Kenya, Ghana, Angola have experienced immense depreciation pressure on their domestic currencies, especially following the strengthening of the US dollar since 2020, thereby increasing the amount of debt in domestic currency and the cost of servicing dollar-denominated. On average, between 2022 and 2023 the domestic currencies of Siera Leone, Angola, Ghana, Zambia and Kenya depreciated by 51.7%, 48.7%, 33.2%, 19.3% and 18.6% respectively, against the US dollar (Figure 5).

- viii. Fragility of some of the economies, i.e., civil strife, political instability, susceptibility to natural disasters — thus, it is not surprising that some of the countries in debt stress fall under this category.
- ix. Inefficiency and weak fiscal management. Whereas macroeconomic management has generally improved over time, fiscal management including public spending is still hampered by inefficiency, wastage and governance challenges including misappropriation of funds. The numerous concerns often flagged out in the Auditor General reports in several SSA countries attest to these challenges. Additionally, lack of proper planning and prioritization has in some case led to poor implementation of projects, some of which end up becoming white elephants.
- x. Political factors- though often underestimated or less stated, politically driven factors including the urge to establish political legacies has partly played a role in driving debt accumulation. This is often manifested in multiple development projects hastily initiated without proper planning, and assessment of viability and financing options.

Figure 5: Local currency depreciation (%) against US\$ (period average)



Source: author's illustration based on IMF International Financial Statistics database.

4 Approaches to Debt Sustainability Assessment

There is no universally accepted definition of sustainable debt. Low or high debt levels do not necessarily imply that debt is sustainable or unsustainable. Although various public-to-GDP debt thresholds are often proposed or suggested in the literature, the critical level of debt depends on a variety of factors and bound to vary across countries. In the literature, perspectives to debt sustainability generally revolve around fiscal sustainability. That notwithstanding, fiscal sustainability is an elusive concept, particularly owing to the key challenge of accurately determining a government's inter-temporal budget constraint, which is the core of fiscal sustainability analysis (Pradhan 2019). The complexity has been worsened by increased integration of financial markets in a global environment that has become highly uncertain. Whereas there are various approaches to fiscal sustainability assessment, the solvency approach is perhaps the most widely adopted. Others include Domar's stability approach, backward-looking approach, balance sheet approach and Ricardian equivalence approach (see Pradhan 2019 for details).

A government is considered solvent if net debt obligations over a finite horizon, with a stream of future primary surpluses can be achieved (Brady and Magazzino 2018). Governments are faced with a present-value borrowing constraint, such that they have to intertemporally balance their budgets by setting the current market value of debt equal to the discounted sum of expected future surpluses. A violation of intertemporal budget balance could be taken as indication that the fiscal policy is not sustainable in the long run, as the value of debt could explode over time (Collignon 2012).

An overview of fiscal/debt sustainability approaches in the empirical literature and the commonly used IMF–World Bank debt sustainability framework is briefly summarized below.

4.1 Debt sustainability assessment in the empirical literature

The empirical literature on assessment of public debt sustainability has mainly focused on testing the sustainability of the intertemporal budget constraint using various techniques. In this regard, the most influential and commonly used empirical approach is the model-based approach following Bohn (1998), under which a policy rule, i.e., a fiscal reaction function of primary surplus to increases in public debt is estimated to ascertain the fiscal sustainability of debt. Based on Bohn (1998), the risk of public debt becoming unsustainable can be averted if the government reacts effectively to changes in public debt through primary balance. Thus, the fiscal reaction function describes a country's fiscal response through primary balance, which is often specified as a function of lagged public debt measured as a ratio to GDP and business cycle fluctuations (output gap). The lagged primary balance is typically included as part of the explanatory variables to control for possible deficit bias or sluggish budget response.

The responsibility of ensuring debt sustainability is placed on the behaviour of fiscal policy, such that when the debt rises a sustainable fiscal policy requires an increase in primary surplus or reduction in fiscal deficit. In a nutshell, the relationship captures the link between a fiscal instrument (primary balance) and debt stability as the fiscal goal. The primary balance captures the structural imbalance between non-interest government spending and revenue in relation to debt accumulation, which if not contained could lead to unsustainable debt.

The fiscal reaction approach is underpinned by the intuition that to ensure debt sustainability, governments need to take corrective actions by increasing primary balance to take care of increases in debt accumulation. The limitation of this approach is the emphasis placed on the role of fiscal policy in isolation from other factors such as developments in international financial markets and the role of monetary policy (see Leeper 1991).

4.2 IMF-World Bank Debt Sustainability Framework

In practice, the joint IMF-World Bank Debt Sustainability Framework (DSF) for Low-Income Countries (LIC-DSF) and Market Access Countries (MAC-DSF) is the most commonly and widely used framework for conducting DSAs. The latter constitute part of the surveillance activities under Article IV consultations by the IMF. Since the introduction of DSF in 2005, the DSAs are often relied upon to inform borrowing and lending decisions particularly in low-income and emerging market economies. SSA countries' DSAs are mainly analysed using LIC-DSF.

The analysis entails projection of a country's debt burden over the next 10 years and its vulnerability to shocks, based on medium-term macroeconomic projections and assumptions for key variables such as growth and changes in the primary balance, on the basis of which baseline

and stress tests are calculated. The assessment of risk of external and overall debt distress is based on various debt burden thresholds and benchmarks.⁵

The debt sustainability thresholds are based on the country's debt carrying capacity, which is measured by a composite indicator (CI). The latter is computed using a measure of quality of institutions and policies, and macroeconomic performance indicators. Countries are classified on the basis of their debt-carrying capacity according to the CI ranking: strong ($CI > 3.05$), medium ($2.69 \leq CI \leq 3.05$) or weak ($CI < 2.69$), underpinned by the assumption that countries with better policies, institutions and macroeconomic prospects can sustain a higher debt level. The threshold indicators are assessed in terms of GDP, exports and revenue, with higher thresholds for countries considered to be stronger performers. The computed debt burden indicators are compared to indicative thresholds over the projection period to assess sustainability of debt. The risk of public debt distress is based on four types of ratings: 'low risk', 'moderate risk', 'high risk' and 'in debt distress'. A country is considered to be in debt distress if it is unable to fulfil its financial obligations and debt restructuring is required (Rakara 2020).

The main advantage of the IMF-World Bank DSF lies in its simplicity that makes it easier to replicate across countries. This in turn facilitates comparison and makes it easier to obtain a bird's eye view of debt sustainability landscape in SSA or generally across the countries covered. That notwithstanding, the framework has some shortcomings. For instance, concerns have been raised regarding its simplistic assumptions, reliability of medium-term projections including growth and fiscal adjustments, analytical challenges and the emphasis on present value of debt despite the profusion of multiplicity of creditors with different interest rates (see Bonizzi, Laskardis, and Toporowski 2019; Atingi-Ego, Timuno, and Makuve 2021).

5 Implications of debt accumulation on debt sustainability

The analysis of SSA's debt sustainability challenges is mainly based on the published DSA outcomes. However, a brief overview of debt sustainability based on empirical evidence from the literature is summarized below.

5.1 Overview of empirical evidence on fiscal sustainability

The empirical literature on fiscal sustainability of debt has been growing and continue to evolve. However, most of the emerging empirical studies on debt sustainability have largely focused on advanced and emerging economies, mainly using the fiscal reaction function approach (Park and Sung 2020; Small, Brown, and Canavire-Bacarreza 2020; Joy and Panda 2020; Beqiraj, Fedeli, and Forte 2018). For instance, focusing on six major emerging economies (Argentina, Brazil, Russia, Turkey, Philippines and South Africa), Paret (2017) found evidence suggesting the countries' fiscal policies were responsive to debt. However, Joy and Panda (2020) found sustainability of public debt for BRICS (Brazil, Russia, India, China, South Africa) to be weak. Country-level studies include Lankester-Campos et al. (2020), Rathnayake (2020) and Serju-Thomas (2020) who found evidence of unsustainable public debt for Costa Rica, Sri Lanka and Jamaica, respectively.

Despite the growing literature, empirical studies focusing on SSA are still limited. The studies show mixed results. Using 2000–16 panel data for 32 SSA countries, Mupunga and Ngundu (2020) found a positive and significant response of primary balances to increases in debt levels, thus implying

⁵ Present value of debt obligations is computed using a 5% discount rate for external debt.

fiscal sustainability of public debt. Based on data for 37 SSA countries for 2008–17, Abubakar (2020) found that fiscal tightening led to a decline in public debt while fiscal loosening increased public debt. However, in a more current study using data for 2010–20 for a panel of 45 SSA countries, Olaoye and Olomola (2022) found SSA’s public debts to be weakly sustainable. Additionally, a highly procyclical fiscal policy bias was noted particularly in resource-rich and oil-exporting countries. Focusing on Economic Community of West Africa States (ECOWAS), Omotor (2021) found the public debt levels to be unsustainable using data for the period 2010–17. In the case of Tanzania, Were and Mollel (2020) found sustainability of public debt to be weak, while a study by Ackah et al. (2020) — on fiscal evolution and oil and gas development in Ghana — showed that despite the additional revenue from oil, Ghana’s debt to GDP ratio continued rising while domestic revenue to GDP ratio remained constant.

In sum, the evidence of fiscal sustainability of public debt in SSA based on recent studies is generally weak, if any. This is corroborated by the weak relationship between fiscal balance and public debt as depicted by scatter plots for select countries (Appendix Figure 1).

5.2 Recent IMF-World Bank DSA outcomes

Based on the joint World Bank-IMF DSAs, the risk of debt distress in SSA has generally increased. The combined impact of multiple shocks, tighter financial conditions and exchange rate pressures on the domestic currencies amid lack of fiscal space and high cost of debt servicing have, among other factors, heightened debt sustainability challenges. Basically, all the SSA economies covered under the LIC-DSF are facing some form of debt sustainability risks, at varying degrees ranging from moderate to high, or in distress.^{6 7} By end of September 2022, one-half of SSA’s low-income countries were either already in debt distress or at high risk of distress, while the rest were facing moderate risk of debt distress (Figure 6a).⁸ The latter include HIPC countries — such as Madagascar, Rwanda, Senegal, Tanzania, Uganda — that had generally been considered to have a low risk of debt distress following the HIPC debt relief initiative.

Based on the published DSAs as of 30 June 2023, the number of SSA countries in debt distress increased to seven out of the total 11 countries in debt distress, with Ghana and Malawi being the latest economies to have joined the list. Other countries in debt distress included Zambia, Congo Republic, Mozambique, and Zimbabwe. Malawi quickly transitioned from moderate risk of debt distress before 2020 to high risk and eventual distress, following multiple shocks including a cyclone. Ghana has been rocked by severe economic and financial challenges since early 2022, leading to a default on some of its debt in December 2022. That notwithstanding, Ghana’s fiscal balance (excluding grants) had deteriorated significantly from an average of -6.6% in the period 2011–19 to -17.4% in 2020 — highest recorded among SSA countries in the COVID year 2020. Public debt-to-GDP ratio increased remarkably from an average of 49.6% to 72.3% and 92.4%, in 2020 and 2022, respectively. The country’s challenges seem to have been further heightened by the multiple downgrades that were made by credit rating agencies. On a positive note, the latest DSA outcomes show Chad has since graduated from being ‘in debt distress’ to ‘high risk’ of debt distress following debt restructuring agreement with its creditors (Figure 6b). The same applies to Mozambique, which also reached an agreement on some of its defaulted debt. As of February

⁶ Excluding Eritrea whose DSA is not publicly available.

⁷ South Africa, Nigeria, Botswana, Angola, Mauritius, Namibia, Seychelles, and Eswatini are excluded.

⁸ Excluding Eritrea whose DSA is not publicly available.

2024, four out of the six SSA countries in debt distress were middle-income countries (Republic of Congo, São Tomé and Príncipe, Zambia and Zambia)(Figure 6b).

Figure 6a: Overview of SSA countries' DSA as of 2019 and 2022

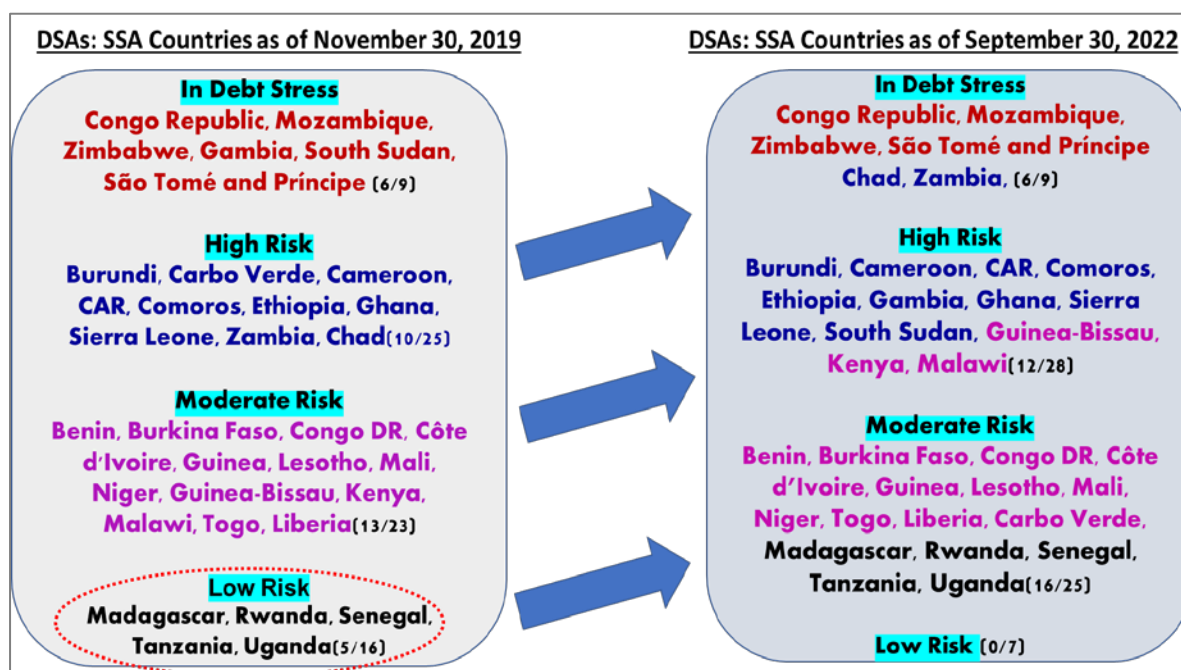
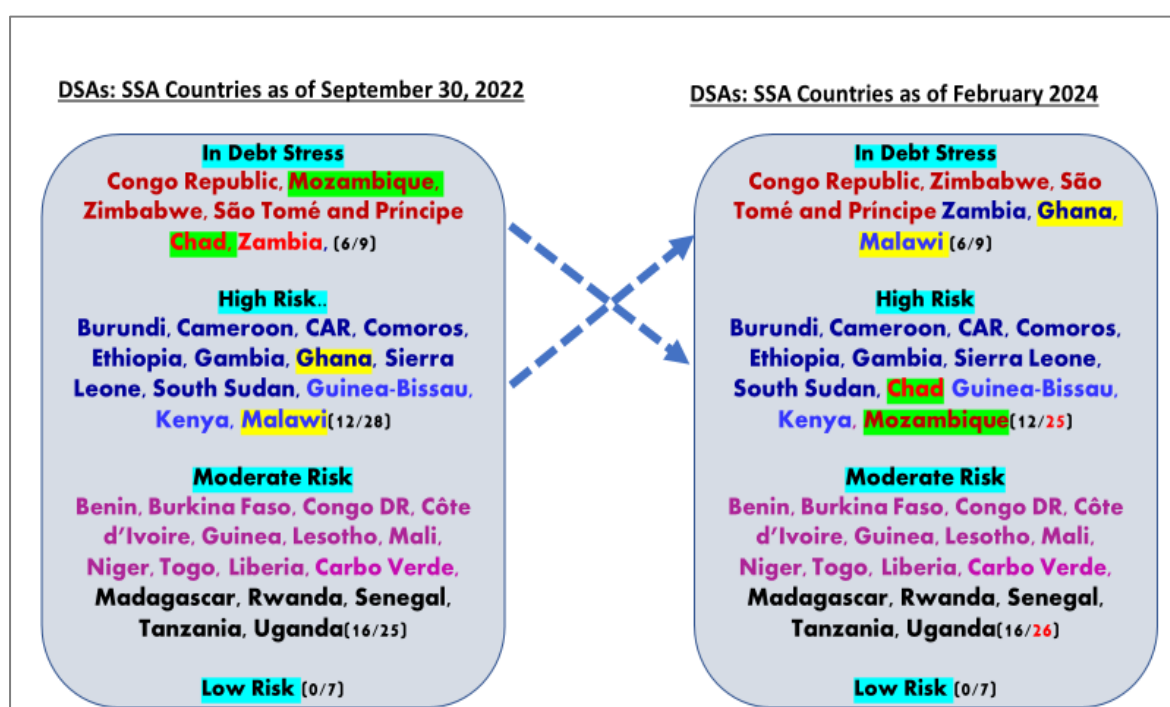


Figure 6b: Overview of SSA countries' DSA as of September 2022 and February 2024



Source: author's illustration based on various published DSAs.

Meanwhile, several countries are facing a high risk of debt distress. These include Ethiopia, Cameroon, Gambia, Sierra Leone, South Sudan, Burundi, Comoros, Burundi (Figure 6a and 6b). Kenya, and Guinea-Bissau whose risk of debt risk was classified as moderate before the COVID pandemic also joined the list of countries at high risk of distress.⁹ Kenya's public debt to GDP increased rapidly from 45.8% in 2015 to 68.4% in 2022. As of end of March 2023, total outstanding public debt was KES9.4 trillion against a ceiling of KES10 trillion.¹⁰ Although the economy has exhibited resilience in the face of multiple shocks, the country is experiencing a credit squeeze considering the high costs of debt servicing and constrained fiscal space. This has led to increase in taxes in a bid to increase domestic revenue as the government embarks on implementation of fiscal consolidation plan.

It is worth noting that all the low-income/HIPC SSA countries (Tanzania, Rwanda, Senegal, Uganda and Madagascar) whose risk of debt distress had remained low before COVID-19 pandemic have since shifted to 'moderate' risk category, which suggests increased vulnerability to debt sustainability challenges. Moreover, even for countries that are not in distress, the cost of debt servicing has nearly doubled since the pandemic, with the average yield of over 12% on outstanding Eurobonds compared to 7% before the pandemic (IMF 2023b). The average yield on sovereign bonds increased notably in 2022 and 2023, leading to significant rollover risks. Figure 7 shows the average monthly yields on 10-year Eurobonds for Kenya, Ethiopia and Angola, 11-year bond for Ghana and 12-year bond for Zambia.¹¹ The heightened impact of COVID-19 pandemic in 2020 and interest rate hikes in advanced economies in 2022 coupled with downgrade in credit ratings is clearly evident especially for Ghana, Zambia and Ethiopia, which slid into debt distress. For instance, the yields for Ghana's sovereign bond had remained relatively low and stable at an average of 7.9% in 2019 before COVID. While they temporarily increased slightly during March-May 2020 COVID period (to an average of 11.4%), they remained below 10% on average (8.9% in 2020, and 8.1% in 2021), but increased sharply to an average of 22.4% in 2022. By the time Ghana defaulted on payment of its external debt, the yield on its 11-year outstanding Eurobond had surged to over 30%. Meanwhile, annual average inflation soared to 31.7% and 31.5% in 2023, respectively. Similarly, the yields on Ethiopia's 10-year outstanding Eurobond increased substantially from 7% and 11.6% in 2020 and 2021 to an average of 31.1% in 2022, and continued rising further in 2023 (Figure 7).

Zambia's public debt challenges started biting much earlier following multiple issuance of sovereign bonds and increased reliance on bilateral lending from China — about a third of external debt is owed to China. The country issued its first Eurobond in 2012, followed by two subsequent sovereign bonds in 2014 and 2015. Zambia was assessed to be at high risk of debt distress in 2017 as the macroeconomic environment and, quality and pricing of Eurobonds continued to deteriorate over time. The country was downgraded several times in 2018 to the grade of CCC, just before the COVID-19 crisis. By 2019, commercial debt accounted for a half of the external debt. The rapid debt accumulation was accompanied by high cost of debt servicing — by 2019, debt service became Zambia's largest spending category, accounting for over 30% of expenditure (Mbewe et al. 2024). Following a period of expansionary fiscal policy and ambitious infrastructural development drive, the stock of public debt doubled from 60.6% of GDP in 2016 to an unsustainable level of 120% in 2019, before increasing further to 140.2% in 2020. Meanwhile,

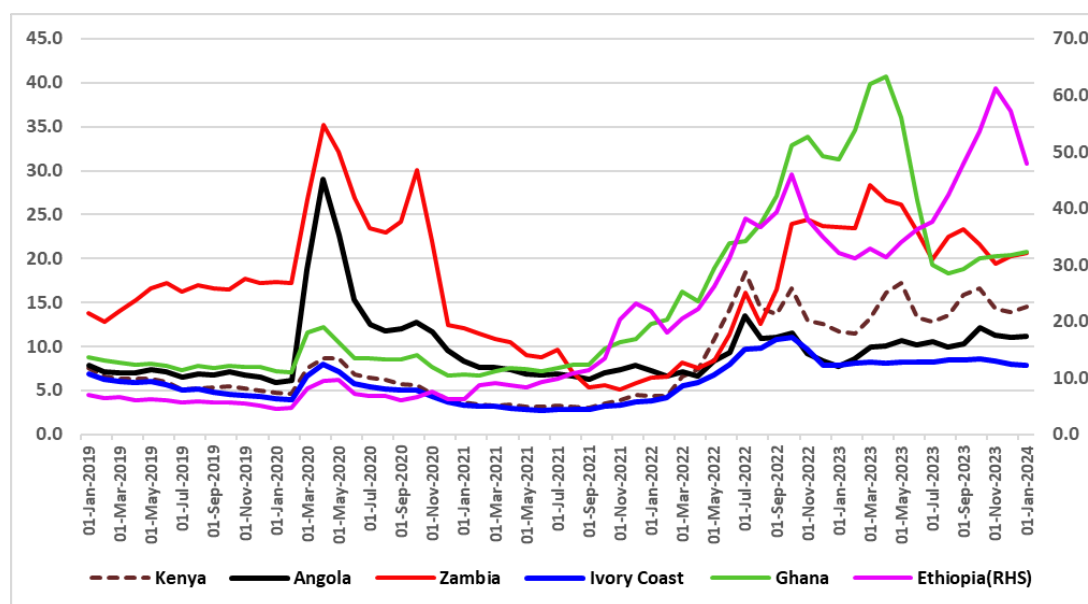
⁹ Both countries are classified as middle-income countries.

¹⁰ The government has since shifted from specifying the debt ceiling in terms of levels (maximum amount of public debt), to the case where the public debt ceiling is set as a percentage of GDP, i.e. 55%.

¹¹ Maturity dates for Kenya and Ethiopia are June and December 2024, while maturity dates for Angola, Zambia and Ghana are May 2025, July 2027 and May 2029, respectively.

overall fiscal balance (including grants) deteriorated substantially to -13.8% of GDP in 2020. The yields on its sovereign bonds increased substantially; e.g. the yields on 12-year outstanding bond increased from 15.9% in 2019 to 24.2% in 2020 on average, having risen to as high as 35.4% and 30.1% in April and October 2020, respectively (Figure 7). It was, therefore, not surprising when Zambia defaulted on its external debt payment in November 2020 during the COVID-19 period. Furthermore, in 2020, the Zambian kwacha depreciated notably against the US dollar, following the fall in copper prices and downgrade of credit scores. This fuelled inflation, which rose to 22% in 2021 from 9.1% in 2019, though it has since declined to 11% in 2022 and 2023. Although the yields declined to 8.4% after Zambia sort debt restructuring, they rose to over 10% beginning the first half of 2022 and remained relatively high.

Figure 7: Trends in Eurobond yields for select countries (monthly averages)



Note: average for January 2024 based on daily rates up to 16 January 2024.

Source: author's illustration based on Thomas Reuters (Refinitiv) data.

The tighter financing conditions in international financial markets have priced out low- and middle-income countries (LMICs). According to World Bank (2023), total net debt flows to this category turned negative in 2022 for the first time since 2015, reflecting a sharp retrenchment in bond issuance by sovereigns and other public and private borrowers.¹² Until recently, there was no Eurobond issuance since April 2022. However, there seems to be some light at the end of the tunnel following successful Eurobond issuances by Côte d'Ivoire, Benin and Kenya early in 2024. The trio managed to raise a total of US\$4.8 billion. Yields on Côte d'Ivoire's sovereign bonds have remained relatively low and stable, a factor that is likely to have facilitated the country in being the first one to resume sovereign bond issuance after a long period of no issuance by SSA countries. Kenya's 7-year bond of US\$1.5 billion was slightly higher priced with a coupon rate of 9.75% compared to Côte d'Ivoire's with a slightly longer maturity at 8.5%. Nonetheless, it seems to be what the country needed most to avert the steady decline in the value of its domestic currency, which had depreciated notably to over 150 against the US dollar by December 2023, partly driven by increased speculation about the risk of defaulting on its 10-year Eurobond of US\$2 billion due for maturity in June 2024.

¹² According to the World Bank International Debt Report 2023, there was a net outflow of US\$127.1 billion from LMICs to bondholders in 2022, compared to an average annual inflow of US\$202 billion in 2019–21.

Notwithstanding the positive signal, the public debt burden still remains a major challenge, considering the murky horizon the SSA economies are facing. Although inflation in advanced economies has eased, core inflation has been relatively sticky and hence, policy rate cuts are unlikely to be drastic if any. This implies international financial markets could remain relatively tight or volatile, with high rollover risks for several countries whose sovereign bonds are due to mature in next few years. Meanwhile, domestic tax revenue mobilization remains a challenge in light of subdued demand, a large informal economy, adverse climate change impact and high cost of production as exchange rate pressures continue to persist. The global economic environment remains uncertain, given the rising geopolitical tensions, including the Israel–Palestine war.¹³ On the upside, a faster than expected fall in global inflation could lead to further easing of financial conditions. Nonetheless, long-term solutions to SSA’s debt sustainability challenges are still needed.

6 International initiatives towards public debt challenges

Despite the biting public debt challenges, a comprehensive debt relief initiative akin to the HIPC debt relief package is yet to be seen. There have been some initiatives at the international level, albeit patchy with limited scope, coverage, and impact. Key ones include the G20 Debt Service Suspension Initiative (DSSI) and Common Framework for Debt Treatment beyond the DSSI.

Launched in May 2020, DSSI was initiated by the G20 countries with the support of the World Bank and the IMF to assist LICs by providing a temporary suspension (without cancellation) of debt-service payments owed to official bilateral creditors during the challenging COVID-19 period. Although the initiative was extended twice, it lasted for a short period of about one and a half years until December 2021, forcing participating countries to resume debt service payments thereafter. While the initiative offered some temporary relief, it was short lived and limited in scope. Moreover, only a small fraction of Africa’s total bilateral debt was covered. Two-thirds (48 countries of the 73 eligible debtor countries) participated in DSSI. That notwithstanding, the low-income countries have been confronted by additional burden of having to pay the accumulated principal, interest and fees incurred under DSSI besides paying the steeper interest rates countries are generally paying for their debt (World Bank 2023).

Given the temporary nature of DSSI and mounting concerns of debt distress, the G20 in conjunction with the Paris Club launched the Common Framework for Debt Treatment beyond the DSSI in November 2020, with the aim of providing a more structured and comprehensive debt treatment support to LICs with unsustainable debt, on a case-by-case basis. Upon receiving a request for debt treatment from an eligible debt country, a Creditor Committee is convened, with IMF and the World Bank providing the necessary support to the negotiations. The debt treatment, which could be anything from short-term debt reprofiling to deep restructuring, should be accompanied by various reforms including IMF-supported reform programmes to ensure future sustainability of public debt (Cassimon, Essers, and Presbitero 2023). The debtor is expected to seek ‘comparable’ (i.e., at least as favourable) debt treatments from all other official bilateral and private creditors (Cassimon et al. 2023). However, participation remains limited and, hence, many eligible countries have not benefitted. The framework has been rocked with coordination challenges and prolonged negotiations for the few countries that have made requests, partly due to the multiplicity of creditors. The latter include the traditional Paris Club creditors and new

¹³ The resultant escalation of Houthi attacks on cargo ships in the Red Sea poses a major risk to global trade and growth, with adverse implications on SSA economies.

creditors particularly China, whose share of public debt in LICs has increased significantly. Chad was the first country to reach a debt restructuring agreement with its official and private creditors under the G20 Common Framework (IFC 2023). Other countries that have sought debt restructuring under the Framework are Ethiopia and Zambia in early 2021, and lately Ghana in 2023. Although Zambia applied for debt treatment in early 2021, the negotiations were prolonged. It was not until June 2023 that Zambia eventually finalized a US\$6.3 billion debt restructuring deal, which included China but excluded private creditors.¹⁴

Besides coordination challenges, the multiplicity of creditors particularly the participation of private creditors remains a challenge. Volz et al. (2020) note that the short time frame set for DSSI liquidity relief by the G20 made private sector participation less likely, partly because the debtor governments refrained from requesting their involvement. From the debtors' perspective, the limited participation in the G20 debt relief initiatives can be attributed to concerns about potential implications associated with the negative stigma of taking part. Cassimon et al. (2023) argue that in considering whether to participate or not, the eligible debtor countries only choose to participate now when the expected net benefit of doing so exceeds the value of waiting and being able to gather more information about the net benefits. Of particular concern is the negative signal their participation could send about their creditworthiness, and thereby lead to a sovereign default and prolonged exclusion from capital markets (Volz et al. 2020). Arguably, countries guard against such repercussions including being downgraded by credit rating agencies. A missed debt service payment to a private creditor implies an outright default. Moreover, in the case of distressed debt exchange (DDE), a default does not require a missed payment.¹⁵ The Common Framework for Debt Treatment still lacks a mechanism for meaningful private creditor involvement and fails to address the first-mover problem for participating countries.

In general, the current G20 initiatives, besides being inadequate, have seemingly remained less attractive and fallen short of providing the much-needed restoration of debt sustainability pathway for the SSA economies in distress or at high risk of debt distress. While a timely and orderly debt resolution could help to foster confidence and encourage participation, a comprehensive package including debt relief is vital. Additionally, debt contracts should include clauses that automatically lower or suspend debt service in the event of significant economic shocks or natural catastrophes. Debt restructuring need not wait until a country defaults.

Most SSA economies have had no choice but to turn to the multilateral financial institutions, particularly the Bretton Wood Institutions for support through their various respective lending facilities. According to World Bank (2023), the World Bank accounted for 42% of the debt stock owed to multilateral creditors by countries eligible for borrowing from its International Development Association (IDA) in 2022. As of March 2023, IMF had 21 lending arrangements with countries in the SSA region, with additional programmes under request or discussion. Since March 2020, the IMF stepped up its lending including emergency financing following the immense challenges caused by the pandemic. The IMF financial assistance to LICs increased markedly from an average of US\$2 billion a year before the pandemic to about US\$12 billion in 2020, largely through emergency financing instruments (IMF 2021). More than half of the countries that

¹⁴ The country is still working out a deal with its international bondholders.

¹⁵ 'A DDE is a situation in which the issuer offers bondholders a new package of securities that amounts to a diminished financial obligation, or where the exchange has the apparent purpose of helping the borrower avoid default (Moody's 2002)' (Volz et al. 2020: 41).

received that financial support were in SSA.¹⁶ Additionally, in 2021, the IMF Board approved a general allocation of about (Special Drawing Rights) SDR456 billion (equivalent to US\$650 billion) to boost global liquidity. However, since the allocations are traditionally based on existing quotas and not on need basis, Africa's share was meagre — US\$27billion which is equivalent to 4.2% of total allocation.

While the IMF's balance of payment financial support has been handy, the programme loans often come with several stringent conditionalities. These currently include fiscal consolidation attained through increased taxation, removal of subsidies, and expenditure cuts. Whereas aggressive fiscal consolidation could be one of the key strategies of managing public debt, it is coming at a time when the African governments and economies are writhing from tough economic challenges ranging from depleted fiscal buffers following the aftermaths of COVID-19 pandemic, high cost of living, the impact of the Russia-Ukraine war, subdued demand, and the ravaging climate change impact, among others. In a bid to increase domestic tax revenue, the Kenyan government has for instance, instituted multiple taxes and levies that have led to a public outcry and concern with regard to their efficacy and impact on the economy. Excessive blanket budget cuts coupled with the high debt servicing costs could derail development progress in the region, including investment in infrastructure, social sectors such as health and education, and provision of safety nets to the vulnerable population.

Avenues for long-term concessional sources of finance are needed. The New Development Bank set up by BRICS¹⁷ — a group of emerging economies — has potential to play a more prominent role in supporting Africa's sustainable development agenda; e.g. through concessional financing. The Bank was set up in 2015 with the aim of mobilizing resources for infrastructure and sustainable development projects in emerging market economies and developing countries. However, so far its impact on the continent is limited.

7 Conclusion and policy insights

SSA's rising public debt burden remains a challenge to sustainable development in the region. This follows a period of increased debt accumulation, largely propelled by access to commercial debt via international financial markets and bilateral lending particularly from China. The debt accumulation is mainly attributable to large-scale financing of increased investment demand for infrastructure projects in a bid to fill the huge infrastructure gaps, maturity and currency mismatches, and high vulnerability to interest rate and exchange rate volatility, among others. The public debt challenges have been heightened by multiple shocks particularly the adverse impact of COVID-19 pandemic, the tight global financial conditions following monetary policy tightening in advanced economies, depreciation of domestic currencies and climate change impacts amid lack of fiscal space, leading to increased cost of servicing debt. Unlike multilateral concessional lending, commercial debt is costlier and subject to interest rate changes. SSA governments are grappling with a high debt servicing burden amidst multiple development challenges and limited revenues.

The heavy debt burden has led to heightened public debt sustainability challenges. Consequently, the risk of debt distress has increased. One half of SSA's low-income countries are either already in debt distress or at high risk of it. Basically, all the SSA countries whose debt sustainability is

¹⁶ In 2021, the Catastrophe Containment and Relief Trust was modified to allow for debt service relief for LICs affected by pandemic.

¹⁷ Saudi Arabia, Iran, Egypt, Ethiopia, and the United Arab Emirates joined recently.

assessed using the joint World Bank-IMF LIC-DSF are facing some form of debt sustainability risk, ranging from ‘moderate’ to ‘distressed’. Based on the published DSAs as of end of February 2024, six out of the nine countries in debt distress are in SSA. Of the six, four are middle-income countries (Congo Republic, São Tomé and Príncipe, Zambia, Ghana), while two (Zimbabwe and Malawi) are LICs, with Malawi and Ghana being the latest countries to join the group. Additionally, 12 SSA countries are at high risk of debt distress, including countries like Kenya and Guinea-Bissau whose debt distress risk was moderate before COVID-19 pandemic. Meanwhile, debt sustainability risk of the HIPC countries that were traditionally known to be at low risk of debt distress before the pandemic have since increased from ‘low’ to ‘moderate’ — these include Tanzania, Rwanda, Senegal, Madagascar, and Uganda.

There are no quick fixes nor a one-size-fits-all solution to SSA’s rising public debt burden — particularly considering the multiplicity of creditors and challenges. Sustainable long-term solutions will require a concerted multi-pronged approach. This calls for critical role of various stakeholders at the domestic and international levels. Despite the pressing public debt challenges, and unlike the debt crisis of the 1980s, a debt relief programme is still largely missing in global public debt-related initiatives and debates. In the short run, and at the very worst, most countries in debt distress require debt restructuring to get breathing space and re-organize. Unfortunately, the G20 Common Framework has been rocked with coordination challenges and protracted negotiations for the very few countries that have sought debt treatment and, hence, not lived up to expectations. More needs to be done to make the framework more effective in addressing SSA’s public debt burden. While timely and orderly debt restructuring could help to foster confidence and encourage participation, a comprehensive package including debt relief and expansion of the framework to debt-burdened countries at high risk of distress is crucial. More importantly, access to long term international finance in the form of concessional flows remain a critical source of external financing for LICs. Hence, there is need for concerted efforts by the international community to enhance its availability and predictability.

Domestically, fiscal consolidation has become inevitable, particularly for countries on IMF lending programmes. However, fiscal consolidation comes at a cost and at a time when the economies are struggling with multiple challenges such as climate change impact, high cost of debt servicing, cost of living, and unemployment. High cuts in government spending are likely to curtail development spending and expenditure towards provision of public services, social protection and human capital development. Domestic resource mobilization through widening of the tax base, digitalization, financial deepening, capital market development as well as innovative public-private partnership strategies are viable options to be explored. That notwithstanding, these strategies should be accompanied by enhanced efficiency in public spending, accountability, proper planning and effective debt-management particularly considering complexities of multiple creditors. SSA’s long-term sustainability of public debt and socioeconomic development will require economic transformation; e.g., export-led growth through increased access to global markets and value chains, leveraging regional trade integration opportunities such as African Continental Free Trade Area, increased value addition and unlocking domestic supply constraints. Development banks geared towards providing long term finance could also prove helpful. In this regard, BRICs’ New Development Bank should play a more prominent role in supporting Africa’s quest for development.

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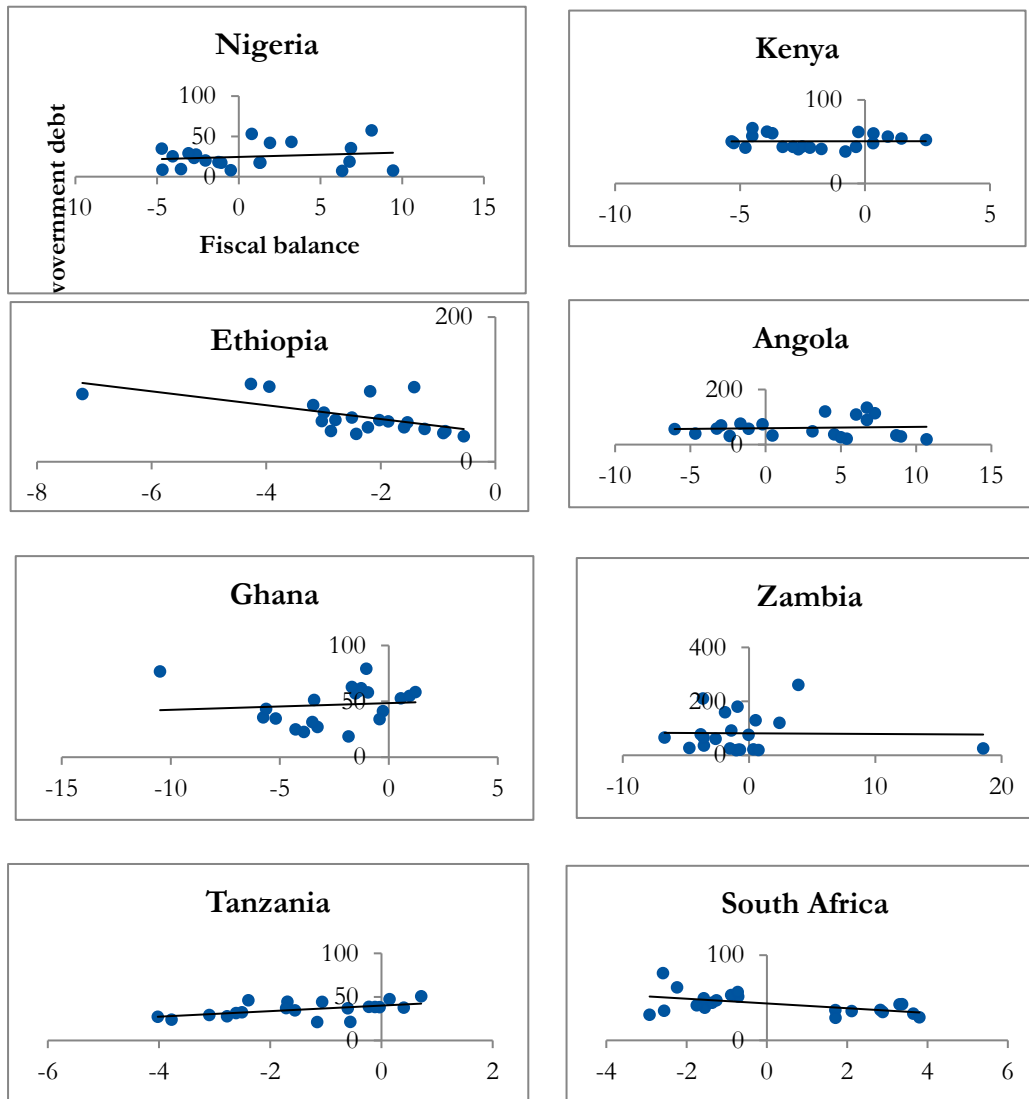
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Appendix 1

Figure 1: Relationship between public debt and fiscal balance in select SSA countries



Source. author's illustration based on WEO data (various).