

AFRICA'S RISING DEBT

IMPLICATIONS FOR DEVELOPMENT FINANCING AND A SUSTAINABLE DEBT MANAGEMENT APPROACH

Adedeji Adeniran, Mma Amara Ekeruche, Olalekan Samuel
Bodunrin, Abdelaaziz Ait Ali, Badr Mandri & Ghazi Tayeb



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The Global Economic Governance (GEG) Africa programme is a policy research and stakeholder engagement programme aimed at strengthening the influence of African coalitions at global economic governance forums such as the G20, BRICS, World Trade Organization and World Bank, among others, in order to bring about pro-poor policy outcomes.

The second phase of the programme started in March 2016 and will be implemented over a period of three years until March 2019.

The programme is expected to help create an international system of global economic governance that works better for the poor in Africa through:

- undertaking substantial research into critical policy areas and helping South African policymakers to prepare policy papers for the South African government to present at global economic governance platforms;
- ensuring that African views are considered, knowledge is shared and a shared perspective is developed through systematic engagement with African governments, regional organisations, think tanks, academic institutions, business organisations and civil society forums; and
- disseminating and communicating research and policy briefs to a wider audience via mass media and digital channels in order to create an informed and active policy community on the continent.

The programme will be focused on three thematic areas: development finance for infrastructure; trade and regional integration; and tax and transparency.

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EXECUTIVE SUMMARY

Presently, 19 African countries have exceeded the 60% debt-to-gross domestic product (GDP) threshold prescribed by the African Monetary Co-operation Programme (AMCP) for developing economies, while 24 have surpassed the 55% debt-to-GDP ratio suggested by the International Monetary Fund (IMF). More worryingly, using the IMF debt service-to-revenue threshold and benchmark, only two out of the 16 countries facing a high risk of debt distress have the capacity to pay it off. The debt increase raises concerns among bilateral creditors and international financial institutions, as several countries continue to take on more debt to manage debt burdens and poor macroeconomic conditions. This is taking place on the back of two prominent debt relief initiatives, the Heavily Indebted Poor Country (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI), which offered \$99 billion in debt relief, addressing about 40% of Africa's total public debt.

Several factors are driving Africa's rising debt, including deteriorating macroeconomic conditions and rising fiscal deficits on the back of poor growth, exchange rate volatility, adverse climatic conditions, political instability (in some countries) and the 2014 commodity price shock.

Over the last decade, the structure of Africa's debt profile has changed considerably. There has been a shift to market-based loans and a decline in concessional loans as a share of external loans, from 66% in 2005 to 54% in 2016. This has increased debt-servicing costs for African countries. While China has emerged as a dominant financier relative to other creditors, there has been an overall downward trend in the total value of loans that China has offered the continent since 2013. Nonetheless, there are important differences and implications for African borrowers in the approaches of Development Assistance Committee lenders versus that of China.

This paper draws on comparative debt management strategies across the region, highlighting both challenges and best practices, specifically in Nigeria and Morocco. Fiscal authorities in both countries and beyond employ key strategies, such as issuing bonds on the longer end of the spectrum, to finance long-term projects that have the capacity to generate adequate revenue. In addition, borrowing is skewed towards external debt and a variety of debt instruments are being issued to mitigate the crowding out of the private sector and capturing a wider set of creditors. In addition, other non-conventional methods are being deployed to reduce the size of debt. Several countries are increasingly mobilising domestic resources through voluntary tax compliance schemes and efforts to formalise their economies, while improving the efficiency of public expenditure. However, challenges such as the

quality of cost–risk analysis, viable and independent debt management offices and data inefficiencies still exist.

In view of the continent’s development needs and socio-economic challenges, alongside current fiscal constraints, sovereign debt financing is inevitable. However, achieving debt sustainability while working towards meeting the Sustainable Development Goals and attaining macroeconomic stability is critical. While the current debt situation at 46% of GDP in 2017 in no way corresponds with the 116% debt-to-gross national income ratio of 1995, the paper makes several recommendations to manage Africa’s debt burden in a more sustainable manner:

- Maintain and promote prudent macroeconomic principles to curb and closely manage rising debt servicing costs.
- Promote economic diversification and expand revenue generation to reduce the effect of commodity price shocks on fiscal stability.
- Develop and deepen domestic debt markets to curtail the dependence on external loans and avoid exchange rate risks, while carefully managing the structure of debt.
- Explore other domestic financing options, such as expanding the tax base through efficient tax collection, leveraging private sector capital through public–private partnerships and using various debt instruments.
- Establish autonomous, well-resourced and functional debt management offices, enhance debt-recording systems, improve data transparency and invest in debt management and risk strategies.
- Explore the capacity-building and technical assistance offered by multilateral development banks (MDBs) to develop sound debt management institutions.
- Enhance engagement between lower-income countries and MDBs to overcome their reluctance to access concessional loans despite the long maturity and low interest rates on offer.

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INTRODUCTION

Debt sustainability in Africa is resurfacing on the back of the rising debt profile of many African countries. Currently, 19 out of 54 countries on the continent have exceeded the debt benchmark ratio of 60% of gross domestic product (GDP) prescribed by the African Monetary Co-operation Programme (AMCP) and 24 countries have surpassed the 55% debt-to-GDP ratio suggested by the International Monetary Fund (IMF),¹ at which additional debts lead to output volatility or weakens economic growth.² According to the World Bank's pulse report, 18 countries were at high risk of a debt crisis as at March 2018, compared to eight countries in 2013.³

- 1 World Bank, 'World Development Indicators', 2018, <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>, accessed 26 September 2018.
- 2 Greenidge K *et al.*, 'Threshold Effects of Sovereign Debt: Evidence from the Caribbean', IMF (International Monetary Fund) Working Paper, 2012, <https://www.imf.org/external/pubs/ft/wp/2012/wp12157.pdf>, accessed 10 September 2018; Pescatori A, Sandri D & J Simon, 'Debt and Growth: Is There a Magic Threshold?', IMF Working Paper, 2014, <file:///C:/Users/684971/Downloads/wp1434.pdf>, accessed 4 September 2018; Rustomjee C, 'Debt Sustainability in African HIPC's; Deteriorating Prospects', CIGI (Centre for International Governance Innovation) Policy Brief, 120, 2017, <https://www.cigionline.org/publications/debt-sustainability-african-hipcs-deteriorating-prospects>, accessed 26 September 2018.
- 3 World Bank, *Africa's Pulse: An Analysis of issues Shaping Africa's Economic Future*, 16, October 2015.

In addition, tax receipts are dwindling given worsening macroeconomic conditions (Figure 4) and continuing oil and commodity price shocks, making it difficult to meet the rising cost of debt – even for countries with a modest debt-to-GDP profile.

Of concern too is the changing structure of Africa's debts: countries are tilting towards non-concessional and domestic debt with higher interest rates. The ease of access to and control by governments over the domestic debt market is leading to excessive public debt accumulation and macroeconomic instability.⁴ Aside from the high interest rate and debt-servicing burden, excessive domestic debt also stifles credit to the private sector, the main engine of growth and job creation. Africa's debt position has significant broader implications given the interconnectivity of African economies with the global financial market, the social impact of debt build-ups on sustainable development, the widening infrastructure deficit despite the rising debt commitment, dampened growth prospects and the high incidence of poverty.

The deleterious effect of past debt crises is well recognised in Africa. Notably, the debt overhang of the 1990s significantly constrained fiscal space and had a debilitating effect on economic development. In fact, the motivation for the debt-forgiveness initiatives (the Heavily Indebted Poor Country, or HIPC, initiative and the Multilateral Debt Relief Initiative, or MDRI) was to remove debt bottlenecks and free resources for development. Following debt relief, several African countries experienced a decade of robust economic growth and positive gains in poverty reduction. Another debt crisis is a major threat to these gains and therefore requires a swift and effective policy response to ensure fiscal responsibility without neglecting development needs.

The paper has five sections. The first section provides a historical background of the past debt crises in Africa and the key drivers of the present debt build-up. This is followed by a discussion of the current fiscal position of African countries and an evaluation of the level of debt sustainability. The next section examines conventional and complimentary debt management strategies being deployed by countries. The paper then explores debt sustainability more deeply through case studies of Nigeria and Morocco, and concludes with a summary of the findings and policy recommendations on viable debt strategies.

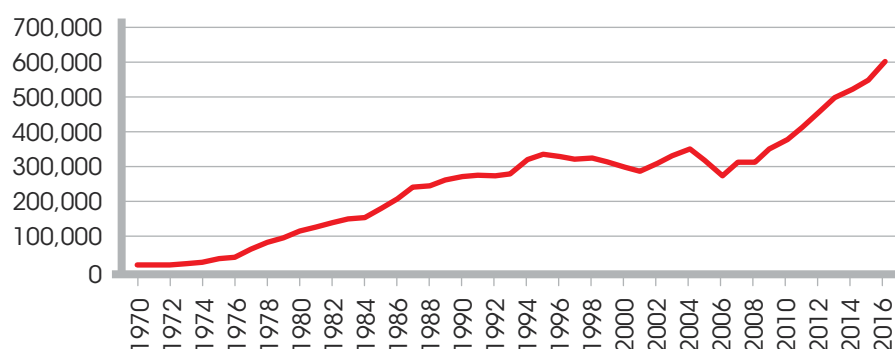
HISTORY OF DEBT CRISES IN AFRICA

Africa's debt crises began in the late 1970s when many African countries, handicapped by the shortage of domestic savings and relying on commodity price booms, accumulated external loans to finance public expenditure. Following the oil and commodity price shocks of 1973, countries increasingly took on new loans to smooth their expenditure with the expectation that the prices would eventually

4 World Bank, *Africa's Pulse*, 17, April 2018.

recover. Between 1976 and 1980, external debt grew by 187%, from \$39 billion to \$112 billion (see Figure 1).⁵

FIGURE 1 EXTERNAL DEBT IN AFRICA (\$ MILLION), 1970–2016



Source: World Bank, 'International Debt Statistics', http://databank.worldbank.org/data/download/IDS_Excel.zip, accessed 5 June 2018

For many countries, particularly those affected by commodity price developments, the rationale for incurring debt was to stimulate economic recovery through an expansionary fiscal policy, but lax fiscal management led to sclerotic growth. In addition, productive sectors such as manufacturing and agriculture collapsed. For example, most of the borrowed funds were channelled towards consumption and non-export-oriented projects, which lacked the capacity to generate revenue for debt service repayments. A second commodity shock followed in 1979–80, further depressing the non-tradable sector and worsening the overall export performance. As a result, external debt-to-export and debt-to-gross national income (GNI) ratios grew by 218% and 110% respectively between 1980 and 1987 (Figure 2). Growing fiscal deficits were followed in short succession by a rise in foreign interest rates and a decline in net capital inflows, leaving many African countries unable to meet their debt service obligations.⁶

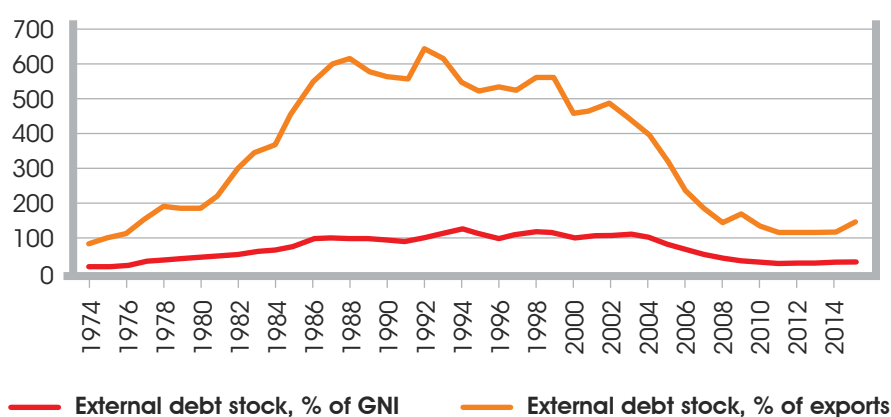
Development finance institutions responded to the 1980s debt crisis by establishing adjustment programmes to strengthen export earnings and reduce imports alongside inflation. In 1980, the WB and IMF introduced structural adjustment lending, which stipulated certain economic pre-conditions for funds to be released

5 Krumm KL, 'The External Debt of Sub-Saharan Africa: Origins, Magnitude and Implications for Action', World Bank Staff Working Paper, 741, 1985, <http://documents.worldbank.org/curated/en/958551468768269528/pdf/multi0page.pdf>, accessed 26 September 2018.

6 Greene JE & MS Khan, 'The African Debt Crisis', AERC (African Economic Research Consortium) Special Paper, 3, February 1990, <https://idl-bnc-idrc.dspacedirect.org/bitstream/handle/10625/12010/88201.pdf?sequence=1>, accessed 26 September 2018.

for targeted projects. These conditionality-based financial assistance programmes catalysed the granting of debt relief by bilateral creditors and commercial banks. Between 1980 and 1984 the Paris and London clubs granted \$10 billion in debt relief to sub-Saharan Africa.⁷

FIGURE 2 EXTERNAL DEBT AS A PERCENTAGE OF GNI AND EXPORT, 1974–2015



Source: World Bank, 'International Debt Statistics', http://databank.worldbank.org/data/download/IDS_Excel.zip, accessed 5 June 2018.

Despite the emergence of structural adjustment loans and debt relief by bilateral creditors, economic conditions remained troubling across the continent. In response, the IMF established the Structural Adjustment Facility (SAF) in 1986 to provide assistance on concessional terms to low-income countries that were undertaking Structural Adjustment Programmes (SAPs). The SAPs targeted the restructuring and diversification of the productive base of the economy, achieving fiscal and balance of payments' stability, laying the foundation for non-inflationary growth and reducing the dominance of unproductive investments in the public sector.⁸ In 1988 the SAF was modified into the Extended Structural Adjustment Facility (ESAF), providing additional financial assistance to have a greater impact on accumulated debt burdens. However, instead of achieving the intended impact, the SAPs resulted in large current account deficits, astronomical inflation and depressed currencies

7 Greene J, 'The external debt problem of sub-Saharan Africa', *IMF Economic Review*, 36, 836, 1989, pp. 836–874.

8 Jauch H, 'Structural Adjustment Programmes: Their Origin and International Experiences'. LaRRI (Labour Resource and Research Institute), 1999.

across the continent.⁹ At the end of the SAPs, debt burdens had increased even further and most of the continent was clearly on an unsustainable debt path.¹⁰

This led the WB and the IMF to establish the HIPC initiative in 1996 to provide debt relief and reduce debt service payments for countries in debt distress. Eligible countries under the HIPC were granted an annual debt service reduction of up to 80% of their debt obligations as they became due until the committed debt relief had been provided in full. Countries were selected based on three parameters: a debt-to-GDP ratio of 50% and above; a debt-to-export ratio of 150% and above; and a debt-to-government revenue ratio of 250% and above.

The selection criteria were criticised for lacking a poverty reduction component and being overly uniform in approach. In 1999 the HIPC was modified to allow more countries to qualify for the initiative, increase the size and pace of debt relief, and link debt relief to poverty reduction. In addition, in 2005 the IMF initiated the MDRI to support the continent in achieving the Millennium Development Goals by providing full debt relief on eligible debt. Under the HIPC and MDRI, 36 countries – including 30 African countries – reached the completion point, resulting in debt relief of \$99 billion by the end of 2017.¹¹ The HIPC and MDRI reduced the external debt-to-GNI ratio by more than half, from 118% to 45% between 1999 and 2008 (Figure 2).

RECENT DRIVERS OF INCREASING DEBT IN AFRICA

After more than a decade of debt relief, the debt trajectory of African countries is again edging upwards (see Figure 3). Between 2013 and 2017, the debt-to-GDP ratio of sub-Saharan Africa rose from 30% to 46%. The situation is much worse for oil producers, where the ratio more than doubled in the same period. In 2013 Djibouti was the only African country with a high debt risk.¹² By 2018, nine countries, including eight post-HIPC countries, had transitioned from a low or moderate debt risk level to a high risk of debt or debt distress.¹³

Several factors are driving Africa's rising debt. One way to delineate these inter-related factors is by dissecting the evolution of the key components of debt.

9 For instance, one dollar was worth 77 Nigerian kobo (1 naira = 100 kobo) in 1986 before the introduction of the SAP. By 1993, one dollar was worth 22 Nigerian naira.

10 Jauch H, *op. cit.*

11 IMF, 'Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) Statistical Update', Policy Paper, 15 September 2017, <file:///C:/Users/684971/Downloads/pp090117hipc-mdri.pdf>, accessed 26 September 2018.

12 IMF, 'Macroeconomic Developments and Prospects in Low-Income Developing Countries', Policy Paper, 2018, <https://www.imf.org/external/np/pp/eng/2014/091814.pdf>, accessed 26 September 2018.

13 *Ibid.*

A change in the debt equation can be written as:

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

where D/Y = ratio of past debt to GDP;

P/Y = ratio of primary deficit to GDP;

r = real interest rate;

g = growth rate of real GDP.¹⁴

Over the past decade, parameters have changed in a direction that has increased Africa's debt. For instance, deficit financing (P) has increased significantly following the 2007/2008 global financial crisis. Between 2004 and 2008, the overall fiscal balance as a share of GDP in sub-Saharan Africa stood at 0.4%, declining severely to -5.6% in 2009 and remaining in negative territory since the financial crisis, reaching -5.5% in 2016. In broad terms, the 2014 commodity price shock, low global demand and underlying structural defects in African economies have cumulatively contributed to the low earning position of governments. In addition, some countries have accessed international capital markets to finance infrastructure investment as a countercyclical fiscal measure to compensate for the fall in private sector spending.¹⁵ The WB supports the claim that rising fiscal deficits have driven debt accumulation.¹⁶

The interest rate (r) has not had a significant impact on the change in debt during the period under consideration. While domestic interest rates are relatively high, their impact on debt has been insignificant. Only a few African countries, such as South Africa, Nigeria, Uganda and Ghana, have developed debt markets capable of absorbing large transactions.

From 2012 onwards, exchange rate volatility has contributed significantly to the worsening debt profile in several countries.¹⁷ Large exchange rate depreciations particularly in oil exporters and countries with worsening economic conditions (Democratic Republic of Congo, or DRC, Liberia) inflated the size of the external

14 Rangarajan C & DK Srivastava, 'Dynamics of debt accumulation in India: Impact of primary deficit, growth and interest rate', *Economic and Political Weekly*, 38, 46, 2003, pp. 4851–4858.

15 In Nigeria, for instance, where external debt increased by 63% in 2017 alone, the government accessed international capital markets twice, with a Eurobond issuance of about \$7.8 billion to fund capital expenditure in the 2016 budget and a \$3 billion issuance to restructure the debt portfolio and fund capital expenditure in the 2017 budget. See DMO (Debt Management Office), 'Using sukuk to finance infrastructure', Press Release, 9 April 2018, <https://www.dmo.gov.ng/fgn-bonds/sovereign-sukuk/2403-using-sukuk-to-finance-infrastructure-dmo-inspects-roads-financed-by-sukuk/file>, accessed 10 September 2018.

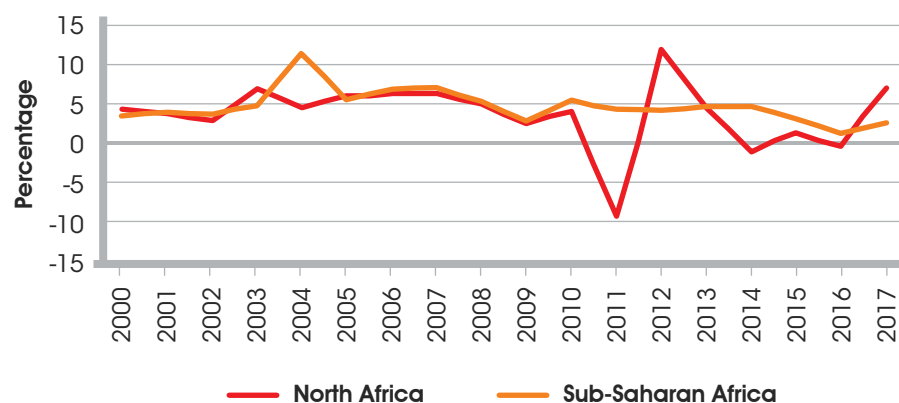
16 World Bank, 'Debt: Overview', <http://www.worldbank.org/en/topic/debt/overview#2>, accessed 2 October 2018.

17 IMF, 'Review of the Debt Sustainability Framework for Low Income Countries – Annexes', IMF Policy Paper, 17/380. Washington DC: IMF, 2017.

debt. According to the WB, exchange rate dynamics account significantly for the marked increase in African debt.¹⁸

Over this period, the continent also experienced tepid economic growth (g), which adversely affected debt levels. Sub-Saharan Africa's real GDP growth declined from 5.3% in 2013 to 2.8% in 2016 (see Figure 3). These declining revenues have affected the debt-servicing capacity of several countries. As a result, the fiscal fragility of countries has increased as a higher share of the budget goes into debt-servicing payments.

FIGURE 3 AFRICA GDP GROWTH (ANNUAL %), 2000–2017



Source: World Bank, 'World Development Indicators (WDI)', <https://datacatalog.worldbank.org/dataset/world-development-indicators>, accessed 5 June 2018. (Graph generated by Author)

CURRENT OVERALL STATE OF DEBT ON THE CONTINENT

COUNTRIES' FISCAL POSITIONS

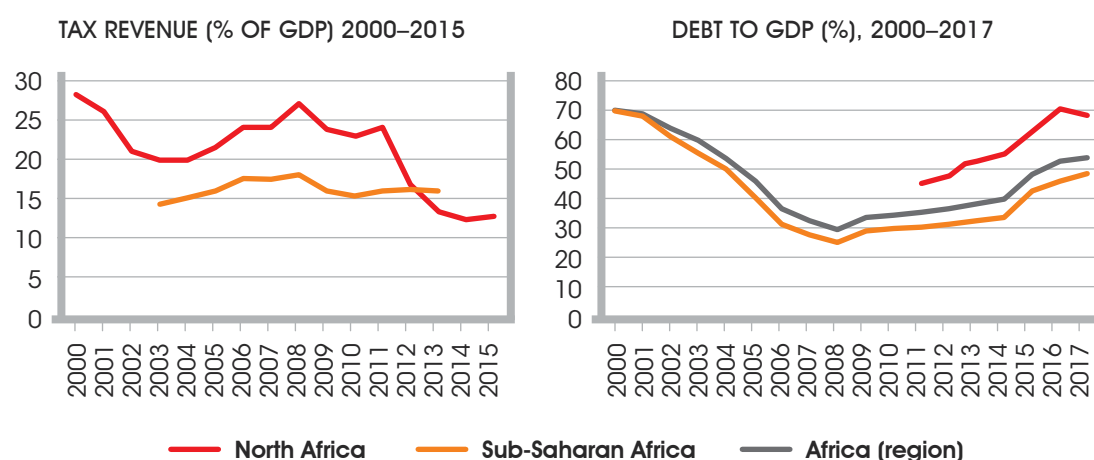
African countries are only now slowly recovering from the collapse in oil and other primary commodity prices in 2014–2016 and the adverse climatic conditions that affected agricultural producers in the last three years. Commodity-dependent economies experienced not only dwindling revenues but also increased inflation, currency depreciation, rising unemployment and economic recession.¹⁹ Most resorted to borrowing, leveraging either their previously strong growth or their low

¹⁸ World Bank, April 2018, *op. cit.*

¹⁹ Allen K & C Giles, 'Rising tide of debt to hit rich countries' budgets, warns OECD', *Financial Times*, 22 February 2018, <https://www.ft.com/content/e83eb3a8-1663-11e8-9e9c-25c814761640>, accessed 9 September 2018.

debt-to-GDP ratio. While Africa's debt-to-GDP ratio rose to an average of 50% in 2017, tax revenue-to-GDP remained flat at 17% (Figure 4). These trends reflect the countercyclical fiscal policies implemented in most African countries, coupled with poor public financial management. Those countries with increased fiscal deficits tended to fill the gap with accumulated debt (Figure 4), showing a strong correlation between several years of current account and government budget deficits.²⁰

FIGURE 4 TAX REVENUE TO REVENUE AND DEBT TO GDP, % (2000–2017)



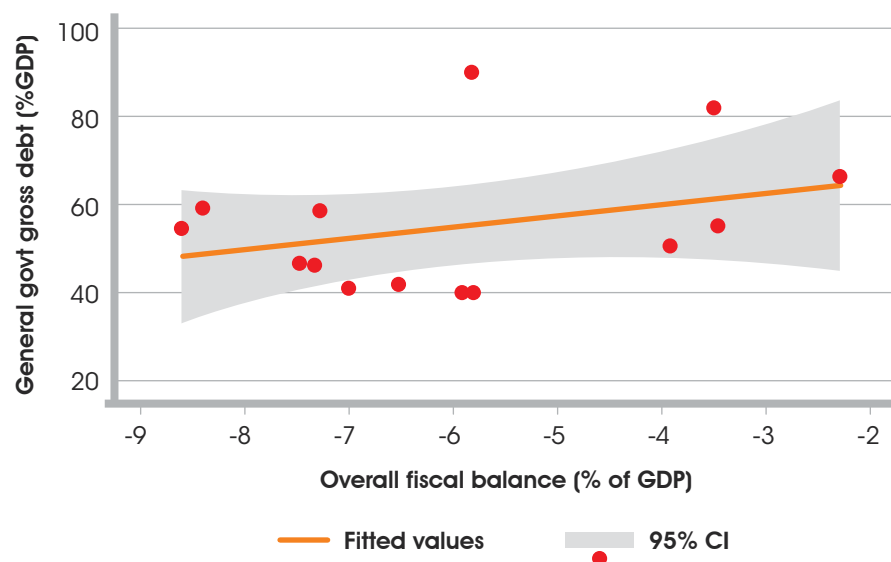
Source: World Bank, 'World Development Indicators (WDI)', <https://datacatalog.worldbank.org/dataset/world-development-indicators>, accessed 5 June 2018; IMF, 'General government gross Debt (percent of GDP)', https://www.imf.org/external/datamapper/ggxdwg_ngdp@weo/oemdc/advoc/weoworld, accessed 5 June 2018

Since 2014, countries in Northern Africa, including Morocco, Algeria, Tunisia, Egypt and Sudan, have confronted economic challenges. This is due in the main to commodity dependence. Presently, Morocco has one of the highest debt-to-GDP ratios in North Africa, after Egypt and Tunisia (see Figure 6). Egypt is currently undergoing reform supported by the IMF's Extended Fund Facility (EFF Arrangement) to address its economic regression following years of political and social instability.²¹

20 Ighobor K, 'Commodity prices crash hits Africa', *Africa Renewal*, December 2016 – March 2017, <https://www.un.org/africarenewal/magazine/december-2016-march-2017/commodity-prices-crash-hits-africa>, accessed 9 September 2018.

21 Tešić A, Ilić D & AT Đelić, 'Consequences of fiscal deficit and public debt in financing the public sector', *Economics of Agriculture*, 61, 2014, pp. 177–194; IMF, 'Arab Republic of Egypt 2017 Article IV Consultation Second Review under the Extended Arrangement under the Extended Fund Facility, and Request for Modification of Performance Criteria – Press Release; Staff Report; and Statement by the Executive Director for the Arab Republic Of Egypt', Country Report, 18/14, 2018, <https://www.imf.org/en/Publications/CR/Issues/2018/01/22/Arab-Republic-of-Egypt-2017-Article-IV-Consultation-Second-Review-Under-the-Extended-45568>, accessed 20 November 2018.

FIGURE 5 GROSS DEBT AND FISCAL BALANCE, 2004–2017



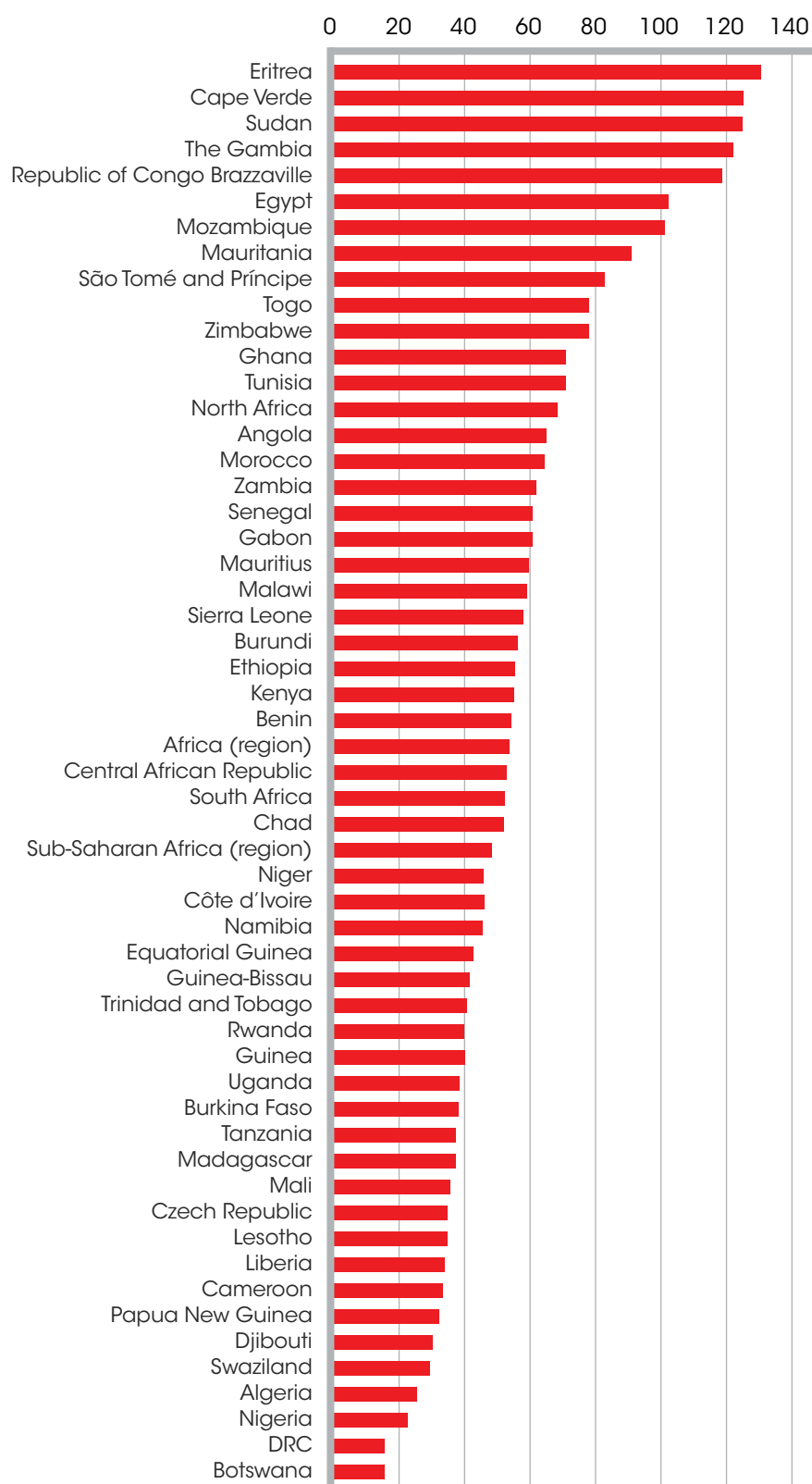
Source : World Bank, 'World Development Indicators', <https://datacatalog.worldbank.org/data-set/world-development-indicators>, accessed 5 June 2018]. (Graph generated by Author); IMF, 'General government gross Debt' https://www.imf.org/external/datamapper/ggxwdg_ngdp@weo/oemdc/advec/weoworld, accessed 5 June 2018

In sub-Saharan Africa the story is similar, as the overall fiscal balance has been negative since the financial and economic meltdown of 2007–08. Commodity price volatility and the resulting revenue declines have led to a debt build-up to meet the huge infrastructure gap. The economic crisis has been more severe in oil exporters such as Nigeria, Equatorial Guinea, the Republic of Congo Brazzaville, Gabon, Sudan and Angola, necessitating Angola to call on the IMF's supported policy coordination instrument to stabilise and diversify its economy.²² Angola's annual GDP growth declined in 2016 to -0.813 from 6.84% in 2013 following the oil price shock, with its current account deficit reaching 10% of GDP in 2015. The economic situation worsened when the agriculture sector contracted because of an input shortage, leading to foreign exchange rationing, a rising fiscal deficit, public debt accumulation and erosion of external buffers.

By 2016 public debt as a percentage of GDP had reached 79.8%, from 29.9% in 2012. Zambia had a similar experience with the collapse of the copper price in 2015, which weakened its fiscal position and led to an unsustainable debt build-up. While East African countries such as Ethiopia, Tanzania, Djibouti, Rwanda, Seychelles and Kenya have experienced robust growth in the agricultural and industrial sector, the

22 IMF, 'Statement by IMF Deputy Managing Director Tao Zhang on Angola', Press Release, 18, 2018, <https://www.imf.org/en/News/Articles/2018/08/21/pr18333-statement-by-imf-deputy-managing-director-tao-zhang-on-angola>, accessed 20 November 2018.

FIGURE 6 DEBT (% OF GDP), AFRICA COUNTRIES, 2017



Source: IMF, 'Regional Economic Outlook: Sub-Saharan Africa', World Economic and Financial Surveys, 2018

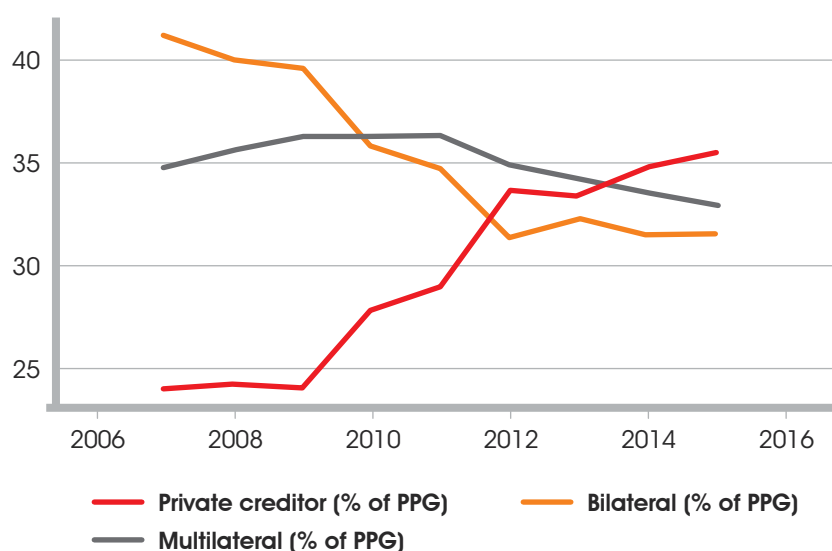
overall fiscal position is still fragile²³ owing to low domestic resource mobilisation and high public investment spending. A relative rise in current account deficits has led to build-ups in external debt ranging from 21.2% of GDP in Burundi to around 50% of GDP in Ethiopia and Somalia. Ethiopia, for example, has maintained an average annual real GDP growth rate of about 9.5% over the last five years, but also has a growing debt profile to finance its yearly fiscal deficit.

Despite significant socio-economic challenges, including a huge infrastructure gap, it is crucial to balance resource needs and the increase in debt with sustainability concerns, to avoid another debt crisis that could impair growth over the long term.

DEBT CHARACTERISTICS

Prior to the 1990s, Africa's debt was pre-dominantly bilateral (about 70%) as opposed to multilateral (30%), with concessional loans to low-income countries (LICs) with long maturity periods and low interest rates in the majority. Africa's debt structure changed after the HIPC and MDRI, shifting predominantly towards domestic debt. This shift was also from multilateral and bilateral to private creditors (Figure 7), despite the continued concessional terms available on multilateral and bilateral debt.

FIGURE 7 COMPOSITION OF AFRICA'S LONG-TERM DEBT



Source: World Bank Group IDS, 'Composition of Africa's long-term debt', <https://datacatalog.worldbank.org/dataset/international-debt-statistics>, accessed 5 June 2018

23 IMF Blog, 'Chart of the week: The potential for growth and Africa's informal economy', 8 August 2017, <https://blogs.imf.org/2017/08/08/chart-of-the-week-the-potential-for-growth-and-africas-informal-economy/>, accessed 2 October 2018.

This change has increased the cost of debt servicing as the interest rates on private sector loans range from between 15% to 25%, compared to less than 5% for concessional loans (multilateral and bilateral). This partly accounts for the increase in external debt from \$329.79 billion in 2007 to about \$600 billion in 2017.

Private vs. concessional

African debt stocks are from official and private sources. While official sources (multilateral and bilateral) have a higher proportion of concessional loans, private sources are made up of bonds issued by governments and commercial bank loans. Concessional loans are extended to countries at terms that are below market rates with a grant element. The grant element is the difference between the loan's face value and the net present value of future debt servicing, as a percentage of the loan's face value. A loan is considered concessional if its grant element is at least equal to 35% of the total loan.²⁴ The IMF is a major multilateral lender and provides concessional loans through the Global Concessional Financing Facility (GCF) and the Poverty Reduction and Growth Trust (PRGT). The GCF provides development support on concessional terms to middle-income countries (MICs) impacted by refugee crises and the PRGT is accessed through IMF-led programmes in LICs.²⁵ On average, concessional loans have a 25–40-year maturity period and zero to 2.5% interest rate.

In 2016, concessional loans represented 54% (see Figure 8) of total external loans in Africa, down from 66% in 2005.²⁶ African LICs²⁷ have greater access to concessional loans. Between 2007 and 2016 Africa moved away from concessional debt (see Figure 9) by 5.52 percentage points.²⁸ However, considerable variance exists across countries. For example, Botswana moved further away than any other African country, by about 65.4 percentage points, while Liberia, in contrast, has taken on more concessional debt.

24 Scott S, 'The Grant Element Method of Measuring the Concessional of Loans and Debt Relief', OECD (Organisation for Economic Co-operation and Development) Working Paper, 339, 2017, [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DEV/DOC/WKP\(2017\)5&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DEV/DOC/WKP(2017)5&docLanguage=En), accessed 14 September 2018.

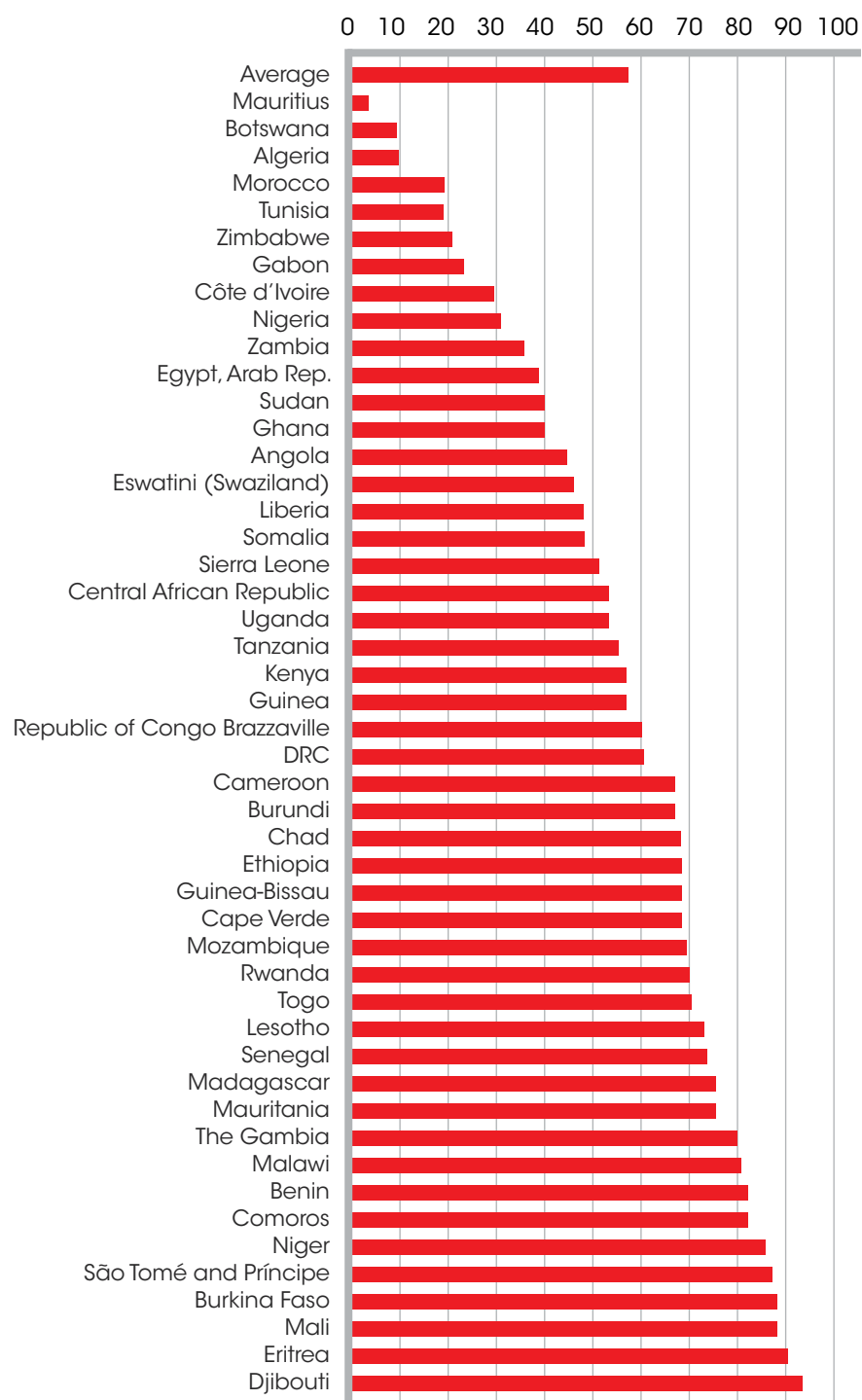
25 IMF, 'Factsheets: IMF support for low-income countries', <http://www.imf.org/en/About/Factsheets/IMF-Support-for-Low-Income-Countries>, accessed 2 October 2018.

26 World Bank, 'Debt: Overview', *op. cit.*

27 Countries with a gross national income per capita of \$1,025 or less, according to the World Bank 2016 classification.

28 For an analysis of why LICs are hesitant to access concessional loans, see Bertelsmann-Scott T, Markowitz C & A Parshotam, 'Mapping Current Trends in Infrastructure Financing in Low-Income Countries in Africa within the Context of the African Development Fund', GEG-Africa Discussion Paper, November 2016, http://www.saiia.org.za/wp-content/uploads/2016/11/GA_Th1_DP4_bertelsmann-scott-et-al_20161130.pdf, accessed 20 November 2018.

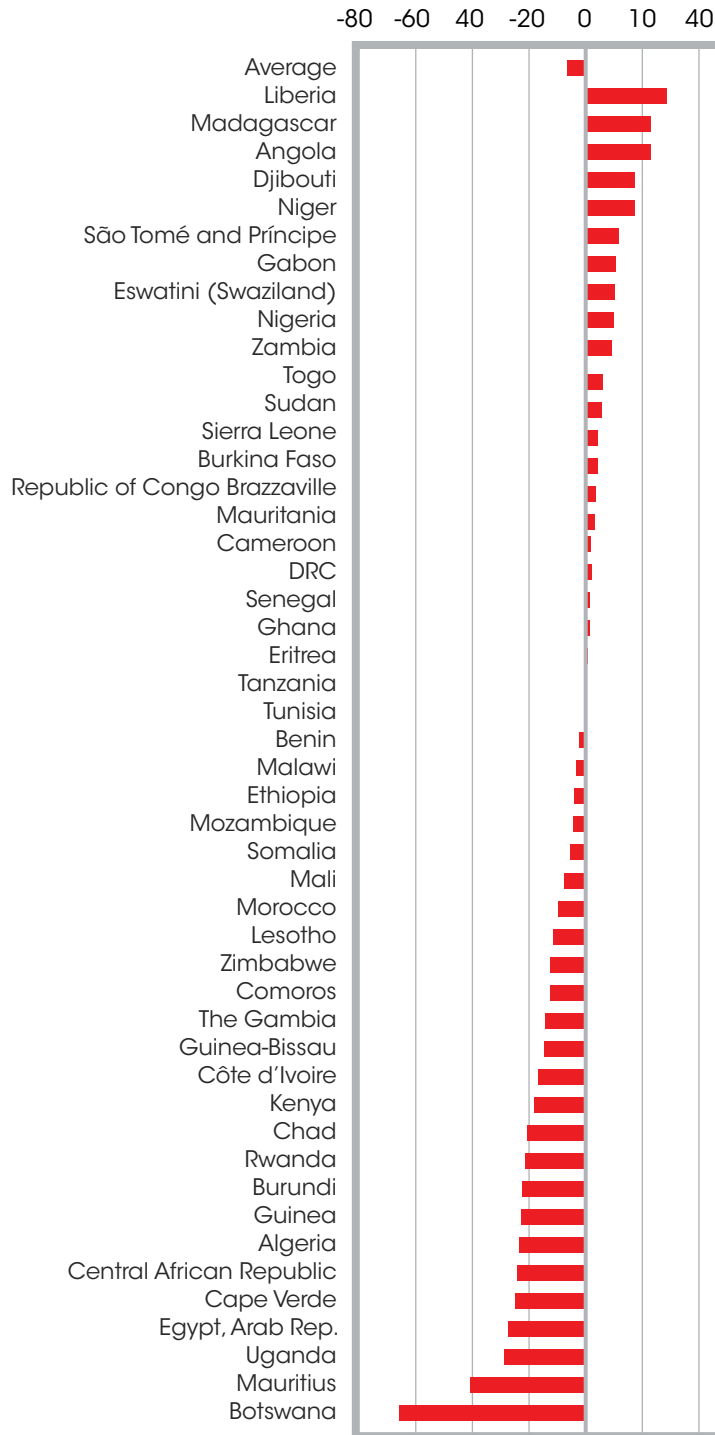
FIGURE 8 CONCESSIONAL DEBT IN AFRICA, (% OF TOTAL EXTERNAL DEBT) 2016



Note: Only African countries with any percentage of concessional debt of total external debt

Source: World Bank, 'World Development Indicators (WDI)', <https://datacatalog.worldbank.org/dataset/world-development-indicators>, 5 June 2018. (Graph generated by author)

**FIGURE 9 CONCESSIONAL DEBT AS A % OF EXTERNAL DEBT
(% POINT CHANGE, 2007–2016)**

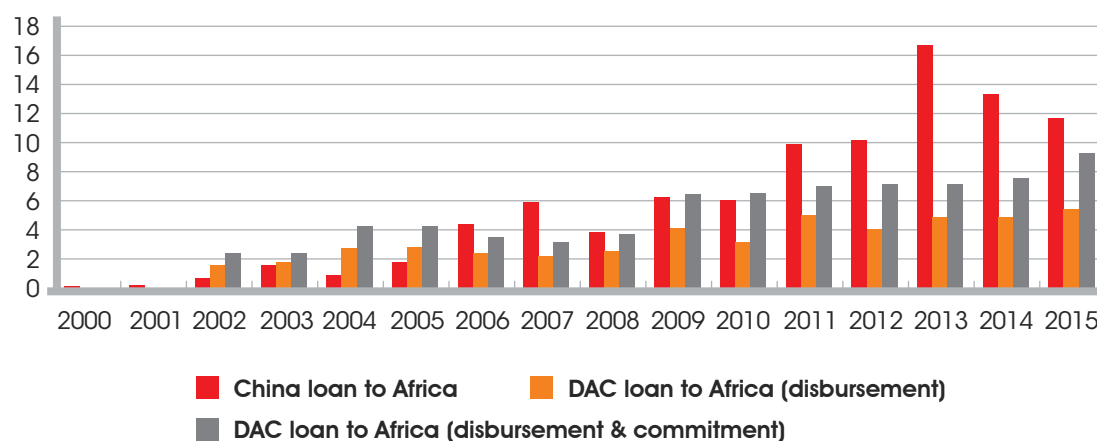


Source: World Bank, 'World Development Indicators', <https://datacatalog.worldbank.org/data-set/world-development-indicators>, accessed 10 July 2018. (Graph generated by author)

Debt sources: DAC vs. China

China's loans to Africa date back to the 1970s.²⁹ China's recent lending to Africa includes concessional loans to fund infrastructure projects as part of its Belt and Road Initiative (BRI). From 2009 to 2012 China provided \$10 billion in financing to Africa in the form of concessional loans, and about \$20 billion from 2013 to 2015.³⁰ Chinese lending to Africa is disbursed through its EXIM bank and targets project-oriented concessional loans for infrastructure construction in agriculture and hydroelectric dams, transportation, railway, telecommunications and agricultural equipment. In 2015 Chinese loans to Africa reached \$91.97 billion, with Angola the biggest recipient. However, overall Chinese lending to Africa has fallen progressively since 2013 (see Figure 10).

FIGURE 10 DAC VS CHINESE LOANS TO AFRICA, 2000–2015



Source: OECD, 'Detailed aid statistics: ODA Official development assistance: disbursements', OECD International Development Statistics (database), <https://doi.org/10.1787/data-00069-en>, accessed 5 June 2018. China Africa Research Initiative, 'the SAIS China Africa Research Initiative (SAIS-CARI)', 2015, <http://www.sais-cari.org/data-chinese-loans-and-aid-to-africa>, accessed 21 June 2018

29 China provided a zero-interest loan of RMB 980 million for the construction of the Tanzania–Zambia Railway between 1970 and 1975. Sun Y, 'China's Aid to Africa: Monster or Messiah?', Brookings East Asia Commentary, 7 February 2014, <https://www.brookings.edu/opinions/chinas-aid-to-africa-monster-or-messiah/>, accessed 20 November 2018.

30 Ebere U, 'Impact of South–South Co-operation in Achieving the Millennium Development Goals (MDGs) in Low-Income Countries', Background Paper for the 2015 European Report on Development, 2015, https://ec.europa.eu/europeaid/sites/devco/files/erd5-background-paper-ssc-impact-2015_en.pdf, accessed 15 September 2018.

DAC loans from Organisation for Economic Co-operation and Development (OECD) states have varied conditions (see Table 1).³¹ DAC loans to Africa reached \$48.9 billion in 2015 with committed (yet to be disbursed loans) of \$27.2 billion. Angola again was the biggest beneficiary of DAC loans. DAC loans are mostly deployed in the social sector, including education, health, social security and budget support.³²

TABLE 1 DAC LOAN TERMS

| | | BELGIUM | FRANCE | GERMANY | ITALY | JAPAN | KOREA | POLAND | PORTUGAL | TOTAL DAC |
|-----------------------------|----------------------------------|---------|--------|---------|-------|-------|-------|--------|----------|-----------|
| Loan share of total ODA (%) | | 1.9 | 35.5 | 20.5 | 2.5 | 61.7 | 51.4 | 11.1 | 11.9 | 16.2 |
| Terms of bilateral loans | Average maturity (years) | 35.8 | 18.1 | 15.0 | 38.3 | 32.0 | 39.5 | 35.0 | 24.8 | 25.8 |
| | Average grace period (years) | 14.6 | 5.3 | 5.5 | 25.6 | 8.8 | 12.3 | 6.2 | 8.9 | 7.6 |
| | Average interest rate (per cent) | 0.0 | 1.6 | 2.0 | 0.0 | 0.4 | 0.2 | 0.3 | 2.3 | 0.9 |
| | Grant element (percent) | 88.4 | 53.5 | 47.2 | 94.6 | 76.8 | 87.1 | 78.8 | 59.3 | 66.3 |

Source: OECD, 'Detailed aid statistics: ODA Official development assistance: Other Terms Parameters for loan-giving DAC countries', <https://www.oecd.org/dac/financing-sustainable-development/development-finance-data/TAB22e.xls>, accessed 5 June 2018

Compared to DAC loans, Chinese loans have strict requirements to ensure that infrastructure projects are constructed and completed. This is evident in the controversial use of Chinese firms and workers for project implementation, as well as the importation of construction materials from China.³³ For instance, China's concessional loan to Ethiopia in 2007 to support power, transport infrastructure, roads and industrial development was tied to the use of Chinese companies.³⁴ While some DAC loans are based on the macroeconomic conditions of borrowing

31 Korea has the highest average maturity years (39.5 years) and Germany has the lowest (15 years). Italy and Belgium's loans are interest-free, while Portugal has the highest interest rate of 2.3%.

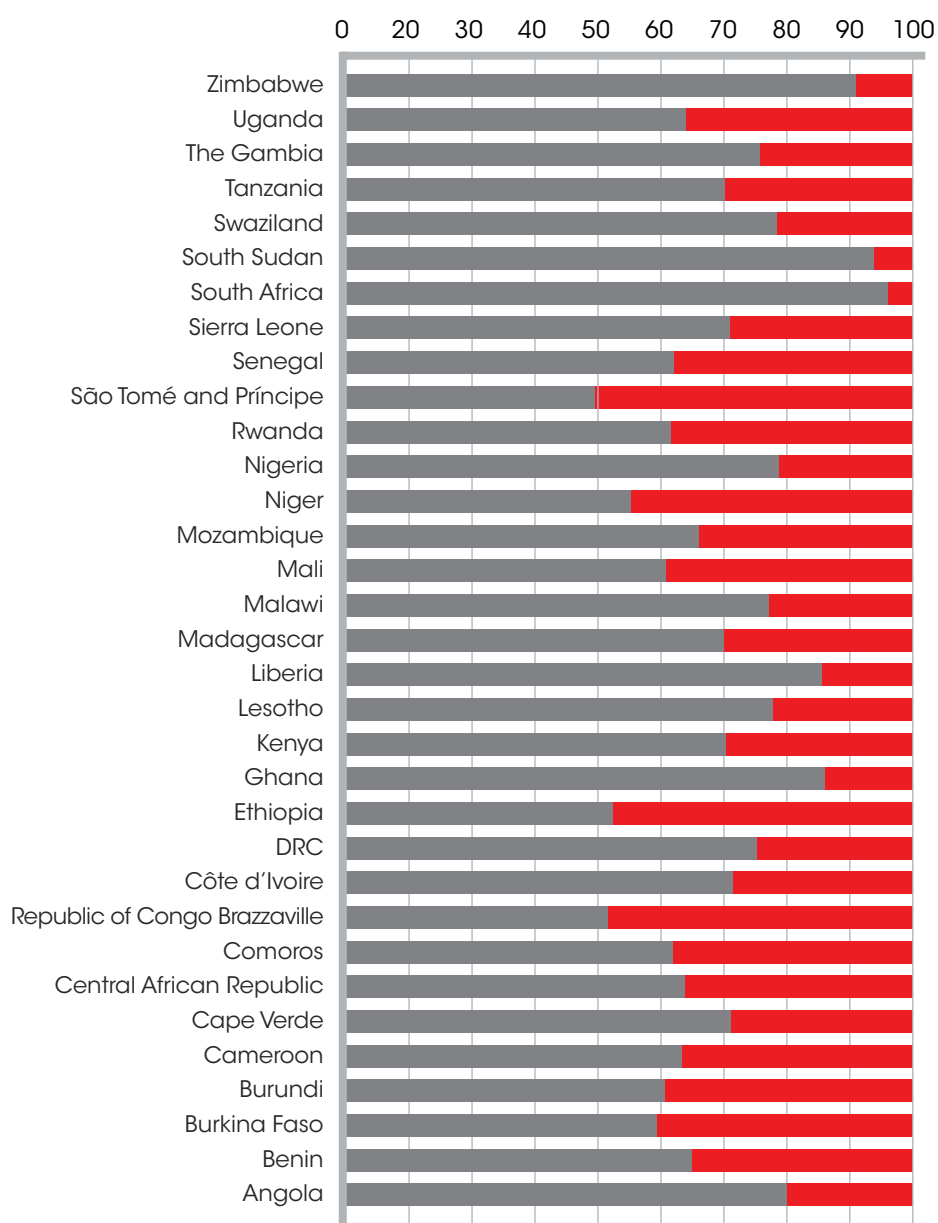
32 Ebere U, *op. cit.*

33 African Labour Research Network, 'Chinese Investments in Africa: A Labour Perspective', May 2009, https://www.fnv.nl/site/over-de-fnv/internationaal/mondiaal-fnv/documenten/english/publications/Chinese_investments_in_Africa_final_report1.pdf, 12 September 2018.

34 The Chinese government also provided the loan, construction firms and equipment for the construction of the \$12 million occupational training college in Addis Ababa. Davies M *et al.*, 'How China Delivers Development Assistance to Africa', Centre for Chinese Studies, University of Stellenbosch, 2008, http://www0.sun.ac.za/ccs/wp-content/uploads/2009/04/dfid_fa_final.pdf, accessed 1 September 2018.

countries, the disbursement of Chinese loans is based on the borrowers' openness to China's exports and the expected return on funded projects.

FIGURE 11 RECURRING VS CAPITAL EXPENDITURE, 2015–2017



Source: Government Spending Watch Database 2018, <http://www.governmentpendingwatch.org/spending-data>, accessed 9 September 2018

Debt use: Productive vs. recurring expenditure

The productivity of Africa's accumulated debt was assessed by observing the use of debt, the structure of government expenditure and total investment. In most African countries recurring expenditure represents the largest share of total government spending (Figure 11). Between 2015 and 2017 total government spending on recurring expenditure in South Africa, South Sudan and Zimbabwe was 95.90%, 93.33% and 90.49% respectively.³⁵ In the case of South Africa, debt was accumulated through a massive investment in the social sector and the provision of state guarantees to state-owned enterprises (SOEs).

Several African countries have already surpassed the 60% debt-to-GDP threshold set by the AMCP, including Sudan, Cabo Verde, The Gambia, Republic of Congo Brazzaville, Mozambique, Egypt, São Tomé and Príncipe, Togo, Zimbabwe, Tunisia, Angola, Ghana, Zambia, Burundi, Morocco, Sierra Leone and Senegal.

The Gambia, Eritrea, Cabo Verde, the Republic of Congo Brazzaville, Mozambique, São Tomé & Príncipe, Togo, Zimbabwe, Ghana, Malawi, Burundi, Sierra Leone, Guinea-Bissau, the Central African Republic (CAR), Chad, Kenya and Senegal have been unable to convert their higher debt-to-GDP ratio sufficiently into higher total investment. Zimbabwe allocates only 9.5% of its yearly budget spending to capital infrastructure, while Ghana allocates 15.41%. They also face a high risk of debt distress in the future based on the rationale that to be sustainable, debt accumulation should improve the future revenue-earning capacity of borrowing countries by increasing investment and infrastructure development. Most African governments tend to increase their borrowings and base their revenue calculations on the future price projections of their main export commodities. Africa's debt build-up reflects rising recurring expenditure, with low spending on productive capital investment (Figure 12).

ANALYSIS OF COUNTRIES' ABILITY TO SERVICE DEBT

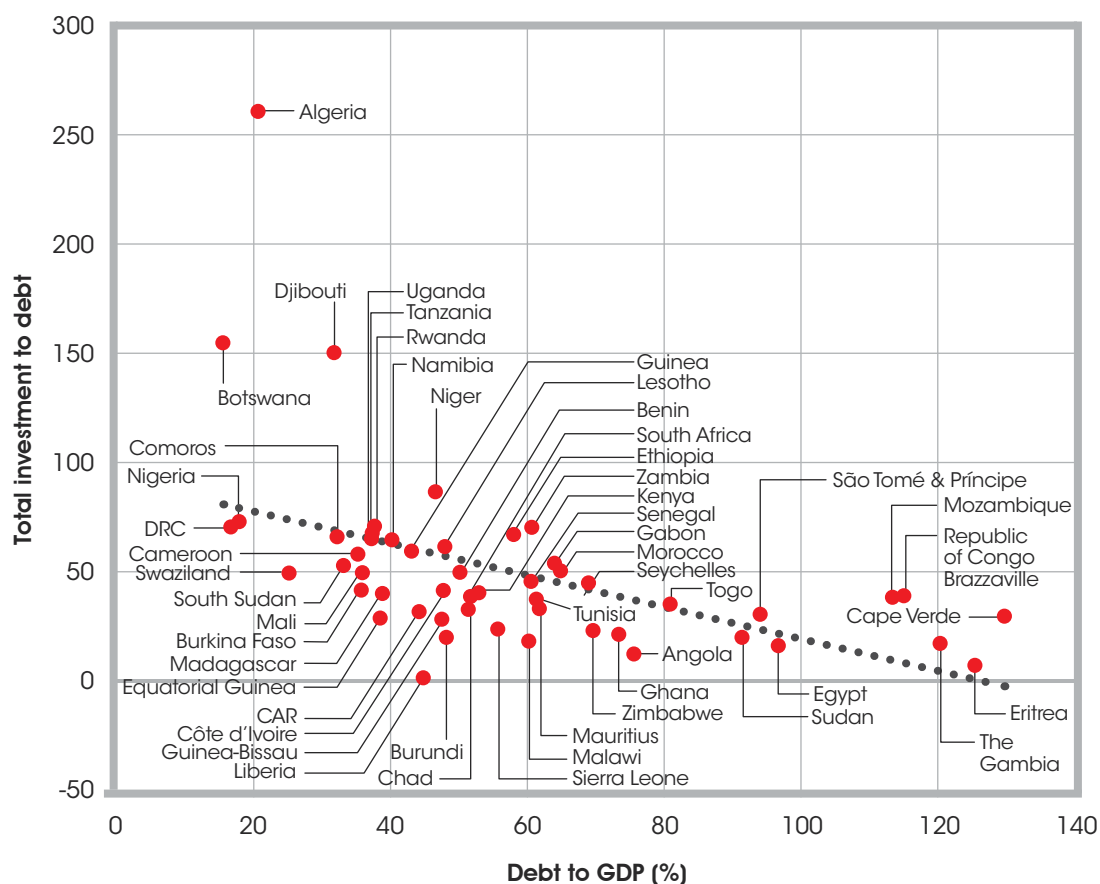
Table 2 provides an overview of debt sustainability levels across African countries. According to the IMF's debt sustainability framework – which uses the Country Policy and Institutional Assessment³⁶ (CPIA) score in addition to a set of threshold levels for selected debt burden indicators to estimate the debt-carrying capacity of individual countries and their ability to service the debt – only eight countries are at low risk of debt distress. These countries fall within the strong and medium CPIA. Nonetheless, Uganda, Tanzania, Kenya and Senegal have breached their debt service-to-revenue thresholds (undermining their capacity to pay off debts) and may likely enter into medium debt risk if non-concessional debt refinancing becomes the preferred option.³⁷

35 Government Spending Watch, 2018, <http://www.governmentspendingwatch.org/spending-data>, accessed 31 October 2018.

36 IMF, 2017b, *op. cit.*

37 *Ibid.*

FIGURE 12 TOTAL INVESTMENT-TO-DEBT AND DEBT-TO-GDP OF AFRICAN COUNTRIES, 2016



Source: World Bank, 'World Development Indicators' <https://datacatalog.worldbank.org/dataset/world-development-indicators>, accessed 10 July 2018. (Graph generated by author)

Of the 21 countries that are at moderate risk of debt distress, Togo, Guinea, Madagascar, Benin, Nigeria, Niger, Burkina Faso and Tunisia have breached their debt service-to-revenue thresholds. Togo, Guinea and Madagascar are likely to slip into high risk of debt distress owing to their weak policies and institutions. Furthermore, the CAR, Angola, Burundi, Djibouti, São Tomé and Príncipe, Cameroon, Zambia, Mauritania, Ethiopia, Ghana and Cabo Verde are at high risk of debt distress. Of these countries, only Djibouti and São Tomé and Príncipe (despite their weak policies) have the capacity to pay off their debt, owing to the higher portion of concessional debt in their total debt portfolio (see figures 8 and 9).

More worrisome, Sudan, The Gambia, Mozambique, Chad and Zimbabwe have surpassed all debt sustainability thresholds and are experiencing debt distress, with Chad still maintaining sustainability in the present value of external debt-to-exports. Sudan's debt distress (with a total public debt of over 116% of GDP) resulted from

TABLE 2 DEBT SUSTAINABILITY INDICATORS AT A GLANCE

| SN | COUNTRIES | QUALITY OF POLICIES & INSTITUTIONS | PV DEBT/GDP 2017 | PV OF EXTERNAL DEBT TO EXPORT | DEPT SERVICE TO EXPORT | DEBT SERVICE TO REVENUE | SOVEREIGN RATINGS 2018 | | | CAPACITY TO PAY OFF | RISK OF DEBT DISTRESS |
|----|--------------------------|------------------------------------|------------------|-------------------------------|------------------------|-------------------------|------------------------|-----------------|-------------------|---------------------|-----------------------|
| | | | | | | | MOODY'S RATING (+) | S&P RATINGS (+) | FITCH RATINGS (+) | | |
| 1 | Angola | Weak | 65.3 | 103.3934 | 26.5 | 42.84 | B3 | B- | B | Low | High |
| 2 | Benin | Medium | 54.6 | 88.1 | 5.1 | 19.40 | | NR | B | Low | Moderate |
| 3 | Burkina Faso | Medium | 38.3 | NA | 4.39 | 30.8 | | B | | Low | Moderate |
| 4 | Burundi | Weak | 56.7 | 186.034 | 16.73 | 19.3 | | | | Low | High |
| 5 | Cape Verde | Medium | 126 | 140 | 10 | 30.8 | | B | B | Low | High |
| 6 | Cameroon | Weak | 33.8 | 77 | 6.2 | 15.8 | | B | B | Low | High |
| 7 | Central African Republic | Weak | 53.4 | 120 | 9.3 | 21.8 | | | | Low | High |
| 8 | Chad | Weak | 52.5 | 89 | NA | 54.4 | | | | Low | In distress |
| 9 | Dem Rep of Congo | Weak | 23.1 | 111 | 1.5 | 4.7 | | CCC+ | | High | Moderate |
| 10 | Rep of Congo Brazzaville | Weak | 119.1 | 43 | NA | 9.6 | | CCC+ | CC | High | Moderate |
| 11 | Cote d'Ivoire | Medium | 46.4 | 84 | 6.3 | 12.9 | | | B+ | High | Moderate |
| 12 | Djibouti | Weak | 30.6 | 235 | 7.14 | 13.4 | | | | High | High |
| 13 | Egypt | Strong | 103.3 | 206.4 | 18.94 | NA | B3 | B- | B | NA | Moderate |
| 14 | Equatorial Guinea | Weak | 42.7 | 20.7 | NA | NA | | | | NA | Moderate |
| 15 | Eritrea | Weak | 131.2 | NA | NA | NA | | | | NA | Moderate |
| 16 | Ethiopia | Medium | 56.2 | 272 | 21.01 | 20.7 | | | B | Low | High |
| 17 | Gabon | Medium | 61.1 | 98.4 | 1.4 | 2.95 | | NR | B | High | Low |
| 18 | Gambia, The | Weak | 123.2 | 181.2 | 15.17 | 50.2 | | | CCC | Low | In distress |
| 19 | Ghana | Medium | 71.8 | 120 | 10.49 | 76.5 | | B- | B | Low | High |
| 20 | Guinea | Weak | 39.7 | 54.9 | 3.6 | 26.3 | | | | Low | Moderate |
| 21 | Guinea-Bissau | Weak | 42 | 26 | 2.57 | 11.9 | | | | High | Moderate |
| 22 | Kenya | Strong | 55.6 | 137 | 10.62 | 32.8 | | B+ | B+ | Low | Low |
| 23 | Lesotho | Medium | 34.7 | NA | 4.19 | 5.8 | | | | High | Low |
| 24 | Liberia | Weak | 34.4 | 77 | 2.94 | 3.1 | | | | High | Moderate |
| 25 | Madagascar | Weak | 37.3 | 52 | 3.66 | 27.6 | | | | Low | Moderate |
| 26 | Malawi | Weak | 59.3 | 72 | 5.03 | NA | | | | Low | Moderate |
| 27 | Mali | Medium | 35.6 | 67 | 4.23 | 10.5 | | | B- | High | Moderate |
| 28 | Mauritania | Medium | 91.1 | 181 | 13.16 | 23.3 | | | | Low | High |
| 29 | Mauritius | Strong | 60.2 | 49.9 | 18.21 | NA | Baa1 | | | NA | Moderate |
| 30 | Morocco | Strong | 64.4 | NA | 10.87 | 0.013 | Ba1 | BBB- | BBB- | High | Moderate |
| 31 | Mozambique | Weak | 102.2 | 171 | 12.65 | 28.8 | Caa3 | SD | RD | Low | In distress |
| 32 | Namibia | Strong | 46.1 | 161.5 | NA | NA | Ba1 | | BB+ | NA | Moderate |
| 33 | Nigeria | Medium | 16.3 | 46.5 | 2.2 | 44.9 | | B | B+ | Low | Moderate |
| 34 | Niger | Medium | 37.4 | 298.8 | 6.34 | 40.8 | | | | Low | Moderate |
| 35 | Rwanda | Strong | 34.6 | 153.8 | 8.29 | 7.9 | | B | B+ | High | Low |
| 36 | Senegal | Strong | 52.8 | 63.3 | 10.49 | 32.6 | Ba3 | B+ | | Low | Low |
| 37 | Sierra Leone | Weak | 35.3 | 125 | 6.65 | 13.9 | | | | High | Moderate |
| 38 | South Africa | Strong | 52.7 | 159.8 | 13.17 | NA | Baa3 | BB | BB+ | NA | Low |
| 39 | Sudan | Weak | 126 | 1538 | 33.5 | 43.7 | | | | Low | In distress |
| 40 | São Tomé and Príncipe | Weak | 83.3 | 115 | 2.99 | 6.6 | | | | High | High |
| 41 | Tanzania | Medium | 38.2 | 88 | 5.4 | 22.2 | | | | Low | Low |
| 42 | Togo | Weak | 78.6 | 51 | 3.2 | 85.9 | | | | Low | Moderate |
| 43 | Tunisia | Strong | 71.3 | NA | 10.7 | 24.82 | B2 | NR | B+ | Low | Moderate |
| 44 | Uganda | Medium | 39 | 85 | 18.8 | 39.6 | | B | B+ | Low | Low |
| 45 | Zambia | Medium | 62.2 | 105 | 8.6 | 26.6 | | B | B | Low | High |
| 46 | Zimbabwe | Weak | 78.4 | 175 | 13.4 | 9.2 | | | | Low | In distress |

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

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

fiscal and external imbalances because of political unrest, South Sudan's secession, sanctions, weakened oil revenues, exchange rate depreciation and rising prices. Mozambique's debt distress stems from weaker commodity prices, limited control over borrowing by SOEs and real exchange rate depreciation. In the case of The Gambia, the country slipped from a moderate to a weak policy (CPIA) performer, thereby narrowing its sustainability thresholds, in addition to collapsed agricultural output, foreign exchange scarcity and macroeconomic instability. Zimbabwe's distress resulted from fast-rising domestic debt owing to increased external arrears, limited access to external sources, and large fiscal deficits.³⁸ Chad, with ongoing debt restructuring and HIPC debt relief, is on its way out of distress if it can sustain this path.

Overall, the result shows a rising debt burden in Africa, especially in weak and medium CPIAs. Only about 11 countries have high capacity to pay off accumulated debt and are still within low or moderate debt stress levels. Countries in debt distress or with a high risk of debt distress spend a significant component of their yearly government spending on recurring expenditure and have more non-concessional debt. The limited external sources for these countries increase their appetite for domestic debt, thereby also increasing the chances of crowding out investors from the credit market and fuelling inflation.

DEBT MANAGEMENT

INSTITUTIONAL FRAMEWORK AND STRATEGIES FOR DEBT MANAGEMENT IN AFRICA

Robust debt management plans play an important role in ensuring debt sustainability and effective fiscal management. It is therefore crucial to develop a proper strategy and institutional framework for debt management that works side-by-side with monetary and fiscal authorities. It is notable that the 1990s debt crisis in Africa originated from poor debt management.³⁹ Theories on optimal public debt management have identified four main objectives:⁴⁰

- maintain macroeconomic stability,
- develop a domestic financial market,
- support monetary policy, and
- minimise interest costs and risk.

However, debt management institutions in Africa are most likely to focus on the last two functions – raising finance for government at the lowest possible cost and

38 *Ibid.*

39 Aluko F & D Arowolo, 'Foreign aid, the Third World's debt crisis and the implication for economic development: The Nigerian experience', *African Journal of Political Science and International Relations*, 4, 4, 2010, pp. 120–127.

40 Wolswijk G & J Haan, 'Government Debt Management in the Euro Area Recent Theoretical Developments and Changes in Practices', European Central Bank Occasional Paper, 25, 2005.

risk in order to navigate the economy away from a debt crisis and developing the domestic debt market.

After the implementation of the HIPC and MDRI, a number of African countries strengthened their legal frameworks for debt management, improved debt recording and reporting, and prepared debt management strategies supported by the WB and IMF. In 2008 the WB established the Debt Management Facility (DMF) for LICs, which provides resource tools, technical assistance and debt management training with the goal of formalising debt management operations and building the debt management capacity of LICs.⁴¹ In 2014, the WB partnered with the IMF to launch the DMF II, the second phase of the DMF, to build on the achievements of the programme and broaden its reach. Debt management capacities are developed using a demand-driven approach reliant on four resource tools: debt management performance assessment, medium-term debt management strategy (MTDS), debt management reform plans and domestic debt market development.⁴²

One of the core debt management strategies is to increase the maturity of the debt profile by issuing long-term bonds in the international capital market. In recent times, Kenya, Côte d'Ivoire, Egypt, Morocco, South Africa and Nigeria have issued Eurobonds at the long end of the maturity spectrum, typically 30 years. In addition, countries with a fairly developed debt market such as Kenya and Nigeria are also issuing longer-term bonds in their domestic debt market. The Nigerian debt management office, for instance, issued its maiden 20-year instrument at the beginning of 2018. The expected outcome of this strategy is that the capital projects for which the debt have been issued will eventually contribute significantly towards debt servicing and ensure debt sustainability. The graduation of several African countries away from low-income status makes this inevitable, given constrained access to concessional loans.⁴³ This approach has several advantages, including reducing rollovers, interest rates, refinancing and cost-of-debt servicing risks.

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

41 Since its establishment, 61% of the DMF's activities have been conducted in sub-Saharan Africa. See World Bank, 2018, *op. cit.*

42 World Bank, 2018, *op. cit.*

43 See Prinsloo C, 'Partnering with the New Development Bank: What Improved Services Can It Offer Middle-Income Countries?', GEG-Africa Discussion Paper, November 2016, <http://www.saiia.org.za/wp-content/uploads/2016/11/GEG-africa-DP-nov2016-prinsloo-FINAL-WEB.pdf>, accessed 20 November 2018.

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

COMPLEMENTARY DEBT MANAGEMENT APPROACHES IN AFRICA

Other actors, such as MDBs and especially the African Development Bank, refrain from extending grant and other budget support facilities to countries with weak fiscal positions, to counter unsustainable debt accumulation. This is prompting African countries to explore debt management strategies other than the traditional modalities offered by multilateral lenders. These include strategies that target the underlying causes of accelerated borrowing in Africa. For instance, weak domestic revenue capacity is a major reason why most countries rely on deficit financing for development. With huge development and infrastructural gaps in Africa, it is crucial to strengthen domestic capacity to ensure repayment and diversity of financing options, prompting several countries to concentrate on improving tax revenues. The most recent estimate of the average tax revenue-to-GDP (excluding resource royalties) ratio in Africa of about 15% is far below the 25% benchmark required to finance development.⁴⁴

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

Formalisation of the economy is another major reform initiative. After Latin America and the Caribbean, sub-Saharan Africa's economy has the largest informal sector, estimated at about 38% of GDP, which ranges from 25% in South Africa to about 65% in Nigeria.⁴⁵ Policymakers are targeting regulations to incentivise the transition to the formal sector. Bureaucratic bottlenecks are major challenges to formalisation

44 AfDB (African Development Bank), 'African Economic Outlook', 2018, https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/African_Economic_Outlook_2018_-_EN.pdf, accessed 01 October 2018.

45 IMF, 'Regional Economic Outlook: Sub-Saharan Africa', 2017, <https://www.imf.org/en/Publications/REO/SSA/Issues/2017/05/03/sreo0517>, accessed 1 October 2018.

for many small-scale firms. In 2017, 36 sub-Saharan African countries implemented reforms to improve the ease of doing business, the largest number recorded in a single year.⁴⁶ In general, reducing informality can directly benefit economic growth by mobilising domestic savings for investment. Some countries are taking advantage of the digital revolution to formalise the economy. Kenya is a pioneer through the development of M-Pesa, a mobile money platform that has engendered financial inclusion and reduced informality.

Improving the efficiency of government expenditure is another focal priority to indirectly enhance debt management. Crucially, one of Africa's biggest challenges remains the mismanagement of scarce development resources. The huge debt incurred over the past years has not yielded the expected development outcomes. Corruption by public officials and the poor prioritisation of resource allocation, as evident in high recurrent expenditure, are major contributory factors to lower development outcomes. Capital expenditure is arguably aligned more to Africa's development needs.

Key reforms in this area have targeted debt use. Specifically, borrowing is more directly linked to specific critical projects. *Sukuk bonds* follow this modality, as do multilateral and bilateral creditors who similarly link borrowed funds to specific projects. While this improves debt sustainability, there is a risk of losing critical national assets in cases of default, requiring countries to balance the risk of default versus the potential benefit of projects.

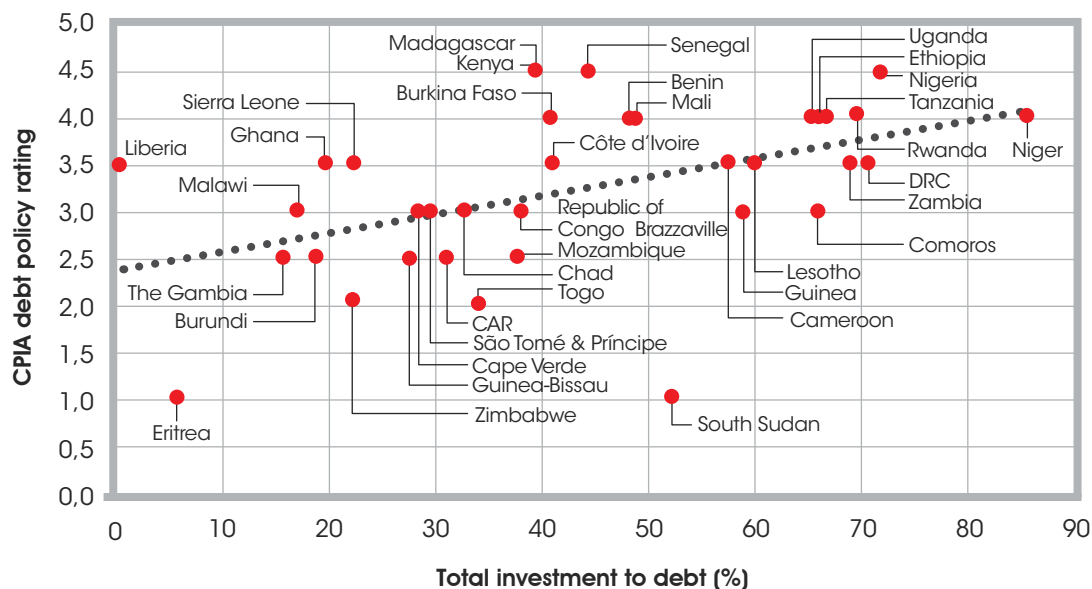
DEBT MANAGEMENT STRATEGY AND DEBT PERFORMANCE

Figures 13 to 16 illustrate the extent to which the quality of the debt management strategy affects debt performance. Quality of debt management is assessed using the annual CPIA debt policy rating provided by the WB. It measures the degree to which the present debt management strategy of a country is conducive to minimising budgetary risk and ensuring long-term debt sustainability. The rating is based on the adequacy of debt management strategies; presence of debt management units, debt recording and monitoring systems; and coordination with macroeconomic policies. Debt performance, on the other hand, is captured by four different indicators: debt-to-GDP, total investment-to-debt, fiscal deficit-to-GDP and debt-to-revenue ratio. For African countries, the benchmark for the debt-to-GDP ratio is 60% and fiscal deficit-to-GDP threshold 5%.⁴⁷ The total investment-to-debt ratio and debt-to-revenue have no benchmark, but are important indicators of debt use. Specifically, a high score on the former suggests that debt is deployed for productive activities in the economy and a high score on the latter indicates a sound debt servicing capacity.

46 World Bank Group, 'Doing Business Report 2018: Reforming to Create Jobs', 2018, <https://openknowledge.worldbank.org/handle/10986/28608>, accessed 31 October 2018.

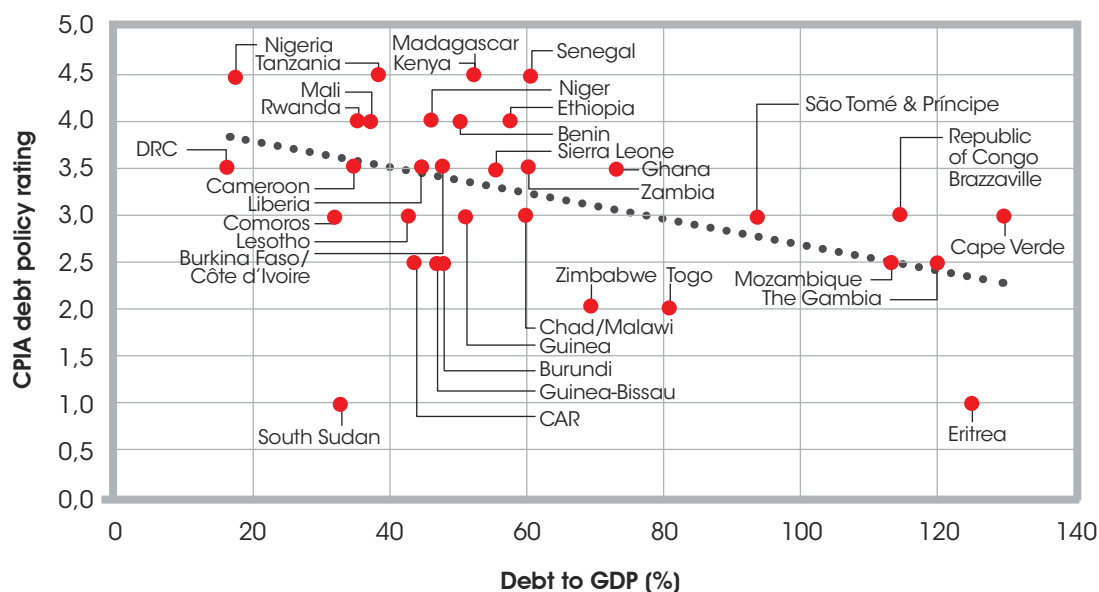
47 AMCP (African Monetary Cooperation Programme), 'Implementation of the African Monetary Cooperation Programme in the Southern African Subregion (2004–2005)', 2005, http://www.aacb.org/sites/default/files/PROGRESS_REPORT_ON_THE_AMCP_2004-2005.pdf, accessed 2 October 2018.

FIGURE 13 TOTAL INVESTMENT TO DEBT (%) FOR AFRICAN COUNTRIES WITH CPIA DEBT POLICY RATING, 2016



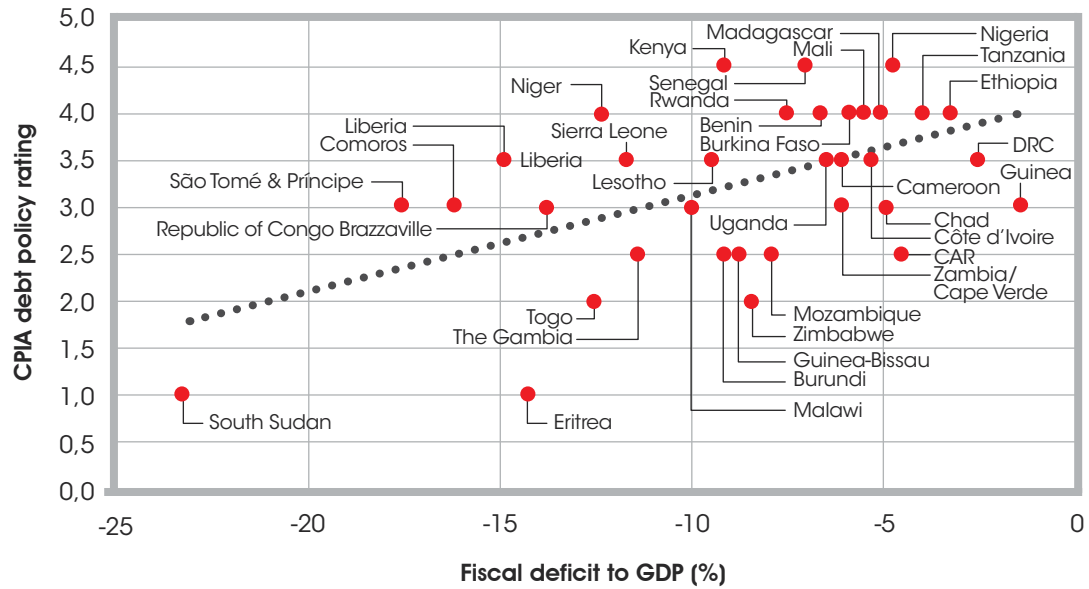
Source: World Bank, <https://data.worldbank.org/indicator/IQ.CPA.DEBT.XQ?view=chart>; accessed on 5 June 2018; Author's calculation based on IMF (2018) Regional Economic Outlook: Sub-Saharan Africa.

FIGURE 14 DEBT TO GDP (%) FOR AFRICAN COUNTRIES WITH CPIA DEBT POLICY RATING, 2016



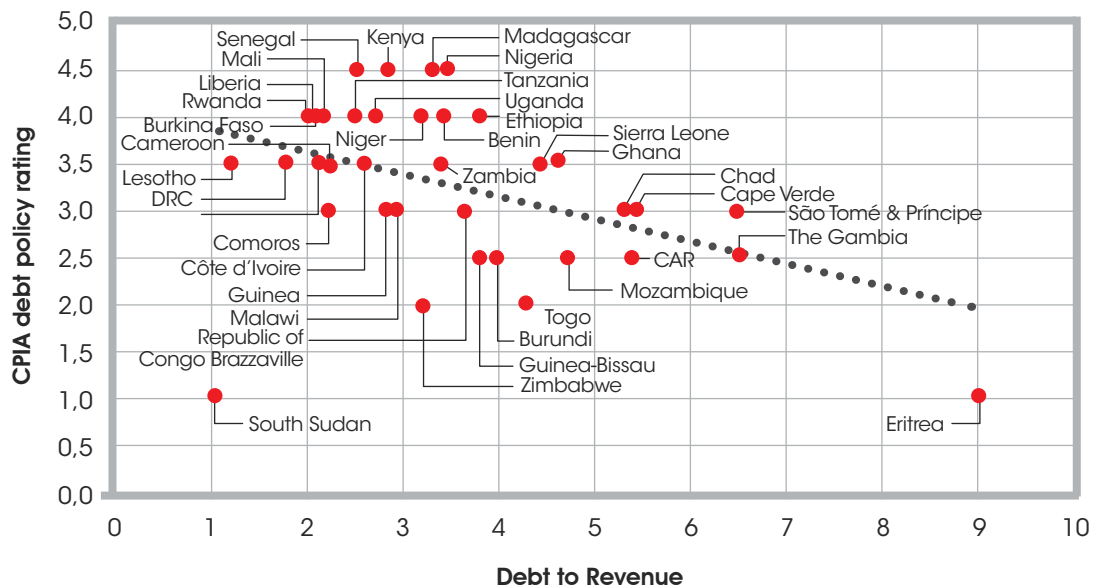
Source: World Bank, <https://data.worldbank.org/indicator/IQ.CPA.DEBT.XQ?view=chart>; IMF, 'Regional Economic Outlook: Sub-Saharan Africa', 2018

FIGURE 15 FISCAL DEFICIT TO GDP FOR AFRICAN COUNTRIES WITH CPIA DEBT POLICY RATING, 2016



Source: World Bank, IMF Regional Economic Outlook: Sub-Saharan Africa, 2018; <https://data.worldbank.org/indicator/IQ.CPA.DEBT.XQ?view=chart>; accessed 5 June 2018

FIGURE 16 DEBT TO REVENUE FOR AFRICAN COUNTRIES WITH CPIA DEBT POLICY RATING, 2016



Sources: World Bank, IMF Regional Economic Outlook: Sub-Saharan Africa, 2018 <https://data.worldbank.org/indicator/IQ.CPA.DEBT.XQ?view=chart>; accessed 5 June 2018

The various scatter diagrams underscore the importance of having a sound debt management strategy. Figures 13 to 16 show that high-debt countries have the lowest CPIA score. Similarly, efficient debt use for investment is strong among countries with sound debt management strategies. It is also no coincidence that the majority of the high-performing countries have domesticated fiscal responsibility laws in their respective jurisdictions. Interestingly, there is room for improvement for all countries, as none has yet attained the top score of 6. The highest ranked African countries score 4.5. The two most important areas to strengthen are improved coordination between debt and broad macroeconomic policies and reduced susceptibility to external shocks owing to resource dependency.

MAJOR CHALLENGES IN DEBT MANAGEMENT

Debt management offices face several challenges in ensuring effective debt management, ranging from poor cost-risk analysis to institutional challenges.

Poor cost-risk analysis

With the initial Eurobonds reaching maturity, rising interest rates in developed economies and the anticipated reversal of capital, it is becoming increasingly difficult to adequately capture refinancing costs. Between 2010 and 2015 several countries – including Senegal, Angola, Nigeria, Namibia, Rwanda, Kenya, Ethiopia and Zambia – issued Eurobonds in excess of \$9 billion. Many of these Eurobonds will mature between 2021 and 2025. Further issuances of Eurobonds could lead to foreign exchange refinancing risks and higher debt servicing costs, because countries that intend to leverage the low interest rate abroad to finance their high-interest domestic debt may be understating the currency depreciation-related cost involved. These and other unforeseen risks associated with the changing characteristics of debt may pose a challenge to debt management units when it comes to analysing the cost-risk trade-off of the debt portfolio.

Institutional challenges

Autonomous, functional and well-resourced debt management offices support credible and sound debt management in most instances. Often, debt management offices are not autonomous and may be embedded within other state institutions, which could raise concerns about the integrity of debt management activities and the efficiency of borrowing programmes. This lack of independence may influence lender confidence. More importantly, a number of countries with debt management offices have weak capacity to formulate strategic debt management plans for proper cost-risk modelling and monitoring of debt.

Data-related inefficiencies

Opacity in debt statistics is also a major challenge.⁴⁸ The presence of multiple actors makes coordination and uniform reporting difficult, as especially bilateral loans are often linked to development assistance and trade. Deliberately understating debt to improve eligibility for additional loans is a concern.⁴⁹

Many countries fail to consolidate and reconcile public and publicly guaranteed debt and private non-guaranteed debt. Specifically, debt management operations are undermined by large contingent liabilities emerging from guaranteed or non-guaranteed loans obtained by SOEs such as national carriers and electricity utilities, which are not reported to debt management units. The Republic of Congo Brazzaville, Kenya, Ethiopia and Madagascar do not reflect debt accrued by SOEs in their debt statistics. Nigeria's debt statistics do not include debt accrued by its national oil corporation.

IN-DEPTH FOCUS: NIGERIA

RECENT MACROECONOMIC CONTEXT

Nigeria's recent economic performance has been disappointing. Since 2014 economic growth has slowed significantly, with the economy sliding into recession between the first quarter of 2016 and the first quarter of 2017 (see Table 3). This weak performance is largely owing to an overreliance on crude oil as the main source of foreign earnings and government revenue. The commodity shock that began in the fourth quarter of 2014 severely affected the economy. While the country emerged out of the recession in the second quarter of 2017, growth and government revenue remained weak and largely driven by the oil prices. Revenue closely mirrors the global oil price pattern, illustrating the economy's susceptibility to external shocks (see Table 3). The revenue shortfall has shaped the fiscal response to the oil price shock, prompting deficit financing and a debt build-up to maintain a counter-cyclical fiscal stance.

The naira depreciated by about 87.5% between the first quarter of 2014 and that of 2016. The rebound in oil prices and persistent interventions from the monetary authorities ensured relative stability in exchange rate movements in recent quarters.

48 IDA (International Development Association), 'G-20 Note: Improving Public Debt Recording, Monitoring, and Reporting Capacity in Low and Lower Middle-Income Countries: Proposed Reforms', 2018, <http://documents.worldbank.org/curated/en/645621532695126092/pdf/128723-repo-For-VP-IMPROVING-PUBLIC-DEBT-RECORDING-clean.pdf>, accessed 1 October 2018.

49 The case of Mozambique, where local authorities hid \$2 billion worth of debt from the IMF to qualify for more loans, is particularly instructive about the data gaps impeding effective debt management. See Hill M and B Nhamire, 'IMF expects Mozambique to default on foreign debt until 2023', *Bloomberg*, 28 February 2018, <https://www.bloomberg.com/news/articles/2018-02-28/imf-expects-mozambique-to-default-on-external-debt-until-2023>, accessed 2 October 2018.

However, the pass-through effect on inflation largely remains. The inflation rate has maintained an average of 15.6% over the period despite recent growth and exchange rate gains. A key reason for this is weak growth in the non-oil sectors, especially agriculture and manufacturing. While depreciation of the local currency should theoretically improve exports, the terms-of-trade have dampened it in reality. The absence of a viable tradeable sector has constrained export opportunities that a weak currency would have provided, while a lack of sufficient foreign reserves makes input prices expensive.⁵⁰ This is a persistent structural and systemic bottleneck in the tradeable sector.

TABLE 3 NIGERIA: KEY MACROECONOMIC INDICATORS

| YEAR | QUARTER | GDP CONSTANT MARKET PRICE (NGN MILLION) | OIL GROWTH RATE (%) | NON-OIL GROWTH RATE (%) | EXCHANGE RATE (INTER-BANK) QTR. AVG (%) |
|------|---------|---|---------------------|-------------------------|---|
| 2014 | 2014Q1 | 15,601,048.05 | -6.6 | 8.21 | 162.82 |
| | 2014Q2 | 16,249,366.98 | 5.14 | 6.71 | 162.29 |
| | 2014Q3 | 17,707,533.42 | -3.6 | 7.51 | 160.39 |
| | 2014Q4 | 18,419,510.77 | 1.18 | 6.44 | 172.02 |
| 2015 | 2015Q1 | 16,203,803.56 | -8.15 | 5.59 | 191.11 |
| | 2015Q2 | 16,623,053.88 | -6.79 | 3.46 | 196.97 |
| | 2015Q3 | 18,208,475.09 | 1.06 | .05 | 196.99 |
| | 2015Q4 | 18,745,360.19 | -8.28 | 3.14 | 196.99 |
| 2016 | 2016Q1 | 16,087,230.32 | -4.81 | -0.18 | 197.00 |
| | 2016Q2 | 16,349,290.03 | -11.63 | -0.38 | 208.59 |
| | 2016Q3 | 17,775,969.03 | -23.04 | 0.03 | 303.18 |
| | 2016Q4 | 18,439,940.98 | -17.70 | -0.33 | 305.20 |
| 2017 | 2017Q1 | 15,919,656.99 | -15.60 | 0.72 | 305.64 |
| | 2017Q2 | 16,477,424.32 | 3.53 | 0.45 | 305.77 |
| | 2017Q3 | 17,988,950.81 | 23.03 | -0.76 | 305.81 |
| | 2017Q4 | 18,819,658.99 | 11.20 | 1.45 | 305.94 |
| 2018 | 2018Q1 | 16,244,997.20 | 14.77 | 0.76 | 305.81 |

NGN = Nigerian naira

Source: Central Bank of Nigeria (CBN), 'Quarterly Statistical Bulletin, 24 June 2018. <https://www.cbn.gov.ng/documents/QuarterlyStatbulletin.asp>, accessed 5 July 2018; National Bureau of Statistics, 2018. <http://www.nigerianstat.gov.ng/elibrary>, accessed 5 June 2018

Policymakers have responded with targeted fiscal and monetary measures. On the monetary front the bank repo rate increased to 14% at the peak of the crisis in July 2016 and has remained there. The Central Bank of Nigeria implemented various import suppression policies such as outright bans on some commodities

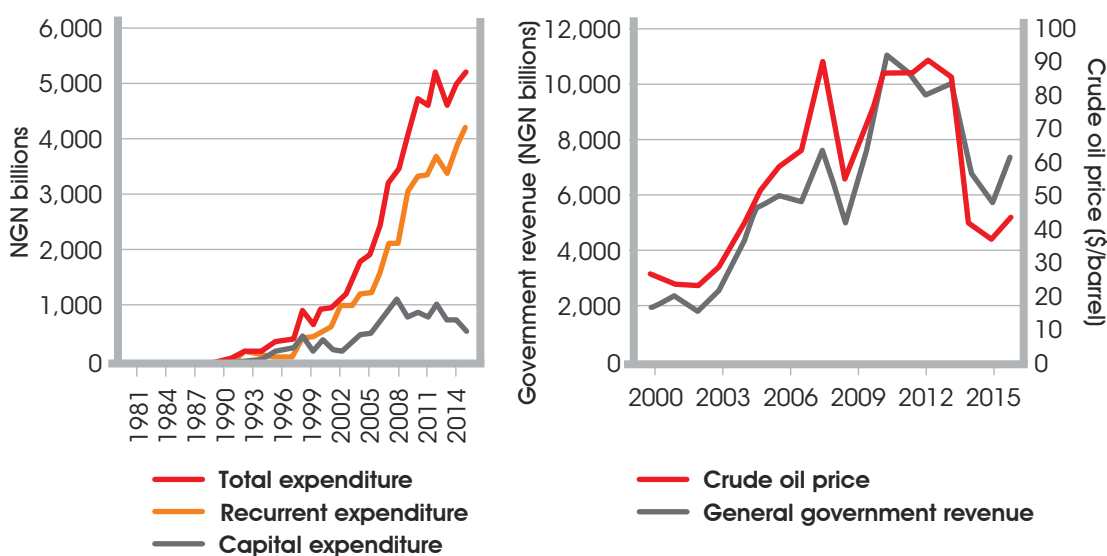
⁵⁰ Most inputs are imported.

and restricted access to forex for others. The monetary policy is currently anchored primarily on an injection of forex to ensure stability and maintain a low bound between the official and black-market rates. The policies have so far proved effective in stabilising the naira to a NGN 305/\$ interbank rate for six consecutive quarters (see Table 3) and foreign reserves have increased significantly to about \$45.3 billion in 2018, up from \$25 billion in 2016⁵¹.

Fiscal policy, on the other hand, has been mainly expansionary, targeting infrastructure development while attempting to diversify the revenue base. However, poor budget implementation has constrained its efficacy, with only 55% of budget implementation achieved in the 2017 budget cycle, down from 64.61% in 2016. Reining in high recurrent expenditure (about 80% of the budget) to make way for additional capital expenditure is a major challenge, hence a significant proportion of debt goes into funding recurrent expenditure (see Figure 17).

However, creditors and the government are deploying innovative financing options to improve the situation. Recent Euro- and Sukuk bonds were tied directly to specific infrastructure projects. This ensures long-term debt is channelled towards the productive sector, which will galvanise long-term growth. An important area to which the government seems to accord low priority is social security, which receives insignificant and unpredictable funding despite the high poverty rate.

FIGURE 17 NIGERIAN GOVERNMENT REVENUE, SPENDING AND OIL PRICE



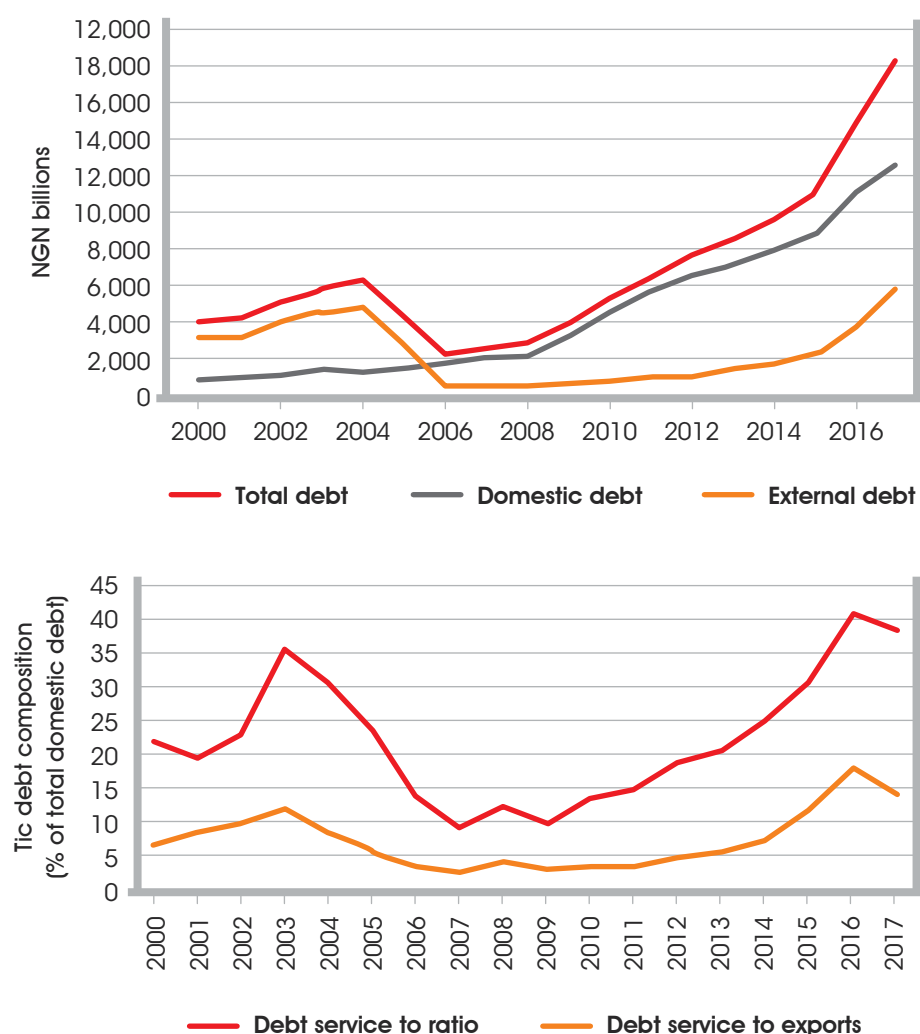
Source: Central Bank of Nigeria (CBN), 'Annual Statistical Bulletin', Public Finance Statistics, <http://statistics.cbn.gov.ng>; <https://www.cbn.gov.ng/documents/statbulletin.asp>, accessed 10 July 2018 (Graph generated by author)

51 Central Bank of Nigeria (CBN). (2018, June 9). *International Operations*. Retrieved July 2018, from Reserve Management; The Movement in Reserves: <https://www.cbn.gov.ng/intops/Reserve.asp>, accessed 5 September 2018.

STATE OF DEBT

Nigeria's debt profile, based on 2018 data from the Debt Management Office (DMO), shows a total debt stock of NGN 22 trillion (\$74.45 billion) as of March 2018 (see Figure 18). This represents a 251.4% increase from debt levels in 2004, prior to the debt forgiveness initiative.

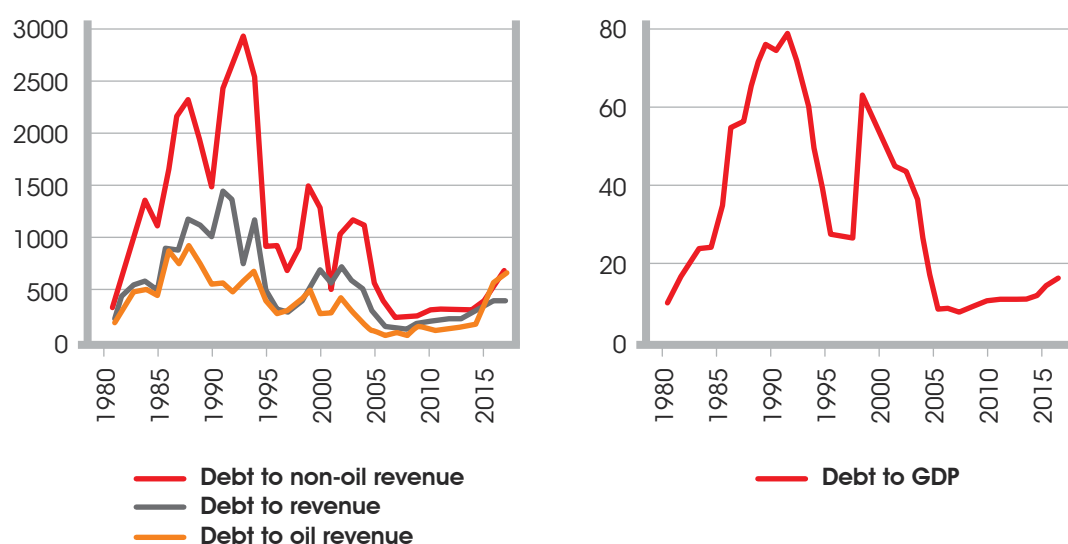
FIGURE 18 NIGERIAN DEBT STOCK LEVEL, DEBT SERVICE TO REVENUE AND DEBT SERVICE TO EXPORT, 2000–2017



Source: Central Bank of Nigeria (CBN), 'Annual Statistical Bulletin', Public Finance Statistics, <http://statistics.cbn.gov.ng>; <https://www.cbn.gov.ng/documents/statbulletin.asp>, accessed 10 July 2018 (Graph generated by author)

As a proportion of GDP, debt stands at 16%, which is well below the 60% benchmark recommended by the AMCP. However, the ratio of debt to revenue in 2017 is considerably higher at 361%, up from 89% in 2008 (see Figure 19). In addition, the IMF estimated a fiscal deficit-to-GDP ratio at 3.5% and 4.7% in 2015 and 2016 respectively, which is significantly above the 3% benchmark specified by the Fiscal Responsibility Act of 2007. The government also seems to be overly optimistic in its revenue and economic growth projections proposed in Nigeria's economic recovery and growth plan in 2016.⁵² While the debt level is rising fast, past macroeconomic performance has dampened concern around debt sustainability, at least in the interim.

FIGURE 19 NIGERIA KEY DEBT RATIOS, GDP (%)



Source: Graph generated by Authors based on data from the following sources: CBN, 2018 and World Bank WDI, 2018 World Bank, 'World Development Indicators (WDI)', <https://datacatalog.worldbank.org/dataset/world-development-indicators>, accessed 5 September 2018

Yet long-term threats to fiscal sustainability remain. First, the economic reliance on oil prices makes another oil price bust an important source of shock. Second, there is already a significant cost to debt financing. Servicing these debts represented about 22.8% of total government budgetary expenditure (NGN 1.66 trillion [\$5.4 billion]) in 2017 and 21% in 2018 (NGN 2.01 trillion [\$6.6 billion]). These concerns are widely recognised by Nigerian economists and policymakers, necessitating a change

52 Nigeria, Ministry of Budget and National Planning, 'Economic Recovery and Growth Plan 2017–2020', 2017, <http://www.budgetoffice.gov.ng/index.php/economic-recovery-growth-plan-2017-2020>, accessed 21 August 2018.

in the debt management strategy to reduce the domestic debt portfolio in favour of external debt at a lower interest rate and therefore lower servicing cost.⁵³

A notable change in Nigeria's debt profile is the shift from external to domestic debt. At present, domestic debt constitutes 70.29% of the total debt stock at \$52.21 billion. In comparison, between 1986 and 2005, 30% of the total debt stock was domestic. This change largely reflects the impact of the debt relief initiative, which wiped out approximately 90% of Nigeria's external debt. FGN bonds now account for 66% of the present domestic debt, together with a mix of Treasury bills and Treasury bonds.

Treasury bonds and federal government bonds were introduced in 1989 and 2003 respectively to replace Treasury certificates and development stock, which were discontinued in 1996 and 2006. FGN bonds have a maturity period of two to ten years and are mainly dollarised for deficit financing and debt refinancing. Treasury bills are short-term securities issued at a discount for a tenor ranging from 91 to 364 days by the federal government through the Central Bank to provide short-term funding.

External debt stands at \$22.07 billion with multilateral debt accounting for 49.52%, followed by commercial (39.87%) and bilateral (10.62%) debt.⁵⁴ The structure, composition and maturity profile of a country's debt has implications for its cost and sustainability. A predominantly domestic debt profile reduces risks from exchange rate volatility or external shocks to the economy. In fact, the forex crisis experienced between 2014 and 2017 had a limited impact on debt performance because only 20% of the debt is in foreign currency. However, there are other salient risks to domestic debt. One is high interest and a smaller investor base. This also means that the government is crowding out private investment owing to the effect of the deficit on interest rates. The DMO is therefore pursuing a more efficient debt portfolio, with plans to achieve a 60–40 domestic to external ratio by 2019.⁵⁵

The present maturity level of Nigeria's debt is viable but could be improved. Long-term debt presently constitutes 69% of the total debt. While this is lower than

53 DMO, Policy, Strategy and Risk Management Department, 'Nigeria's Debt Management Strategy, 2016–2019', 2016, <https://www.dmo.gov.ng/publications/other-publications/debt-management-strategy/1288-nigeria-s-debt-management-strategy-2016-2019/file>, accessed 26 September 2018.

54 Of the \$2.34 billion bilateral debt, 80.98% is owed to the China EXIM bank, 11.74% to France's Agence Française de Développement (AFD), 3.31% to Japan's International Cooperation Agency (JICA) and 3.97% to Germany's Kreditanstalt fuer Wiederaufbau (KfW) development bank. Nigeria's external commercial debt consists of \$8.5 billion in Eurobonds and \$300 million in diaspora bonds. The \$10.93 billion multilateral concessional debt is made up of about 76.82% from the WB's IDA, 12.08% from the AfDB, 7.64% from the African Development Fund (ADF), 1.5% from the International Fund for Agricultural Development, about 1.14% from the International Bank for Reconstruction and Development (IBRD), and less than 1% from the Arab Bank for Economic Development in Africa (BADEA), the Export Development Fund (EDF) and the Islamic Development Bank (IDB).

55 DMO, 2018, *op. cit.*

the DMO's benchmark of 75%,⁵⁶ it still indicates productive allocation of debt. This structure allows for the financing of long-term projects with external loans and short-term financing with domestic debts. However, it raises another type of risk – loss of critical infrastructure to foreigners in case of default, as witnessed in Sri Lanka and Djibouti's ceding ports to China. The default risk at present is minimal given the moderate share of external debt. However, the present position is susceptible to shocks, owing to current fragile economic growth (Table 3). The recent downgrade of Nigeria's sovereign issuer rating, owing to the level of exposure of the government's balance sheet to economic shocks and high debt servicing cost, reflects this vulnerability.⁵⁷ Another risk is continuous implementation under different administrations, which is crucial to recouping huge investments over the long run.

DEBT MANAGEMENT

Nigeria's debt management strategy is coordinated by the DMO, which was created in 2000. Prior to its establishment, public debt management responsibilities were diffused across several agencies and operators, leading to ineffective and poor coordination of debt functions. This weakness partly contributed to the growth in the country's debt portfolio, from less than \$1 billion in 1970 to \$35.94 billion in 2004.⁵⁸ Since its inception, the DMO has managed both the reporting and issuance of debt. It is semi-autonomous and formulates the medium-term debt plan independently.

The debt policy is codified in the Strategic Plan and Medium-Term Debt Strategy (MTDS). The most recent plan is the MTDS (2016–2019). Nigeria's debt management strategy has three principal targets:

- It pursues a debt composition of 60:40 for domestic and external debt by accessing more long-term external financing without ignoring foreign exchange risk. (For domestic debt ratios, it pursues a ratio of 75:25 for long- and short-term debts to bring down the cost of debt service and rollover risk.)
- It seeks more concessional and semi-concessional external sources for the financing of key infrastructure projects.
- It places a threshold of 20% on debt maturing within one year as a percentage of the total debt portfolio and extends the Average Time-to-Maturity for the total debt portfolio to a minimum of 10 years.

56 DMO, 2016, *op. cit.*

57 Moody's Investors Service, 'Moody's downgrades Nigeria's sovereign issuer rating to B2 with a stable outlook', 2017, https://www.moody's.com/research/Moodys-downgrades-Nigerias-sovereign-issuer-rating-to-B2-with-a-PR_374801, accessed 26 September 2018.

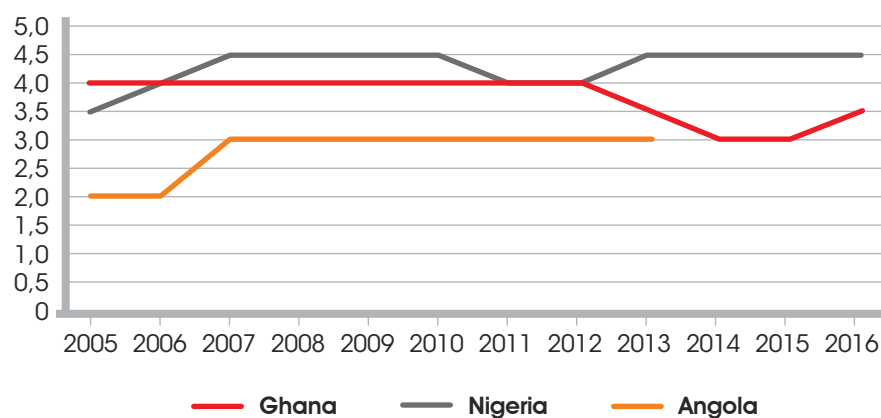
58 DMO, 'Nigeria National Debt Management Framework (2008–2012)', 2008, <https://www.dmo.gov.ng/publications/other-publications/national-debt-management-framework/1769-national-debt-management-framework-2008-2012-1/file>, accessed 2 October 2018.

Achievements of the DMO

The DMO is crucial in ensuring transparency and effective reporting of debt at a national and sub-national level and providing guidance on debt sustainability. The agency produces an annual report on Nigeria's debt sustainability and is actively involved in raising debt for budget deficit financing. In line with the MTDS (2016–2019), while most objectives are yet to be achieved, there is evidence of substantial gains in rebalancing the debt portfolio. The domestic to external debt ratio has been reduced from 80:20 in 2015 to around 70:30 in 2018. The successful issuance of Euro- and Sukuk bonds also suggests the agency is on course to lengthen the maturity period of Nigeria's debt to 10 years before 2019, from 7.15 years in 2015.

In Figure 20 and Table 4, the Nigerian CPIA debt policy rating⁵⁹ is compared with that of two oil-producing and lower-middle-income countries: Ghana and Angola. The results reinforce the key conclusion that Nigeria's DMO has been relatively effective. Specifically, Nigeria has scored higher than Ghana and Angola over the years and is ranked among medium-debt-performing countries in Africa. A comparison of various debt performance indicators with the expected threshold similarly shows that debt remains at sustainable levels.

FIGURE 20 CPIA DEBT POLICY RATING – NIGERIA, ANGOLA AND GHANA



Source: World Bank, 'CPIA Africa: Assessing Africa's Policies and Institutions', Office of the Chief Economist for the Africa Region, Washington DC: World Bank Group, 2018, <https://openknowledge.worldbank.org/handle/10986/30155>, accessed 10 July 2018

59 CPIA debt policy rating: debt policy assesses whether the debt management strategy is conducive to minimising budgetary risks and ensuring long-term debt sustainability.

TABLE 4 DEBT SUSTAINABILITY INDICATORS (%) – NIGERIA'S PERFORMANCE (2017)

| DEBT RATIO/INDICATOR | INTERNATIONAL THRESHOLD | NIGERIA (2017) |
|----------------------------------|-------------------------|----------------|
| Debt to GDP | 60 | 16 |
| PV of external debt/exports | 150 | 27.1 |
| PV of external debt/revenue | 250 | 106.5 |
| Total debt to exports | – | 135.2 |
| Total debt service/revenue | – | 62 |
| External debt service/exports | 20 | 0.9* |
| External debt service/revenue | 20 | 3.4* |
| Year-on-year growth (total debt) | – | 26.41 |

* Data only covers 2017

Source: IMF Regional Economic Outlook, DMO Debt Sustainability Report. 'Regional Economic Outlook: Sub-Saharan Africa, World Economic and Financial Surveys. Report of the Annual National Debt Sustainability Analysis (DSA), <https://www.dmo.gov.ng/publications/reports/debt-sustainability-analysis/2504-2017-debt-sustainability-analysis-dsa-report>, accessed 5 June 2018

A key contributor to the achievements of the DMO is its detachment from the fiscal and monetary authorities. A review of the DMO's 15-year operation in 2015 highlighted the role of power, pressure, passionate leadership and technical professionalism⁶⁰ in its successes. Essentially, an alignment of political interest to ensure debt relief in 2004 ensured that the DMO was set up in a way that mitigates inefficiency and other bureaucratic bottlenecks in the public sector. This is an important lesson in public sector reform for other developing countries; in particular the need to mitigate interests/power linkages with key stakeholders.

However, other areas need improvement. First, the DMO lacks monitoring power over the use of debt or the extent of borrowings. Second, it remains totally reliant on government guidance. This lack of independence could impact its effectiveness negatively. For instance, the deficit-to-GDP ratio over the past two years has contravened the Fiscal Responsibility Act of 2011. The overly optimistic projection of key debt indicators, which are consistently missed, reflects weak technical capacity and political influence. Third, there is weak coordination and oversight of the debt management authorities at the sub-national level.⁶¹ The weak fiscal

60 Akunyili D, Katz M & A Duncan, 'Fifteen Years of UK Partnership with Nigeria on Debt Management: Lessons for DFID's Wider Approach to Building Capability', Centre for the Study of the Economies of Africa Working Paper, 3, 2013, <https://thepolicypractice.com/wp-content/uploads/2014/03/Nigeria-Debt-Management-Report.pdf>, accessed 26 September 2018.

61 Raji J *et al.*, 'Nigeria Biannual Economic Update: The Case for Sustaining State Fiscal Reform', World Bank, October 2017, <http://documents.worldbank.org/curated/en/277951510594783976/pdf/121301-REVISED-Nigeria-Biannual-Economic-Update-October-2017-F.pdf>, accessed 2 October 2018.

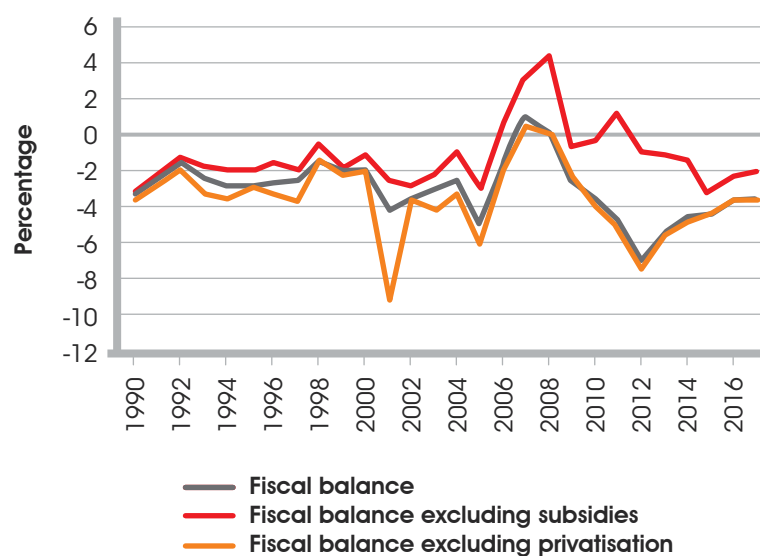
performance in the majority of Nigerian states suggests that good practices at the national level are not yet in place at lower levels.

IN-DEPTH FOCUS: MOROCCO

HOW DID THE FINANCIAL CRISIS AFFECT THE FISCAL DEFICIT?

Morocco has managed to maintain a fiscal deficit of around 2–4% since 1990 for over a decade with the sole exception of 2005, when the fiscal deficit reached 6.4% because of the impact of the rising oil price on government expenditure (Figure 21).⁶² Public finances recovered quickly, resulting in a surplus of 0.4% and 0.2% respectively in 2007 and 2008. This improvement was largely the result of a surge in tax revenues. However, after the exceptional budget surplus in 2007/2008, the fiscus was severely affected by the longer-term fall-out of the financial crisis.

FIGURE 21 MOROCCO FISCAL BALANCE (% OF GDP)



Source: Morocco, Ministry of Economy and Finance, Direction des Etudes et des Previsions Financieres, Tableau de Board Des Finances Publiques, June 2017, https://www.finances.gov.ma/Docs/depf/2017/TB_FP_01_06_2017.PDF, accessed 5 September 2018

An analysis of the fiscal imbalance and debt trends during this period is largely concentrated on the drivers of expenditure, notably subsidies, investment and

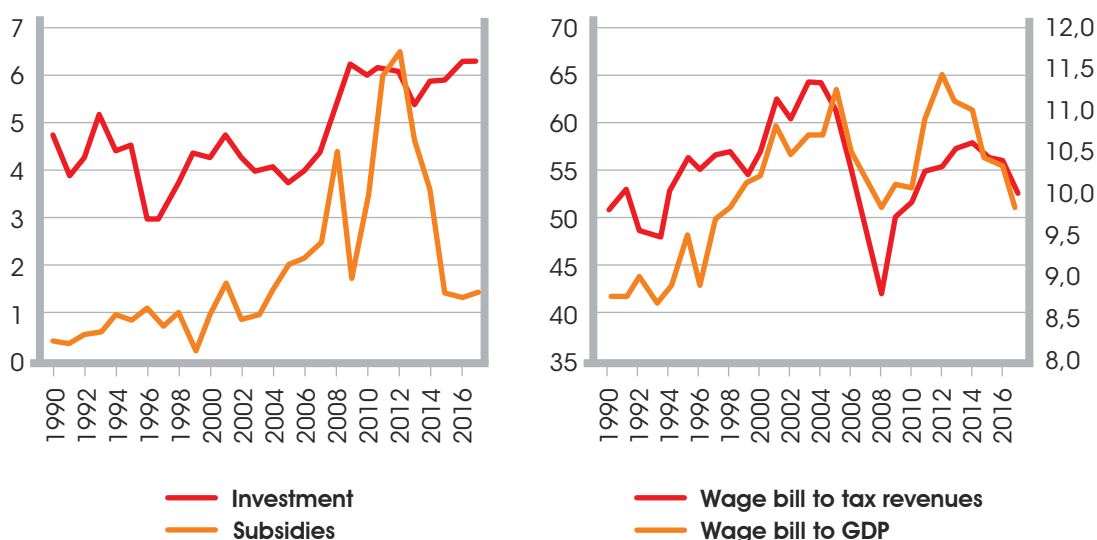
62 The cost of oil had increased to \$55 per barrel in 2005, compared to \$32 per barrel in 2004.

wages, given that revenue generation remained fairly stable at around 20% of GDP between 2007 and 2012.

Until the mid-2000s, government subsidies of oil products did not exceed 1.5% of GDP, but between 2007 and 2008 they almost doubled to 3% and 4% of GDP respectively, because of the increase in the oil price to over \$100 per barrel in the first half of 2008. The oil price increase automatically widened the fiscal deficit to reach a peak of 6.5% in 2012 when, for the first time, subsidies represented over 6% of GDP as oil prices trailed close to \$120 a barrel.

Post-2008, the capital expenditure-to-GDP ratio shifted to a new level of around 6% of GDP as a counter-cyclical measure, compared to around 4% previously – in part also explaining the fiscal deterioration since 2009 (see figures 22 and 23).

FIGURES 22 MOROCCO CENTRAL GOVERNMENT INVESTMENT AND SUBSIDIES (% OF GDP) AND WAGE BILL

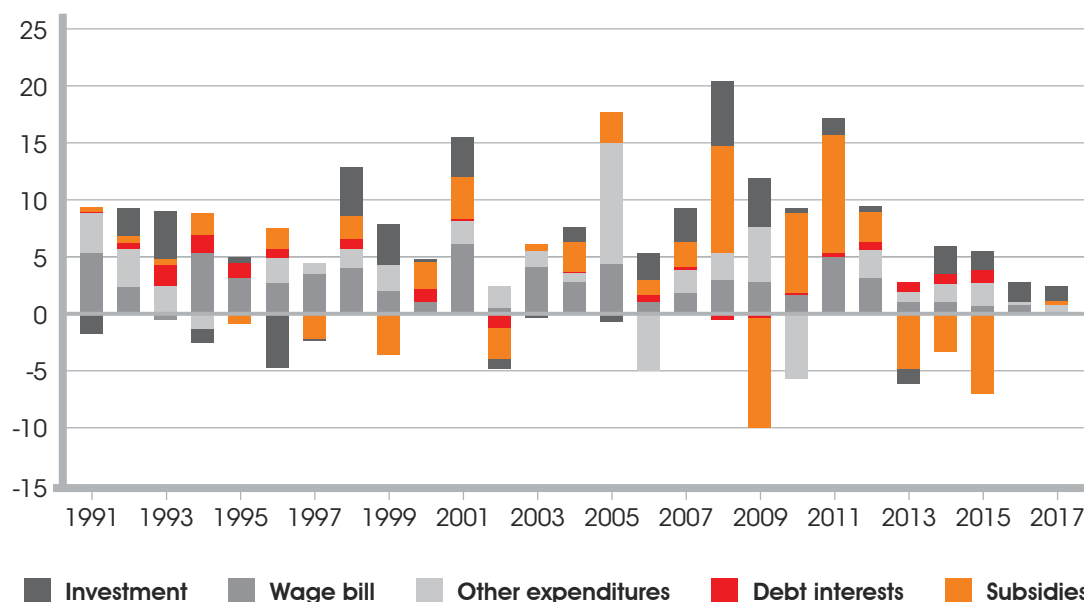


Source: Morocco, Ministry of Economy and Finance, Direction des Etudes et des Previsions Financieres, Tableau de Board Des Finances Publiques, June 2017, https://www.finances.gov.ma/Docs/depf/2017/TB_FP_01_06_2017.PDF, accessed 5 September 2018

Finally, the growing wage bill was also responsible for budget slippage. In 2011–2012 more than a third of the increase in total government expenditure was driven by the expansion of the wage bill. In fact, more than 50% of total tax revenues (11% of GDP) covered public wages. This increase reflected an adjustment of wages rather than employment creation. In 2011, for example, the number of public servants increased by roughly 2%. In that year, the government reached an agreement with

the unions that granted civil servants a monthly net increase of MAD⁶³ 600 (\$60), equivalent to a 6% increase in the average gross wage per worker.⁶⁴ This agreement occurred against the backdrop of the Arab Spring, when Middle Eastern and North African governments faced growing social and economic demands from civil society. These factors cumulatively led to a fiscal deficit of around 7.7% of GDP⁶⁵ in 2012. Since then, several measures, in some cases painful, were implemented to restore Morocco's fiscal balance, resulting in a gradually narrowing of the deficit to 3.5% of GDP in 2017 (Figure 23).

FIGURE 23 MOROCCO CONTRIBUTION TO TOTAL EXPENSES GROWTH BY COMPONENT, %



Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique, 2018*, http://www.chambrederespresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

In 2013, the government embarked on an ambitious subsidy reform effort and decided to index domestic prices of petroleum products against international prices. At a time when analysts expected further price increases, the government

63 Currency code for the Moroccan dirham.

64 As data regarding net wages is not available, the increase is reported to gross wage. In real terms, the increase was still important, as inflation in Morocco does not exceed the level of 2% on average. In 2011, for example, it stood at 1%.

65 This number might be slightly different from previous estimates due to changes in GDP measures.

decided to underwrite an insurance policy of around \$0.5 billion to hedge against an additional surge in the oil price beyond \$120 per barrel to avoid a transfer above that level to domestic prices. The reform strategy, bolstered by a fall in commodity prices in mid-2014, significantly reduced the growth of public spending and the deficit. By December 2015 the government abandoned subsidies on gasoline, diesel and fuel products, with the exception of cooking gas. The price liberalisation strategy elicited a broad debate in Morocco given the social implications of unsubsidised cooking gas. The government subsequently postponed its full price liberalisation, given the far-reaching impact on households' well-being.⁶⁶

The government needed to accelerate the process of fiscal consolidation and therefore also targeted the investment budget (see Table 5). From 2008 to 2010 investment had been growing by double digits. However, following the deterioration in the fiscal deficit, investment increased on average by only 1% between 2011 and 2014, so that in real terms it declined.⁶⁷ In 2013 fiscal consolidation was driven by capital expenditure cuts and the reduction in the treasury budget was the result mainly of tightened budgets in infrastructure-focused departments.⁶⁸ In 2013 the investment budget was cut by around 1% of GDP. e

TABLE 5 MOROCCO: CENTRAL GOVERNMENT CAPITAL SPENDING GROWTH BY DEPARTMENT, %

| DEPARTMENT | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 |
|---|------|------|------|------|------|------|------|
| Economy and Finance | -0.1 | 15.2 | -4.9 | -2.3 | 6.2 | 0.8 | 3.8 |
| National Defence | -0.7 | -4.4 | 4.1 | 1.1 | -0.2 | -0.2 | -0.4 |
| Equipment, Logistics & Transport | -1.1 | 2.9 | 0.9 | -3.6 | 1.6 | 2.1 | 0.7 |
| Agriculture | 0.4 | 0.7 | 2.9 | -1.1 | 3.6 | 0.3 | 1.0 |
| Education | -2.7 | -7.5 | 1.8 | 3.1 | 0.3 | 0.0 | 0.5 |
| Interior Minister | 0.5 | -0.1 | 0.9 | -0.8 | 0.4 | -0.8 | -0.1 |
| Health | 0.4 | 0.0 | 0.1 | 0.1 | 0.4 | -0.4 | 1.6 |
| Royal Court | -0.1 | 0.1 | 0.0 | 0.0 | 0.0 | -0.1 | 0.0 |
| Justice | 0.1 | -0.2 | 0.1 | -0.1 | -0.1 | 0.3 | -0.1 |
| Foreign Affairs | -0.4 | 0.0 | -0.2 | 0.2 | -0.2 | 0.3 | 0.0 |
| Culture | 0.1 | -0.1 | 0.1 | -0.1 | 0.0 | 0.1 | 0.1 |
| Other departments | 5.4 | -0.6 | -2.6 | -2.7 | 0.5 | 5.4 | 1.1 |
| Total Investment | 2% | 6% | 3% | -6% | 13% | 8% | 8% |

Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique*, 2018, http://www.chambredesrepresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

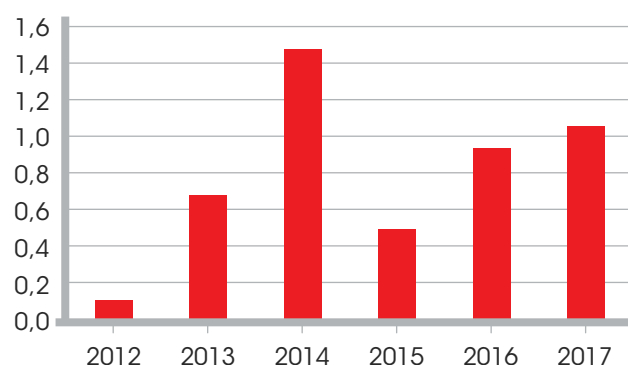
66 However, support for full liberalisation could be achieved through targeted cash transfers.

67 Education expenditure suffered the most from the reduction in government spending in 2011.

68 As data regarding net wages is not available, the increase is reported to gross wage. In real terms, the increase was still important, as inflation in Morocco does not exceed the level of 2% on average. In 2011, for example, it stood at 1%.

Morocco also benefited from the support of the Gulf Cooperation Council, which has provided significant funds to the country since 2012 (see Figure 24). In fact, the budget deficit would have been far worse if the annual subsidies were excluded. These resources reduced the budget deficit by 1.4% of GDP in 2014. In addition, they helped to ensure balance of payments sustainability at a time when the current account deficit reached around 10% of GDP in 2012.

FIGURE 24 MOROCCO GRANTS AS A % OF GDP



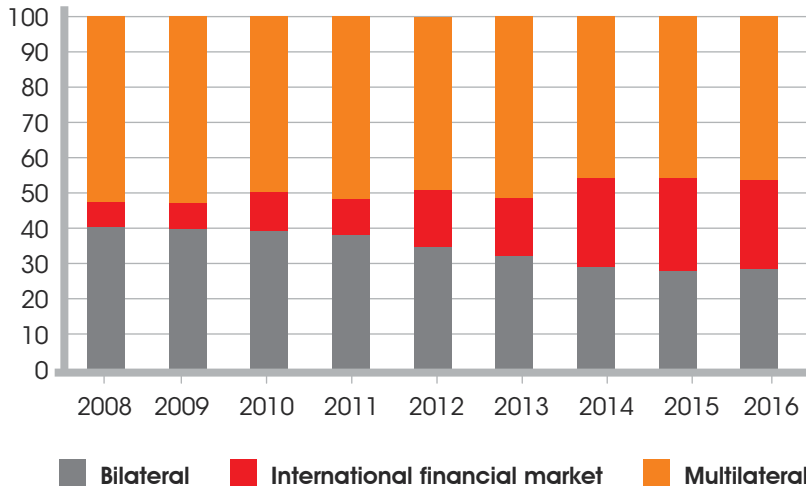
Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique*, 2018, http://www.chambrederespresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

A CHANGE IN THE GOVERNMENT'S FUNDING STRATEGY

The year 2009 marked a turning point in Morocco's financing strategy, when it resorted to external borrowing. The award of an investment grading by Fitch in 2007 and Standard & Poor in 2010 gave it an opportunity to borrow at a reasonable cost. In 2008 about 60% of Morocco's external financing came from bilateral creditors – mainly European – while the remainder came from multilateral institutions. Over time, the structure of its loan book has changed and diversified (see Figure 25).

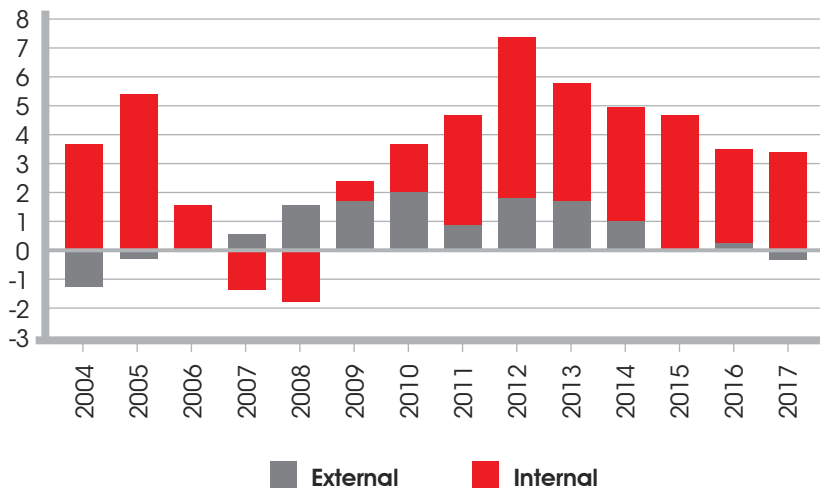
The return to external borrowing (see Figure 26) could be explained by several factors. First, external shocks, including oil price increases, directly affected Morocco's foreign reserves. Whereas in 2007 reserves reached eight months of imports, the downward pressure on the balance of payments reduced the level to less than four months in 2012 (see Figure 27).

FIGURE 25 MOROCCO OUTSTANDING TREASURY EXTERNAL DEBT STRUCTURE, %



Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique, 2018*, http://www.chambrederesrepresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

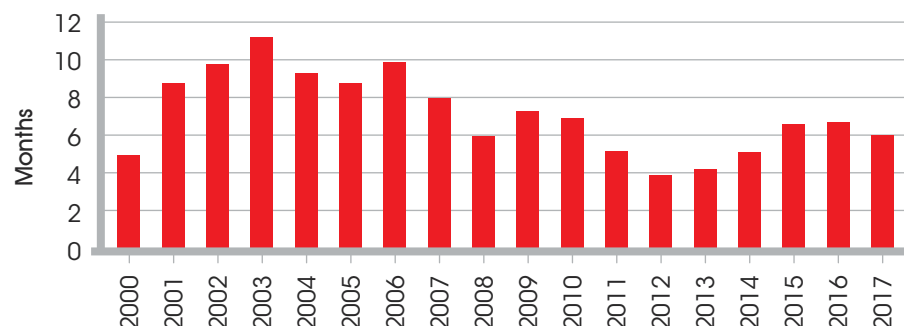
FIGURE 26 MOROCCO NET LENDING/BORROWING OF GOVERNMENT, % OF GDP



Note: The sum of the bars is equal to the fiscal balance

Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique, 2018*, http://www.chambrederesrepresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

FIGURE 27 MOROCCO INTERNATIONAL RESERVES IN MONTHS OF IMPORTS



Source: The World Bank Data, Total reserves in months of imports, <https://data.worldbank.org/indicator/FI.RES.TOTL.MO?end=2016&locations=MA&start=1975&view=chart>, accessed 5 September 2018

A forced migration to a flexible exchange rate regime was in sight. Moreover, capital account restrictions do not allow the private sector easy access to international markets, making the public sector the only borrower.

Another factor was the low interest rates on the international market. The last Eurobond issue by Morocco in June 2014 of EUR⁶⁹ 1 billion (\$1.37 billion⁷⁰) had a maturity of 10 years at a 3.5% interest rate, while Treasury bonds on the secondary market for the same maturity were 130 percentage points higher (see Figure 28).⁷¹

In addition, the risk of crowding-out was communicated by the Treasury⁷² when average interest rates increased by more than one percentage point from 2012 in a context of low and stable inflation, but with a fiscal deficit of more than 7%. The high yields on treasury bills, among other things, discouraged lending to the private sector during this period (see Figure 29). By 2013, commercial banks' net subscription to Treasury bills exceeded loans to the real economy and companies were reluctant to take on loans because of high costs. Moreover, concerns about the long-term sustainability of public finances informed investors' reluctance to take on loans with long maturities. Investors in Treasury bills were unwilling to demand long-term debt in 2012 and 2013, as the share of short and medium-term debt moved to 67% in 2012 and 83% in 2013 (see Figure 30).

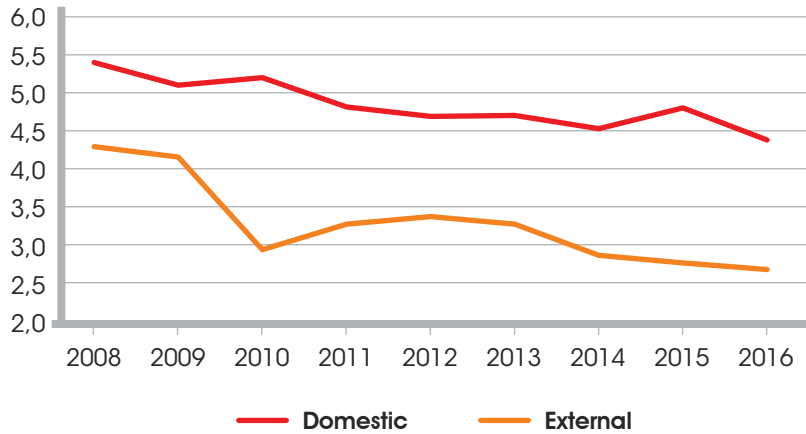
69 Currency code for the EU euro.

70 Using exchange rate of 30 June 2014, <https://fr.exchange-rates.org/Rate/USD/EUR/30-06-2014>, accessed 5 September 2018.

71 Even in real terms domestic interest rates were higher.

72 Morocco, Ministry of Economy and Finance, *Rapport sur la Dette*, https://www.finances.gov.ma/Docs/DB/2017/dette_fr.pdf, 2015.

FIGURE 28 MOROCCO APPARENT COST OF DEBT IN %



Source: Morocco, Ministry of Economy and Finance, Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique, 2018, http://www.chambrederespresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

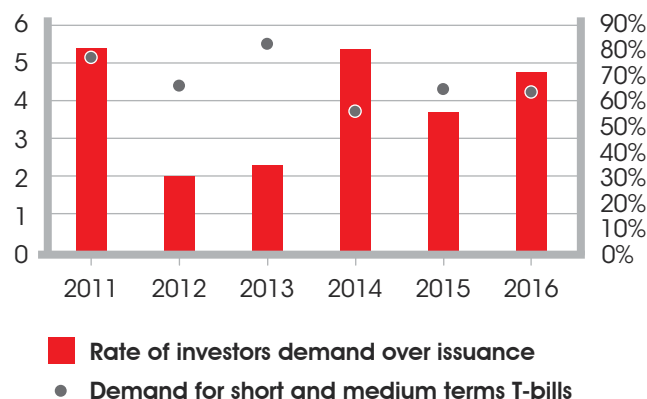
FIGURE 29 MOROCCO YIELD CURVE CHARACTERISTICS (%)



Note: The slope is calculated as the difference between the short-term rate (three months) and the long-term interest rate (20 years)

Source: Central Bank of Morocco and the Ministry of Finance, Maximum rate of conventional interest, 2018, <http://www.bkam.ma/Marches/Taux-d-interet/Taux-maximum-des-interets-conventionnels>, accessed 5 September 2019

FIGURE 30 MOROCCO INVESTOR DEMAND FOR T-BILLS



Source: Central Bank of Morocco and Ministry of Finance, Reference rate of treasury bills, 2018. <http://www.bkam.ma/Marches/Principaux-indicateurs/Marche-obligataire/Marche-des-bons-de-tresor/Marche-secondaire/Taux-de-reference-des-bons-du-tresor>, accessed 5 September 2019

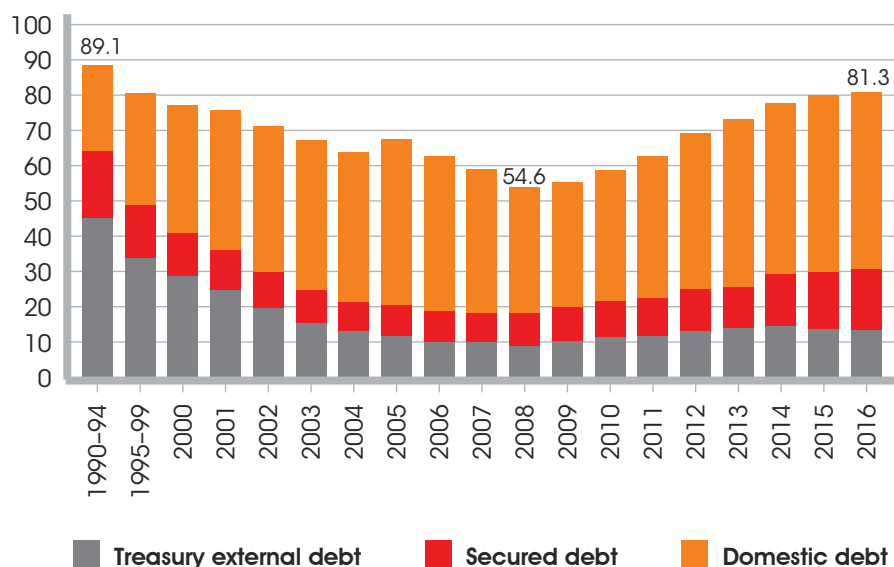
During these consolidation efforts, the IMF granted Morocco a ‘Precautionary Liquidity Line’ (PLL) for an amount of \$6.21 billion over two years in August 2012. The PLL served as an insurance against external shocks⁷³ and demonstrated IMF confidence in the authorities’ ability to restore macroeconomic balance during this difficult period. Since then, the IMF has affirmed Morocco’s qualification for the PLL on an annual basis and concluded every time that the government had the capacity to move forward with necessary reforms, especially of the subsidy system.⁷⁴

Under these conditions, Morocco’s public debt increased dramatically to 81.3% of GDP in 2016 (see Figure 31), with its external component representing the larger part of the new accumulation. Importantly, it is the guaranteed part of SOE debt that has increased the most – exceeding for the first time treasury’s total external debt in 2015. However, the debt structure remains dominated by domestic debt (78%) and long- and medium-term debt (over 80%). In terms of the apparent cost of external debt, it shows a downward trend to around 3% in 2016, well below domestic debt costs in line with falling interest rates on the international market.

73 The PLL has been a peaceful trigger for structural reforms concerning subsidies and the exchange rate regime.

74 IMF, ‘First Review under the Arrangement under the Precautionary Liquidity Line’, February 2015, <https://www.imf.org/en/Publications/CR/Issues/2016/12/31/Morocco-First-Review-Under-the-Arrangement-Under-the-Precautionary-And-Liquidity-Line-42719>, accessed 26 September 2018.

FIGURE: 31 MOROCCO PUBLIC DEBT AS % OF GDP



Source: Morocco, Central Bank and Ministry of Economy and Finance, 2017 Annual Report Presented to the King. <http://www.bkam.ma/Publications-statistiques-et-recherche/Publications-institutionnelles/Rapport-annuel-presente-a-sm-le-roi>, accessed 5 September 2019

HOW SUSTAINABLE IS MOROCCO'S PUBLIC DEBT?

Fiscal consolidation has reduced the budget deficit to below 4% in 2017 from 7.7% in 2012. Most fiscal policy diagnostics confirm the sustainability of Morocco's Treasury debt, which increased to 64.1% in 2016 from 45.4% in 2008. The last IMF article IV consultation held in 2017 confirmed this view.⁷⁵ According to the IMF, the recent increase in external debt is mainly driven by a higher primary deficit and interest rates above nominal growth. However, using less optimistic assumptions, an OCP Policy Center study⁷⁶ revealed that the debt-to-GDP ratio was likely to exceed the 70% threshold and the ratio would rise to 77% once external shocks were taken into account. In analysing Morocco's debt, it is clear that the trend has been upwards since 2008, but that the increase is not as sustained as before. Hence 2017 represented a turning point over the last decade with Treasury debt falling for the first time.

75 IMF, 'Morocco 2017 Article IV Consultation Staff Report', Country Report, 18/75, March 2018, <https://www.imf.org/en/Publications/CR/Issues/2018/03/12/Morocco-2017-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-45713>, accessed 2 October 2018.

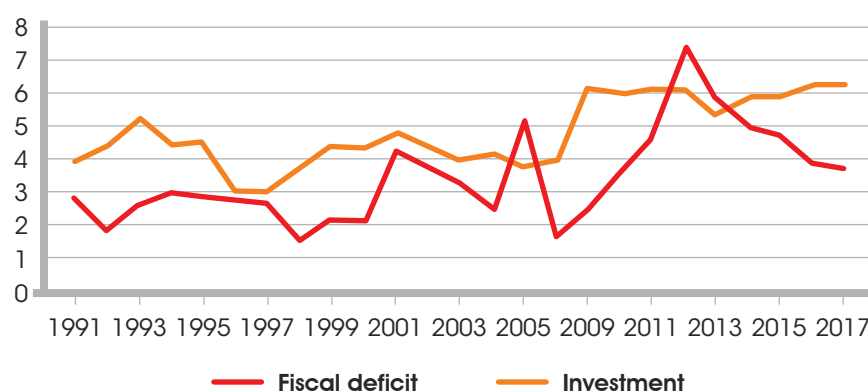
76 OCP Policy Center, 'Politique budgétaire et activité économique au Maroc: une analyse quantitative'. OCP Policy Center, 2015, <http://www.ocppc.ma/publications/politique-budg%C3%A9taire-et-activit%C3%A9-économique-au-maroc-une-analyse-quantitative>, accessed 5 September 2018.

While fiscal consolidation efforts have been enhanced to avoid further debt accumulation, the risk analysis focuses mainly on the Treasury instead of the entire public sector. The Public Auditor has recently published a study confirming that some SOEs have serious financial vulnerabilities and require urgent restructuring. It is important that these companies are monitored closely with the view to address long-term solvency issues through an upgrading strategy that has already started.⁷⁷

LESSONS FOR OTHER AFRICAN COUNTRIES FROM THE MOROCCAN CASE

The new Organic Finance Act, in force since 2016, aims to support a new public finance governance model and requires an annual update of Morocco's three-year financial planning framework to provide full visibility to all departments, increase coherence between public policies and support a sound macroeconomic framework. The requirement to keep cost accounting statements enables the breakdown of individual departments' expenditure. The new law also requires capital expenditure to be executed within a year and disallows deferrals, thus strengthening government commitment towards implementing only feasible projects.⁷⁸ Finally, it sets a fiscal rule that determines the relationship between public debt accumulation and investment efforts, namely that the flow of debt should be dedicated exclusively to fund investment, as it links investment to debt, implying that the fiscal deficit should not exceed the capital expenditure envelope (see Figure 32).

FIGURE 32 MOROCCO FISCAL DEFICIT AND PUBLIC INVESTMENT AS % OF GDP

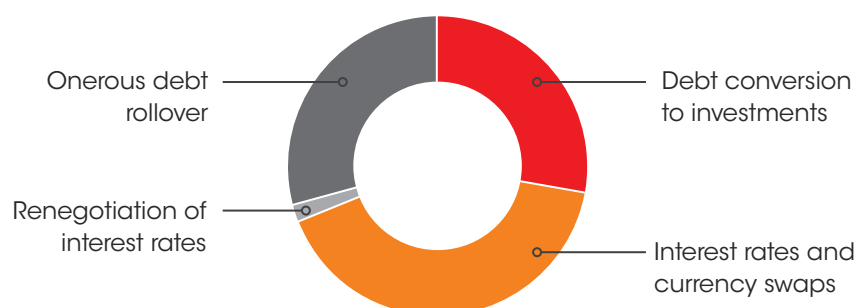


Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique*, 2018, http://www.chambredesrepresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

77 La Cour des comptes, 'Le secteur des établissements et entreprises publics au Maroc: Ancrage stratégique et gouvernance', 2016, http://www.courdescomptes.ma/upload/Module_20/File_20_296.pdf, accessed 5 September 2018.

78 Morocco, Organic Finance Act 2016, Article 20, 'Il ne peut être dérogé à cette règle que pour faire face à des contraintes liées à une détérioration de l'équilibre économique et budgétaire établi par la loi de finances.'

**FIGURE 33 MOROCCO ACTIVE EXTERNAL DEBT MANAGEMENT
STRUCTURE (1996–2016)**



Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique, 2018*, http://www.chambrederesrepresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

Beside its mixed effect on public services delivery, the introduction of contractual employment⁷⁹ in the public sector seeks to increase the Treasury's expenditure flexibility, thereby managing the public wage bill more effectively and enabling greater fiscal policy flexibility over the cycle. The first group of civil servants has been contracted (especially in the education sector) and receives almost the same wages to regular civil servants. While its impact is too early to assess, the new law is expected to improve the inflexible nature of public wage expenditure in the long run.

Private–public partnership (PPP) is seen as an avenue to leverage private funds to sustain development, given that public investment has reached a level that can no longer be sustained at the same rate, whether via the Treasury or SOEs, because of high debt levels. The PPP model has proven effective in attracting private funds into infrastructure, modernising the production system and leveraging private knowledge in key sectors.⁸⁰ In this context, a new PPP law was passed in 2015 to define a consolidated PPP framework for Morocco.⁸¹

Debt conversion into investments, interest and currency swap instruments allow more flexibility for external debt management. The Treasury makes extensive use

79 A law passed in 2016 allows the government to hire public servants under fixed-term contracts.

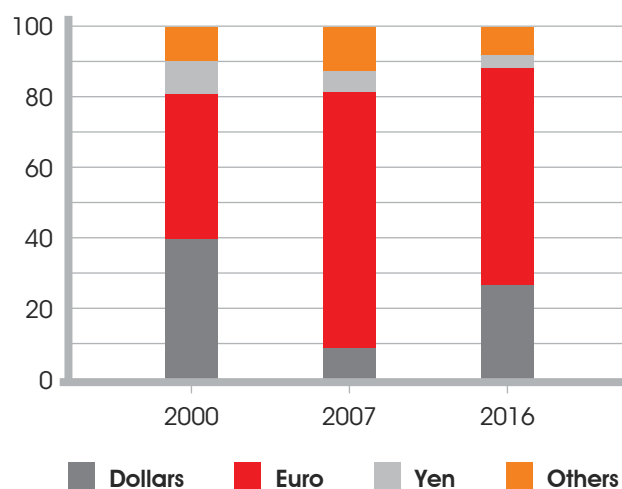
80 World Bank, 'The Economic Impact of Public-Private Partnerships in the Infrastructure Sector: Literature Review', 2016, <https://library.pppknowledge.org/documents/2384/download>, accessed 26 September 2018.

81 The law draws on different legal frameworks of PPPs in various developed countries. Morocco, Ministry of Economy and Finance, 'Introductory Note to the Public-Private Partnership Bill', 2014, http://www.sgg.gov.ma/portals/0/AvantProjet/4/NP_Loi_PPP_Ang.pdf, accessed 26 September 2018.

of three financial instruments to deal with rising external debt: debt-to-investment swaps; interest rates and currency swaps; and expensive debt refinancing (see Figure 33). More than 50% of the outstanding external debt in 2016 was subject to these operations (\$7.2 billion).⁸² Converting debt into private investment increases visibility among foreign investors draws in international expertise in specific areas where national know-how is lacking, enables repayment of debt in national currency and eases the debt burden.

Currency swaps have mitigated the foreign exchange risk and lowered interest rates from 4.25% in 2012 to 3.75% in 2014. Instead of reducing the debt cost, Morocco's main objective was to converge towards a debt structure that reflects the weighting of its currency (80% in euros and 20% in dollars). In April 2015 its currency basket was adjusted to consider the new structure of Morocco's external economic relations, and the weighting of US dollars was increased to 40% at the expense of the euro, now representing 60% of the currency basket (see Figure 34).

FIGURE 34 MOROCCO PUBLIC EXTERNAL DEBT STRUCTURE, BY CURRENCY, %



Source: Morocco, Ministry of Economy and Finance, *Projet de Loi de Finances pour l'année budgétaire: Rapport sur la Dette Publique, 2018*, http://www.chambrederespresentants.ma/sites/default/files/dette_fr_1.pdf, accessed 5 September 2018

In addition, the Treasury used the interest rate swap to switch from a floating to a fixed rate. This made it possible to peg around 75% of the total public debt, compared with 57% at the beginning of 2000. In addition, Morocco has decided

82 MAD 73 billion using the exchange rate of 31/12/2016.

to repay its onerous debt and has financed the repayments at rates currently lower than those of the incurred debts.

Despite these positive initiatives, the public accounting system could be improved considerably. The dominant approach is cash accounting, where the deficit does not provide information on the liabilities incurred. In addition, data coverage needs to be expanded to provide a comprehensive picture of the financial status of the public sector.⁸³

CONCLUSION AND POLICY RECOMMENDATIONS

The rising debt burden across the continent is a clear source of concern for local authorities, creditors and the wider international community. It is particularly worrisome considering that, in the past, the rapid accumulation of debt by African countries resulted in a debt crisis that required extensive debt-relief initiatives. However, it is important to note that public debt as a percentage of GDP in sub-Saharan Africa currently stands at 45.9%, which is well below the 116% debt-to-GNI ratio of 1995. However, sovereign debt financing is inevitable given that the budgetary resources of African countries are insufficient to finance the region's vast development agenda. Consequently, achieving debt sustainability while working towards meeting the development goals and achieving macroeconomic stability is of utmost importance. African countries should:

- **Maintain and promote prudent macroeconomic policies**

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

- **Promote economic diversification and alternative forms of revenue generation**

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

83 The government has welcomed all these comments and is aware of the need to align public sector statistics to international standards. It committed to start reforms in 2018.

- **Develop domestic debt markets and manage debt maturities and interest rates pro-actively**

Governments could deepen their domestic debt markets to curtail the dependence on external loans owing to exchange rate risks. These risks have increased as developed countries begin to raise interest rates. Accordingly, developing and deepening domestic markets could provide a sound alternative to local authorities, although care should be taken not to crowd out the private sector and a careful assessment should be made of the advantages of external loans through bilateral creditors and DFIs, such as low interest rates and long maturities (especially for LICs).

- **Develop other domestic financing options and instruments**

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

- **Establish autonomous, functional debt management offices**

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

- **Role of multilateral development banks**

As detailed in the paper, major MDBs already contribute to debt sustainability in African countries through a combination of technical assistance and capacity-building support programmes. These efforts should be continued to support proper debt management strategies in African countries. In addition to assisting African countries in developing domestic debt markets, development finance institutions should help governments to monitor the risks that emerge from the changing characteristics of debt as African countries become increasingly vulnerable to risks such as investment arbitration. This is to avoid debt default owing to the poor use of debt.

MDBs should also scale up the volumes of concessional lending to the continent and explore more closely with LICs their reluctance to utilise concessional loans.

Finally, concessional loans should be used for key social and economic projects (ie, infrastructure, renewable energy, water and transport) that support productive and sustainable economic development and avoid corruption.



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