

# Is sub-Saharan Africa facing another systemic sovereign debt crisis?

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## SUMMARY

Concern is increasing about the prospect of a new sovereign debt crisis in countries across sub-Saharan Africa.<sup>1</sup> The previous debt crisis of the 1990s is still fresh. It has only been 14 years since officials from major creditor countries (a group known as the Paris Club)<sup>2</sup> and multilaterals adopted the ambitious Multilateral Debt Relief Initiative (MDRI) for outright forgiveness of debt owed by a group of 36 low-income poor countries.<sup>3</sup> The majority of these countries, 29, in fact, were African. The massive debt relief was conditioned on sound economic management and poverty reduction strategies.

The MDRI was the logical advancement of a variety of initiatives for debt relief, the most prominent of which was the Heavily Indebted Poor Countries (HIPC) initiative instituted by the International Monetary Fund (IMF) and World Bank in 1996 to address debt overhang in the poorest countries of the world. African countries had been borrowing into the 1980s, which led to an increasing accumulation of debt that became unsustainable.

These debt relief initiatives, including MDRI, had good intentions and outcomes. Through unloading of the debt overhang, infusion of new loans, improved policies, along with enhanced investment incentives, the overall expectation was that there would be positive economic and social development outcomes. Indeed, for about a decade, most countries witnessed economic upturns and reduced debt burdens. The median public debt level (as a percent of GDP) for sub-Saharan Africa declined to about 31 percent in 2012, far below the levels leading up to the HIPC initiative.

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1. This policy brief covers 44 countries in sub-Saharan Africa based on IMF country classifications excluding Eritrea. Sub-Saharan Africa and Africa are used interchangeably in the text to refer to this group of countries.

2. The Paris Club is a group of 22 permanent members representing bilateral creditors who coordinate on debt resolution problems for developing countries. <http://www.clubdeparis.org/>

3. Eligible countries included those who had completed the HIPC program or had per capita income below US\$380 in 2006. <https://www.imf.org/external/np/exr/mdri/eng/mdrians.htm#q01>

There were concerns associated with the debt relief program, notably the issue of moral hazard (Easterly, 2009). The worry was that, moving forward, this blanket debt forgiveness would distort incentives for weak governments to over-borrow and then over-invest, detracting from economic performance. These concerns are consistent with the belief that poor governance and fiscal indiscipline contributed to the debt overhang and that, unless there are genuine systemic reforms, history will repeat itself.

### **So, as the region once again faces massive debt, is history repeating or is this time different?**

A decade and half after the massive debt forgiveness, African debt is in the global news again. Since 2013, the region's debt has been on the rise, with the median debt ratio as percent of GDP increasing from 31 percent in 2012 to 53 percent in 2017. This growing public indebtedness is fueled not only by domestic, but also external debt, as both categories have risen by about 10 percentage points. Because of the rapid increase in debt burden over recent years, about one-third of the countries in sub-Saharan Africa are either in or at high risk of debt distress, including the majority of countries that benefited from debt relief in the 1990s.<sup>4</sup> Total debt and external debt for these countries is estimated at \$160 billion and \$90 billion, respectively. To assess whether this time is different, it is important to examine the drivers of this debt buildup, the composition of debt, and its design features.

We find that several factors contributed to the debt buildup beginning around 2008 and accelerating after 2014, particularly the global financial crisis and the 2014 terms-of-trade shock. In response to these shocks, economic activity declined and government revenues fell. Primary fiscal balances, which were positive through 2007, turned negative after 2008, partly in response to policy measures to support economic activity. Meanwhile, the low interest rate environment in the aftermath of the global financial crisis and investors' search for yield facilitated access to capital markets for many countries for the first time. Large infrastructure needs, amid rapidly growing populations, also led several countries to issue debt to fill the financing gaps. Additional contributing factors included exchange rate depreciations and, in a few countries, poor governance and corruption.

Our analysis suggests that, while another systemic sovereign debt crisis is not imminent, the rapid pace of the debt increase, as well as important changes in its structure and design features compared with that of the HIPC/MDRI era are concerning. Indeed, median debt as percent of GDP in the region has increased by a staggering 5 percentage points annually between 2014 and 2016. This pace of increase is not sustainable. Moreover, external and foreign-currency denominated debt is predominant, accounting for about 60 percent of total debt on average, exposing these countries to swings in global market conditions. The share of commercial debt is rising too, in part because of eurobonds issued by several countries. In this respect, the current debt build up is different than what occurred during the HIPC/MDRI era. This trend suggests that debt sustainably thresholds are now lower, as already evidenced by relatively high debt servicing costs. Finally, the credit base is now more diffuse. While the plurality of creditors allows for a diversification of funding partners, it makes eventual debt resolution mechanisms more complex.

The debate around another debt crisis less than two decades after major debt relief, serves as reminder that progress has not been sufficient to address the structural issues that constrain sustainable development financing in Africa. Notably, domestic saving rates have remained low at around 15 percent of GDP, on average, since early 2000, despite various initiatives over the past two decades to improve tax revenue collection, combat illicit flows, address profit shifting by multilateral corporations, and strengthen governance in natural resource management. Meanwhile, the financing needs for infrastructure are expanding with rapid population growth and urbanization, and multilateral development banks' financing in that sector has been meager.

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4. Based on debt sustainability analysis (DSA) of the IMF and World Bank. Six countries are in debt distress: Mozambique, the Gambia; Republic of Congo; São Tomé and Príncipe; South Sudan; Zimbabwe. No recent DSA is available for Republic of Congo but the country has been classified as 'In debt distress' in recent IMF publications after missing several debt payments (Macroeconomic developments and prospects in low-income countries 2018).

Even though a systemic sovereign debt crisis is not imminent, governments and their development partners should take the necessary steps to address any vulnerabilities and contain the risks of a systemic crisis. Governments should also ensure that debt management frameworks and strategies are updated to reflect the new structure of the debt, especially greater financial market risks, and take bold steps to strengthen governance around tax revenue collection. Enhancing efficiency in tax revenue collection could mobilize up to \$110 billion annually over the next five years and reduce the need for debt financing (Coulibaly and Gandhi, 2018). According to a study by the International Monetary Fund, developing countries lose about 1.3 percent of GDP in revenues to companies shifting profits to low-tax locations (IMF, 2019). Stronger international cooperation around corporate tax rules and enforcement will help raise tax revenues further.

Moreover, concerted international efforts and collaboration to combat illicit capital flows and repatriate stolen funds will go a long way to alleviate development financing needs. Development banks also have an important role to play in infrastructure financing, yet multilateral banks financed only about 3 percent of region's infrastructure between 2012 and 2016 (AfDB, 2018). Development banks should be adequately capitalized so that they can leverage that capital to play a bigger role in infrastructure financing. Their involvement will alleviate pressures on national government budgets and the buildup of debt. Finally, it is imperative that countries accelerate the process of developing financial sectors that are deep, dynamic, and inclusive.

## FROM DEBT RELIEF TO LOOMING DEBT CRISIS: THE DEBATE

**Rapid increase in debt levels.** Beginning in the late 1990s, 29 sub-Saharan African countries benefited from the HIPC and MDRI debt relief programs. As a result, average general government debt as a percent of GDP, fell substantially from 110 percent in 2001, to 35 percent in 2012. The median debt-to-GDP ratio peaked at 90 percent in 2001 and fell to 31 percent in 2012. The difference between the median and average point to significant heterogeneity in debt dynamics, as shown by the shaded area of Figure 1.

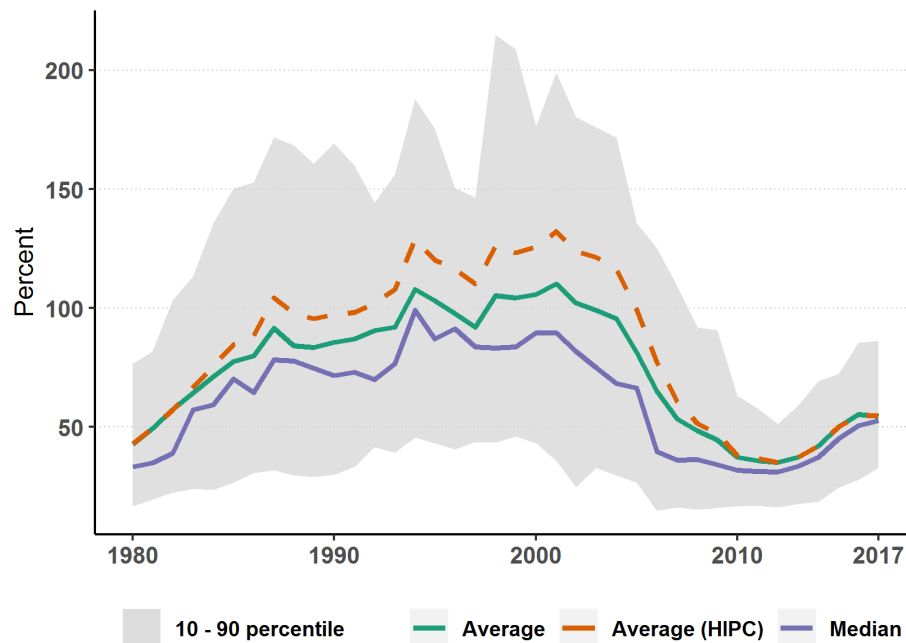
Since 2012, the debt-to-GDP ratio has increased by more than 10 percentage points in 31 countries of the 44 we examined, and by 25 percentage points or more in one-third of those countries. The average debt as a percent of GDP rose among those same countries from 35 percent to 55 percent in 2017, and the median rose from 31 percent to 53 percent.

This rapid increase (exceeding 20 percentage points) in the level of debt over the past five years is raising concerns that the region is heading toward a debt crisis reminiscent of the situation in the lead up to the HIPC/MDRI episode. Indeed, some observers have been sounding the alarm over a looming debt crisis across Africa (Gill and Karkulah, 2018; Pilling, 2018). The debt sustainability analysis of the IMF and World Bank indicates that the number of countries in the region either in or at high risk of debt distress rose from 6 in 2013 to 15 in 2019.<sup>5</sup>

To the skeptics of a looming debt crisis in Africa, these concerns are overblown. They argue that attention to this trend unfairly targets African countries as the increase in indebtedness is a global phenomenon that reflects widespread fallout from the global financial crisis (GFC) and the 2014 terms-of-trade (TOT) shock and policy responses. Indeed, since the GFC, debt has increased significantly in other low-income countries, emerging market economies, and developed countries. General government debt has risen by 17 percentage points globally, rising from 64 percent in 2008 to 81 percent in 2017. The increase has been larger for advanced economies where debt has gone from 78 percent in 2008 to 105 percent in 2017 (IMF, 2018a).

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5. Data as of January 31, 2019.

Figure 1: General government debt as a percent of GDP<sup>6</sup>

Source: IMF World Economic Outlook Database, October 2018;  
IMF Historical Public Debt Database; Authors' calculations

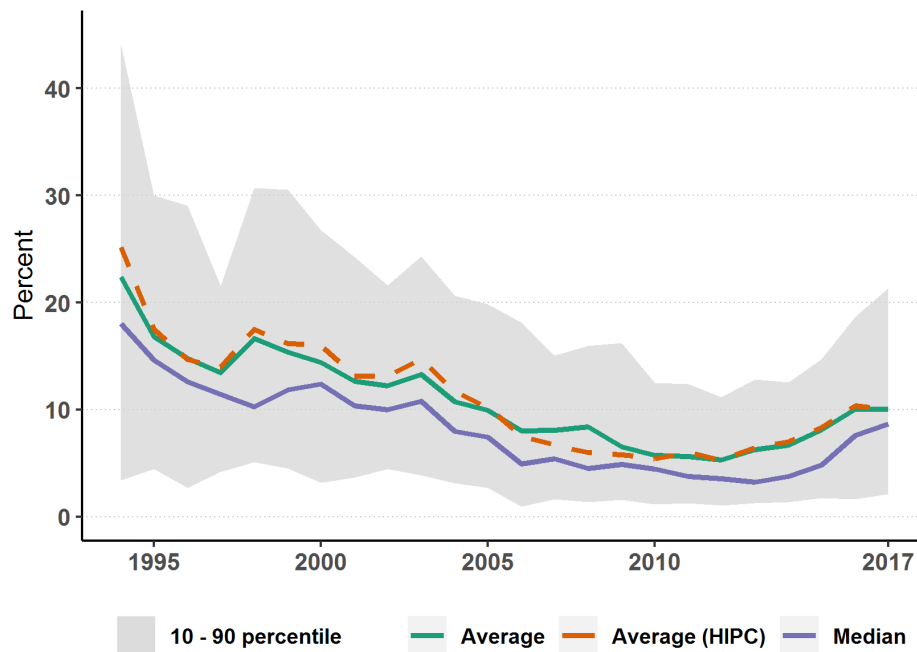
The current global average debt is much higher than that of sub-Saharan African countries. Moreover, sub-Saharan Africa's debt ratio remains far below that of the pre-HIPC period, when the average debt-to-GDP ratio was closer to 100 percent of GDP. Only three countries (Cabo Verde, Republic of Congo, and Mozambique) have debt levels above 100 percent of GDP. In 2017, only two HIPC recipients—Benin and The Gambia—had debt-to-GDP ratios higher than in 2001, when debt levels in Africa peaked.

**Rapid increase in debt servicing costs.** Debt levels are just one dimension of debt burden assessment. Another important metric is the burden of servicing debt. The cost of servicing debt has increased significantly in several African countries: As Figure 2 shows, interest cost as a share of government revenue doubled from 5 percent in 2012 to 10 percent in 2017, its highest level since the early 2000s.

Heterogeneity exists across countries, with the cost of debt servicing rising 10 percentage points in seven countries in the most extreme cases. The increase has been particularly large in Angola, Nigeria, Ghana, and Burundi, rising by almost 20 percentage points. As a result, interest costs now account for 10 percent of government revenues in 17 countries, compared with 6 countries in 2012. In one-third of African countries, the interest cost has now reached or exceeded its HIPC/MDRI level. This significant deterioration in interest rate cost, despite relatively low debt levels, points to a possible deterioration in the quality of debt during the current period of debt accumulation compared with the HIPC/MDRI era.

6. Unweighted averages are used to calculate mean debt levels.

Figure 2: Interest cost as a percent of government revenue



Source: IMF World Economic Outlook Database, October 2018; IMF sub-Saharan Africa Regional Economic Outlook; Authors' calculations

## DRIVERS OF THE DEBT ACCUMULATION: HOW DID WE GET HERE?

An assessment of debt accumulation and the associated burden requires an understanding of its drivers.

**Shocks of the global financial crisis and the 2014 term of trade shock.** The global financial crisis and the 2014 terms-of-trade shock hit economies around the world hard. The economic downturn, which ensued and the policy response contributed to a widespread accumulation of debt. Africa was not an exception. In the years leading up to the GFC, most countries in the region ran a primary fiscal surplus averaging about 3.5 percent of GDP between 2005 and 2008. Following the GFC, the surpluses turned into deficits, averaging 1.6 percent of GDP through 2013. The 2014 terms-of-trade shock further widened the deficit to 3.2 percent, on average, between 2014 and 2017, which accelerated debt accumulation.

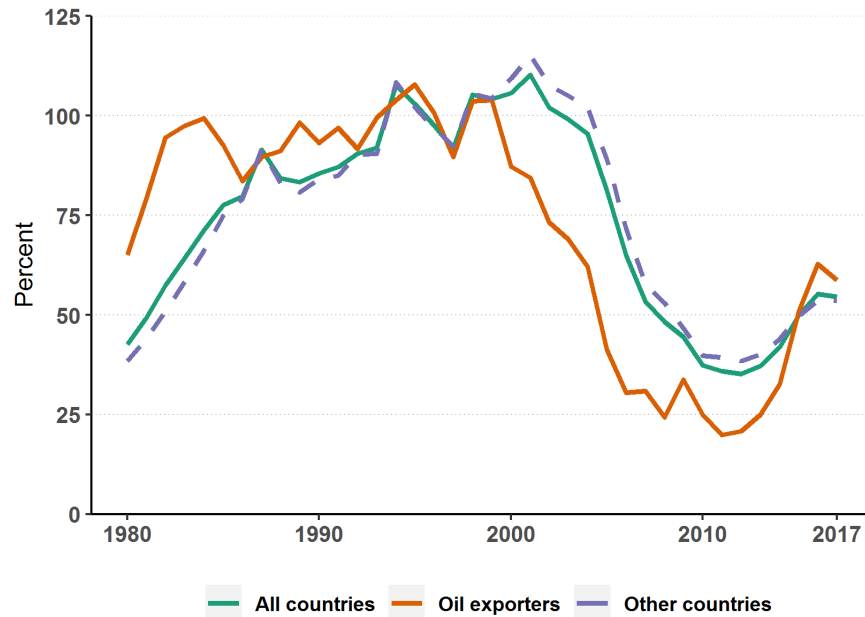
Deficits in resource-intensive countries ballooned; these economies experienced a more rapid increase in debt (Figures 3 and 4). Among the region's eight oil-exporters, average debt increased by almost 40 percentage points from 21 to 59 percent of GDP, far higher than the 16 percentage points increase in the continent's non-oil exporting economies, which is still rapid. Five of 10 countries with the fastest debt accumulation were oil-exporting economies.

**Figure 3: Average primary deficit by country group (percent of GDP)<sup>7</sup>**



Source: IMF World Economic Outlook Database, October 2018  
 Note: 'Other countries' include all countries in the sample excluding oil exporters

**Figure 4: Average government debt by country group (percent of GDP)**

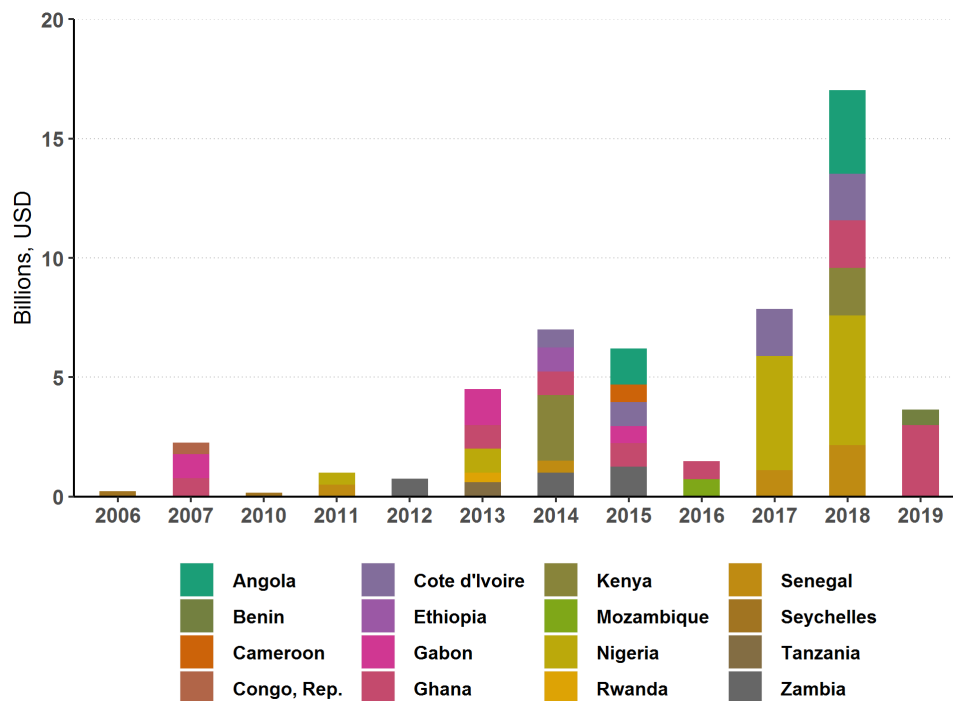


Source: IMF World Economic Outlook Database, October 2018; IMF Historical Public Debt Database  
 Note: 'Other countries' include all countries in the sample excluding oil exporters

7. Eight countries are classified as oil exporters based on IMF sub-Saharan Africa Regional Economic Outlook.

**Low global interest rate environment.** The changing financial landscape in the advanced economies pursuant to the GFC has facilitated the debt build-up in Africa. Following the GFC and the European debt crisis, the ensuing ultra-low interest rates prevailing in the U.S. and other advanced economies markets led to the private market stepping up lending to frontier markets, including to several African countries, in a search for higher yielding assets. For their part, several African countries began in 2006 to access international capital markets, with the pace of issuance and number of countries entering the markets ramping up after 2012 (Figure 5). Currently, 16 countries have issued eurobonds in international debt markets. These bonds were typically denominated in US dollars, unlike what their name implies ('Europe'). The appetite for such bonds persists despite the debate about the possibility of a debt crisis, increase in spreads, and sovereign downgrades in some countries. The majority of the eurobonds are issued by six countries: Angola, Côte d'Ivoire, Ghana, Kenya, Nigeria, and Senegal. In the last two years, all six countries have issued bonds with 30 year maturities. Eurobond issuances in the context of a low interest rate environment and appetite for higher yields contributed to the increase in debt.

**Figure 5: International bond issuances (selected countries)<sup>8</sup>**



Source: Bloomberg

**Large financing gaps, particularly for infrastructure.** The rapid increase in debt for non-oil exporters highlights other contributing factors. Low domestic saving rates in face of growing financing needs for infrastructure and other economic programs led governments to contract debt from a variety of sources: international debt markets (eurobond issuance, in particular), domestic markets, multilateral institutions, and Paris and non-Paris Club countries, with China being the major non-Paris Club player. The African Development Bank (AfDB) estimates Africa's annual financing needs for infrastructure at \$130 billion to \$170 billion and the financing gaps at \$68 billion to \$108 billion (AfDB, 2018).

8. Data as of March 2019. This excludes South Africa which has been issuing bonds for a longer period.

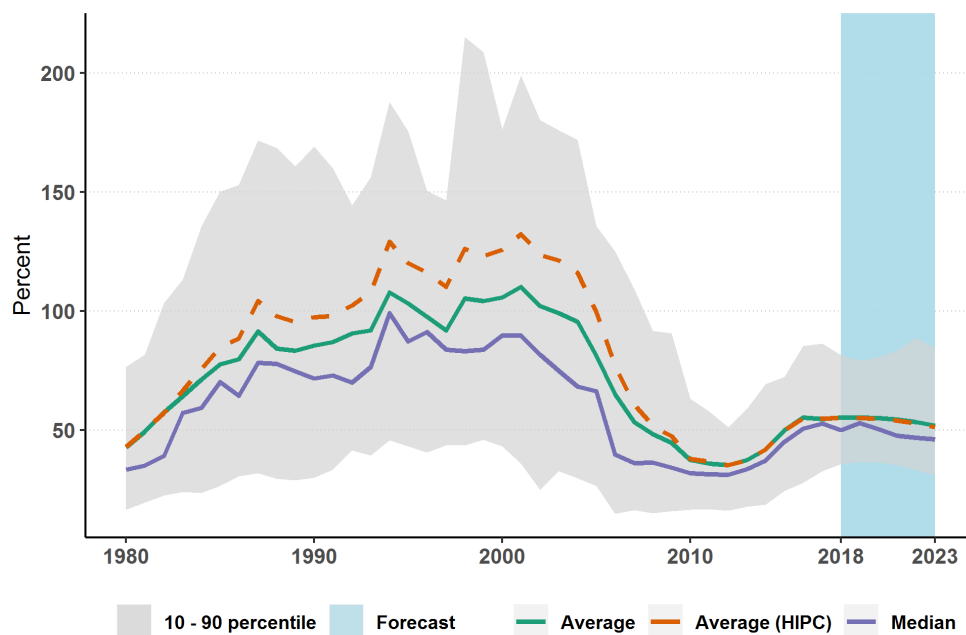
The role of China in infrastructure development and financing is particularly prominent. Apart from emerging as the largest trading partner for Africa, China has been the most prominent external player in the construction of railways, roads, power plants, ports, and so on. Accompanying this growth in investment is its large-scale provision of debt financing. Between 2012 and 2016, African governments financed over 40 percent of their own infrastructure needs. Over this period, China financed 15 percent, much more than the 3 percent from multilateral development banks.

**Poor governance.** In a few countries, poor governance has contributed to the increase in debt. For example, in Mozambique, one of the countries currently in debt distress, the disclosure of hidden loans issued by public companies, but guaranteed by the government, led to the deterioration of debt sustainability. This hidden debt included borrowing by three companies that were created shortly before the borrowing took place and were all headed by the same CEO, who at that time was a senior officer in the country's security services.<sup>9</sup> This example highlights the importance of strengthening governance around debt issuance, especially transparency.

**Exchange rate depreciation.** A portion of the debt accumulation can be attributed to balance sheet effects of exchange rate depreciations. A sizeable share of Africa's debt, including eurobonds, is denominated in foreign currency. As these issuances generally are not hedged against currency risks, the domestic currency value of unhedged debt increases with exchange rate depreciations like the ones that followed the GFC and the 2014 terms-of-trade shock.<sup>10</sup>

**More favorable debt dynamics.** Most of the drivers of the increases in debt appear to be dissipating. Commodity prices have retracted their declines, economic growth is recovering, exchange rates have strengthened, and in many cases, fiscal consolidation is under way. Accordingly, median debt levels are projected to decline to 47 percent by 2023, as shown in Figure 6.

**Figure 6: Outlook for general government debt as a percent of GDP**



Source: IMF World Economic Outlook Database, October 2018; IMF Historical Public Debt Database

9. <https://www.justice.gov/opa/pr/mozambique-s-former-finance-minister-indicted-alongside-other-former-mozambican-officials>

10. Large primary deficits and exchange rate depreciation account for more than half the rise in public debt levels since 2014 (Brookings, 2017).



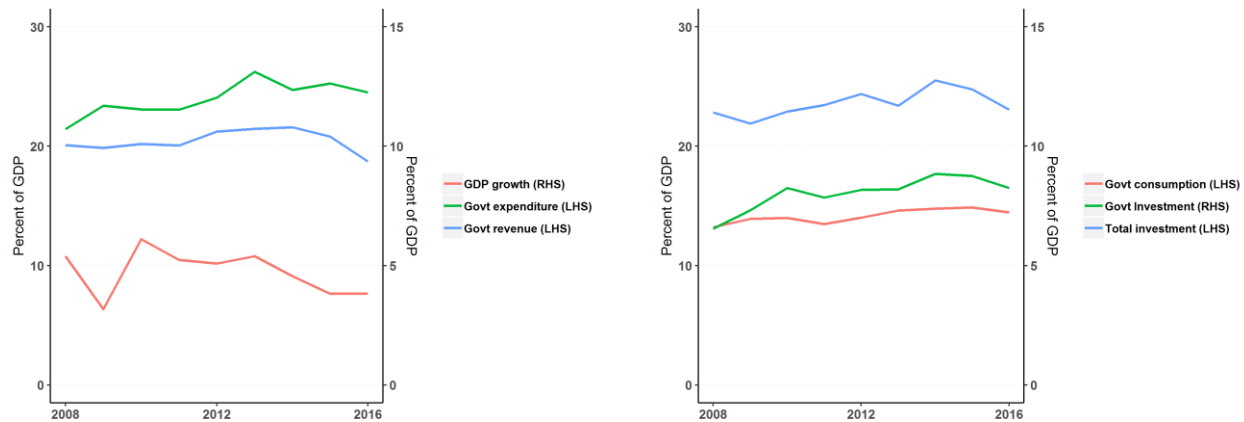
## USAGE OF THE DEBT: CONSUMPTION OR INVESTMENT?

The accumulation of debt is not in itself evidence of an ill-advised policy. Debt can be an important tool, especially when used to finance projects with adequate future social or economic returns. In addition, during periods of economic downturn, countercyclical fiscal policy to stimulate the economy is often recommended when there is fiscal space, even though such spending increases indebtedness. Therefore, the bright side of debt should not be underestimated while focusing on the dark side. It is a balancing act. In principle, debt should be targeted toward value-creative economic and social projects, which can potentially outweigh the adverse consequences of heavy indebtedness.

As shown in Figures 7 and 8, between 2013 and 2016, when debt rose most rapidly, median economic growth fell from 5.3 percent in 2013 to 3.8 in 2016. Government revenues as a percent of GDP also fell, but expenditures remained roughly flat. Total investment as percent of GDP fell significantly. Public investment also fell somewhat but to a lesser extent than total investment. Out of the 41 countries in the region for which we have data, both government consumption and public investment increased in 14 of them (Figure 9).<sup>11</sup> In 14 other countries, consumption increased but not investment, and in seven others, investment increased but not consumption. Finally, 6 countries experienced declines in both public investment and government consumption.

All told, the dynamics of these macro-variables during the most rapid phase of debt accumulation suggests that debt was used to stimulate consumption as well as investment in one-third of the countries.<sup>12</sup> In another one-third and one-fifth of the countries, the debt boosted mainly consumption and investment, respectively. In the remainder of the countries, both investment and consumption fell.

**Figures 7-8: Dynamics of macroeconomic variables (median)**

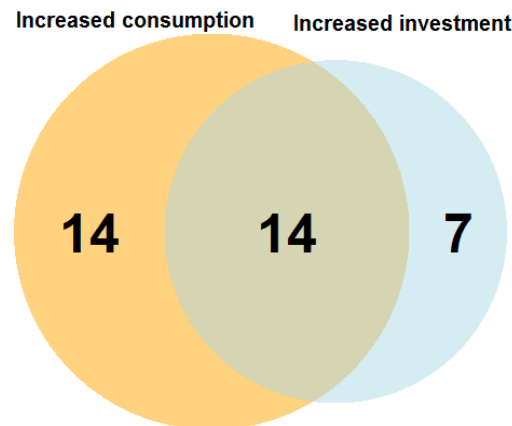


Source: Author's calculation using data from IMF World Economic Outlook Database, October 2018 and World Development Indicators Database.

11. The Gambia, São Tomé and Príncipe, and South Sudan, are excluded due to lack of sufficient data.

12. Changes in public investment and consumption are calculated using 2008-12 average as a baseline for each country. The average change in investment or consumption is the 2013-16 average minus the 2008-12 average.

**Figure 9: Number of countries with increases in government consumption, public investment, or both between 2013 and 2016<sup>13</sup>**



Source: Author's calculation using data from IMF World Economic Outlook Database, October 2018 and World Development Indicators Database.

## CHANGES IN STRUCTURE AND DESIGN FEATURES OF DEBT: THE NEW LANDSCAPE

The debt structure and design features of sub-Saharan African countries are changing in four significant ways. First, external debt has risen in recent years even though domestic debt has also increased. Second, the share of commercial debt has increased relative to that of concessional debt. Third, the creditor base is more diffuse. Fourth, there is an emergence of commodity-linked debt instrument. These four changes have major implications for debt sustainability.

**External debt vs. domestic debt.** The current debt buildup is characterized by increases in both domestic and external debt, with each category contributing almost equally. The average level of domestic debt rose from 14 percent of GDP in 2012 to 23 percent in 2017, and that of external debt increased from 23 percent to 31 percent. Compared with the pre-HIPC build up in debt, external debt still predominates, but its share of total debt has declined from about 80 percent to 60 percent. The increase in domestic debt is due in part to issuances of government bonds on local debt markets with commercial banks as creditors. The higher exposure of commercial banks to government debt make those banks particularly vulnerable to debt distress.

**Commercial vs. concessional lending.** For the external debt, contrary to the pre-HIPC/MDRI period when the debt build up was due to an increase in lending by multilateral institutions, the current build-up in external debt is due to a significant increase in private borrowing. The share of private lending to Africa has risen from 9 percent of external debt in 2000 to 17 percent in 2017. Meanwhile, the share of multilateral and bilateral debt has declined. Indeed, since 2006, a group of 16 sub-Saharan African countries has regularly issued foreign currency bonds in international debt markets (eurobonds). Moreover, a higher share of the region's borrowing was on non-concessional terms (World Bank, 2018a).

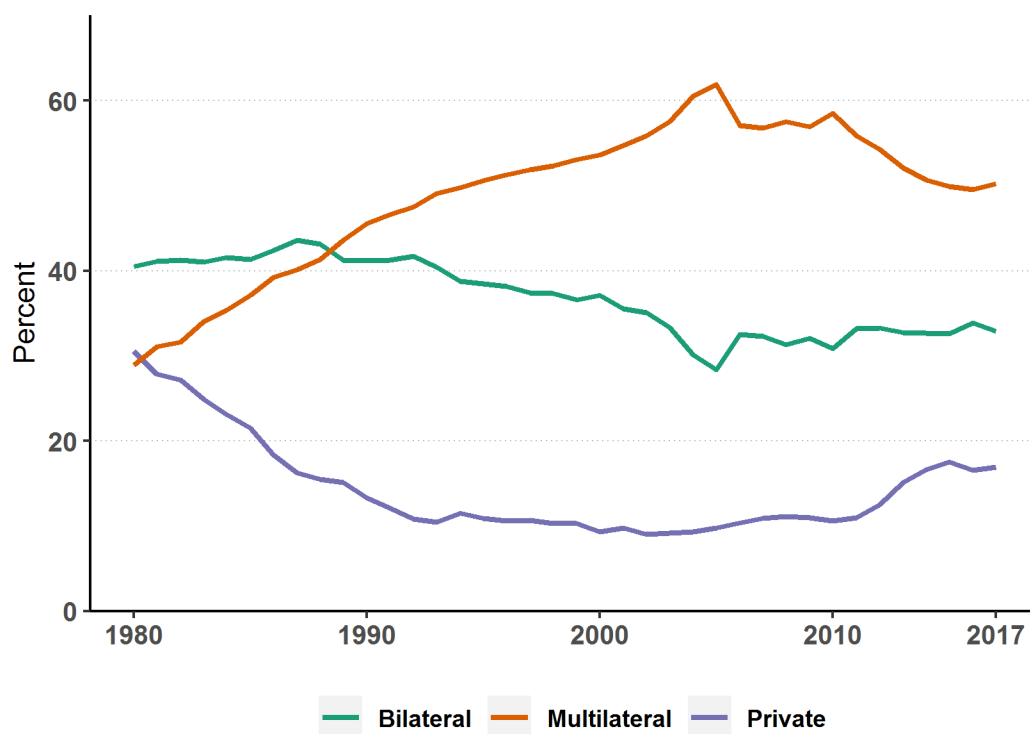
**Prevalence of eurobond issuance.** As mentioned above, and as Figure 10 shows, sub-Saharan African countries are increasing their private external borrowing with the share of bilateral and multilateral debt falling as a result.

13. For six countries (not shown), both investment and consumption fell.

One glaring feature of African debt, unlike the previous HIPC/MDRI era, is the prevalence of eurobond issuance despite sustainability concerns. In particular, countries in the region issued a record \$17 billion in eurobonds in 2018, with several countries also issuing their first ever 30-year eurobonds. At the end of 2017, the share of eurobonds in total external debt for the group of Eurobond issuers averaged 20 percent, ranging from 4 percent in Ethiopia to 52 percent in Côte d'Ivoire.

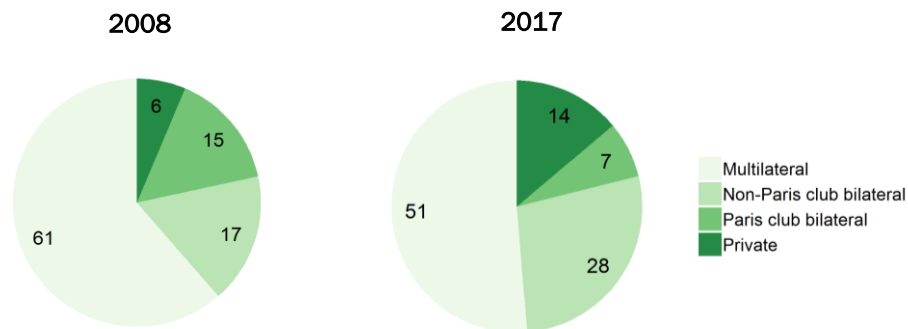
Access to international financial markets by some of the region's economies is an inevitable and welcome part of economic development. This access allows for a diversification of funding sources and subjects the economies to the discipline of financial markets, and increased attention to domestic economic developments and policies. The access to market financing also carries some risks, including exposure to global market volatility and other developments outside the control of local policymakers. In particular, such swings in the global financial markets are potentially around interest rates, exchange rates, and debt rollover risks. Debt issued on global financial markets also generally have 5-to-10-year maturities, which are not suited for financing infrastructure projects with much longer maturity-return profiles. In this regard, the recent push by countries to issue 30-year bonds is a step in the right direction.

**Figure 10: Share of private, bilateral, and multilateral debt in external debt**



Source: Author's calculations World Bank International Debt Statistics 2019

**Diffuse creditor base.** The other noteworthy change in the region's debt landscape is the more diffuse creditor base. As discussed previously, a larger portion of the region's debt is commercial rather than concessional. This shift has contributed to a diffusion of the credit base. Moreover, there has been a significant shift in bilateral partners. Notably, the region's bilateral debt has increasingly moved away from Paris Club member countries towards non-traditional lenders, such as China. In 2017, Paris Club countries owned less than 7 percent of Africa's outstanding external debt, down from 15 percent in 2008 (Figure 11).

Figure 11: External debt by source<sup>14</sup>

Source: Author's calculations using data from World Bank International Debt Statistics 2019 and Paris Club

While the plurality of creditors allows African countries to diversify their external funding sources, it has the potential to complicate debt resolution in case of default. The most notable development in the creditor base of countries in the region pertains to Chinese lending, reflecting China's stronger engagement in the region over the past several years.

**Chinese lending.** China has been the single most important bilateral lender to sub-Saharan Africa in recent years. China is particularly prominent in the financing of various infrastructure projects. Based on data from the China-Africa Research Initiative (CARI), China committed \$125 billion in loans to sub-Saharan African countries between 2000 and 2017. Chinese lending to the region has accelerated since 2012 to about \$10 billion every year from an average of \$5 billion between 2005 and 2010. Angola has been the largest recipient of Chinese loans, accounting for a third of Chinese lending in Africa.<sup>15</sup> Ethiopia and Kenya round out the top three destinations for Chinese loans, with 11 and 8 percent, respectively. During the 2018 Forum on China-Africa Cooperation, China committed an additional \$60 billion in African financing over the next three years, mostly in the form of loans. Despite the increase in Chinese lending to Africa, China is not a majority holder of external debt in most countries. According to a recent analysis of the CARI data, China holds the majority of external debt in only two of the countries in or at risk of debt distress, namely the Republic of the Congo and Zambia (Eom et al., 2018). Chinese lending in the two countries totals around \$14 billion, representing just over a tenth of its total lending on the continent.

**Commodity-linked sovereign debt.** Another emerging trend is the issuance of commodity-linked debt. Much of the commodity-linked finance, borrowed on commercial terms, has originated largely from bilateral lending from China and private international entities, sometimes on terms that are not sufficiently transparent. Commodity-backed loans allow African countries to access more financing while reducing lending risks to creditors. One estimate suggests that export commodities were used to secure one-third of Chinese loans in Africa (Brautigam and Hwang, 2016). Angola, for example, where over half of the external debt is owed to China, has received over \$10 billion in oil-backed loans. These loans have been non-concessionary and required that 70 percent of the contracts go to Chinese companies (Brautigam and Hwang, 2016). Reportedly, Angola has sent higher volumes of oil to China following the oil price collapse, leaving limited supply for the country to sell elsewhere (Reuters, 2016).

Commodity-linked loans from private lenders are also serviced by future commodity sales, most often oil, as seen in the recent cases of Chad and the Republic of the Congo. Chad's state-owned oil company took a large loan from Glencore in 2014 at the time when crude oil was trading above \$100 per barrel (*The Economist*,

14. Due to data limitations, averages are based on data for 38 African countries.

15. Chinese Loans to African Governments 2000 - 2017, China Africa Research Initiative, Johns Hopkins School of Advanced International Studies. Data as of September 2018.

2018). Under the contract, revenues from future sales of crude oil would service the loan. Two months after the issuance of the loan, the price of crude crumbled, and Chad found itself with debt payments cannibalizing 85 percent of oil revenues. This scenario suggests there are some deficiencies in the contract designs that are detrimental to borrowers in a highly volatile commodity environment. A better design, such as linking repayments with growth indicators, would have allowed for more efficient risk sharing.

## CONCLUSION AND POLICY RECOMMENDATIONS

It has been only 14 years since the MDRI was adopted by the Paris Club countries and multilaterals for outright forgiveness of debt owed by some poor and indebted countries. The build-up in debt in recent years, along with sharp increases in debt servicing costs, raises concerns that another debt crisis is looming reminiscent of the MDRI/HIPC period. Our analysis suggests that, while another systemic sovereign debt crisis is not imminent, the rapid pace of the increase in debt as well as four important changes in the structure and design features in the recent debt build-up, and associated debt servicing costs, should be of concern.

First, external foreign-currency debt is predominant, accounting for about 60 percent of total debt. This high share of foreign-currency debt exposes countries to swings in global market conditions. With the outlook for less monetary policy accommodation in advanced economies, global interest rates could rise rapidly and push up debt servicing costs across Africa. It is important for African policymakers to ensure that their debt is sufficiently hedged against currency and interest rate risks.

The second development relates to the higher share of debt contracted on commercial terms due in part to the issuance of eurobonds by several countries. The access of African countries to global financial markets is a welcome and inevitable phase in economic development: Along with access to global financial markets comes increased scrutiny of the fundamentals of the local economies and of domestic policies, which, in turn, imposes more discipline and accountability on policymakers. However, the relatively short maturity of commercial debt and higher interest rates make such instrument ill-adapted to finance long-term economic development projects, particularly infrastructure (Coulibaly, 2019; Foresight Africa 2019).

Third, the region's increasingly diffuse creditor base reflects more diversified funding partners and likely attests to greater confidence in the region's economic prospects. However, the plurality of creditors can make coordination in the event of debt resolution more complex and protracted. It would be prudent to think of new frameworks for debt restructuring that reflect this plurality of creditors. What are the respective roles of large creditors, such as China and eurobond creditors, in debt resolution and restructuring, and in genuine debt reliefs conditioned on reforms for inclusive development? This issue should be at the top of the agenda of high-level meetings of the multilateral and bilateral institutions, including the upcoming G-20 meetings.

Fourth, the emergence of commodity-linked debt provides an opportunity for economies to secure more financing at a lower cost. Much of this commodity-linked finance has originated from bilateral lending from China and other private international lenders. However, improperly designed commodity-linked debt contracts (e.g., linking debt payments to oil revenues such as in Chad) can be economically and socially harmful. Commodity-linked debt contracts should incorporate risk-sharing to cushion the effect of adverse terms-of-trade shocks.

The debate around another debt crisis less than two decades after the MDRI/HIPC debt relief serves as reminder that progress to address the structural issues that constrain sustainable development financing has not been sufficient. Thus, despite the fact that an African sovereign debt crisis is not imminent, there should be proactive measures in place to improve preparedness, and bolster the capacity for crisis resolution if it ever occurs. Below we highlight some key measures.

**Boost domestic resource mobilization.** Most sub-Saharan African countries suffer from perennially low **domestic saving rates**, which averaged just 15 percent of GDP last year—among the lowest in the world. These low average savings rates, which fall significantly short of investment financing needs of at least 25 percent to 30 percent of GDP, are similar to the rate during the debt relief era. **Tax revenues** in the region (excluding those raised from the natural resource sector) moved up from 11 percent of GDP in the early 2000s to about 15 percent in 2015. Even so, the ratio falls short of the desired level and remains below that of the OECD (24

percent) and other emerging and developing countries. This tax rate is 4 percentage points below the tax capacity of the region due to inefficiencies in revenue collection, which cause leakages estimated at about \$110 billion a year (Coulibaly and Gandhi, 2018).

Moreover, estimated **illicit capital flows** remain massive. As a result, Africa has been a *net* creditor to the rest of the world. While it is hard to measure the illicit resource flows from Africa, various estimates suggest around \$50 billion to \$60 billion per year.<sup>16</sup> Illicit resource outflows are enabled by domestic governance failures and corruption as well as practices of some multinational corporations engaged in tax avoidance and profit shifting (UNECA, 2015). The positive is that there is a growing movement for reversal of the resource outflows through a combination of **domestic governance improvements**, including anti-corruption measures, as well as capacity building for tax administration and resource management. To effectively combat illicit flows and repatriate illicit funds, supplementing the domestic effort with global coordination and cooperation are paramount. International cooperation on the taxation of multinational corporations will also go a long way in boosting tax revenues. As noted earlier, developing countries lose an estimated 1.3 percent of GDP in revenues to companies **shifting profits** to low-tax locations (IMF, 2019). For sub-Saharan Africa, this trend amounts to over \$20 billion a year. Stronger international cooperation and enforcement on taxation will also raise tax revenues in Africa. Similarly, better governance in **natural resources** can mobilize additional substantial resources for the region's development financing.

**Boost lending capacity of development banks, particularly for infrastructure.** The lending capacity of development banks to finance infrastructure in the region has been very low. Between 2012 and 2016, total infrastructure lending to Africa was \$75 billion per year on average. The share financed by multilateral development banks was only 3 percent, compared with 40 percent for African governments, and 6 percent for the private sector (AfDB, 2018). Development banks have the unique expertise to play a bigger role in infrastructure financing. It is important that these banks are well-capitalized to play this core function and provide better alternatives to Africa governments than the use of more expensive and risky commercial debt. Development banks, in turn, are well positioned to leverage that capital to crowd in private sector financing.

**Accelerating financial sector development:** Continued reliance on large-scale external borrowing, including concessional borrowing, can create disincentives for African countries to get their house in order. In particular, such borrowing reduces the urgency to develop the financial sector and enhance capacity for domestic resource mobilization. It is imperative that these countries develop financial sectors that are deep, dynamic, and inclusive. This strategy is consistent with Agenda 2063 laid out by the African Union and with the UN's Agenda 2030. The current state of financial affairs is inadequate for financing the bold transformative agenda of Africa. These goals can be facilitated through the regional integration of many disparate and low-scale financial systems in Africa, including stock exchanges. The new African Continental Free Trade Agreement is a step in the right direction.

**Capacity building:** Capacity building and strengthening are needed at all levels, including in the area of debt and risk management, financial management, research, and knowledge generation. There should be robust investments in knowledge institutions, including universities, think tanks, and economics units of policy institutions. Robust cooperation between Africa and its partners on technical assistance and capacity building will be critical. In particular, as African financial systems develop and increasingly integrate into the global financial system, there should be a commensurate commitment to the development of capacity to manage and control risk, and commitment to foster commensurate regulatory capacity.

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16. See: Global Financial Integrity, the 2015 Thabo Mbeki Commission Report to the Council of African Ministers of Finance among others.

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