Domestic Debt Management in Africa

In the face of budget deficits, against a backdrop of drying up of concessional lending and reduction in development assistance due to the impact of the global financial crisis among others, borrowing from domestic markets becomes a viable option. Unfortunately far less attention has been given to domestic debt in most development policy discussions.

This policy brief describes factors that lead countries to borrow domestically, the legal and institutional frameworks governing domestic debt management. The brief also identifies possible challenges and gaps in domestic debt management practices in Africa. The brief concludes that while the switch towards more domestic debt can play a positive role in development, policymakers should include a country's domestic public debt in the debt sustainability analysis. There is also need to strengthen the legal and institutional frameworks of domestic debt management and increase governments' capacity to implement these frameworks.

Introduction

Domestic debt has not received the same level of attention as external debt from development actors in Africa. It is not surprising that in times of reduced financial resources some African substitute external debt for domestic debt to fill the gap in financial needs. In certain cases African countries have gone to the extent of servicing external debts through the accumulation of domestic debts.

Reforms in total debt management, not only external debt, are critical to avert a vicious cycle of recurring debt burden. Unsustainable levels of domestic borrowing will eventually erode the gains from initiatives like HIPC and MDRI. These initiatives have given African countries the fiscal space that has allowed them to increase their pro poor expenditures. Good management of domestic debt can be beneficial if and when the borrowed resources are invested in the right developmental sectors. On the

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other hand enormous levels of domestic debt can lead to financial instability. It can also crowd out private investment and impinge on economic growth particularly in countries with narrow and under developed domestic financial markets.

Why are African Governments Borrowing Domestically?

Most external debts are offered at very low interest rates and have longer maturity than domestic debts and sometimes these are on grant term. External debts can also improve a country's supply of foreign exchange used for import cover. Despite these sweeteners of external debts, African governments find themselves turning to domestic debts. This is because the availability of external debts is in the hands of the foreign governments and their assessment of the creditworthy of the borrowing country. Furthermore, most external debts are linked to project financing and not government's recurrent expenditures or capital projects that are favourable to the external creditors.

Domestic debt has been used to finance government deficits that are not fully funded by external debts and also to implement monetary policies. While government deficits can be partly financed by either drawing down government assets (selling property or reducing deposits), most government prefer to incur new liabilities as a result of constraints in the asset stocks and the unattractive nature of assets.

Sometimes domestic debt is used as an instrument of monetary policy. In addition domestic debt is becoming an option for financing long terms infrastructural development projects in the current economic environments characterized by volatility in Official Development Assistance.

It is clear that domestic debt can be beneficial if used for the right purposes; however, enormous levels of domestic debt may have a negative effect on financial stability.

Legal and Institutional Framework Governing Domestic Debts

Sound debt management requires an institutional framework that provides clear accountability and responsibility for managing debt. It also requires clear reporting lines and proper coordination among the various units responsible for debt management. In addition a debt office should have well skilled and compensated staff. Debt being important, although in some cases it does not get the necessary attention also requires support from the highest levels of management. Besides having the requisite structures for debt management, it is important that debt operations are governed and guided by the necessary legal framework.

In the majority of the countries both external and domestic debt is governed by various legal instruments. There are Acts covering and assigning the responsibility and processes of domestic debt management with the Central Banks and Ministry of Finance playing important roles. However, these Acts are not comprehensive enough to include issues like ceilings on domestic debt and do not guarantee a deeper accountability to parliament and citizens. There are also weak linkages between the Central Banks and the Ministry of Finance in any countries.

Debt Management Policy and Strategy

Despite a general practice for African governments to develop and adopt debt management policies, there are still weaknesses mainly related to issues of adherence to the policies. This can be attributed to the lack of political will and capacity to implement such policies.

The implementation of the debt management policies is also hampered by the lack of clear and agreed indicators to measure the domestic debt sustainability. The focus on debt sustainability has been on the external debt. This is dangerous because a country's debt sustainability status need to take into account the total debt stock and not only one aspect of the debt. Furthermore, these frameworks do not include the participation of other actors like CSOs and citizens in their structures, investment assessment decisions, impact monitoring and in the development financing aspects of the domestic debt.

It is also clear that most countries lack a communication strategy in all the policy instruments. The information on domestic debt, its strategies and policies is too technical therefore alienating the participation of other important actors like citizens, CSOs and parliaments in the decisions and accountability of domestic debt decisions made by the governments. Compounding unavailability of access or freedom to Information Acts exists in most African countries.

Recommendations

Best practice requires that existing primary Law (Constitution or at least an Act of Parliament such as States Loans and

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Guarantees Act, Public Finance Act, Budget Law) explicitly accords the Legislature the ultimate power to borrow or issue guarantees on government's behalf, or to delegate this power to the Executive branch or its agents or officials. Any second-level delegation of borrowing, guaranteeing and debt management powers (e.g. to Central Bank, state/local authorities, or other implementing entities wishing to borrow) should be defined in written executive orders, decrees, agency agreements, etc. that are in line with the primary law.

Primary legislation should define not only to whom borrowing powers are delegated, but also the limits and purposes for borrowing or issuance of guarantees (e.g. for purposes of implementing a Parliament-approved budget).

Legal provisions should also outline the due diligence process to be followed when borrowing, spending debt proceeds, processing transactions, accounting, reporting, and complying with internal and external auditing (per Public Audit Act).

Legislation needs to further spell out the objectives and strategies for debt management or guarantees issuance, and may list the specific than generic purposes for borrowing in this regard.

Domestic debt policy should be developed in the context of total public debt management. The policies should be consistent with other macroeconomic areas, notably fiscal and monetary policies as well as government cash management and forecasting. There is also a need to address the level, use, cost and risk of borrowing and indebtedness over the medium to long term, within the objectives for debt management.

In addition countries should develop a medium term debt strategy to factor in the changes in the global and local economic environment. The policy and strategy should be informed by incisive debt sustainability analysis which takes into account the total debt as opposed to only external debt.

Debt management functions could be best performed under a specialized office, which may be autonomous, semi-autonomous or embedded with the structures of Ministry of Finance and/or Central Bank. The important point is that this office should manage the country's total debt.

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