South African Reserve Bank

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Growing with Debt in African Economies – Options, Challenges and Pitfalls

Good morning ladies and gentlemen. I would like to thank the African Economic Research Consortium for inviting me to introduce this important topic. I hope you will indulge me while I reflect the opportunities, challenges and pitfalls presented by debt to developing economies in sub-Saharan Africa.

Economic growth in sub-Saharan Africa (SSA) has been improving from the low base in the early 1990s and is set to continue. Real GDP is projected to pick up to 3.5% in 2019 and 3.7% in 2020. However, this remains well below the averages of the 2000s. There are also growing questions about macroeconomic stability given the weakening of fiscal positions in a number of low income developing countries (LIDCs) in recent years. According to the IMF, debt burdens and vulnerabilities of LIDCs have risen significantly since 2013, reflecting a mix of factors, including exogenous shocks and loose fiscal policies.

This calls for a reflection on the role played by public debt in economic development. It is broadly accepted that governments resort to borrowing because taxation alone cannot provide sufficient funds for economic development. The challenge is to ensure that debt financing is done in a sustainable way.

At the turn of the 21st century, billions of dollars' worth of debt was wiped clean across sub-Saharan Africa. South Africa was instrumental in pushing for debt relief and we succeeded in late 1990s when the HIPIC programme was agreed through the Development Committee of the World Bank and International Monetary Fund. At the time, the solution appeared simple – wipe off the debt and allow countries space to get their affairs in order and growth and stability will follow.

For a time, we saw significant improvements in the continent, with many countries strengthening their macroeconomic frameworks and institutions. A number of countries also gained market access. In 2018, international bond issuances in the region reached a new high, totalling more than USD17 billion, with the average issuance rising to nearly USD3 billion[1]. As the IMF has observed, SSA has been the

[1] World Bank Africa Pulse, April 2019

region with the fastest debt growth in recent years across a group of low income and developing countries.

In 2018, about 16 SSA countries were at high risk of debt distress – more than double the 2013 levels. Average public debt across the region rose close to 56% of GDP at the end of 2018, with wide disparities in debt dynamics across countries. For example, in 2018, public debt-to-GDP stood at 72% in Zambia and 100% in Mozambique. Debt servicing costs have also risen sharply, with the median interest payment burden doubling to about 10% of revenue between 2011 and 2018.

While debt levels is not as high as they were in 1990s, there is growing concern that Africa is at risk of landing in debt traps once again.

In their 2010 paper, titled "Growth in a Time of Debt", Reinhart and Rogoff argue that high debt could create uncertainty, deter investment and innovation, and the literature shows that it could have a negative impact on growth. I am inclined to agree with them. In addition, unsustainable debt burdens and rising debt service costs crowd out spending in key development areas such as education, health and infrastructure. These were exactly the lessons learned during the African debt crisis of the 1980s and 1990s, and which justified debt relief. Consequently, badly managed debt could now reverse some of the developmental progress made over the past twenty years.

The financial landscape has also been changing, not only because of easier global financial conditions but also the increasing share of borrowing from non-traditional lenders and the types of debt instruments in the market. The share of borrowing from non-traditional lenders has risen to about 15% of global GDP. Financing instruments such as collateralised sovereign loans are also gaining prominence. The terms of these loans are often complex and typically only revealed after countries experience debt distress as was seen in Chad and the Republic of Congo recently[2].

This increased reliance on non-traditional creditors has raised borrowers' exposure to market risk, while at the same time posing additional challenges to the sustainability of external debt in the region. For instance, in the case where countries find themselves in debt distress, it may be harder to come to a rescheduling agreement with a large number of private creditors than when you had, in the past, a relatively small number of public creditors (Paris Club) or commercial bank lenders (London Club). In Chad, for example, collateralisation also made debt restructuring more complex since it reduced the room for manoeuvre for sovereign borrowers[3]. We can also think of the problems recently faced in Argentina, where bondholders refused to accept restructuring terms.

Data from the World Bank shows that the region's foreign currency-denominated debt as a share of total debt reached approximately 60% in 2017. Most of the increase in foreign-currency debt can be attributed to the increasing issuance of Eurobonds. A

[2]In 2014, Glencore had lent Chad's oil company around USD1,45 billion, in a move to secure access to the country's oil. However, the decline in the oil price later that year left the sovereign struggling to meet the repayment schedule. By the end of 2016, Glencore held 98 per cent of Chad's external commercial debt. Eighty-five per cent of Chad's oil proceeds – its primary source of revenue – was directed towards paying Glencore back.

[3] Mustapha S. and Prizzon A., "*Africa's rising debt – How to avoid a new crisis*", October 2018

large amount of these Eurobonds are set to mature in 2019-2020 and in 2024-2025, which may pose substantial refinancing risks in the foreseeable future, especially if countries' fiscal positions remain weak[4]. Nearly 90% of the region's Eurobonds are denominated in US dollars, which further raise currency and interest rate risks and the potential for tighter global financial conditions in global settings clouded by significant downside risks.

It is also important to consider fiscal risks posed by state-owned enterprises (SOEs). In some instances, SOE liabilities have reached worrisome levels of 10% of GDP or more in countries such as Cameroon, Ghana and South Africa, threatening government's debt sustainability and potentially crowding out social spending (Botswana, Cabo Verde, Madagascar)[5]. The dominance of SOE debt in the banking system is a considerable financial stability risk in countries that don't have deep financial markets.

These challenges also highlight the need for countries to strengthen debt management practices and improve transparency, which is fundamental to sustainable financing. Addressing these challenges would require countries to make tough fiscal choices to prevent debt burdens from becoming unsustainable. Fast-growing countries that face elevated debt vulnerabilities would also need to prioritise rebuilding buffers, including through structural reforms and improvement in fiscal frameworks.

There is wide consensus that countries need to raise more domestic revenue to make debt financing more sustainable. There also needs to be a greater focus on improving the efficiency of public spending in such a way that it helps to improve economic growth. While the primary responsibility for avoiding the build-up of unsustainable debt lies with the borrower, creditors also have a role to play in encouraging greater transparency. Irresponsible borrowing ultimately contributes to unsustainable debt burdens.

In closing, I wish to reiterate that public debt has an important role to play in financing development, particularly in augmenting government budgets. However, it should be clear that debt is not a replacement for domestic revenue mobilisation. Meanwhile, debt levels have to remain sustainable so as to not undermine market confidence. To ensure that debt plays a meaningful role, it must be utilised for revenue generating activities that increase the productive capacity of the economy.

Countries in the region could benefit from the slower-than-expected monetary policy normalisation in major economies to build additional buffers, preferably aimed at increasing fiscal space and setting development priorities on course. The international community is eager to help. Early in May, the G20 called a high-level conference on

[4] Mustapha S. and Prizzon A., "*Africa's rising debt – How to avoid a new crisis*", October 2018

[5] In Madagascar, for instance, large subsidies and transfers to troubled state-owned enterprises (SOEs) such as the electricity utility JIRAMA and Air Madagascar to cover debt obligations have increased government liabilities. The IMF, in its 2018 Article IV assessment, highlighted that unexpected losses at SOEs or delayed reforms in public spending could crowd out pro-growth priority spending in Madagascar. In Ghana, the government also faces significant contingent liabilities from the energy SOEs, which continue to face challenges.

Sustainable debt for sustainable growth (the Paris Forum). The key objective is to assist countries with debt management capacity and improve debt transparency.

The key conclusion of the Paris Forum was not to say that countries should borrow less but that they should be assisted to “borrow smarter”, by ensuring that borrowers are equipped with expertise to understand their real needs, to secure good terms and to effectively manage their debt, while holding creditors to higher standards on transparency and sustainability.

I also want to take this opportunity to congratulate the AERC for continuing to have a policy-oriented research programme that remains relevant for policy makers. Today’s programme is filled with the right mix of policy practitioners and academics to give us for food for thought.

Thank you