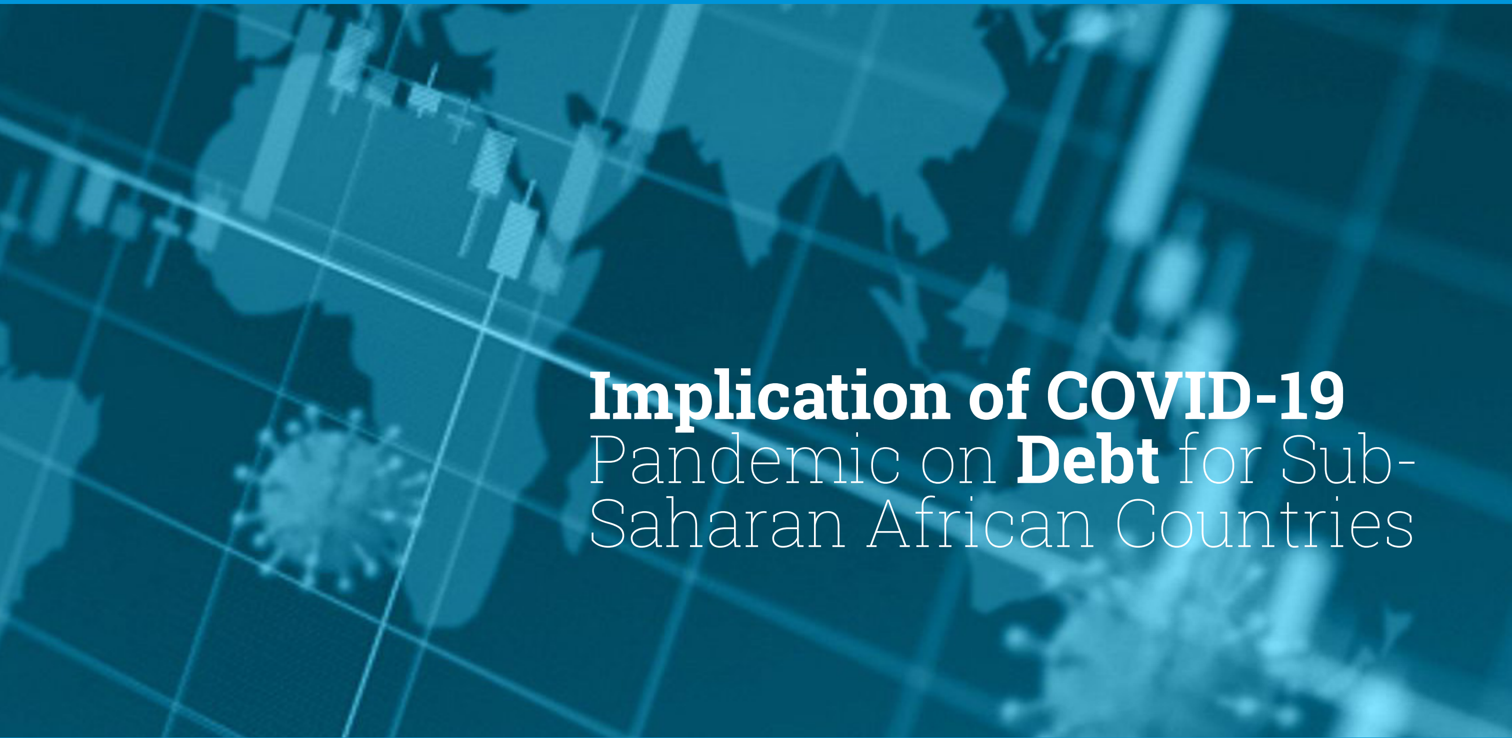
Common Market for
Eastern and Southern Africa



Implication of COVID-19 Pandemic on **Debt** for Sub-Saharan African Countries

Special Report

By Dr Lucas Njoroge
Senior Economist
COMESA Monetary Institute

Implication of COVID-19 Pandemic on Debt for Sub-Saharan African Countries

Recently, the number of countries vulnerable to debt distress has increased significantly reflecting, among others, the effect of exogenous shocks and loose fiscal policies. This paper provides a debt situation analysis just before Covid-19 pandemic and its impact on debt for Sub Saharan Africa.

Date

2nd December 2020

1. Introduction

Governments borrow because taxation alone cannot provide sufficient resources for economic development. The main challenge however is to ensure that debt financing is sustainable. Recently, the number of countries vulnerable to debt distress has increased significantly reflecting, among others, the effect of exogenous shocks and loose fiscal policies. This is especially worrying because a number of Sub-Saharan African (SSA) countries in the 1990s enjoyed debt relief under the Heavily Indebted Poor Countries Initiative (HIPC) programme, with the understanding that writing off debt would allow these countries space to put their economies in order and devote the released resources to growth and economic stability. Even though a number of countries managed to make strides in the right direction including gaining market access to international debt markets, the debt situation has started to worsen.

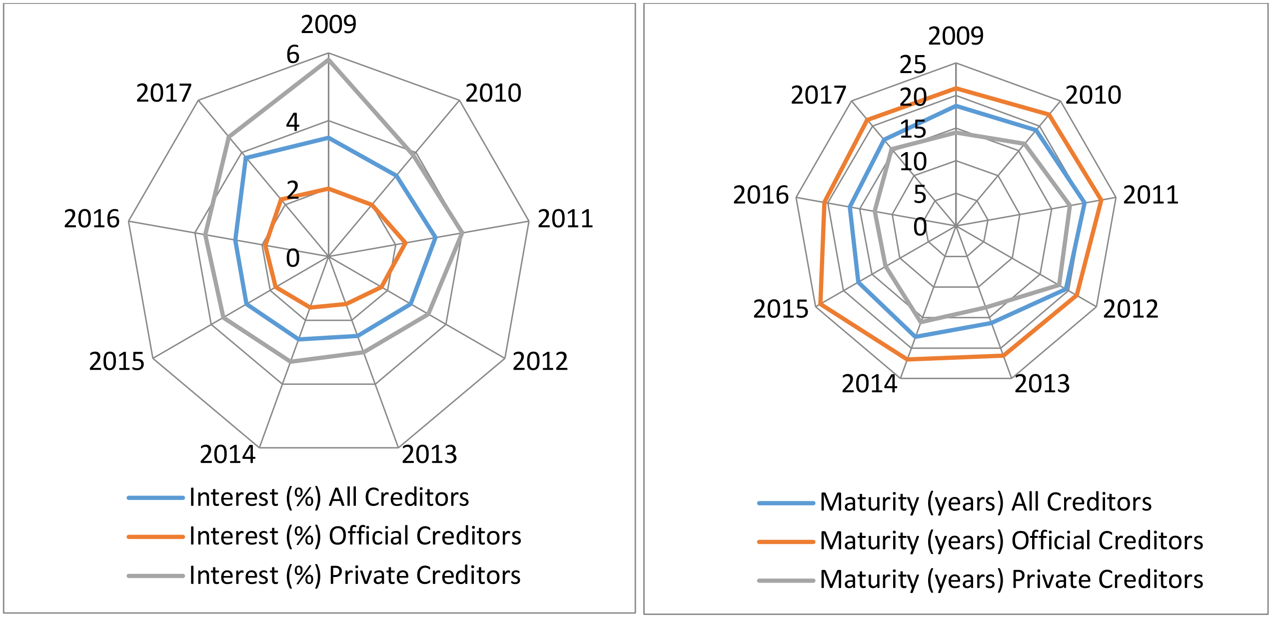
Covid-19 pandemic has worsened the debt situation even further. The need to spend more in a raft of public health measures to save lives together with the slowdown in economic activities following partial or full lockdowns and general economic slowdown, are all exerting considerable pressure on government finances. As a result, most governments in SSA are forced to run wide fiscal deficits that are slowly translating into increasing debt and debt distress.

2. Debt Situation Analysis

(a) Increasing Debt before COVID-19 Pandemic

Debt in most SSA countries was already increasing before Covid-19 pandemic. But even more worrying is the change in the composition of debt that is fast moving away from concessional and long term financing (Figure 1: right hand panel) towards short term maturities and market-led debts with non-traditional creditors. This has resulted in average debt servicing costs in Africa rising sharply with the median interest payment burden doubling to about 10% of revenue between 2011 and 2018 (Figure 1 : left hand panel). This is exposing countries to complex market led risks that are less well equipped to manage, especially since the maturities are mismatched with tightening fiscal spaces, while at the same time posing additional challenges to the sustainability of external debt in the region.

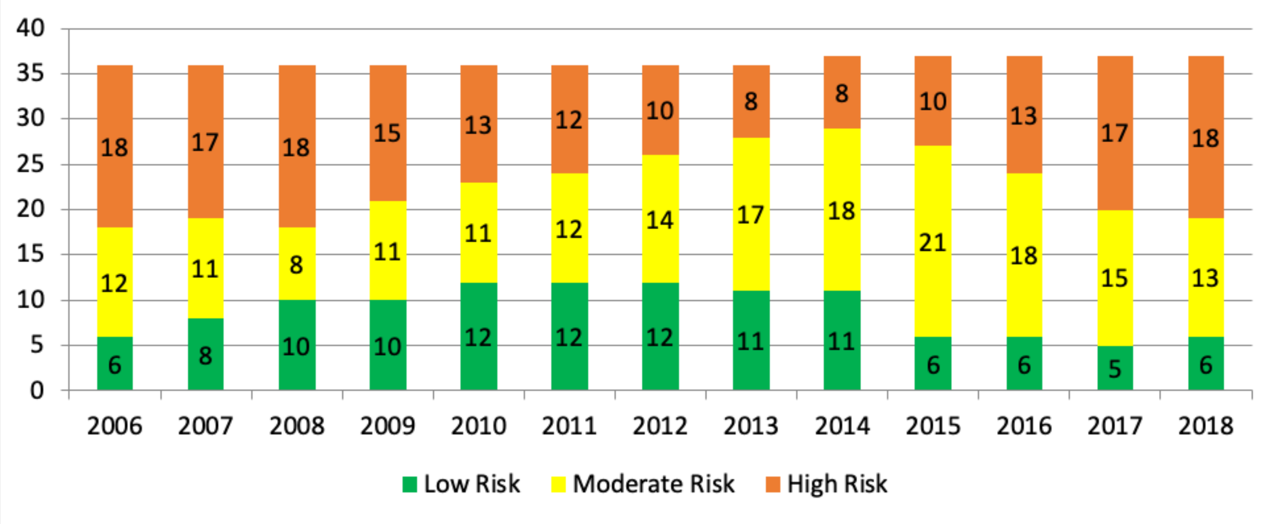
Figure 1: Interest Rate Payment Burden with Different Creditors



Source: Author's computation from the World Bank, International Debt Statistics

The situation is worsened when some countries borrow for consumption instead of investing, while others still, who invest heavily, are doing so inefficiently. As a result, the number of countries at high risk of debt distress more than doubled since 2013 from 8 to 18 in 2018 as indicated in Figure 2.

Figure 2: Number of Sub Saharan Countries at Risk of Debt Distress



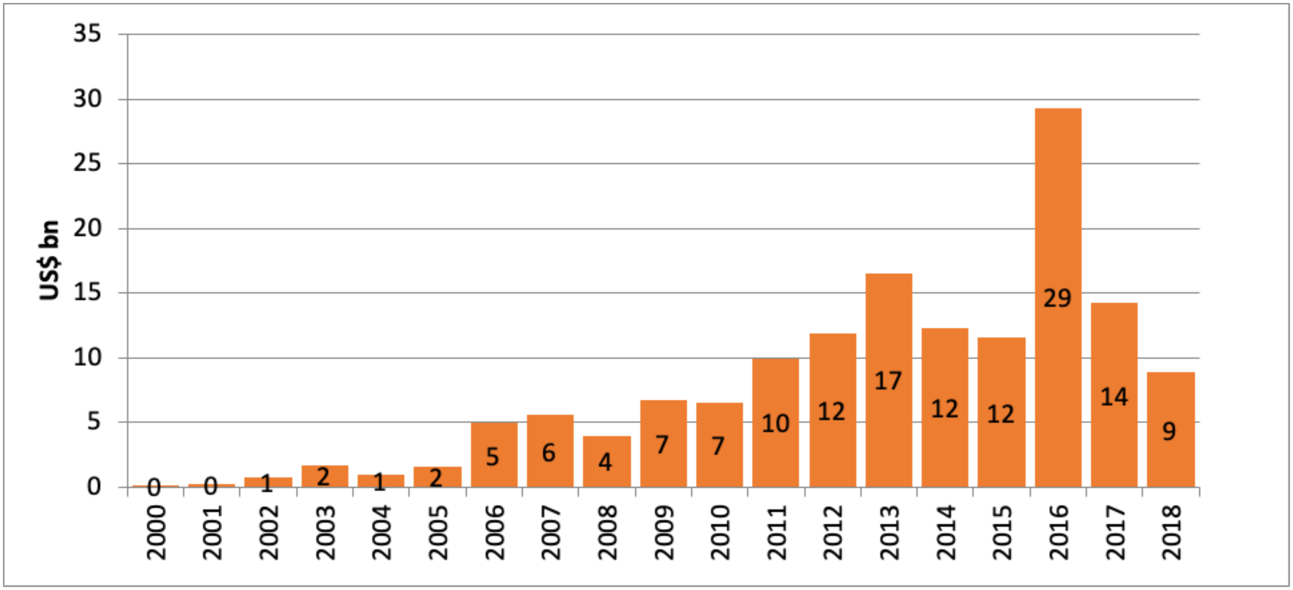
Source: Author's Computation from the World Bank/IMF Debt Sustainability database

The worsening debt situation in Africa will soon result in debt unsustainability with rising debt service costs crowding out spending in key development areas such as education, health and infrastructure. Debt being unsustainable could also create uncertainty, deter investment, negatively impact on growth and could reverse some of the developmental gains made over the last couple of years (IMF, WEO 2019).

(b) Role of Chinese Debt

The current concern across Africa is the increasing debt from China due to among other factors, relatively less conditions of accessing these loans and its competitive policy on trade and investment with Africa. As Figure 3 indicates, increasing lending within a relatively short period, among others, has contributed to the current debt distress for most African Countries. The total loans from China to African Countries accumulated to US dollars 148 billion from 2000 to 2018, increasing to a peak of US dollars 29 billion in 2016 from near zero dollars in 2000.

Figure 3: Chinese Loans to Africa

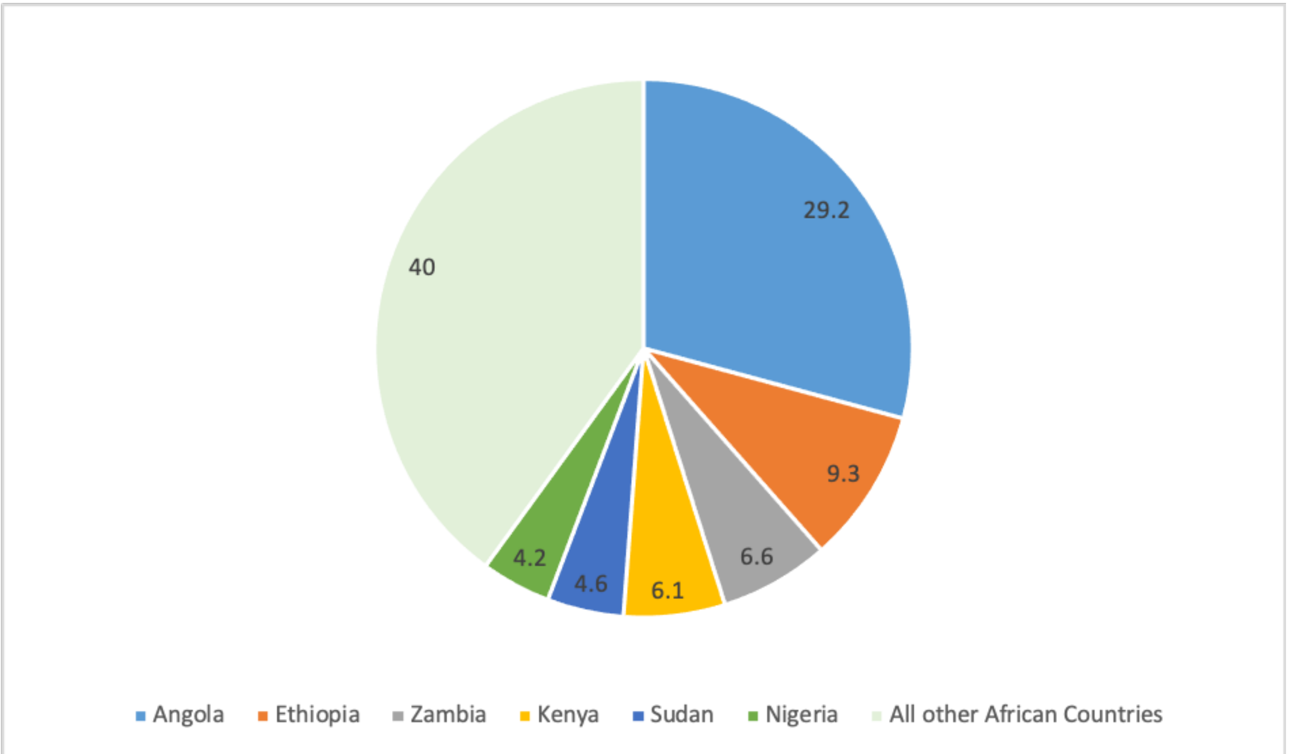


Source: Author's computation from http://www.Sais-cari.org/data-Chinese-loans[1]

Chinese loans have been funding a network of ports and marine infrastructure, transport infrastructures projects including key segments of cross-border railway networks, special economic zones (SEZs) and industrial estates, under the Belt and Road Initiative (BRI). Figure 4 shows African Countries with the highest Chinese loans.

1 Johns Hopkins School of Advanced International Studies (SAIS) China-Africa Research Initiative (cari) data base

Top Recipients: China's Debt to a country as a percentage of total China's debt to Africa (2000-2018)



Source: Author's computation for http://www.Sais-cari.org/data-Chinese-loans[2]

Figure 4 indicate that Angola is leading as the most highly indebted country to China with US dollar 43 billion accumulated loans over the period 2000 to 2018. Next is Ethiopia ($14 billion), Zambia ($ 10 billion) and Kenya (US dollars 9 billion) .

Chinese supported investments present a number of opportunities for African industry and manufacturing. Investments in manufacturing offers much needed employment as demonstrated in Chinese sponsored industrial parks in Ethiopia. Investments in industry provides broader technology transfer and economic transformation as they offer opportunity to diversify the economy and move up

2 Johns Hopkins School of Advanced International Studies (SAIS) China-Africa Research Initiative (cari) data base

the global value chain. In addition, Chinese capital and technical capacity is assisting African countries fill the infrastructural gap that remain huge and largely unmet.

On the contrary, China supported infrastructure development have also raised a number of concerns. There are concerns of how economically viable some of the projects are especially where the rate of return of these investments do not commensurate with the costs of invested funds. Technology and skills transfer are also debatable since in a number of cases, it is only happening among the unskilled laborers through "learning by doing", without building capacity of locals to be able to take over these operations in the long run. Some projects are also not paying attention to environmental and local impacts and have serious societal and political implications.

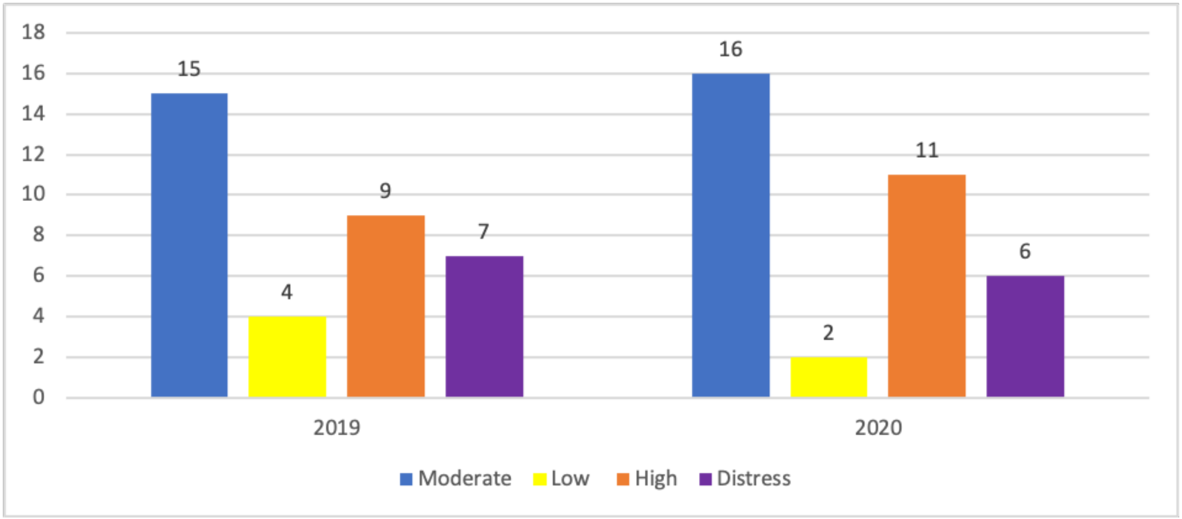
However, the biggest concern so far relates to the debt-based finance nature of China Projects, which have enormous incipient pressure on debt sustainability. The risk of debt-financed infrastructure is becoming more pronounced in resource-rich economies that rely on low commodity prices, which strains government revenues. Combined with implied exchange rate risk, these have constrained the economies' ability to repay external loans and exposed receipient countries to debt distress. Rising debt levels are also constraining governments' ability to borrow elsewhere as well as fund other public expenditures and could result in a vicious cycle of deficits and debt for affected countries. Such cycle in a country, is a consequence of the need to increase spending resulting in higher fiscal deficits that triggers more borrowing, leading to more debt, which results in higher interest payments that again triggers increased fiscal deficit.

3. Impact of COVID-19 on SSA's Debt

The Sub-Saharan Africa (SSA) region's average Government debt as a share of GDP was 50.4% in 2019 as compared to 48.5% in 2018. This is consistent with increased investments in infrastructures across the entire region. However, IMF projects that this will increase to 56.6% and 57.8% of GDP in 2020 and 2021 respectively due mainly to Covid-19 pandemic. In some countries, the debt increase is more than twice their annual budget. The current expenditure to contain the spread of the Corona Virus, dwindling revenues occasioned by lockdowns and general economic slowdown is exerting considerable pressures on government finances and forcing almost all the economies in the region to run widening fiscal deficits (IMF, April and October, 2020).

It is worth noting that even with limited fiscal space, the choice between lives and livelihoods has forced some countries, to institute a number of fiscal policy response measures. These include providing tax waivers, cash transfers to the most vulnerable, direct support to sectors such as tourism and travel, and consumer demand support. These massive fiscal costs could lead to vulnerability of the countries to debt default. According to IMF (WEO, October 2020) regional economic outlook, 16 countries of Sub-Saharan Africa entered the pandemic either at high risk of debt distress or already in distress (Figure 5). Most of these countries are now in worse position than they were in 2019, with higher debt levels and very uncertain economic environment going forward. This is against the backdrop of deterioration in market conditions that are increasing the rollover risk and difficulties in meeting large foreign debt service payments.

Figure 5: Number of countries Debt Vulnerability



Source: IMF Debt Sustainability Analysis

A number of countries have been forced to reschedule their loan repayments. Unless measures are implemented to curtail growth in debt, these countries could face an implosion in the stock of external debt and servicing costs. If left unchecked, the rate of debt accumulation could become a major source of macroeconomic instability. Already, some countries have defaulted on their debt obligations during the current Covid-19 pandemic and others are facing repayment difficulties, with the risk of debt distress (default) increasing to high with only two countries out of 35 Sub-Saharan African countries remaining at low risk category (Figure 5).

4. Policy Implications

(a) Immediate Policy Priorities

The immediate policy priorities for most SSA countries include the following, among others:

(i) Saving lives and protecting livelihoods especially now when the second wave of the pandemic seems to be more aggressive and vicious. High on the list to stopping the spread of Covid-19 pandemic is continued public health efforts including contact tracing, quarantine, isolation and treatment.

(ii) Availability of an effective affordable and trusted vaccine will ensure a quick turnaround depending on how persistent the Covid-19 pandemic shock becomes.

(iii) Fiscal stimulus targeting public health, crisis response and income support to the most vulnerable for the countries that are still severely affected by the pandemic. However, for countries that have managed to bring the pandemic under control, it will be important to start unwinding some of the fiscal measures that had been put in place to support lives and livelihoods, in order to reduce the pressure on government finances, thereby release resources to support aggregate demand.

(iv) SSA countries should use macroeconomic policies to speed up recovery that should include fiscal, monetary and more flexible exchange rates that would permit exchange rate depreciation.

(v) There is need to address the huge resource gap created by increased spending required to keep the pandemic under control, the need to stimulate these economies and debt service obligations. IMF estimates a financing gap of about US dollars 290 billion to ensure a rebound of these economies, and a further US$410 billion to pay off all foreign debts by 2023. The G20 debt service suspension initiative has provided the much-needed temporary breather for most countries as they tackle the pandemic. Further support and negotiations with creditors, across the spectrum, should endeavor to provide permanent debt relief to hardest hit African countries.

(b) Medium Term Policy Priorities

In the medium term, the following are the key policy priorities, among others:

(i) There is need for structural transformation and economic diversification of individual economies in the region; and,

(ii) Reforms in revenue mobilization and increased trade integration.

(iii) Leveraging on the African Continental Free Trade Area to strengthen value addition and industrial growth will be crucial.

(c) Long Term Policy Priorities

In the long term, the following are important policies, among others:

(i) Debt need to play a meaningful role and must be used for revenue generating activities that increase the productive capacity of the economies of the region. Countries should therefore borrow smarter, understand their real needs, ensure good terms and effective management of their debt while holding creditors to higher standards on transparency and sustainability; and,

(ii) African Countries must ensure, among others: proper evaluation of the returns of the projects to a certain economic viability; technology and skills transfer and building local capacity to operate the projects in the long term.

Reference:

Ahir H, Bloom N, and Furceri D, 'The global economy hit by higher uncertainty' 2019, VoxEU.org.

Calderon, Cesar; Kambou, Gerard; Korman, Vijdan; Kubota, Megumi; Cantu Canales, Catalina, 'An Analysis of Issues Shaping Africa's Economic Future'. *Africa's Pulse, No. 19*, 2019, April, Washington, DC: World Bank. © World Bank.

Foster, V. W. Butterfield, C. Chen, & N. Pushak, 'Building Bridges: China's Growing Role as Infrastructure Financier for Sub-Saharan Africa' *Trends and Policy Options,* Vol. 5, 2009, World Bank Publications, Washington, D. C.

International Monetary Fund (IMF), *World Economic Outlook (WEO)*, (Washington D.C. 2019. April and October)

International Monetary Fund (IMF), *World Economic Outlook (WEO)*, (Washington D.C. 2020. April and October)

International Monetary Fund (IMF), Debt Sustainability Analysis, Data Base.

World Bank, *Aid and Growth in Africa* (New York, Oxford University Press, 2001)

http://www.Sais-cari.org/data-Chinese-loans: Johns Hopkins School of Advanced International Studies (SAIS) China-Africa Research Initiative (cari) data base.

COMESA SECRETARIAT
COMESA Center
Ben Bella Road
P.O. Box 30051

+260 211 229 725

www.comesa.int

info@comesa.int

facebook.com/COMESA/

@twitter.com/comesa_lusaka