ISS AFRICAN FUTURES

Current Path

Debt

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Last updated 14 December 2024 using IFs 8.34

Debt

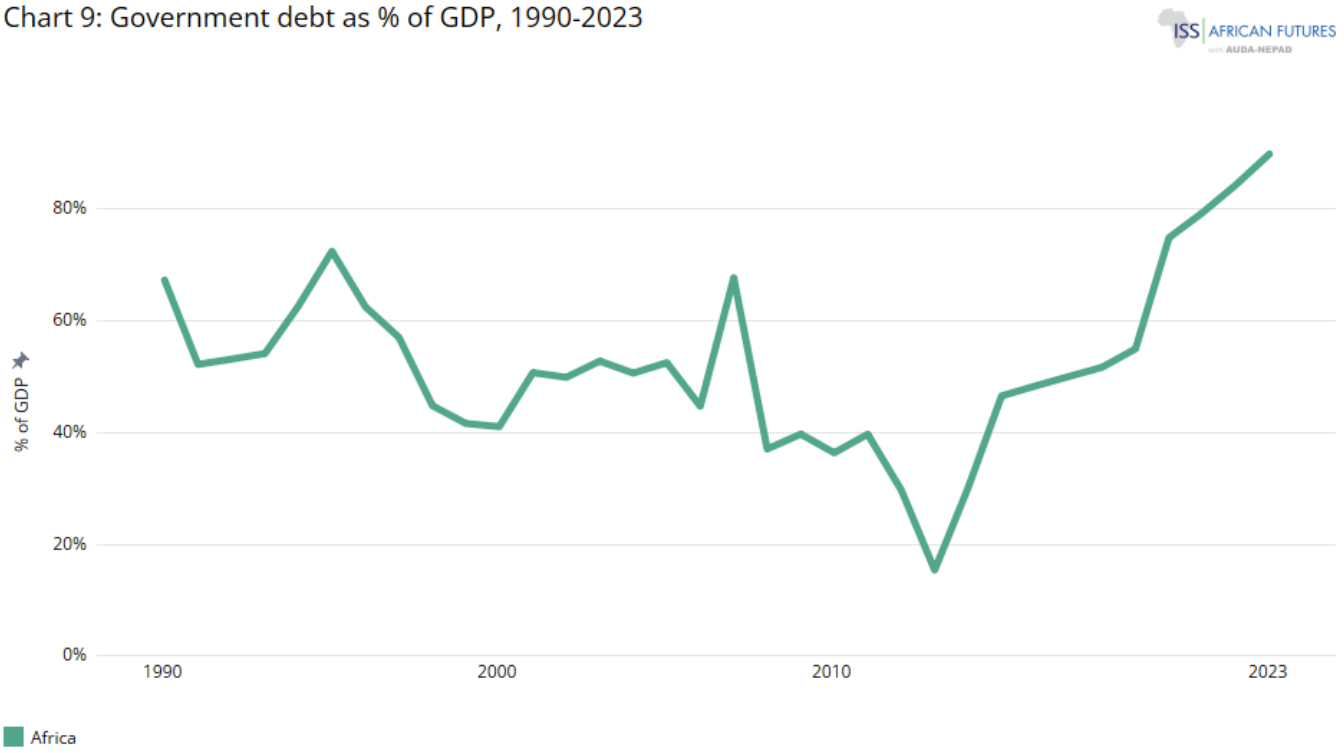
Debt dependency has played a significant role in shaping Africa's economic landscape, often constraining the continent's development prospects.

After independence, many African nations sought to accelerate their development through borrowing from international creditors, including Western banks, the International Monetary Fund (IMF) and the World Bank. The funds were aimed at financing infrastructure projects, industrialisation efforts and social programs. However, punitive interest rates, mismanagement, corruption and global economic shocks, including oil crises and fluctuating commodity prices, meant that many countries found themselves trapped in cycles of debt. Poor governance and limited institutional capacity to transparently manage debt funds to date continue to undermine development, making governance reform essential for debt sustainability and economic autonomy.

The situation was exacerbated in the 1980s and 1990s by the implementation of Structural Adjustment Programs (SAPs), which, while intended to promote economic stability and growth through liberalisation and austerity measures, often led to increased poverty and reduced access to essential services for the population. The debt crisis impeded African governments' expenditure, curtailing their ability to invest in critical sectors such as health, education, and infrastructure development. This has hampered sustainable development and economic autonomy.

In 1995, public debt for Africa's lower-middle-income countries peaked at 97% of GDP. The following year, public debt for low-income Africa was at 174% of GDP. In response, the IMF, the World Bank and other creditors began the Heavily Indebted Poor Country (HIPC) Initiative in 1996. The HIPC was reviewed and comprehensively expanded in 1999 and complemented by the Multilateral Debt Relief Initiative (MDRI), a debt relief proposal initially advanced by the Group of Eight (G8) countries in 2005.

Chart 9: Government debt as % of GDP, 1990-2023



Source: IFs 8.34 initialising from IMF and OECD data

As the HIPC programme matured, the international community focused on strengthening the links between debt relief and progress in implementing poverty reduction strategies and macroeconomic and structural reform programmes. As a

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result, public debt among low-income African countries declined to 15% of GDP in 2013 and 11% among lower-middle-income countries the following year.

The problem with this approach is that the medicine was killing the patient. Structural reform required that governments constrain their expenditure, meaning that they had to cut back on the provision of services such as housing, education and security. The reductions inevitably reduced economic growth and poverty increased. Lower economic growth exacerbated high debt/GDP ratios as African countries could not grow out of their high debt levels.

With the decline in commodity prices after 2011, levels of debt again started to increase, which hit Angola, Chad, the Republic of the Congo, Niger, Nigeria and Zambia particularly hard. Other factors also contributed, such as internal conflict (Burundi), the impact of epidemics such as Ebola (in Liberia and Sierra Leone) and corruption (Mozambique and The Gambia). Finally, a larger liquidity crunch, delays in the start of natural resource production and weaknesses in revenue administration negatively affected debt levels in Benin, Cameroon, Djibouti, Ethiopia, Ghana, Kenya, Senegal, São Tomé and Príncipe, Rwanda, Togo, Uganda and Zimbabwe.

By 2016, according to the IMF, public debt rose above 50% of GDP in 22 countries, up from ten countries in 2013.

In a wide-ranging study on the relationship between debt and growth, Carmen Reinhart and Kenneth Rogoff concluded that 'when external debt reaches 60% of GDP, annual growth declines by about 2%'. For almost two decades since the mid-1980s, Africa's low- and lower-middle-income countries consistently had average debt levels above 60% of GDP. Yet, this period coincided with Africa's most rapid period of economic growth since independence, pointing to the challenge of using fixed debt levels such as 60% of GDP as a reliable guide to debt sustainability.

Based on the dataset from the Boston University Global Development Policy Center on Chinese loans to Africa (CLA) and AidData's Global Chinese Development Finance Dataset, there was a significant accumulation of Chinese loan commitments to African countries from the establishment of Forum on China-Africa Cooperation (FOCAC) in 2000 until 2016. However, these loans have seen a sharp decline from 2016 to 2023. Subsequent FOCAC meetings post-2015 have placed greater emphasis on trade rather than debt-financing for infrastructure development in Africa as in the past. Exact information is complex to decipher as Chinese and Western national banks do not release comprehensive data. However, it seems that interest-bearing loans from the Chinese government, banks, and contractors went from almost nothing in 2000 to US$143 billion in 2017, representing about a third of Africa's overall debt of around US$365 billion. The trend is ongoing. Chinese lending now dwarfs World Bank loans to Africa. In response, successive US administrations sought to characterise Chinese loans as 'debt-trap diplomacy'—arguing that China is seeking to use debt for strategic leverage to eventually gain control over strategic state assets such as rail and harbours. The reality is more complex. The majority of Chinese funding agencies are state-owned, with the Export-Import Bank of China (Exim Bank) and the China Development Bank (CDB) being the primary sources of funding. Additionally, most Chinese loans show some level of concessionality when measured against the OECD's Official Development Assistance (ODA) concessionality threshold of 25%, compared to loans from Western private financiers.

The primary reason for the preference of Chinese loans in developing countries is that Chinese lending agencies tend to overlook institutional quality and debt sustainability thresholds during their pre-lending assessments, unlike the World Bank and IMF.

To cushion the economic and social impacts of the subsequent COVID-19 pandemic, several African governments announced fiscal stimulus packages that averaged about 3% of GDP, financed partly by debt. The average debt-to-GDP ratio, which had somewhat stabilised at around 60% of GDP at the end of 2019, was increasing rapidly when, in April 2020, the G20 countries, the IMF and the World Bank announced the Debt Service Suspension Initiative, potentially available for 73 eligible countries, including 40 in sub-Saharan Africa. The IMF also approved six months of debt service relief for 25

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low-income countries, including 19 in Africa, and approved additional funding support for several as well. China's participation was a big step forward but without the involvement of a private creditor, which holds the majority of African debt, the DSSI proved too little too late as, in November 2020, Zambia became the first African country to default on its debt.

Almost simultaneously, in neighbouring Angola, falling oil prices placed immense pressure on the country as its previous system of using oil to pay for debt came under pressure. Oil-backed loans then already accounted for two-fifths of Angola's external debt, most of it to China, which agreed to provide deferment over and above that promised under the G20 DSSI. In Kenya, China agreed to a six-month debt repayment holiday worth US$245 million in January 2021, shortly before a critical deadline when a US$1.4 billion loan from the China Exim Bank to build the Nairobi-to-Naivasha standard gauge railway would have come due.

In sum, China has probably taken more aggressive assistance measures to assist Africa during COVID-19 than much of the West, providing restructuring and postponing debt repayments to Angola, Zambia and Ethiopia in rapid succession in 2020. However, it has not offered substantive debt cancellation.

The administration of US President Joe Biden agreed, in April 2021, to allocate US$650 billion in Special Drawing Rights (or emergency credit) via the IMF. Given its large IMF shareholding, US support was crucial. However, only a limited amount (around US$33 billion) will flow to Africa. Having stimulated their domestic economies with several trillion dollars, several G7 members agreed to donate their Special Drawing Rights to low-income countries.

China is now Africa's largest official bilateral lender, owning at least 12% of the continent's outstanding debt. Africa's fortunes are increasingly tied to China, which is also its single largest trading partner. Looking to the future, China could opt to be a majority shareholder in some key assets of countries with high debt levels as an alternative to repaying maturing debt.

China's spectacular growth rates are also set to steadily decline (probably to below 4% per annum by 2033) as its population ages, and it no longer runs a regular trade surplus. The growth slowdown and the efforts for the restructuring of the Chinese economy towards a consumption-based economy, will decrease its demand for commodities such as iron ore, oil and gas from Africa.

Recent years have already seen a decline in Chinese official sector lending to African governments (so-called sovereign debt by the two 'policy banks', China Exim Bank and China Development Bank). As debt levels increased the so-called 'hidden debt' from state-owned Chinese commercial banks such as the Bank of China, the Industrial and Commercial Bank of China and the China Construction Bank rose. For example, whereas Zambia (before its September 2021 elections) admitted to a sovereign debt of US$3.4 billion, research by AidData indicated that Zambia actually owed US$6.6 billion to 18 different Chinese creditors once the hidden debt component was included.

Hidden debt differs from sovereign debt, which central government institutions directly own, as it is a debt between a Chinese commercial bank and, often, a special-purpose vehicle specifically created to 'hold' the debt in the African country requiring the loan. Such debt is still guaranteed by the respective African government but indirectly. Hidden debt does not appear on public balance sheets. According to AidData, the average annual underreporting of repayment liabilities to China is equivalent to 5.8% of GDP.

What makes this trend alarming is not only the extent of the debt, including the lack of public reporting but the nature of collateral (such as profits from the port of Mombasa) and the steep terms. 'A typical loan from China has a 4.2% interest

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rate and a repayment period of less than 10 years. By comparison, a typical loan from an OECD-DAC lender like Germany, France or Japan carries a 1.1% interest rate and a repayment period of 28 years,' writes AidData. Accordingly, it seems that 'Beijing has used debt rather than aid to establish a dominant position in the international development finance market.'

By 2024 it is clear that Africa's debt has shifted from concessional financing to more expensive and short-term commercial debt, with Eurobonds accounting for 44% of Africa's total debt, up from 14-17% previously. In 2010 debt service payments amounted to US$17 billion. In 2024 the continent will pay several times that amount at US$74 billion.

The continent must also be able to sustain higher debt levels and benefit from more concessional financing.

According to the Organisation for Economic Co-operation and Development (OECD), a 30% to 50% debt threshold range is a reasonable target for emerging economies, including Africa's 46 low-income and low-middle-income economies. The OECD further recommends that a prudent debt target should average 15 percentage points below the debt threshold since exogenous events, such as COVID-19 or Russia's invasion of Ukraine, could push up interest rates. Domestic developments such as unrest or a coup can cause countries to lose market confidence and increase their borrowing costs. Therefore, according to the OECD, most African countries can only sustain debt levels of 15% to 35% of GDP, which is significantly below requirements.

Five matters are crucial in considering the debt-to-GDP ratio. The first is how much the debt costs, i.e. the interest rate at which the debt is incurred. A 2023 report by UNCTAD reveals that Africa pays four times more for borrowing than the US and eight times more than the wealthiest European countries.

The second is the currency in which the debt is held. Currency depreciation regularly increases the public debt stock in many African countries because a significant portion of the debt is in foreign currency. For instance, with the COVID-19 pandemic, on average, exchange rate depreciations increased public debt in Sub-Saharan Africa by ten percentage points of GDP by the end of 2022.

Third, what is the economic growth rate? An expanding economy offsets debt repayments by increasing in size, thus reducing the size of the debt as a portion of GDP. After Africa's debt peaked at 26% of GDP at the height of the COVID-19 pandemic in 2020, it declined to 24% two years later as modest economic growth resumed.

Fourth, how vulnerable is the borrower to exogenous effects? A single-commodity-based economy is, for example, very vulnerable to price swings. In contrast, a diversified economy where agriculture, manufactured goods and service exports contribute to earnings is much more resilient.

Finally, prudent financial management is essential. Is the money loaned put to productive use?

Africa's post-COVID debt levels have now become victim to the rise in tensions between the US and China with each side using debt and its capital contribution to organisations such as the World Bank as a cudgel with which to beat the other, demanding haircuts and resisting first-mover concessions. Africa's voice and interests are often quite peripheral in this emerging great power game.

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Cite this research

Jakkie Cilliers (2024) Current Path. Published online at futures.issafrica.org. Retrieved from https://futures.issafrica.org/thematic/01-africas-current-path/ [Online Resource] Updated 14 December 2024.

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Dr Jakkie Cilliers is the ISS's founder and former executive director. He currently serves as chair of the ISS Board of Trustees and head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the Institute. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

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