COVID-19 & AFRICAN DEBT: FURTHER DISTRESS OR THE BEGINNING OF A NEW PARADIGM?

By Ben Chandler, Junior Researcher

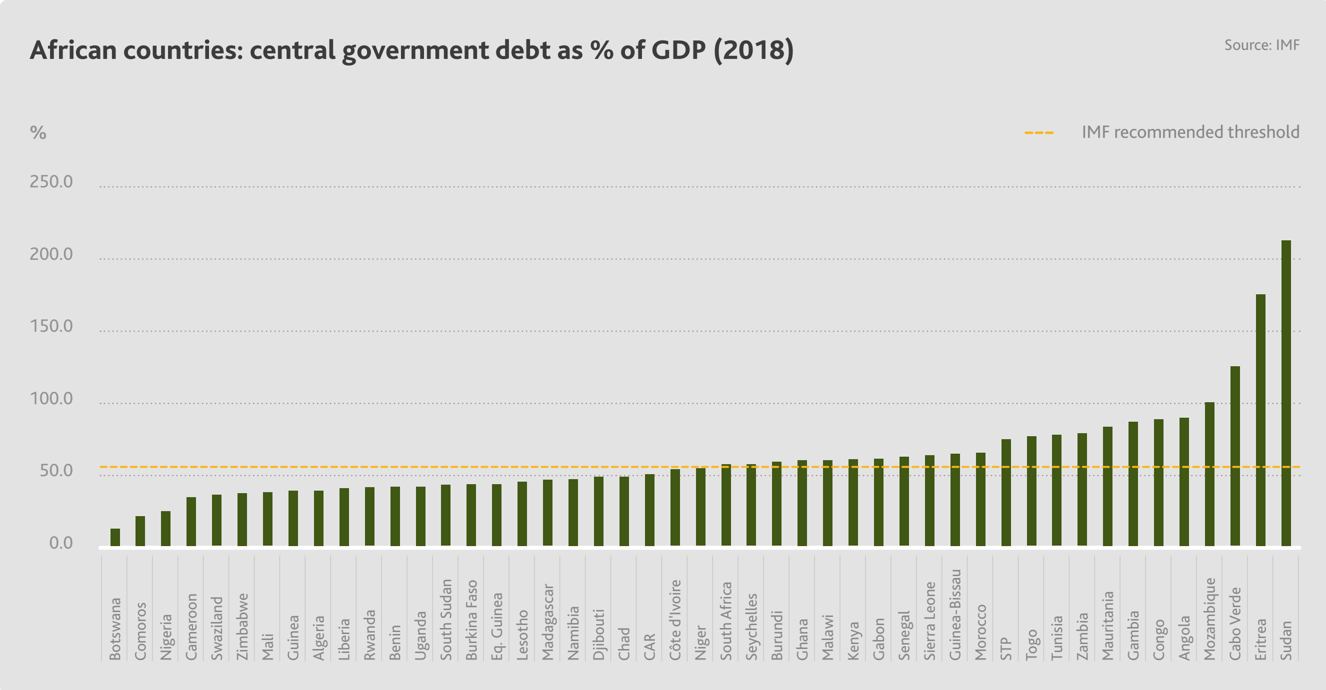
The global coronavirus pandemic has triggered concerns that in the face of diminishing resources and increasing costs, African countries risk tipping into debt distress. An already precarious fiscal environment, where debt repayments account for a disproportionate share of public expenditure, has been exacerbated by virus-induced economic shutdowns, falling commodity prices, capital flight and currency volatility. Add this to the immediate need to divert existing resources towards combatting COVID-19 and it is apparent that the continent's debt situation is no longer sustainable. In the absence of debt forgiveness or debt relief, the crisis threatens to undo the economic promise that much of the continent had been showing. Alternatively, some see this as the beginning of a new paradigm surrounding debt and beyond. The current crisis could lead to a reassessment of the value of debt. Moreover, it could also offer an opportunity for restructuring resource mobilisation on the continent, as well as for resetting and reinventing Africa's role on the global stage and its relations with the rest of the world.

Africa faces unique debt challenges

Assisted by earlier debt relief operations from traditional partners, African public debt is now comparatively low, compared with the rest of the world and its own historic levels. Though countries such as Sudan (212.1%) and Eritrea (174.3%) have some of the proportionally highest levels of central government debt in the world, it is a feature they share with advanced economies such as Japan (198.4%), Greece (194.3%) and Italy (131.1%). **In 2018, central government debt as a percentage of GDP in African countries was on average 61.4%, lower than in EU countries (64.9%).**

However, 38 African countries have seen central government debt rise as a proportion of GDP between 2009 and 2018, while 24 African countries now surpass the 55% debt-to-GDP ratio recommended by the International Monetary Fund (IMF). **Additionally, African countries face specific challenges in servicing their debt with a high dependency on commodity prices, volatile currencies and a weak capacity for domestic revenue mobilisation.** African countries have also borrowed increasingly from private sector creditors who impose high interest rates and servicing costs due to the inflated risk premium credit agencies attach to the continent. **Problematically, servicing costs are growing faster than domestic resource mobilisation.** The latter has risen 31% since 2013, against a 128% rise in interest payments.

As such, for many African countries, an ever-higher proportion of government revenues are spent on debt servicing. **Even prior to COVID-19, as many as 30 African countries spent more on repaying public debt than on healthcare.** Gambia for example, spends as much as nine times its health budget on debt servicing, while Angola and Congo spend six times.



COVID-19: increasing government financial burden while decimating revenues

COVID-19 is imposing specific expenses on countries across the world, as governments mobilise resources to respond to the demands created by the pandemic. Africa's healthcare capacity was already weaker than other parts of the world, with fewer doctors, hospital beds and ventilators per capita than any other region. McKinsey estimates the cost of critical supplies alone to be around $5 billion if virus rates were to reach 1% on the continent, excluding the costs of wider responses such as building hospital capacity, quarantining individuals and implementing a widespread testing strategy.

Beyond the health impact of COVID-19, fiscal stimulus packages are critically needed to keep economies afloat. For many African countries, the impact is uniquely challenging. While economic shutdowns require fiscal packages that maintain livelihoods, external demand is falling, leading to a collapse in commodity prices. With primary commodities a key source of government revenue for many countries and an essential source of foreign exchange reserves, the cost of spending increases. Jobs and investment are disappearing across multiple sectors due to capital flight, with over $20 billion having migrated from the continent already this year, damaging both short and long-term economic prospects. Furthermore, revenue from tourism, a key industry for several African countries, has almost completely stopped.

An environment of rising costs and decreased revenues has prompted further borrowing, compounding existing debts.

Nigeria, damaged by the collapse in oil prices, has secured a $3.4 billion loan from the IMF, having resisted borrowing from the organisation for years. It has also requested a further $3.5 billion from the World Bank. Egypt, hurt by a lack of tourism revenue and decreased trading through the Suez Canal, has received $2.8 billion from the IMF and is seeking a further $5 billion to account for the coronavirus-induced budget shortfall.

Calls for debt relief complicated by Africa's range of creditors

The risk remains however, that without a suspension of existing debt repayments, new loans and fiscal support packages will not stay in-country and be used to payback creditors. This has led to calls for the immediate suspension of debt repayment across the continent, allowing governments the fiscal space to respond effectively to the virus. Some African Heads of State have even called for the complete forgiveness of all bilateral and multilateral debt.

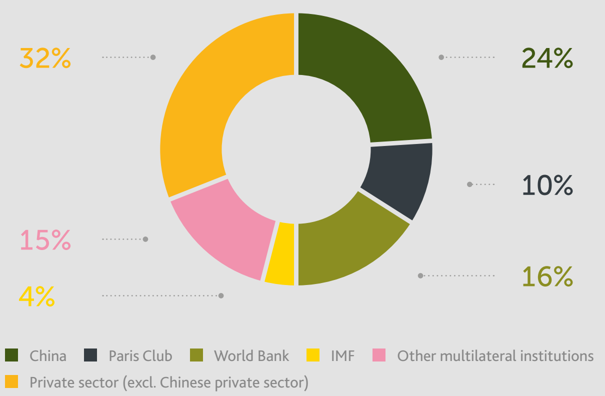
In response to these calls, the G-20 and the Paris Club lenders have already suspended debt repayments for all IDA (International Development Association) and all UN-defined 'least developed' nations, which covers many African countries. The IMF has also approved a $500 million package to give six months of debt relief to developing nations struggling with the coronavirus pandemic.

Critics have described these measures as 'more symbolic than substantive'. The IMF package has been described by some as a 'drop in the ocean', while the debt moratorium is simply kicking the can down the road, avoiding the cancellation of debt, the only viable solution. Notably, the G-20 moratorium also does not cover several of Africa's more advanced economies such as Kenya, Nigeria and South Africa. In addition, some countries that already have the greatest debt burden and are most sensitive to the economic changes brought about by COVID-19 are also excluded. **Libya does not qualify for debt relief, but has debt equating to 142% of central government revenue in 2017 and is further damaged by the collapse of oil markets.** Cabo Verde is also not eligible despite proportionally having the third highest levels of central government debt on the continent in 2018. But calls for further action are met with resistance from the USA and China.

The situation is further complicated by Africa's myriad of creditors. African countries have a complicated history with multilateral IFIs (International Financial Institutions), particularly the Bretton Woods institutions. The SAPs (Structural Adjustment Programmes) imposed on the continent during the 1980s and 1990s, tied loans to neo-liberal policy prescriptions that saw dubious policy results and were accused of undermining national sovereignty. So, in recent years, African countries have sought to diversify their sources of credit. According to the Jubilee Debt Campaign, as of 2017, only 35% of debt was owed to multilateral institutions (IMF, World Bank and others). 32% of government external debt was owed to private lenders and a further 24% to China.

Notably, the cost of servicing debt owed to the private sector is particularly burdensome in Africa, with high interest rates imposed due to harsh credit ratings and an often over-inflated risk premium. Even Senegal, with largely peaceful transitions of power and an average growth rate of 6% over the past 10 years still has a junk status credit rating. This contrasts with the concessional nature of loans from multilateral institutions. **Of all Africa's external interest payments, 55% are made to private creditors, while only 17% are made to multilateral institutions, with the same figure going to China.**

Africa: Percentage of external debt owed by creditor (2017)



Note: Figures add up to 101% because of rounding

Source: Jubilee Debt Campaign

Private creditors are also more resistant to calls for debt suspension and debt relief. The African Private Creditor Working Group has said it is striving to assist African countries in cushioning the economic impact of the coronavirus pandemic. At the same time, it is rejecting calls for a blanket stoppage of debt repayment or debt forgiveness and favours a 'case-by-case' approach that will secure 'the best outcome for both borrowers and lenders'. However, Tim Jones, head of policy at Jubilee Debt Campaign, claims that private creditors lent at high interest rates to poor countries, because they claimed these loans were high-risk and now 'the risk has come home to roost and lenders need to accept they cannot make large profits from these loans'.

A new paradigm on debt?

There are also those who believe that debt relief or debt forgiveness alone is not enough to address Africa's challenges. Such measures are likely to further downgrade the credit ratings of African countries and leave them facing even higher borrowing costs in the future. They would be insufficient in getting to the heart of the issues this crisis has highlighted, that are primarily structural in nature. A permanent solution means 'no going back to business as usual'. It involves capital controls to prevent the bleeding of wealth from the continent and a clamp down on tax dodging to reduce the need for external borrowing.

Indeed, it has been suggested that the coronavirus crisis could usher in a much-needed paradigm shift surrounding debt, economic policy and Africa's relationship with the rest of the world. Carlos Lopes, former head of UNECA (United Nations Economic Commission for Africa), believes that the crisis looks like "abolishing the rules of budgetary discipline and economic orthodoxy". In recognising the need for expansionist policies and the essential role for the state in the protection of public goods such as health, Lopes claims we are "witnessing the birth of a completely different cycle, in which the value of debt will be radically reassessed in terms of economic policy". This could pave the way for the realisation of a key objective of the African Union Agenda 2063, that of strengthening domestic resource mobilisation on the continent. **Moreover, it could also create an opportunity to reset and reinvent the role Africa wishes and is able to play on the global stage, its profile, and its relations with the rest of the world.**