IS SOVEREIGN DEBT AN ISSUE FOR SUBSAHARAN AFRICA?

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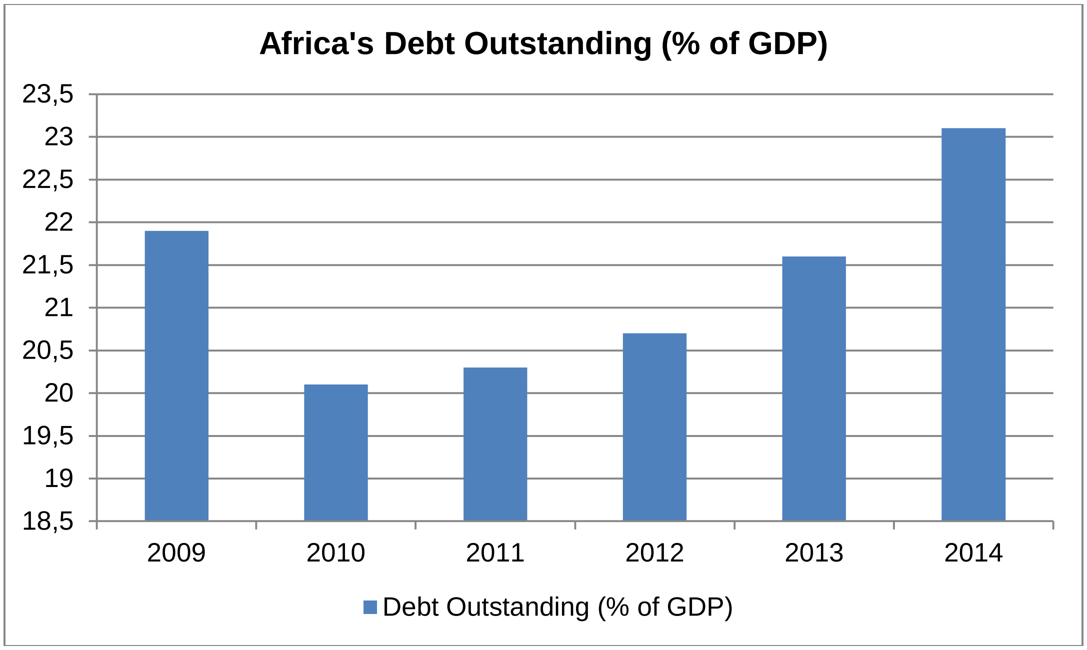
Introduction

The issue of sovereign debt has been a continuous issue on the continent. Concern with the high levels of debt and pressure from civil society, academics and African governments the World Bank and the International Monetary Fund (IMF) launched the Debt Initiative for Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), which created a framework for all creditors, including multilateral creditors, to provide debt relief to the world's poorest and most heavily indebted countries, most of which were sub-Saharan African countries.

These two initiatives substantially reduced the debt burden of African countries. However, during the past several years, sub-Saharan African countries have increasingly turned to the international sovereign debt market for their capital needs. Unfortunately some of the countries (Ghana and Zambia) that issued sovereign debt have run into fiscal problems. The cost of borrowing in international markets has risen sharply. It is for the reasons that overall debt levels of the Post HIPC counties ate fast approaching the HIPC levels and that there is now a new craze of sovereign bonds that some CSOs including AFRODAD are concerned about the sustainability of Africa's debt burden and the effectiveness of sovereign debt in promoting economic development.

The African Sovereign Debt is on the Rise

The debt levels as a percentage of GDP have increased since 2010 for African countries. If the trend continues the ratio will soon breach the 30% which is considered safe by the IMF.



The evidence of the excitement with international sovereign debt markets is evident in the statistics. In 2008 the stock of sub-Saharan African governments bonds on the international markets was less than $1 billion. This has increased to over $18 billion in 2014. One of the major reasons for this increase is that bond markets are seen as an alternative to the bilateral and multi lateral creditors whose debts while concessional come with macroeconomic conditions.

Despite some of the advantages of sovereign debt, its recent history in Africa has not been entirely positive. The experiences of a number of countries have highlighted the risks associated with sovereign debt:

• To attract international investors, sovereign debt is issued in foreign currencies, either in dollars or Euros. This means that the debt is subject to currency risks if the currency of issuance strengthens relative to the currency of the issuing country.

In 2014, the currencies of countries such as Ghana and Angola declined sharply in value, largely due to the decline in prices for natural resources, especially oil. The additional Ghanaian Cedis and Angolan Kwanzas needed to service debt denominated in dollars and Euros represented a significant new economic burden for both countries. In part because of this burden, Ghana was obliged to turn to the IMF for assistance.

The Overseas Development Institute estimates that if comparable exchange rate losses were to be repeated across the region, the total impact would amount to a value over time equivalent to 1.13 percent of sub-Saharan African GDP.

• Interest rate risks have also emerged on the African debt market. Record-low borrowing costs in 2014 facilitated sovereign bond sales by several African countries, including Ethiopia, which paid 6.63 percent for its debut offering of $1 billion in December 2014. Beginning in 2015, investors appear to be taking a more jaundiced view of the African scene. On July 23, 2015, Zambia paid 9.38 percent for the sale of $1.25 billion in debt. That was the highest yield ever paid for an African issuer on the Eurobond market and almost 4 percent higher than Zambia's first Eurobond in 2012.

• In part due to past debt relief programs, the overall level of African government debt has remained relatively stable at around 23 percent of GDP. Upward revisions to the GDPs of countries such as Ghana, Kenya, and Nigeria due to updated statistics have helped to lower debt-to-GDP ratios. However, with this new borrowing the debt ratios in four countries Cote d'Ivoire, Ghana, Mozambique, and Seychelles—has reached a moderate level of risk on the IMF's scale of debt sustainability.

• Sovereign international debt is often contracted rapidly. The borrower's intentions regarding the use of the debt principal are generally not binding. The term of the debt is generally 5 to 10 years, in contrast to the 30-year terms often employed in concessional lending. The looser arrangements associated with sovereign debt have led some countries to use the funds obtained for purposes that have little or no development impact. In Ghana and Mozambique, for example, funds were used to increase the salaries of public sector employees[1].

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[1] A final type of risk relates to the differences between sovereign debt and concessional debt. In the case of the latter, negotiations over debt issuance typically take place over a lengthy period

Why should CSOs be concerned?

While the levels of debt on the continent have not yet reached the pre HIPC levels, it is always important to take precautions bearing in mind the devastating impacts of debt on development and poverty in Africa. The burdens of excessive debt are always borne disproportionately by the poorest in society. It is therefore important for CSOs to beginning to sound the warning bells and ensure that African governments can properly and rapidly identify, measure, and manage the risks from their increased external indebtedness. Uganda has done that when in 2014 it declared that it would not issue sovereign debt after all. Its central bank governor warned of the dangers of debt and said that African countries would "never again get debt relief".

There are further reasons to be concerned. First, despite improvement, it is still a concern that more than two-thirds of African countries are at moderate or high risk of debt distress and in particular that one-fifth of countries are either at high risk or actually in debt distress.

In addition, even in the best of policy environments, the approach can result in countries with low debt today still being rated at moderate risk. This is because the stress test scenarios reflect the country-specific historical volatility of certain economic variables (e.g., exchange rates), which can drive up debt ratios in these scenarios. The number of countries at moderate risk can therefore be viewed with some forbearance.

Finally, the apparently continual improvement between 2006 and 2012 does not mean this improvement could not begin to be reversed.

The bottom line is that African governments should heed cautionary notes that many including CSOs like AFRODAD are making. AFRODAD does recognize that if used properly at the time of increasing interest rates, sovereign debt may be appropriate to address some problems like high-impact infrastructure projects

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of time during which issues such as the term of the debt, its sustainability, and its developmental impact are explored in detail.

that are likely to produce significant rewards at low risk. But it is important for sub-Saharan African governments to avoid issuing sovereign debt for purposes that promise low returns, such as financing current expenditures, increasing government salaries, or purchasing military hardware.