United Nations
Office of the Special Adviser on Africa

Unpacking Africa's Debt

Towards a Lasting and Durable Solution

United Nations publication issued by the Office of the Special Adviser on Africa (OSAA).

This publication has been developed as part of OSAA's mandate to undertake analytical work that contributes to improving coherence and coordination of the UN System support to Africa and to facilitate intergovernmental deliberations on the linkages between peace and development in Africa.

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“Many African countries now spend more on debt repayments than on healthcare.

António Guterres,
United Nations Secretary-General

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Acknowledgement

This 2024 flagship report draws on the report of the Secretary-General, "Unpacking the debt of Africa: towards a lasting and durable solution" (A/79/295).

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OSAA's Strategic Management Unit and Front Office also supported the data management, operations and strategic communications aspects of the production process under the coordination of Mafizul Islam, Jorge Vazquez Costa and Rado Ratovonarivo respectively.

Also, OSAA expresses its gratitude to the following members of the Africa Knowledge Network and the flagship report Soundboard for their valuable input (in alphabetical order): Jackie Cheng, Jason Braganza, Lyla Latif, Mohamed Ibrahim, Sara Tawfik Hamouda, Teddy Y. Samy.

Executive Summary

The 2024 OSAA Flagship Report unpacks some of the myths associated with debt in Africa and proposes avenues for sustainable solutions, based on the United Nations Secretary-General's calls to accelerate the implementation of the Sustainable Development Goals (SDGs), the need to deploy an SDG stimulus package for this purpose and to create the financing environment to achieve climate resilience. The report shows that contrary to popular belief that Africa suffers a debt overhang, in fact, the continent requires an additional $1.3 trillion to $1.6 trillion to meet the SDGs and Agenda 2063 Aspirations[1]. Faced with compounding crises such as financial distress, climate change, food insecurity and persistent conflict and unrest, African countries will continue needing to turn to borrowing to build back better and close their development financing gap.

A re-examination of Africa's historical use of debt instruments is needed, to understand the structural constraints and economic opportunities African countries face and which could unlock economic growth and development while ensuring debt sustainability. At the same time, it is urgent to deliver fiscal space to address critical development financing priorities. The policies and reforms identified are situated within the desire expressed by African leaders for increased agency in deploying policy levers at the national level and through the international financing architecture. The reform of this international financing architecture must address the urgency and scale of financing required to meet Africa's development ambition, the affordability of debt financing instruments, the ability to address debt sustainability in a predictable and orderly manner and the prioritization of development outcomes ahead of the protection of private finance interests. This includes a fundamental review of debt restructuring arrangements such as the Common Framework to create space for investment in the SDGs. In terms of domestic policy levers, African countries can further address development goals by deepening domestic debt markets as a means of further incentivizing domestic investment. Being able to effectively engage with the private sector on debt instruments will be a critical factor in properly unlocking domestic capital, as well as opportunities for foreign direct investment. Furthermore, strengthening the regional financing architecture to pool resources for transboundary infrastructure projects and improving capacity for debt management and reform on the continent can complement national efforts. Ultimately debt instruments will play a key role in supporting a new economic model for African countries which aims to deliver more sustainable value chains, moving beyond resource extraction for export. The report will recommend pragmatic and achievable policy actions by governments and address the need for ambitious, equitable reform of the global financing architecture.

1 African Development Bank. (2023). African Economic Outlook 2023: Mobilizing Private Sector Financing for Climate and Green Growth in Africa.

Introduction

The lingering effects of the COVID-19 Pandemic brought to light the role that Domestic Resource Mobilization (DRM) has in strengthening Africa's resilience to external shocks[2]. It also unveiled the triple paradox of Africa's sustainable development. The continent is rich in financial resources, has abundant energy sources and the perfect conditions for leading the world's agro-production, and yet it is dependent on external aid, lacks energy access and suffers chronic food insecurity[3]. Addressing these paradoxes will be crucial to unleashing Africa's developmental potential. In this context, debt servicing is the tip of an iceberg appears as one of the principal causes that diverts African financial resources from development objectives. Over 60 per cent of African countries allocate more towards debt servicing than to critical sectors such as healthcare[4]. This flagship report seeks to support African countries in transforming debt from a burden into an effective tool to achieve development outcomes. To this end, the report examines the nature and magnitude of the debt, dispels the myths associated with debt in Africa, and proposes avenues for sustainable solutions based on the Secretary-General's calls to accelerate the implementation of the Sustainable Development Goals, deploy an SDG stimulus package for this purpose, and create the financing environment aligned with achieving climate resilience.

Africa's debt burden is a reality that pre-existed the independence of the current African countries. Colonial powers engaged in debt transactions on behalf of African colonies, which inherited them upon their independence[5]. Pre-independence debt was essentially procured to finance infrastructure projects to facilitate resource extraction for export to the metropole. Little of the debt went towards improving citizen welfare and expanding production and economic transformation. In the post-independence period, Africa's external debt increased dramatically due to the need to address long-neglected basic services such as health and education, and to a certain extent, to try to advance industrialization. For example, between 1970 and 1987 it rose from $8.2 billion to $174 billion[6]. This new borrowing did not result in economic diversification and transformation either. Several African countries also took on unsustainable debt burdens, sometimes abetted by external creditors, to finance questionable projects. The uncontrolled increase of debt stocks and the absence of a strategy aimed at increasing the generation of predictable flows to service the new debt led to the debt distress of African countries.

An important feature of post-independence debt is that it has primarily relied on external borrowing (usually indexed in foreign currencies) to finance infrastructure, industrial production and exports. However, in many cases, investments financed through debt have not generated a sufficient increase in output and export earnings to meet their debt obligations. With terms of trade deterioration and rising interest rates, in the past decades many countries found themselves unable to finance their external debt, leading to debt crises that necessitated intervention from the international community. To respond to the latest debt challenges posed by the COVID-19 Pandemic, the G-20 established the Debt Service Suspension Initiative (DSSI) to help poorer countries fight the pandemic and safeguard livelihoods. However, the Common Framework for Debt Treatment presents limitations from Africa's perspective, including the exclusion of Middle-Income Countries in debt distress and procedural challenges that have meant only four countries have requested debt relief under the Common Framework.[7] A meaningful mechanism for debt restructuring is still needed to achieve sustainability.

2 United Nations. (2022). Financing for Development in the Era of COVID-19: the Primacy of Domestic Resource Mobilization,

3 United Nations. (2023). Solving paradoxes of Africa's development: financing, energy and food systems

4 For instance, the average African country spends 2-3 times more on debt repayments than on healthcare investments, a troubling gap that affects human capital development.

5 Guissé, E. H. (2004). *Effects of debt on human rights* (E/CN.4/Sub.2/2004/27). United Nations

6 African Development Bank. (2023). African Economic Outlook 2023: Mobilizing Private Sector Financing for Climate and Green Growth in Africa.

7 Economist Intelligence Unit (2024)

Buoyed by increased domestic savings and constraints to access capital markets, several African countries have sought to lessen their dependence on external debt in favour of domestic debt financing. For example, the share of domestic debt rose from 35 per cent in 2019 to approximately 42 per cent in 2021.[8] This approach offers several benefits: increased fiscal space and policy autonomy, lessening the effects of interest and exchange rate volatility on debt, and developing the domestic debt market. These benefits notwithstanding, domestic borrowing is not without cost. Potential risks include inflationary pressures and high interest rates, making it more expensive for businesses to borrow and invest. There are also fears of potential crowding-out effects on private sector investment posed by uncontrollable increases in domestic debt.

Further, the short-term maturity structure of domestic debt, which tends to be costly, also poses severe challenges for debt and macroeconomic management. Rising domestic debt costs in 2020 resulted in increasing debt servicing costs, refinancing pressures and domestic debt restructurings and defaults. For instance, between 2020 and 2023, two African countries (Ghana and Mozambique) have defaulted on their domestic sovereign obligations[9]. The effective management of domestic debt is paramount for achieving economic growth and long-term fiscal stability and enhancing the resilience of African economies in the face of global economic uncertainties.

AFRICA'S EXTERNAL DEBT HAS GROWN SUBSTANTIALLY DURING THE LAST DECADE, REACHING

$656 BILLION IN 2022

REPRESENTING 28 PER CENT OF GDP

Against this background, external debt financing continues to be an important source of development financing for many African countries. Africa's external debt has grown substantially during the last decade, reaching $656 billion in 2022, representing 28 per cent of GDP.[10] Relatively slow growth, an inflationary environment, tightening financing conditions and exchange rate volatility, have heightened the risk of unsustainability. Debt servicing costs have grown faster than the rate at which African countries can generate export earnings. They are also higher than investments in areas that are critical for Africa to attain the SDGs. Debt risks have risen in many African countries, with 63 per cent of African countries either at high risk or already in debt distress[11]. The challenge, though, is how to design and utilize debt instruments that create a win-win situation for creditors and borrowers and are sustainable in the long term.

Africa's debt composition has changed significantly, with commercial debt (bonds and loans from private lenders) representing 43 per cent of total debt stock, up from 17 per cent in 2000.[12] The rise of non-traditional creditors, such as China, India and Turkey, has also transformed the landscape of bilateral creditors which might have implications for debt resolution and sustainability.

In analyzing Africa's external debt problems, it is worth examining the structure of the international financing and debt architecture and the role of asymmetric power to shed light on how the system, by its very design, undermines Africa's debt sustainability. This power imbalance is reflected in the exorbitant rates African countries pay on loans. Furthermore, during crises, sovereign bondholders/creditors get repaid first while African countries are forced to cut expenditures on social services and growth catalytic sectors. The defining features of the IFA are that it facilitates relatively easy and cost-effective access to finance for the public and private sectors in developed countries while making it costly for their counterparts in developing countries,.

The lingering effects of the COVID-19 Pandemic on African countries underscore the importance of reforming the global financing and debt architecture to make them fit for the purpose of financing Africa's development priorities. These measures must be accompanied by complementary steps and efforts at the domestic level to strengthen the regional dimension of financing for development. Following the introductory section, Chapter 1 presents a historical overview of Africa's debt from the colonial to the post-independence period. Chapter 2 discusses the increasing importance of domestic debt and associated macroeconomic challenges. Chapter 3 analyses the evolution of external debt and its implications for debt sustainability and growth. And Chapter 4 unpacks the structure of the international financing architecture and proposes steps to reform the global debt architecture to provide the necessary financing for Africa's development.

8 African Development Bank. (2023). African Economic Outlook 2023: Mobilizing Private Sector Financing for Climate and Green Growth in Africa.

9 Filocca, G., & Gill, F. (2023, November). *African Domestic Debt: Reassessing Vulnerabilities Amid Higher-For-Longer Interest Rates*. S&P Global Ratings.

10 World Bank International Debt Statistics Database

11 International Monetary Fund. (2023). How to avoid a debt crisis in sub-Saharan Africa.

12 World Bank International Debt Statistics Database.

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Evolution Of Africa's Debt – A Historical Overview

1.1 Pre-independence Era and The Legacy of Colonialism

Africa's current debt challenges cannot be disassociated from the structure of colonial economies. In the pre-independence era, the functions of colonial powers in Africa rested on two basic pillars: maintenance of law and order to uphold the authority of the administration, and collection of adequate revenue to finance the running of the colony.[13] Colonial governments deployed an economic model that focused on the extraction and exportation of valuable resources from the African continent.

Debt was used as an instrument to facilitate resource extraction for the industrialization of the metropole, rather than financing the development of domestic productive capacity, strengthening value chains of production or creating a diversified economic base. As a result, African countries' economy became mostly limited to the production and exportation of primary commodities and were vulnerable to the boom-and-bust cycle of the global commodity markets. For example, most colonial rail networks built in Africa operated on a linear route to connect resource-rich hinterlands to ports of export on the coastline, where goods were shipped to Europe and other regions. While this infrastructure could have been crucial for the economic and political vertebration of the territory, the rail service failed to serve its purpose, because they were simply designed to extract and export resources out of the continent, becoming obsolete in many cases after independence.[14]

A second consequence of the colonial approach to debt was that the extensive borrowing undertaken to develop infrastructure for the extraction and exportation of natural resources created liabilities that were attributed to the independent African states. This approach to debt inheritance contradicted previous international practice[15]. For instance, King Leopold II of Belgium controlled the "Congo Free State' as a personal colony and issued bonds worth more than one hundred million francs, or roughly half a billion in today's dollars. As a result, the Democratic Republic of Congo (formerly Zaire) inherited $311 million in external debt[16], which significantly constrained the country's fiscal capacity and hindered its economic development.[17] This constitutes one of the early examples of 'odious debt', which is most commonly defined as "debt incurred on behalf of a sovereign by a despotic leader, used for purposes adverse to the interests of the populace, and purchased by creditors who knew [this]"[18].

Another example of odious debt occurred during the apartheid government in South Africa, which borrowed through the 1980s from private banks to finance the military and police to repress the African majority. The post-apartheid government accepted responsibility for this debt out of the consideration that default would hurt its chance of attracting foreign investment. As South Africa did not qualify for debt relief under the Heavily Indebted Poor Countries Initiative (HIPC), the burden now falls on the South African government and people.[19]

Modern scholars argue that sovereign debt incurred without the people's consent and not benefiting them is 'odious' and should not be transferable to a successor government, especially if creditors are aware of these facts in advance.20 This doctrine seeks to underline how historical circumstances, and colonial legacies shape the structural nature of African debt. It is an important consideration in designing equitable access to affordable debt instruments and in addressing debt distress in African countries.

However, post-independence African nations inherited substantial debts from their colonial powers, which have posed significant challenges to their economic development. The borrowing did not contribute to establishing value chains and stronger economic bases in Africa. Rather, the burden of servicing these debts has often diverted resources away from crucial social services and infrastructure investment, perpetuating cycles of poverty and underdevelopment.

13 United Nations (2022)
14 Sturgis, S. (2015)
15 Guissé, E. H. (2004).
16 Ndikumana, L., & Boyce, J. (1998)
17 Blocher, J., et al (2020).
18 Ibid
19 Kremer, M., & Jayachandran, S. (2002).
20 Ibid.

1.2 Post-independence Borrowing Patterns and Heightened Dependency

A great majority of the African countries gained political independence in the 1960s. In the decades following independence, African borrowing patterns underwent significant shifts. The new political elites placed great emphasis on attracting capital flows from wealthy foreign countries, securing better prices for primary commodities, and gaining greater access to Western markets.[21] At first, newly formed nations faced the challenge of building their economies and infrastructure. However, these fledgling states often lacked the necessary capital reserves and expertise to do so independently, which resulted in borrowing from external sources to finance development projects and improving standards of living. The Cold War further complicated the lending landscape, with both the Western Bloc and the Eastern Bloc vying for influence through loans and aid packages. This period saw a rise in concessional loans, offered at favourable rates but often tied to specific projects or policy adjustments favoured by the lender, potentially hindering long-term economic autonomy.

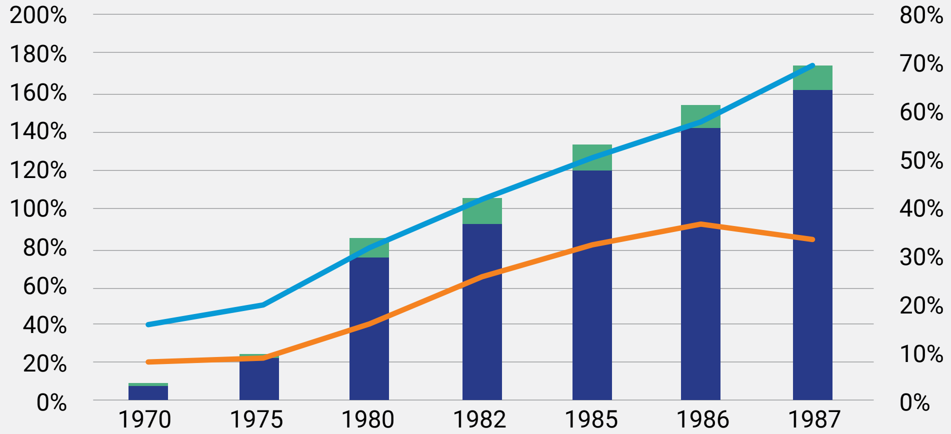
As a result of colonialism's economic structure and debt legacy, African countries had to build basic infrastructure, develop industries, and diversify their economies. For example, Uganda inherited in 1962 a dual economy structure with a profitable cash crop sector built around coffee at the expense of the food crop sector. Similarly, Kenya (gaining independence in 1960), Nigeria (1963) and Botswana (1966) had extraction-based economies. Senegal (1960) had an economy centred around peanut production and phosphate mining. In other cases, such as Angola (1975) decades-long civil war led to an urgent need for reconstruction and development. These colonial-inherited hindrances pushed the newly independent nations to borrow to facilitate economic development [22].

Reckless lending practices by private banks in advanced economies significantly contributed to Africa's debt woes. The oil price shocks of the 1970s resulted in substantial petrodollar deposits in Western banks. Eager to deploy excess liquidity, international banks extended large volumes of loans to African governments without adequate consideration of repayment capacity or the sustainability of such debts. The increased liquidity in the global markets led to more borrowing from private creditors, including bonds, commercial bank loans and other private credits (e.g., from manufacturers, exporters and other suppliers of goods, and bank credits covered by a guarantee of an export credit agency). Between 1970 and 1980, African General Government commercial bank loans from private banks and other private institutions went up from $85.9 million to $7.2 billion in 1980 (measured in current US dollars)[23].

The combination of funding needs and the market's eagerness to lend led a rise in total external debt from $8.2 billion in 1970 to $174 billion in 1987, representing an increase of 20 times over 17 years. During the same period, Africa's total export value did not grow fast enough to keep pace with the debt accumulation, contributing to a rising debt service burden[24] and resulting in a sharp increase of debt service as a percentage of exports of goods and services, from 7.8 per cent to 33.4 per cent (Figure 1.1).[25] Medium and long-term debt accounted for the vast majority of external debt in 1970 ($8 billion), but the amount of short-term debt gradually increased over the years (Figure 1.1). By 1987, medium- and long-term debt expanded by 20 times while short-term debt expanded by 50 times. Between 1970 and 1987, debt-to-GDP ratios increased from 15.9% to 70%, as countries faced increasing fiscal demands and stagnating export revenues[26]. Debt service payments rose dramatically from an estimated $0.9 billion in 1970 to $17.9 billion in 1987, peaking at $19 billion in 1985.

21 Ibid.
22 Latif, L. 2023.
23 World Bank International Debt Statistics
24 Green, J. E., & Khan, M. S. 1990.
25 Ibid.
26 *Ibid.*

Figure 1.1 Post-independence external debt in Africa, 1970-1987

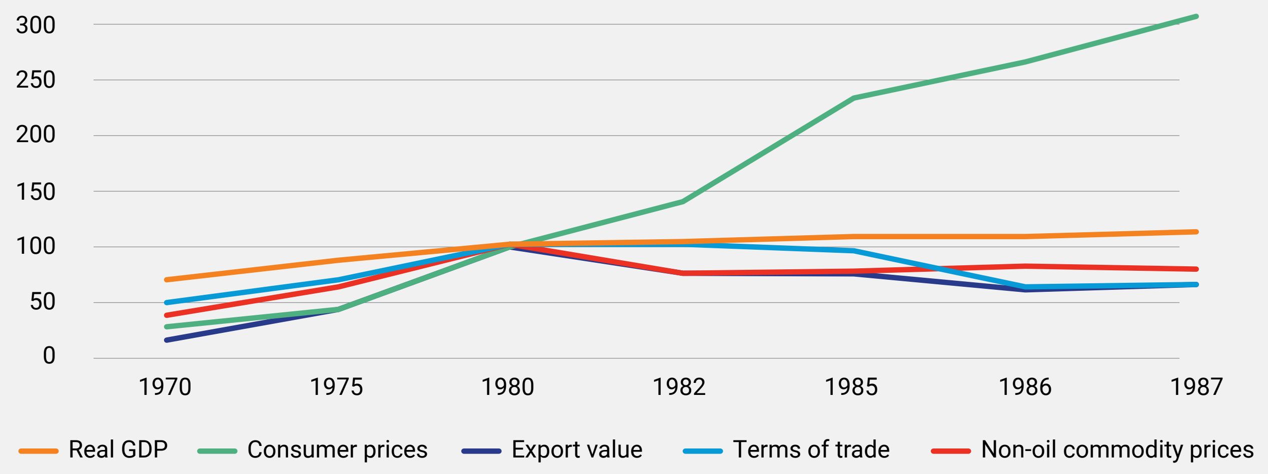


	1970	1975	1980	1982	1985	1986	1987
Short-term debt ($ billions)	0,2	1,0	9,1	13,2	12,5	11,5	11,8
Medium and long-term debt ($ billions)	8,0	22,5	75,1	91,6	120,5	142,3	162,2
Ratio of external debt to GDP (%)	15,9%	19,5%	31,9%	41,4%	50,3%	58,1%	70%
Ratio of debt service to exports of goods and servives (5)	7,8%	8,4%	15,9%	25,5%	32,6%	36,9%	33,4%

Source: Green, J. E., & Khan, M. S. (1990). The authors used IMF data.

One important factor behind the trend is that post-independence, many African countries undertook development projects using foreign financing, with the aim to improve infrastructure, industrial base, export potential and ultimately national income. However, they could not generate a sufficient increase in output and export earnings to meet their debt obligations. This is particularly true for commodity-exporting countries. Following the initial surge in oil prices in 1973, prices of various commodities (cocoa, coffee, sugar, tea, groundnuts, sisal, phosphate and uranium) experienced significant increases. This led to substantial revenue gains for many African nations, prompting them to expand public spending considerably. While revenues from commodity taxes rose, they did not match the pace of expenditure growth. Consequently, governments resorted to foreign borrowing to cover the remaining costs of their ambitious projects. The 1980s saw a decline in commodity prices, and consequently, Africa's total export value gradually decreased. The real GDP growth slowed (Figure 1.2). By 1987, the terms of trade for Africa had plummeted by nearly 40 per cent compared to 1980 levels.

Figure 1.2 Key Economic indicators for Africa, 1970-1987 (index:1980=100)



Source: Green, J. E., & Khan, M. S. (1990). The authors used IMF data.

1.3 Debt Crisis of the 1980s and 1990s

Africa's debt problem emerged prominently in the late 1970s and 1980s, which coincided with the broader debt crisis affecting developing countries worldwide starting in 1982. The crisis arose from a combination of factors, including overborrowing by developing countries (including in Africa) and the reckless lending by international commercial banks in the 1970s; the collapse of world commodity prices (especially petroleum) in the early 1980s; and the rise in international interest rates making borrowing more expensive.[27]

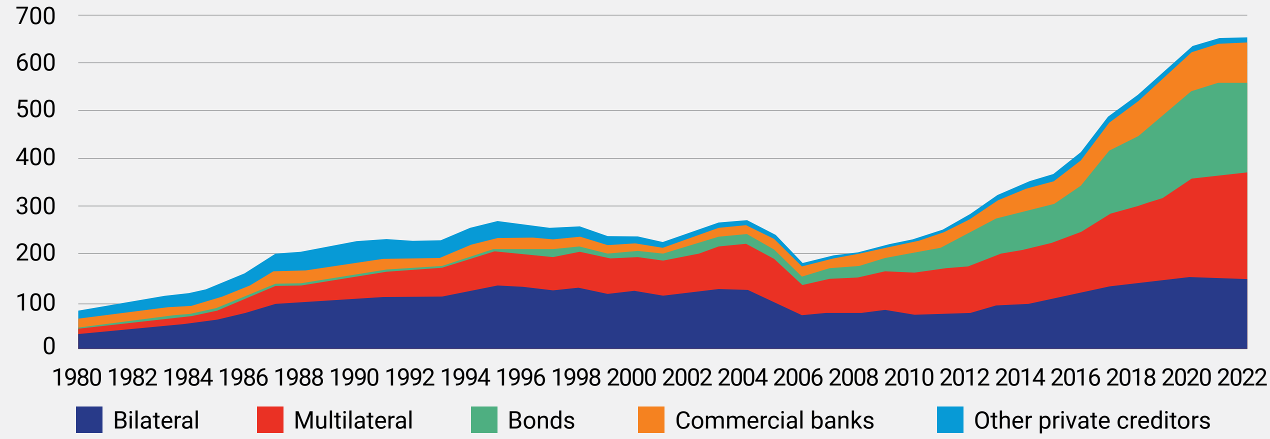
African governments were faced with a combination of slowing output growth, declining export earnings and high inflationary pressures, yet most governments failed to cut back on spending, opting instead to borrow more externally to sustain expenditure levels, resulting in a rapid expansion of debt levels. Domestic savings, which could have been an alternative to expensive foreign debt to finance development projects, were also discouraged by policies designed to keep domestic interest rates low.[28] As a consequence, many African countries struggled to service their debts as unfavourable borrowing terms, resource mismanagement, and external shocks like oil price fluctuations or global economic downturns exacerbated their financial crises[29].

The situation worsened in the 1980s following the collapse of oil prices and sharp increases in interest rates that caused massive defaults by heavily indebted Latin American countries. This prompted international attention towards addressing the growing debt burdens of developing nations, including those in Africa. In the aftermath, most African countries experienced a severe debt crisis in the 1980s and 1990s that led to a pause in economic reform and contributed to a decline in living standards. During the debt crisis, many African countries either experienced stagnation or a reversal of the gains in living standards made in the 1960s and 1970s. With the unsustainable debts came a weaker investment climate, a lack of available trade credit and a reduction in foreign direct investment, which means that other non-debt forms of capital did not flow.

Additionally, a global environment characterized by high inflation and interest rates further fuelled the accumulation of debt in Africa.[30] Africa's total external borrowing nearly tripled from $84.8 billion in 1980 to reach $228.3 billion in 1990, highlighting the rapid escalation of indebtedness during this period.[31] Lending from commercial banks went up by 140 per cent from $7.2 billion in 1980 to $17 billion in 1990 and reached $69.9 billion when all private creditors were considered. Despite the increase in private lending, loans from official creditors (bilateral and multilateral) still accounted for the majority of Africa's government borrowing in the 1980s and 1990s, with a shift from predominately bilateral lending ($107.1 billion) to increased multilateral lending ($50.7 billion) (Figure 1.3). Over 1980-1990, multilateral lending increased by 395 per cent while bilateral lending had a lesser increase by 267per cent.[32]

27 Ajayi, S. I., & Khan, M. S.. 2000.
28 Ibid.
29 *IMF African Debt Statistics, 1980s.*
30 Ajayi, S. I., & Khan, M. S. 2000
31 'Total external debt' is debt owed to non-residents repayable in currency, goods, or services. It is the sum of public, publicly guaranteed, and private nonguaranteed long-term debt, short-term debt, and use of IMF credit). Data are in current U.S. dollars. World Bank International Debt Statistics (IDS)
32 Ibid.

Figure 1.3 Composition of Africa's external debt stocks, public and publicly guaranteed, 1980-2022 (Debt outstanding, current US$ billions)



Source: *World Bank International Debt Statistics.*

This can be attributed to international financial institutions (IFIs) such as the World Bank and IMF that emerged as major sources of credit to developing countries after the end of WWII. Regular borrowing from the IMF by African countries started in the late 1950s when Egypt used IMF resources to help cope with the impacts of the 1956–57 Suez crisis. By 1975, the IMF had credits outstanding to 19 African countries ($727.8 million), a third of all its borrowers, but accounting for just 8.4 per cent of the total portfolio.[33] A decade later by 1985, the total lending to Africa skyrocketed to $9 billion, owed by 38 countries, peaking at $9.2 billion in 1987 before tapering off for a few years (Figure 1.4).

By 1990, five countries alone accounted for half of Africa's credits and loans from the IMF: Sudan (12 per cent), Zambia (11 per cent), Morocco (9 per cent), Ghana (9 per cent), and Algeria (8 per cent), as seen in Figure 1.4. The top ten debtor countries were responsible for three-quarters of the borrowing from the Fund.[34] The surge in IMF lending was precipitated by a few factors: 1) The continent desperately needed stabilization financing on top of its persistent need for development assistance in the 1970s due to the adverse conditions mentioned above; 2) Growing sympathy from developed countries and the international community to provide liquidity support as the challenges faced by Africa were seen as temporary caused by the oil shock and other external events; 3) The IMF introduced new lending instruments that benefited African countries, including the Compensatory Financing Facility (CFF) to provide quick-disbursing and low-conditionality loans to countries facing temporary losses of commodity export revenues; a temporary "Oil Facility" to help oil-importing countries cope with the doubling of world oil prices; the Extended Fund Facility (EFF) to support longer-term adjustment programmes with loans that could be repaid over a longer period; and the Trust Fund as an Administered Account for lending to low-income countries on concessional terms.[35]

ASSISTANCE FROM IFIS

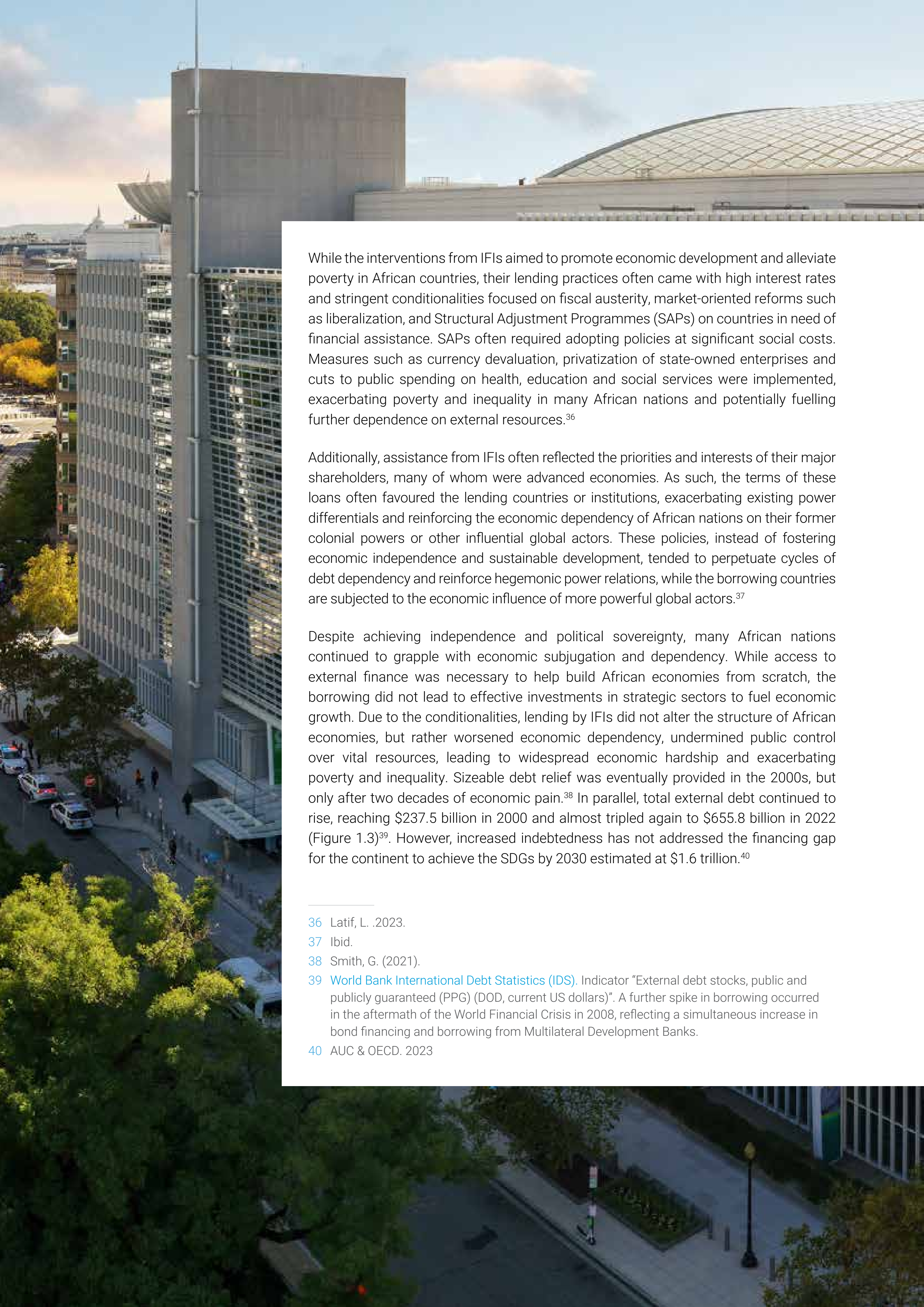
OFTEN REFLECTED THE PRIORITIES AND INTERESTS OF THEIR MAJOR SHAREHOLDERS,

MANY OF WHOM WERE ADVANCED ECONOMIES.

33 Camdessus, M. 2012. .

34 *IMF International Financial Statistics.*

35 Ibid.



While the interventions from IFIs aimed to promote economic development and alleviate poverty in African countries, their lending practices often came with high interest rates and stringent conditionalities focused on fiscal austerity, market-oriented reforms such as liberalization, and Structural Adjustment Programmes (SAPs) on countries in need of financial assistance. SAPs often required adopting policies at significant social costs. Measures such as currency devaluation, privatization of state-owned enterprises and cuts to public spending on health, education and social services were implemented, exacerbating poverty and inequality in many African nations and potentially fuelling further dependence on external resources.[36]

Additionally, assistance from IFIs often reflected the priorities and interests of their major shareholders, many of whom were advanced economies. As such, the terms of these loans often favoured the lending countries or institutions, exacerbating existing power differentials and reinforcing the economic dependency of African nations on their former colonial powers or other influential global actors. These policies, instead of fostering economic independence and sustainable development, tended to perpetuate cycles of debt dependency and reinforce hegemonic power relations, while the borrowing countries are subjected to the economic influence of more powerful global actors.[37]

Despite achieving independence and political sovereignty, many African nations continued to grapple with economic subjugation and dependency. While access to external finance was necessary to help build African economies from scratch, the borrowing did not lead to effective investments in strategic sectors to fuel economic growth. Due to the conditionalities, lending by IFIs did not alter the structure of African economies, but rather worsened economic dependency, undermined public control over vital resources, leading to widespread economic hardship and exacerbating poverty and inequality. Sizeable debt relief was eventually provided in the 2000s, but only after two decades of economic pain.[38] In parallel, total external debt continued to rise, reaching $237.5 billion in 2000 and almost tripled again to $655.8 billion in 2022 (Figure 1.3)[39]. However, increased indebtedness has not addressed the financing gap for the continent to achieve the SDGs by 2030 estimated at $1.6 trillion.[40]

36 Latif, L. .2023.

37 Ibid.

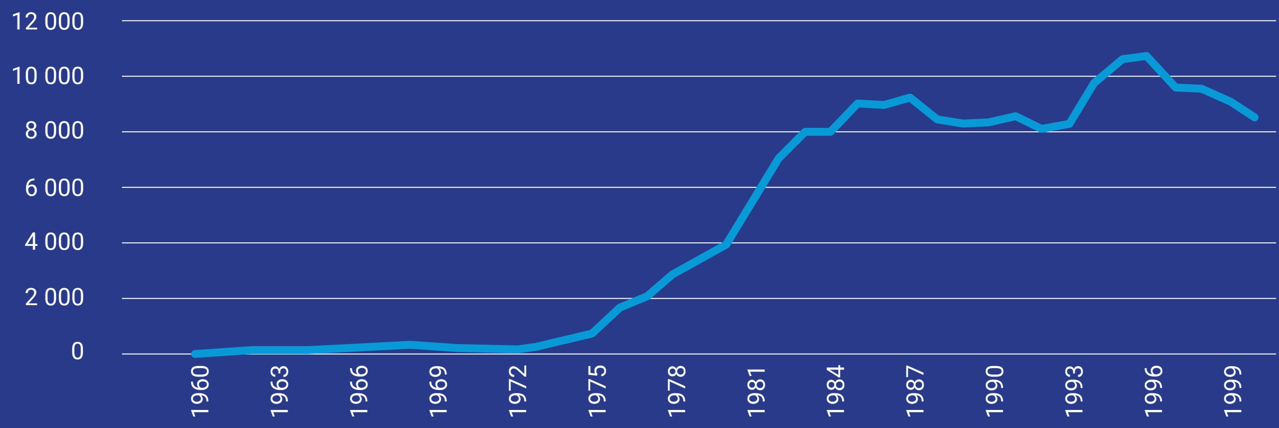
38 Smith, G. (2021).

39 World Bank International Debt Statistics (IDS). Indicator “External debt stocks, public and publicly guaranteed (PPG) (DOD, current US dollars)”. A further spike in borrowing occurred in the aftermath of the World Financial Crisis in 2008, reflecting a simultaneous increase in bond financing and borrowing from Multilateral Development Banks.

40 AUC & OECD. 2023

Figure 1.4 Uptick in IMF lending to African countries since the 1970s

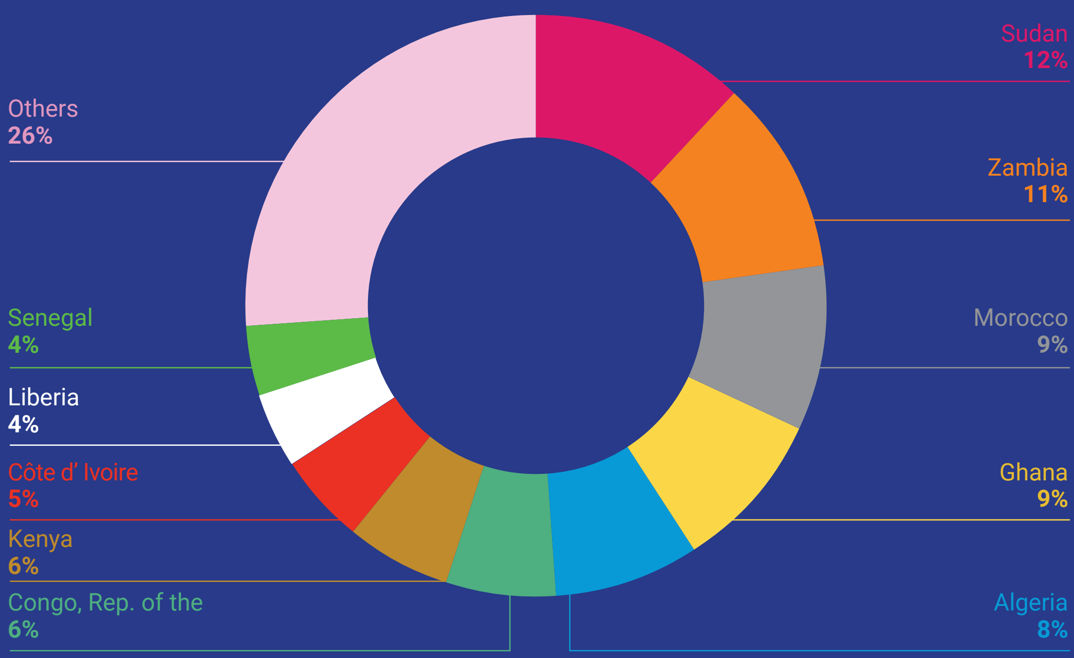
a.Use of IMF Credit and Loans, 1960-2000 ($dollar millions)



Source: *IMF International Financial Statistics*

Figure 1.4 Higher and persistent fiscal deficits in recent years have led to heightening crowding out effect on private sector investments (SOCO index), but countries still have borrowing space.

b.Countries with Highest IMF Loans and Credits, 1990



Source: *IMF International Financial Statistics*

1.4 Debt Relief Initiatives and Their Efficacy

The debt crisis of the 1980s and 1990s was a watershed moment for Africa, characterized by widespread default on loans and economic hardship across the continent. Efforts were made to alleviate the debt burdens of developing nations, including many in Africa, through the Paris Club, an informal group of creditor nations involved in debt restructuring and relief, and through initiatives spearheaded by various multilateral institutions.

The Heavily Indebted Poor Countries (HIPC) Initiative, launched in 1996 by the IMF and World Bank, aimed to alleviate crushing debt burdens and free up resources for poverty reduction. The HIPC initiative was designed to ensure that no poor country faces a debt burden that is unmanageable and had established threshold ratios beyond which debt and debt service would be considered unsustainable. Prior to this, debt relief was coordinated on a bilateral basis or through nongovernmental organizations, therefore HIPC marked a more comprehensive approach involving all creditors in the debt relief process. To date, 31 out of the 37 developing countries that have received debt relief are in Africa.[41] Sudan and Eritrea are under decision to be considered for debt relief under the initiative.[42] In 2005, the *Multilateral Debt Relief Initiative (MDRI)* Initiative was adopted by the IMF to allow countries completing the HIPC Initiative process to receive 100 per cent relief on eligible debts by the IMF, the World Bank and the African Development Fund (AfDF).[43] The HIPC Initiative and MDRI have collectively provided over $75 billion in debt relief to qualifying African countries, significantly reducing their debt stocks and debt service obligations[44]. In response to the COVID-19 pandemic, the G20 launched the Debt Service Suspension Initiative (DSSI) to provide temporary debt service suspension for the world's poorest countries. Contrary to the other initiatives, the G20 DSSI does not involve the writing-off of debt, but only the postponement of payments.[45]

All in all, debt relief efforts have helped free up fiscal space for investment in social services, infrastructure and poverty reduction programmes in many African countries.[46] For instance, under the DSSI, Ghana redirected $500 million towards COVID-19 response and social protection programs. However, debt-relief initiatives have failed to provide long-term solutions. This was obvious not only in the limited application of the DSSI, but also as the main objective of the relief package was to enable increased socio-economic expenditures with no associated measures to address sustainable financing for those growing social programmes. This is not a problem exclusive of the DSSI, but rather has been a traditional impact of debt relief initiatives. As a consequence, of the 37 countries that received relief under the HIPC, 36 required relief under the MDRI and 35 under the DSSI. Eventually, these initiatives failed to address the structural challenges that prompted the need for relief.

DEBT RELIEF EFFORTS HAVE HELPED FREE UP

FISCAL SPACE FOR INVESTMENT

IN SOCIAL SERVICES, INFRASTRUCTURE AND POVERTY REDUCTION PROGRAMMES IN MANY AFRICAN COUNTRIES.

41 The 30 countries are: Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Republic of Congo, Democratic Republic of Congo, Côte d'Ivoire, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, São Tomé & Príncipe, Senegal, Sierra Leone, Somalia, Tanzania, Togo, Uganda, Zambia.

42 Ibid.

43 IMF.

44 *IMF and World Bank. 2020.*

45 Ibid.

46 Latif, L. 2023.

To try to address long-term structural issues, IFIs have also provided support to African countries in debt management practices[47]. This was also the goal of the G20 Common Framework on Debt Treatment to address the growing debt vulnerabilities in low-income countries exacerbated by the COVID-19 pandemic. Its primary objectives are to provide a coordinated and comprehensive approach to debt restructuring, ensuring fair burden-sharing among all creditors, and to support sustainable economic recovery in debtor countries. Middle-income countries are not eligible to apply for relief under the framework. However, the implementation of the framework faces several challenges. These include the complexity of coordinating among diverse creditors, including private sector lenders and non-Paris Club members, the need for greater transparency in debt data, and the potential reluctance of some creditors to participate in debt relief efforts. Additionally, the framework must navigate the delicate balance between providing immediate debt relief and ensuring long-term fiscal sustainability for the debtor nations. As a result, only four African countries—Chad, Ethiopia Ghana and Zambia—have undertaken debt treatment under the G20 Common Framework. The delays and challenges in these cases highlight the need for improvements in the framework to ensure timely and effective debt relief. There are also significant criticisms that the framework prioritizes the needs of private sector creditors above the needs of governments and citizens[48].

While debt relief instruments are essential tools to help countries cope with debt burdens, they are no panacea. The underlying limitations include that these instruments do not address the root causes of excessive debt such as structural economic issues, governance problems, or global financial conditions. Debt relief measures provided to African countries in response to COVID-19 merely postponed debt and created breathing room in the short run for the debtor countries. They also tend to target less-developed countries without the low-interest financing afforded to advanced economies throughout the pandemic.[49]

Latest information from the IMF shows that 8 out of the 10 low-income countries currently in debt distress are located in Africa. Thirteen African countries are assessed to be at high risk of debt distress, while another 17 countries are at moderate risk. Combined, the region accounts for more than half of the countries that are in or at risk of debt distress (Table 1.1).[50]

Table 1.1 African countries Debt Sustainability Analysis (DSA) rating, 2023

	In distress	**At high risk**	**At moderate risk**
World total	10	26	26
Africa	9: Republic of Congo, Ghana, Malawi, Mozambique, São Tomé and Príncipe, Somalia, Sudan, Zambia and Zimbabwe.	12: Burundi, Cameroon, Central African Republic, Chad, Comoros, Djibouti, Ethiopia and the Gambia, Guinea-Bissau, Kenya, Sierra Leone, South Sudan	17: At moderate risk: Benin, Burkina Faso, Cabo Verde, Democratic Republic of the Congo, Côte d'Ivoire, Guinea, Lesotho, Liberia, Madagascar, Mali, Mauritania, Niger, Rwanda, Senegal, Tanzania, Togo, Uganda

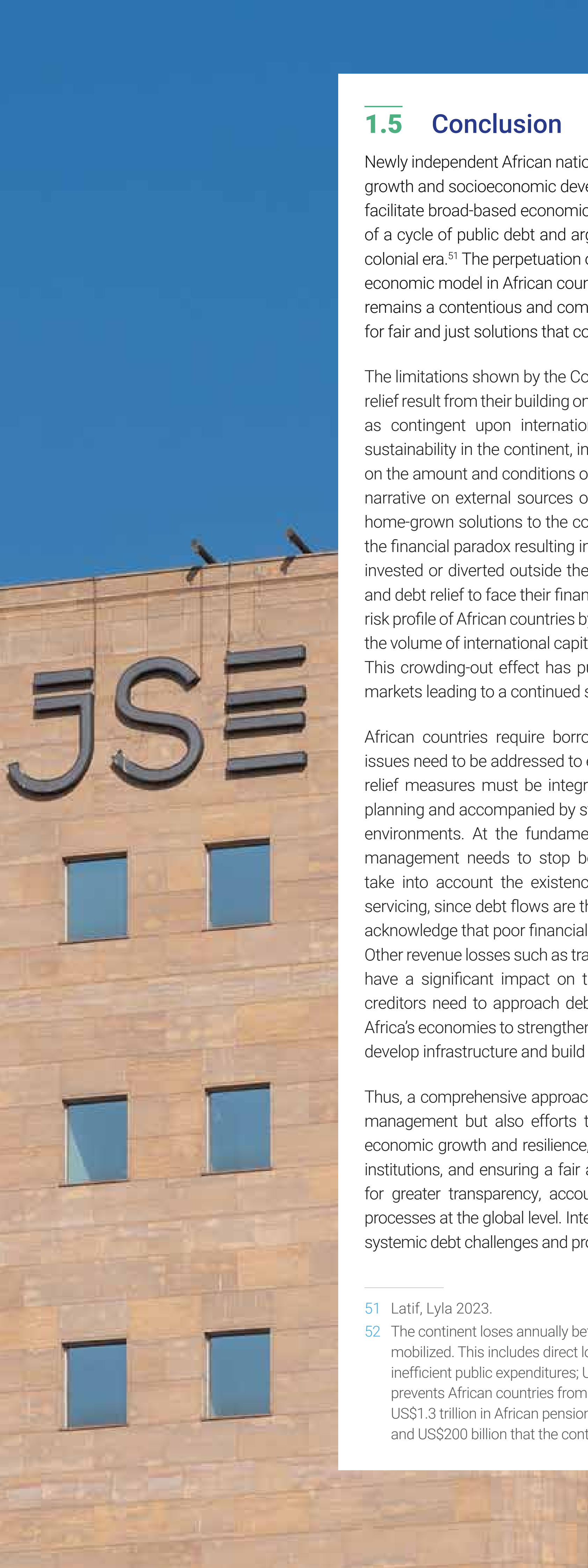
Source: IMF.

47 For instance, in Kenya, the World Bank has supported a decline in commercial-owed debt from 35.6 per cent in 2019 to 28.8 per cent in 2021. In Angola, the World Bank supported the reduction of interest rate risks on 98 per cent of their outstanding debt to the IBRD and helped create up to $270 million in potential savings on interest repayment. In Somalia, the IMF and the World Bank supported enhancing the legal framework for debt management operations, debt recording and debt publication. World Bank. (2023).

48 Debt Justice. 2023.

49 Heitzig, Ordu, & Senbet. 2021.

50 Ibid.



1.5 Conclusion

Newly independent African nations inherited economies that were ill-equipped for diversified growth and socioeconomic development. As a result, they resorted to external borrowing to facilitate broad-based economic development and nation-building. This marked the genesis of a cycle of public debt and arguably a continuation of the extraction characteristic of the colonial era.[51] The perpetuation of this debt cycle also served to anchor the extraction-based economic model in African countries. Therefore, the issue of colonial and post-colonial debt remains a contentious and complex issue for many African countries, highlighting the need for fair and just solutions that consider the historical context of debt accumulation.

The limitations shown by the Common Framework and other prior attempts to provide debt relief result from their building on a traditional narrative that approaches Africa's development as contingent upon international support and consequently considers that achieving sustainability in the continent, in this case, the sustainability of debt management, depends on the amount and conditions of international support received. The excessive focus of this narrative on external sources of funding has undermined the pursuit of endogenous and home-grown solutions to the continent's sustainable development. In this regard, it has fed the financial paradox resulting in African countries generating hundreds of billions of dollars invested or diverted outside the continent[52], while they depend on international assistance and debt relief to face their financing needs. This financial paradox has also undermined the risk profile of African countries by crowding out international capital in two ways: (1) reducing the volume of international capital flows to Africa and (2) increasing the cost of investments. This crowding-out effect has pushed Africa to a marginal position in international capital markets leading to a continued situation of debt distress and unsustainability.

African countries require borrowing to finance their development needs, but structural issues need to be addressed to ensure greater returns to borrowing. Debt management and relief measures must be integrated into macroeconomic policymaking and development planning and accompanied by strong institutions and conducive domestic and international environments. At the fundamental level, three areas need to be addressed. First, debt management needs to stop being approached from a stock perspective but needs to take into account the existence of regular and predictable revenue flows to face debt servicing, since debt flows are the key to sustainability. Second, international actors need to acknowledge that poor financial management is not the only cause of debt unsustainability. Other revenue losses such as trade mispricing, tax redundancies and the cost of remittances have a significant impact on the availability of debt flows. Third, African countries and creditors need to approach debt financing strategically for transformative investments in Africa's economies to strengthen national and regional value chains, deepen capital markets, develop infrastructure and build diversified and resilient economies.

Thus, a comprehensive approach to debt sustainability would not only involve effective debt management but also efforts to address underlying structural issues through promoting economic growth and resilience, improving governance, building the capacity of stakeholder institutions, and ensuring a fair and inclusive international financial system. There is a need for greater transparency, accountability and participation in debt-related decision-making processes at the global level. International cooperation and solidarity are crucial in addressing systemic debt challenges and promoting inclusive and sustainable development in Africa.

51 Latif, Lyla 2023.

52 The continent loses annually between $500 and $600 billion that are generated by Africa but not mobilized. This includes direct losses of US$ 88.6 billion in illicit financial flows, US$ 70 billion in inefficient public expenditures; US$ 46 billion in tax redundancies and missing policy action that prevents African countries from leveraging opportunities such as US$ 100 billion in remittances, US$1.3 trillion in African pension funds which are primarily invested abroad and between US$100 and US$200 billion that the continent could generate through carbon markets.

THE EVOLUTION OF AFRICAN DEBT: A HISTORICAL TIMELINE

This infographic presents a chronological overview of African debt from the 1960s to 2024, highlighting key milestones, statistics, and trends. It illustrates the complex journey of African nations from post-independence borrowing to the current debt landscape, showcasing the changing composition of debt, major global economic events, and debt relief initiatives.

1960s

- Most African countries gain political independence
- African nations begin borrowing from external sources, often former colonizers, to develop their economies
- Debt is primarily used for resource extraction rather than expanding productive capacity

1970s

- Total **external debt as share of GDP: 15.9%**
- Short-term debt begins increasing, but medium/long-term debt still dominates
- Post-independence borrowing patterns are established, with a focus on raw material exports

1973

- Oil price surge leads to commodity price increases
- African nations expand public spending and increase foreign borrowing
- This marks the beginning of a cycle of debt accumulation tied to commodity prices

1980

- Total **African external borrowing reaches $84.8 billion (24.7% of GDP)**
- Shift begins from bilateral to multilateral lending
- The debt burden is growing rapidly as countries borrow to finance development

1987

- **Total external debt as share of GDP reaches 70%**
- **Medium/long-term debt has grown 20x since 1970**
- **Short-term debt has grown 50x since 1970**
- **Terms of trade declined 40% compared to 1980 levels**
- This period marks the onset of the African debt crisis

1990

- **Total African external borrowing: $228.3 billion (42.1% of GDP)**
- **IMF lending to Africa reaches $9 billion, owed by 38 countries**
- Structural adjustment programs are implemented, with mixed results

1996

- Heavily Indebted Poor Countries (HIPC) Initiative launched
- First major debt relief program aimed at reducing the debt burden of poor countries

2000

- **Total external debt: $237.5 billion**
- **Commercial debt: 17% of total debt stock**
- **Bilateral debt: 52% of total debt stock**
- Debt composition is shifting, with commercial debt growing in importance

2005

- Multilateral Debt Relief Initiative launched
- Further efforts to provide debt relief to heavily indebted poor countries

2008

- Domestic bond issuance: <8% of GDP
- African countries begin to tap into domestic debt markets more significantly

2019

- **Domestic debt: 35% of total public debt**
- Growing importance of domestic debt in Africa's financing mix

2021

- **Domestic debt: —42% of total public debt 2021**
- **Domestic bond issuance: >11 % of GDP, amounting to $307 billion**
- Rapid growth in domestic debt issuance, partly in response to global crises

2022

- Total external debt: $655.8 billion (28% of GDP)
- Commercial debt: 43% of total debt stock
- Bilateral debt: 25% of total debt stock
- Dramatic shift in debt composition, with commercial debt now dominant

2023

- Total public debt to GDP ratio: 68%
- Debt levels are high but still lower than many other regions

2024

- Debt servicing cost projected to reach record $89.4 billion
- Rising debt servicing costs are crowding out investment in development priorities

This timeline illustrates Africa's complex debt journey from post-independence to today. While challenges remain, opportunities exist for sustainable solutions through domestic resource mobilization and strategic investments. Collaboration between African nations, international partners, and financial institutions is crucial to ensure debt supports development and progress towards Agenda 2063 and the 2030 Agenda.

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Debt management needs to stop being approached from a stock perspective but needs to take into account the existence of regular and predictable revenue flows

02

Domestic Debt

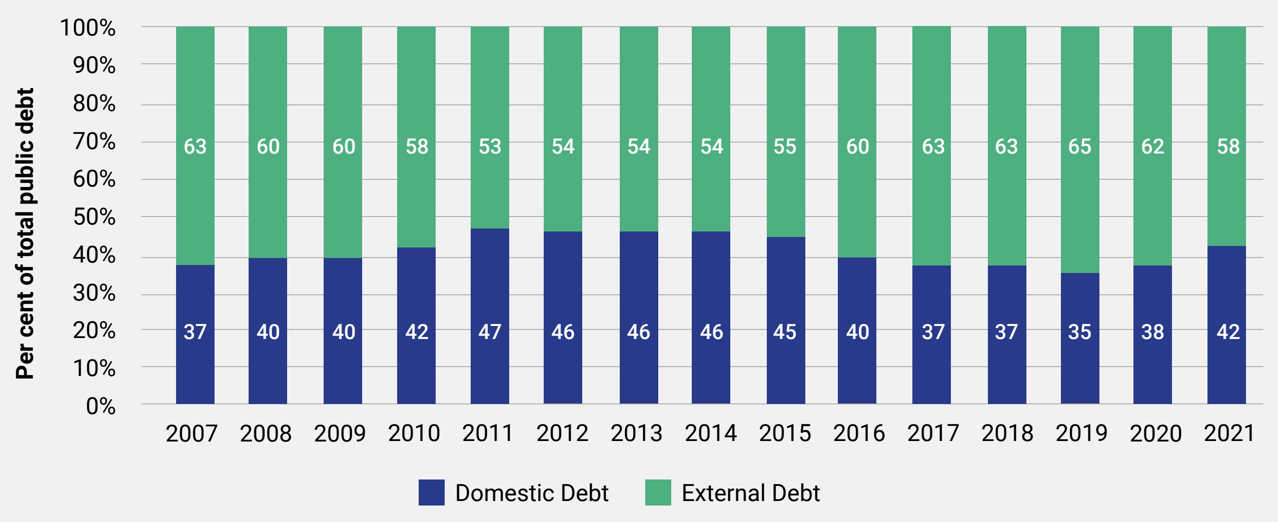
The Financing for Development discourse in Africa is slowly moving away from traditional thinking centred around the primacy of external sovereign borrowing as the main source of finance. A shift has occurred, and several African countries are increasingly tapping into their domestic debt markets and enjoying increasing fiscal space. This is due to sustained economic growth experienced by many African countries which has strengthened national savings and provided a viable opportunity for financing development based on domestic resources.[53] Many African countries borrowed strategically in domestic markets at competitive terms to finance their development, especially during economic downturns. This approach aligns with countries' efforts to foster economic self-reliance by promoting domestic resource mobilization and enhancing economic stability and resilience to external shocks. However, not all African countries are poised to use domestic debt and enjoy larger fiscal space. This is especially relevant for countries with shallow financial markets characterized by low domestic savings.[54]

Domestic borrowing has several advantages, such as avoiding the risk of exchange/ currency volatility and conditionalities attached to external debt, as well as the risk of sudden capital reversal (short-term lending), which can have a potentially destabilizing effect on the economy. However, African governments must navigate the challenges posed by the expanding domestic debt landscape. In this respect, concerns have arisen regarding the potential risks of uncontrolled domestic debt crowding-out private sector investment. In many instances, domestic debt has a short maturity and is more expensive than external debt. The effective management of domestic debt accumulation is paramount for achieving economic growth, long-term fiscal stability and enhancing the resilience of African economies in the face of global economic uncertainties.

2.1 Domestic Debt Dynamics

Africa's total public debt composition is changing, with the share of domestic debt[55] rising from 35 per cent in 2019 to approximately 42 per cent in 2021.[56] (Figure 2.1) The expansion of domestic debt during the post-COVID-19 period corresponds to a similar trend observed after the 2008 financial crisis. The increased reliance on domestic borrowing was due to the tightening global financing environment, reduced access by African countries to the international capital market, and the need to finance widening fiscal deficits and mitigate the effects of these crises.

Figure 2.1 The share of Domestic debt in Africa's total public debt is increasing



Source: AfDB. 2023

53 UNCTAD. 2015.

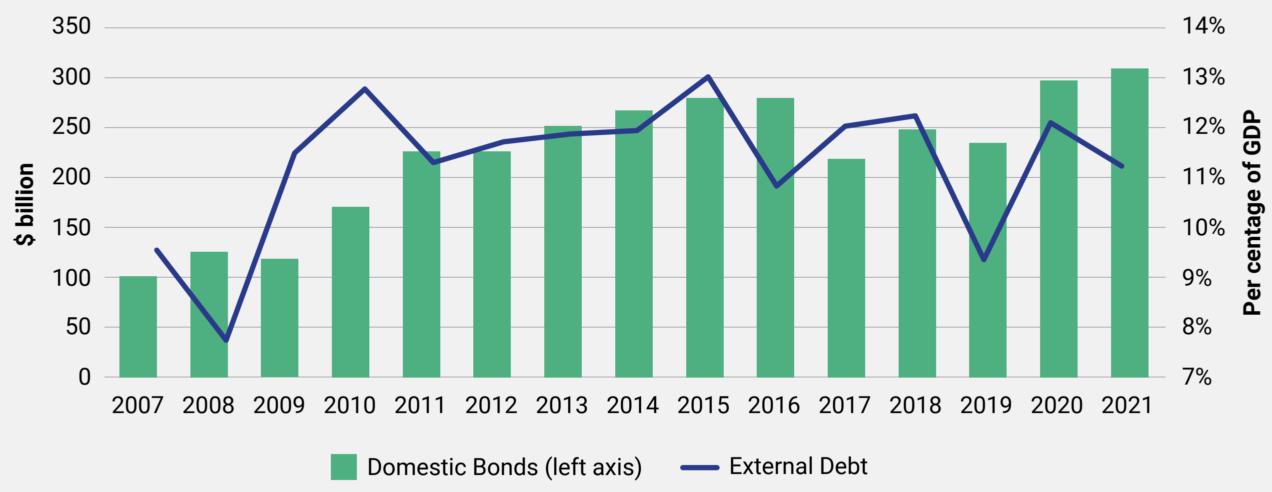
54 UNCTAD. 2016.

55 The domestic debt definition covers only treasury bills and bond issuance. it excludes arrears owed to suppliers of goods and services to the government and guaranteed domestic debt owed by state-owned enterprises and/or contingent liabilities.

56 African Development Bank. 2023

Domestic bond issuance by African countries observed a sharp increase from less than 8 per cent of GDP in 2008 to more than 11 per cent in 2021. The latter period saw the highest bond issuance volume worth $307 billion. Bond issuance peaked at around 13 per cent of GDP in 2010 and 2015. (Figure 2.2) This confirms the observation that African countries resort increasingly to domestic financing whenever external financing opportunities shrink. However, the swift shift in public debt composition towards a more balanced portfolio between domestic and external debt may suggest a strategic choice and proactive approach taken by some countries to prioritize financing needs domestically.

Figure 2.2 Domestic bond issuances are more frequent and represent an important source of public financing



Source: AfDB. 2023

The experience of some emerging markets and developing economies (EMDEs) in successfully tapping into their domestic debt to finance their increasing financing needs and improving their debt sustainability and resilience to shocks, is edifying. For example, Brazil and India have developed domestic debt markets where most of the debt is held by residents and denominated in local currency. India has achieved negative real interest rates on its domestic debt restructuring, thanks to high domestic savings and regulations that channel them into public debt.[57] This was possible by expanding domestic savings and encouraging longer-term local currency financing with low real interest rates. However, some EMDEs still face challenges in developing their domestic debt market, mainly due to shallow financial markets, high inflation and weak institutions.

The heterogeneity of domestic debt situations in African countries is evident, as some have accumulated higher debt stocks than others, reflecting the diverse economic landscapes, savings patterns and depth of financial markets across the continent. For instance, African frontier market economies[58] accumulated important domestic debt levels of more than 50 per cent of their total public debt in 2021. In contrast, Africa's heavily indebted economies, apart from Burundi and São Tomé and Príncipe, have kept relatively low domestic debt levels as a proportion of public debt.[59] These countries generally grapple with lower savings rates (around 14 per cent on average compared to 23 per cent for non-HPIC in 2022) and limited financial infrastructure with underdeveloped capital markets. 60 As a result, African countries with relatively developed capital markets had the opportunity to tap substantially into domestic debt markets to finance their development financing needs, while the rest saw their financing opportunities limited to relying exclusively on concessional debt.

57 S&P Global Ratings. 2022
58 These countries are Côte d'Ivoire, Ghana, Kenya, Mauritius, Nigeria and Tunisia.
59 AfDB. 2023
60 World Bank, World Development Indicators

2.2 Domestic Debt but at Which Terms?

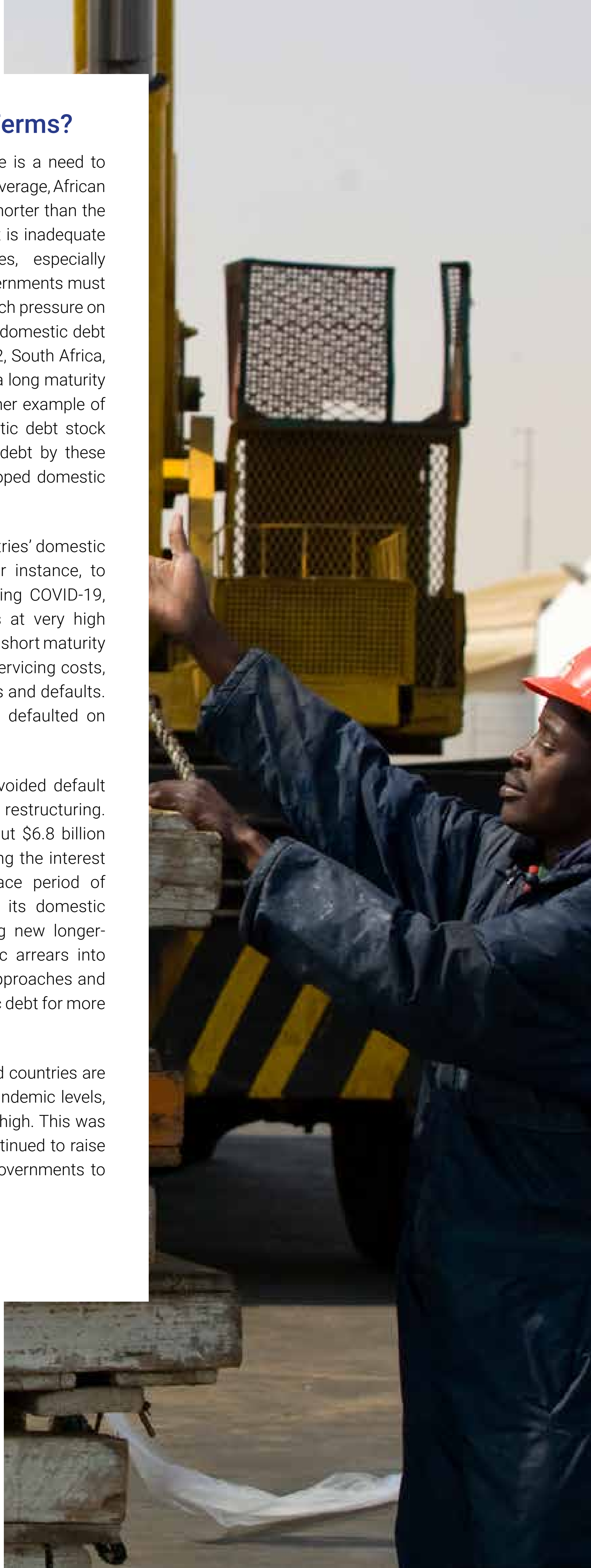
To understand domestic debt dynamics in Africa, there is a need to examine the maturity and bond coupon rates of debt. On average, African domestic debt maturity is around eight years[61], much shorter than the 30 years of official external debt.[62] This short-term debt is inadequate to finance Africa's long-term development priorities, especially infrastructure and energy projects. This means that governments must roll back their domestic debt more frequently, putting much pressure on their budgets. Africa needs to match the maturity of its domestic debt with its financing requirements. Between 2020 and 2022, South Africa, Namibia and Botswana issued government bonds with a long maturity of over 20 years at low coupon rates. Morocco is another example of a country that managed to contract important domestic debt stock at low-interest rates. (Box 2.1) Tapping into low-cost debt by these countries was possible because of the relatively developed domestic capital markets, high savings and quality institutions.

On the contrary, the maturity of the rest of African countries' domestic bonds was, on average, less than seven years.[63] For instance, to mobilize additional financial resources, especially during COVID-19, Malawi, Ghana and Egypt issued government bonds at very high coupon rates (between 15 and 20 per cent) and with very short maturity (less than six years). This resulted in increasing debt servicing costs, refinancing pressures and domestic debt restructurings and defaults. For instance, in 2020, Ghana and Mozambique have defaulted on domestic sovereign obligations.[64]

Nevertheless, some African countries have actively avoided default scenarios and opted for coordinated and voluntary restructuring. Angola restructured its domestic debt in 2020 of about $6.8 billion by extending the maturity by up to three years, reducing the interest rate by 3.5 percentage points, and providing a grace period of six months.[65] Similarly, Zambia rescheduled part of its domestic securities' principal and interest payments by issuing new longer-term domestic bonds and converting some domestic arrears into securities.[66] Kenya and Nigeria have adopted similar approaches and exchanged a substantial portion of their costly domestic debt for more cost-effective alternatives.[67]

Although the restructuring trend is slightly reversing, and countries are reducing their primary deficits to be aligned with pre-pandemic levels, borrowing costs in the domestic market continue to be high. This was because monetary policies of African central banks continued to raise interest rates to tame inflation, making it costlier for governments to issue new domestic debt and refinance their debt.

61 S&P Global Ratings. 2022
62 Editor. 2023
63 AfDB, 2023
64 S&P Global Ratings. 2023.
65 Ibid.
66 Sokpoh, A., & Kessler, M.2023
67 Pangea-Risk and Acre Impact Capital. 2023



Box. 2.1. Domestic Debt Market in Morocco

Morocco's local currency debt market plays a significant role in the country's economy and financial system. A large share of Morocco's debt, about 75 per cent, is domestically financed, which reduces exchange rate risk.[1] The weighted average maturity of issued Treasury bonds and securities is 7.5 years. The average interest rates were low at around 4.5 per cent between 2020 and 2022.[2] The Morocco Treasury plays a crucial role in the local currency debt market by actively enhancing its depth and liquidity. It maintains a strong presence in the market and ensures a consistent supply of government securities through an annual auction programme.

Morocco has recently taken a different approach that prioritizes issuing long-term domestic debt instruments. According to the IMF,[3] Morocco had mainly issued long-term and low-interest rates domestic bonds in 2021. This showcases the country's commitment to diversifying its debt instruments and reducing rollover risks. Morocco's sovereign bonds attracted a diverse set of resident and non-resident investors, which contributed to broadening the investor base and increasing the capital market depth. This allowed the government to mobilize critical resources to finance its fiscal deficit and invest in implementing the SDGs.

Morocco's financing sources diversification and increased reliance on local currency debt embodies the country's strategic choices to mitigate currency fluctuations risk associated with external debt and enhance debt sustainability.[4]

Sources:

1. Atradius. (2021). Country Report MENA Morocco 2021
2. African Development Bank. (2023). African Economic Outlook 2023: Mobilizing Private Sector Financing for Climate and Green Growth in Africa. African Development
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4. Abel Anderson (2023, August 16). Economic Impacts of Currency Market Volatility on Morocco

2.3 Underdeveloped Capital Market Dominated by Sovereign Bonds

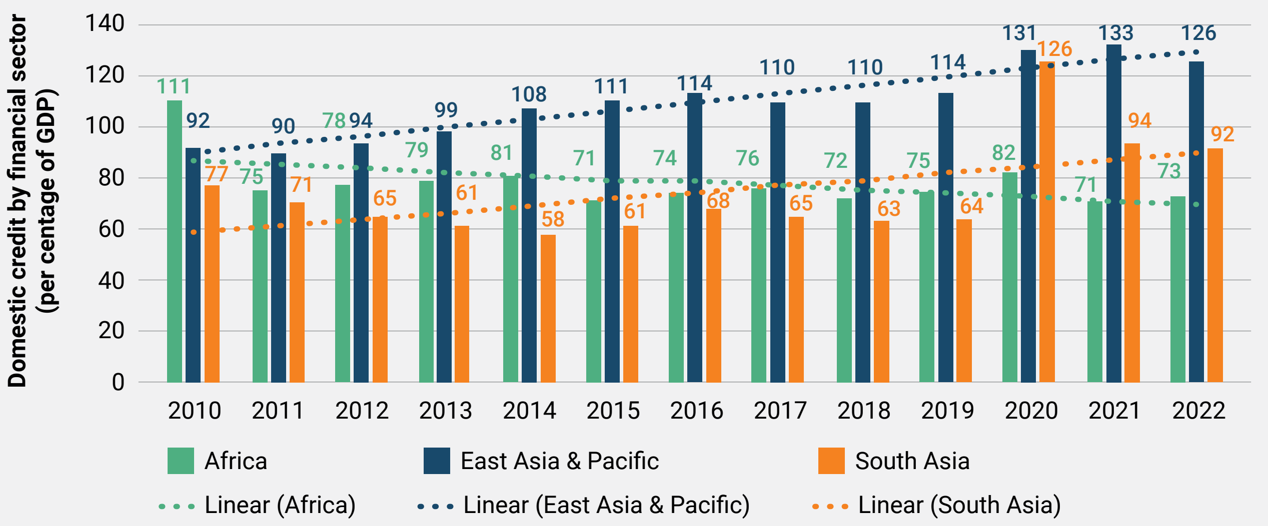
Drawing on cost-effective domestic borrowing remains uncertain and limited for most African countries. This is due to the limited domestic savings estimated at around 17 per cent in 2022 compared to 19 per cent and 24 per cent for South Asia and East Asia and the Pacific, respectively.[68] Volatile incomes, low life expectancy, low financial inclusion and high level of informality in the economy are the major factors impacting on domestic savings.[69] Moreover, the decline of domestic credit provided by the financial sector to African economies over time constitutes a significant challenge for mobilizing resources internally (Figure 2.3). This worrisome trend suggests that the financial sector in Africa is not growing as fast as the economy and that financial inclusion and access to formal financial services are still lacking. On the contrary, the rest of the regions saw a tremendous increase in domestic credit availability to their economies, which boosted their development and enabled governments to increase revenues and borrow at low interest rates.

According to the AfDB African Economic Outlook report (2023), Africa's domestic capital markets are dominated by government securities. For instance, in 2020, Nigeria and Kenya had a corporate bond to sovereign bond market capitalization ratio of only 2.7 per cent and 0.5 per cent, respectively. Since government bonds are considered more liquid compared to corporate debt assets, pension funds and banks tend to acquire an important share of these instruments. Government bonds' high yield and short-term tenure are very attractive to institutional investors, limiting the incentives to develop the secondary market for corporate bonds.

68 World Bank, World Development Indicators.

69 United Nations. 2022

Figure 2.3 Domesic credit by financial sector in Africa is declining, whereas it's increasing in the rest of the world



Source: World Bank, World Development Indicators.

In addition, apart from a few countries, capital markets in Africa remain underdeveloped, as illustrated by their low stock market capitalization. Capital markets are essential to raise funds from banks, pension funds, insurance companies and individual investors. Few economies, such as Egypt, Morocco, Mauritius and South Africa, have financial systems larger than their GDP and succeeded in leveraging their pension funds to finance their development.[70] The rest have much smaller markets below 40 per cent. Several factors contribute to this situation, including low income and savings rates, low liquidity, high-interest rates, weak regulation and lack of diversification. This constrains the government's ability to borrow internally at favorable conditions and pushes them to resort to expensive external debt that further restricts the fiscal space needed to invest in the country's priorities.

Although African countries with relatively well developed capital markets have managed to tap into their domestic debt, they are exposed to unique risks related to the nature of the local currency debt holders. The degree of involvement of non-resident holders in the country's domestic debt market, though reflecting investor confidence, may also threaten the country's economic stability. For instance, Egypt, Ghana and South Africa have attracted non-resident investors to their domestic bond markets looking for high-yield returns. However, this was at the cost of higher interest rates and exposing them to external shocks and capital outflows.[71] For example, at the outset of the pandemic, South Africa experienced significant capital outflow partly triggered by the sovereign credit downgrade. Despite South Africa's limited reliance on foreign currency funding, it remains susceptible to volatility of portfolio outflows (hot money) since almost 30 per cent of its domestic financial portfolio is owned by non-residents. South African pension funds and the insurance sector, holding around 30 per cent of the domestic debt, played an important role in preventing the worsening of the situation, acting as a buffer against external shocks.

CAPITAL MARKETS

ARE ESSENTIAL TO RAISE FUNDS FROM BANKS, PENSION FUNDS, INSURANCE COMPANIES AND INDIVIDUAL INVESTORS.

High domestic debt levels can also distort the banking system, especially when a large share of banks' assets is composed of government securities. This can increase sovereign risk and lead to a 'debt overhang' that stifles economic activity. Moreover, a 'diabolic loop' can emerge, where banks and the government's fiscal health become interdependent, leading to a vicious cycle potentially destabilizing the banking system. Government bonds are considered the safest and most liquid debt instruments that do not require due diligence or monitoring. The exposure of commercial banks in Africa to

70 United Nations. 2022

71 S&P Global Ratings. 2022

domestic sovereign debt has increased, from 10.4 per cent of total banking sector assets in 2010 to 17.4 per cent in 2020.[72] However, this can influence the affordability of credit for the private sector, hampering economic growth and diversification. This was the result of the repeal of the Glass-Steagall Act in 1999 by US Congress, which had significant repercussions for global banking practices, including in Africa, prompting African commercial banks to adopt similar integrated business models as investment banks. Consequently, they have increasingly focused on the lucrative and low-risk practice of subscribing to government bonds, seeking stable returns amid volatile economic conditions. This preference for government securities over private sector lending and capital market development has led to a skewed allocation of financial resources. By prioritizing easy profits from government bonds, banks contribute less to the growth of the capital markets and provide insufficient credit to the private sector.

In general, banks prefer sovereign bonds rather than extending credit to risky private loans. For instance, according to the IMF Financial Soundness Indicators, the African Bank's Non-Performing Loans (NPLs) ratio in 2022 was, on average, 12.5 per cent, the highest in the world. The highest ratio was in Equatorial Guinea (more than 55 per cent in 2022), whereas the lowest was registered in Botswana (around 3.7 per cent).[73]

Pension funds also prefer to hold a considerable share of their assets as sovereign bonds. In Ghana, Egypt and Nigeria, more than 77 per cent of pension funds' assets are composed of high-yield local currency government bonds. In contrast, in other countries, such as Morocco, South Africa, Zambia and Namibia, the share was lower at around 40 per cent.[74]

To enhance debt sustainability and resilience to shocks, African countries must develop deeper and more diversified domestic capital markets. Governments need to embark on structural reforms to encourage domestic savings and amend capital and financial market regulations to encourage the development of the secondary market. Similarly, institutional investors need to expand their exposure to domestic debt rather than invest their assets abroad.

Given the small and fragmented markets, promoting regionalization of financial markets is also paramount to raising and pooling capital for investment in development and strengthening resilience against global economic shocks. The operationalization of the African Continental Financial Institutions will greatly contribute to this objective.

Implementing the African Continental Free Trade Area (AfCFTA) opens up opportunities for integrating factor markets, including finance and investment and deepening regional financial markets. The ongoing efforts by the AUC to create key Pan-African Financial Institutions such as the African Investment Bank, the African Monetary Fund and the African Central Bank are notable endeavours in this direction. African countries must intensify efforts to accelerate the operationalization of these continental financial institutions. Similarly, the existing multilateral banks, such as the African Development Bank, require strengthening to further finance African development priorities.

72 Attout et al., 2020
73 IMF Financial Soundness Indicators (FSIs)
74 RisCura. 2021

2.4 Domestic Debt and Implications for Growth

Overall, most African countries have been using domestic debt in an ad hoc manner for short-term liquidity purposes, often lacking a matching between the deployment of domestic debt and long-term development priorities. This is due to the underdevelopment of domestic capital markets, which made short-term debt instruments often the only viable option for financing as medium and longer-term debts remain largely undersubscribed.

However, when properly managed and strategically invested in sectors like infrastructure, education and healthcare, domestic borrowing can contribute to macroeconomic stability and reduce the risk of exposure to interest rate and exchange rate fluctuations.

While domestic borrowing has provided a lifeline for many African countries during crises, it is important to recognize the potential associated risks. These include inflationary pressures and high interest rates, which make it more expensive for businesses to borrow and invest. (Cottarelli, 2011) (Reinhart & Rogoff, 2010). For instance, Nigeria witnessed double-digit inflation rates, reaching almost 13 per cent in 2020, directly linked to increased domestic borrowing and monetary expansion.[75] In Ghana, where domestic debt reached 76.1 per cent of GDP in 2021, interest rates reached 14.5 per cent.[76]

The Severity of the Crowding Out index (SOCO)[77] analysis reveals that the crowding-out effect of the private sector is a persistent risk in Africa, with an average value of 0.54. (Figure 2.4) Starting at a relatively high level, it dipped to 0.51 in 2016 as the economic slowdown led to a substantial decrease in demand for private-sector credit. Subsequently, it rose again in 2017 and 2018 with the revival of economic activity. In 2019, the SOCO index eased as robust growth in the preceding years bolstered public finances and, therefore, reduced the supply of public debt. The crowding out effect increased significantly in 2022, reaching relatively high levels of 0.56, mainly driven by the sharp increase in private sector demand for credit. Even though the decline in banks' lending sub-index, which was driven by the decline in banks' private sector lending as a percentage of their total assets, points to a crowding out of the private sector, the continued expansion of banks' balance sheets and the increase in credit to the private sector by banks slightly mitigates the impact of crowding out. For instance, domestic credit to the private sector provided by banks increased from 20 per cent of the GDP in 2010 to 25 per cent in 2022, but domestic savings continue to be low. (Figure 2.5).

In 2023, the index is estimated to rise slightly due to the increased demand for private sector credit, which indicates that African banks' interest in contracting sovereign debt remains strong without necessarily impacting on their ability to provide credit to private sector. This finding has critical policy implications for African governments. The analysis revealed that most countries still have domestic borrowing space that could be used to finance their fiscal deficit without being concerned about crowding out of private-sector credit. However, governments need to promote greater macroeconomic stability, implement sound fiscal policies and strengthen domestic resource mobilization, including through the development of domestic financial and capital markets, to effectively mobilize savings for development.[78]

WHEN PROPERLY MANAGED AND STRATEGICALLY INVESTED IN SECTORS LIKE

INFRASTRUCTURE, EDUCATION AND HEALTHCARE,

DOMESTIC BORROWING CAN CONTRIBUTE TO MACROECONOMIC STABILITY AND REDUCE THE RISK OF EXPOSURE TO INTEREST RATE AND EXCHANGE RATE FLUCTUATIONS

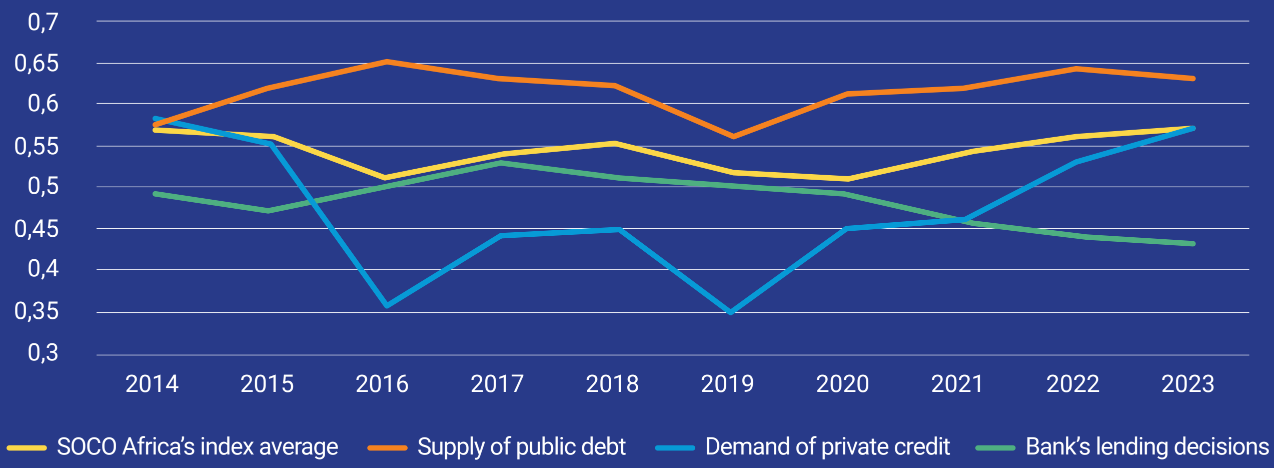
75 World Bank, 2020 and National Bureau of Statistics - Nigeria, 2020

76 Bank of Ghana, 2021 and World Bank, 2021

77 The severity of the crowding out index (SOCO) is the most comprehensive tool that assesses the severity of crowding out and allows for comparisons between countries over time. Each country is assessed using 12 indicators categorized into three sub-indices: the supply of public debt and the local-currency debt-to-GDP ratio; the demand for private credit; and banks' behavior towards lending to the private sector. For more details on the methodology consult European Investment Bank. (2022)

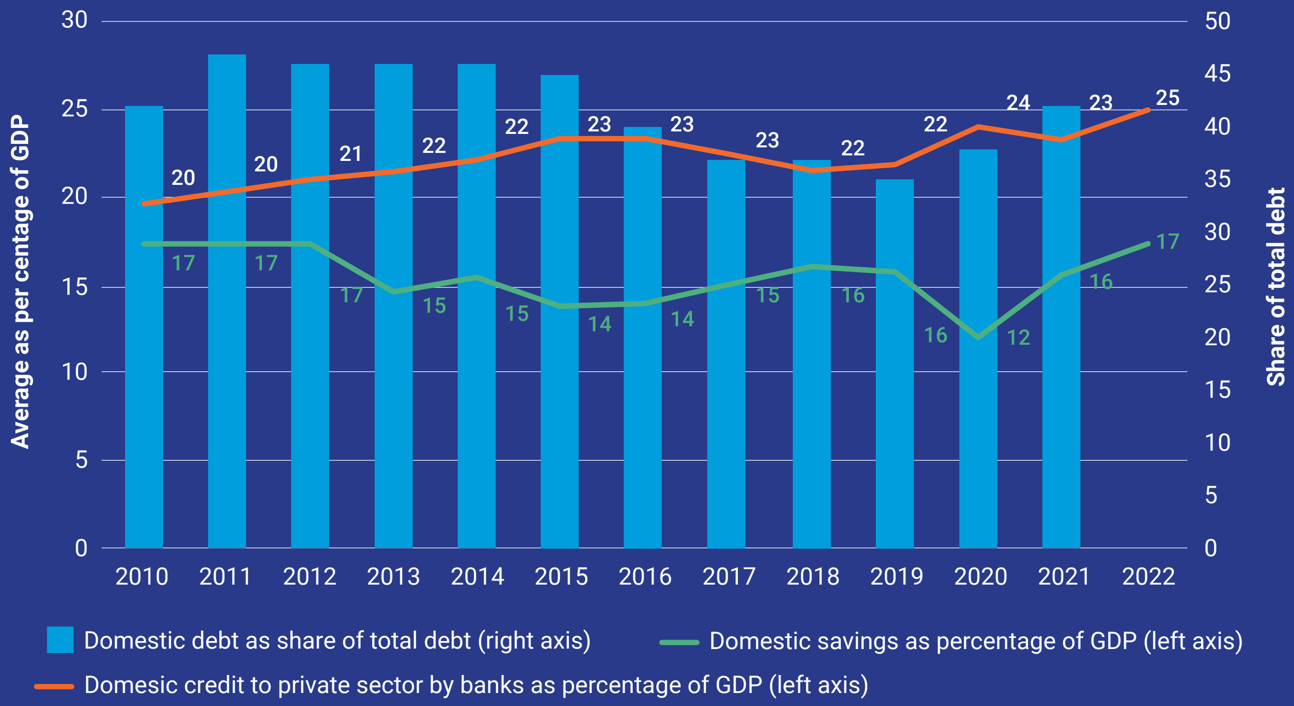
78 United Nations Office of the Special Adviser on Africa. 2022

Figure 2.4 Higher and persistent fiscal deficits in recent years have led to heightening crowding out effect on private sector investments (SOCO index), but countries still have borrowing space.



Note: The sample included 46 African countries. Values of 0 and 1 indicate low and high severity, respectively. The values for 2023 are estimates.
Source: EIB. 2023

Figure 2.5 Increased public domestic debt in shallow financial markets and low savings represent a danger of potentially crowding out domestic credit to the private sector



Source: World Bank development indicators.

2.5 Conclusion and Recommendations

As African countries continue to navigate the economic fallout from the recent global crises, many are increasingly tapping into domestic debt markets to finance their development. This move towards self-reliance allows them to tap into domestic resources, promote economic growth and increase fiscal flexibility. However, the average maturity of African domestic debt is relatively short-term and inadequate for financing countries' long-term development priorities. While few countries have successfully tapped into low-cost debt with long maturities, the majority grappled with increased debt servicing costs, refinancing pressures and a higher debt default risk. As a result, domestic debt restructurings have risen. Nevertheless, some countries have vigorously handled their domestic debt challenges through voluntary restructuring. Managing the sustainability of domestic debt, in the long run, requires accessing debt at competitive terms, which is only possible by addressing the structural challenges hindering the development of financial and capital markets in Africa and influencing borrowing decisions.

The following policy recommendations are proposed:

Debt strategies for African countries need to be anchored to well-designed investment plans, which are linked to the 2030 Agenda and the African Union's Agenda 2063 and which are aimed at delivering the economic transformation required

- DRM strategies are at the heart of successful debt planning and debt management, as they help to provide predictability of financing flows allocated to national development priorities. Focused efforts by governments and international partners on sound DRM strategies can ensure sustained ownership of investment in sustainable development and increased resilience.
- There is a need for scaling up DRM efforts through broadening the tax base, reducing exemptions and loopholes, strengthening tax administration, tackling transfer pricing and reducing tax evasion and avoidance to strengthen Africa's economic resilience and avert the risk of falling into a negative debt cycle. The framework for inclusive tax cooperation as provided for under General Assembly resolution 78/230[79] must address the need for capacity building for countries to effectively address these issues.
- It is essential for African countries to strike a balance between mobilizing short-term domestic debt for liquidity purposes and issuing long-term local debt for investment in productive sectors and to develop coherent strategies for matching domestic debt with their national development priorities.
- To optimize resource allocation, African countries must closely align their debt management strategies with fiscal discipline measures. The design and implementation of such debt policies should consider each country's specific situation and development needs. In addition, African countries need to implement robust debt monitoring mechanisms and transparent budgetary processes that ensure borrowing is aligned with the country's long-term economic objectives and the SDGs.

79 United Nations. 2023.

- For African countries to tap into domestic borrowing space without crowding out private investment, they must encourage domestic savings and develop their domestic financial and capital markets. This will enable them to reduce reliance on external financing and mitigate refinancing risks. However, this requires a stable macroeconomic environment, sound fiscal policies and effective debt management strategies.
- For countries with relatively well-developed capital markets, attracting non-resident investors enhances liquidity and diversifies the investor base, but it also exposes sovereigns to shifts in global market sentiment and capital flow reversals. To address financial volatility and to promote economic stability and growth, countries are encouraged to diversify their policy toolkit and adopt a proactive approach in the management of capital accounts. With the IMF's softened stance, countries have more leeway to implement capital controls that align with national economic objectives and implement policies to incentivize long-term investments. Countries must also adopt macroprudential policies and hold adequate foreign exchange reserves to cope with potential capital outflow shocks.
- The growth of Africa's pension funds and insurance funds, provides a buffer against external pressures and shocks and represents a more stable and long-term source of domestic financing. However, for institutional investors to play such a role, the regulatory and supervisory governance frameworks must be strengthened to allow them to diversify their portfolios and be further exposed to domestic and regional capital.
- Integrated National Financing Frameworks (INFFs) can help coordinate different sources of financing and build cohesion between national financing capacity, development partners, and the private sector.

DEBT STRATEGIES FOR AFRICAN COUNTRIES

NEED TO BE ANCHORED TO WELL-DESIGNED INVESTMENT PLANS, WHICH ARE LINKED TO THE 2030 AGENDA AND THE AFRICAN UNION'S AGENDA 2063

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The compounding and intersecting global crises, including

External Debt And Debt Sustainability

COVID-19, climate change, food insecurity, persistent conflicts and the war in Ukraine, have heavily impacted African economies. They restricted access to international capital markets, escalated debt service, tightened fiscal space and reduced public spending on critical sectors such as education and infrastructure. As a result, many African countries were pushed into debt distress. However, Africa needs additional domestic and external financial resources at scale and scope, including through debt to bridge its huge financing gap estimated at $1.6 trillion.[80] These resources are crucial for achieving the aspirations of African people contained in the SDGs and Agenda 2063. The accumulation of external debt and the changing nature of its dynamics, including the diversification of complex instruments, pose new challenges for debt management, debt restructuring and debt sustainability on the continent.

To address Africa's substantial development financing gap and ensure a fast recovery, it is important to dispel the current conventional view that portrays Africa as suffering from a debt overhang. On the contrary, increased borrowing will be needed to meet sustainable development goals and represents a strategic imperative for African countries. Hence, a nuanced approach focused on the primacy of boosting economic growth and achieving sustainable development while ensuring long-term debt sustainability is needed. Therefore, investigating the debt-growth relationship is critical to identify the conditions under which debt could be a pro-growth tool for fostering Africa's development. In this respect, addressing internal and external challenges hindering debt sustainability in Africa is a must. The unfair global financial and debt architecture heightened Africa's debt burden primordially through the costly sovereign ratings downgrades. African countries also have the responsibility to strengthen their capacity to mobilize domestic resources and enhance the transparency and management of external debt. Without a comprehensive and inclusive approach to address the short and long-term challenges, finding a durable solution to Africa's debt will continue to be an illusion.

3.1 Africa's External Public Debt Dynamics

According to the IMF[81], Africa's total public debt to GDP stood at 68 per cent in 2023. This figure mirrors the peak debt level previously recorded in 2020, which was followed by a slight decline, with the debt stabilizing at 65 per cent of GDP for both 2021 and 2022. The surge in Africa's debt levels is closely aligned with external shocks and crises, such as the financial crisis and COVID-19.

Africa's debt levels have been a concern in the international financial community. While it is true that some African countries have seen substantial increases in their debt levels, it is important to view this in the broader context. When comparing Africa's debt levels with other regions, a more nuanced picture emerges, indicating that high debt levels are not exclusive to Africa, challenging the narrative of a looming crisis. Regions like North America and South Asia have higher debt-to-GDP ratios than Africa. (Figure 3.1). Rather than fixating solely on the debt levels, attention should be given to supporting the overall economic growth fundamentals and development of African countries. Since a growing economy has the potential to outpace the rate of debt accumulation, debt can serve as a pro-growth tool if it finances growth in catalytic areas.

Moreover, the escalated debt levels in Africa are closely tied to external shocks and crises. The continent's growing demands for development financing are also linked to countries' journeys for structural reforms, entailing massive investment in infrastructure. In this regard, African countries' aspirations to meet the SDGs and address pressing socio-economic challenges are also behind the heightened debt levels. To properly address concerns of debt in Africa, it is imperative to consider a flow management model rather than a focus simply on debt stock. In this respect, there's a pressing need to rethink the concept of debt sustainability and its assessment methodologies by filling the long-term analysis gap omitted by the IMF frameworks. By considering long-term outlooks, including the impact of investing in the SDGs, high sovereign risk premiums, magnified by the Credit Rating Agencies (CRAs) ratings, could be moderated and become less sensitive to debt levels. Investing in the SDGs in climate resilience, disaster risk reduction and adaptation can also reduce long-term economic risk. Debt sustainability analysis mechanisms must take this into account.

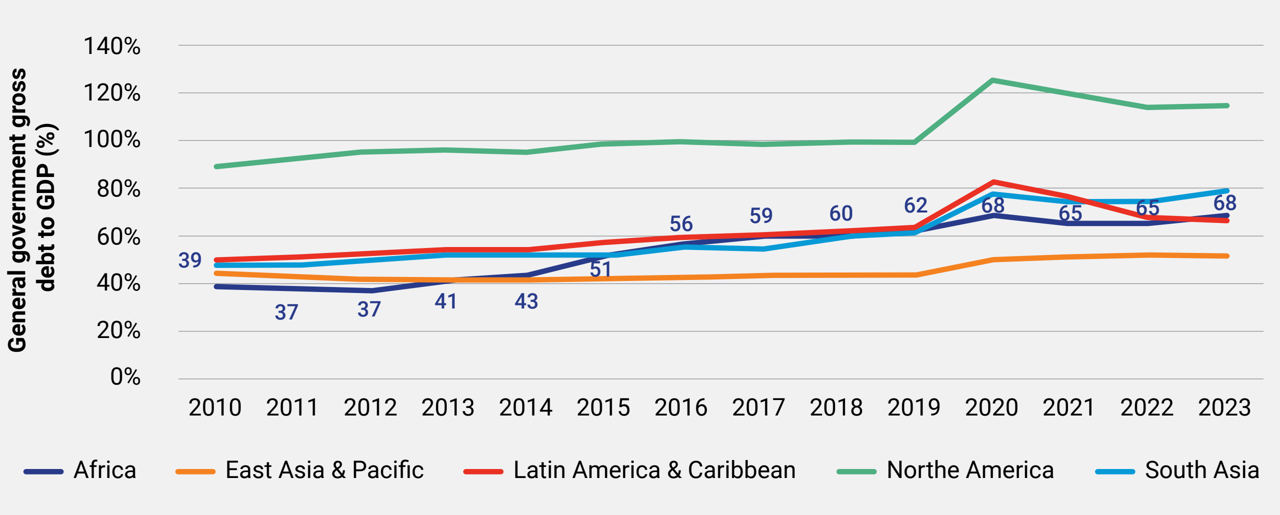
TO PROPERLY ADDRESS CONCERNS OF DEBT IN AFRICA,

IT IS IMPERATIVE TO CONSIDER A FLOW MANAGEMENT MODEL RATHER THAN A FOCUS SIMPLY ON DEBT STOCK

80 AUC and OECD 2023

81 IMF. World Economic Outlook database. Accessed on April 2024

Figure 3.1 Africa's public debt-to-GDP ratio remains lower than most other regions



Source: IMF. 2024

AFRICA'S EXTERNAL DEBT HAS GROWN SUBSTANTIALLY DURING THE LAST DECADE, REACHING A RECORD LEVEL OF

$656 BILLION IN 2022

Nevertheless, the collective debt situation on the continent masks a considerable variation across countries as well as sources and terms of debt. For example, in 2020-2022, Angola, Equatorial Guinea, Gabon and Sudan saw a significant drop in their public debts-to-GDP (Figure 3.2). The hike in oil prices has boosted government revenues and reduced their debt burden. However, about half of African countries experienced an increase in their debt stock. This can be attributed to increasing interest rates and inflation, currency volatility, short-term debt maturities and economic and political shocks. Consequently, according to the IMF Debt Sustainability Framework, 21 low-income African countries were pushed into debt distress or at high risk of debt distress. Ethiopia defaulted on its Eurobond repayment in 2023, making it the most recent country to have failed to meet its obligations[82] and has embarked on a comprehensive macro-economic reform plan with the IMF in 2024.[83]

Africa's external debt has grown substantially during the last decade, reaching a record level of $656 billion in 2022. This was due to reduced export revenues and slow economic growth. For instance, Africa's growth rate in 2022 was estimated at 3.5 per cent, but still lower than the pre-pandemic average of 4.5 per cent. The growth forecast remains subdued, with a slight increase from an average of 3.3 per cent in 2023 to 3.5 per cent in 2024.[84] Several factors influence this weak projection, including the ongoing global economic downturn, stringent monetary and fiscal policies and the escalating climate crisis and geopolitical instability. All these hinder the region's growth potential and increase the persistent risk of unsustainable debt.

82 Reuters. 2023.
83 IMF. 2024b.
84 United Nations. 2024.

3.2 Evolving Debt Landscape

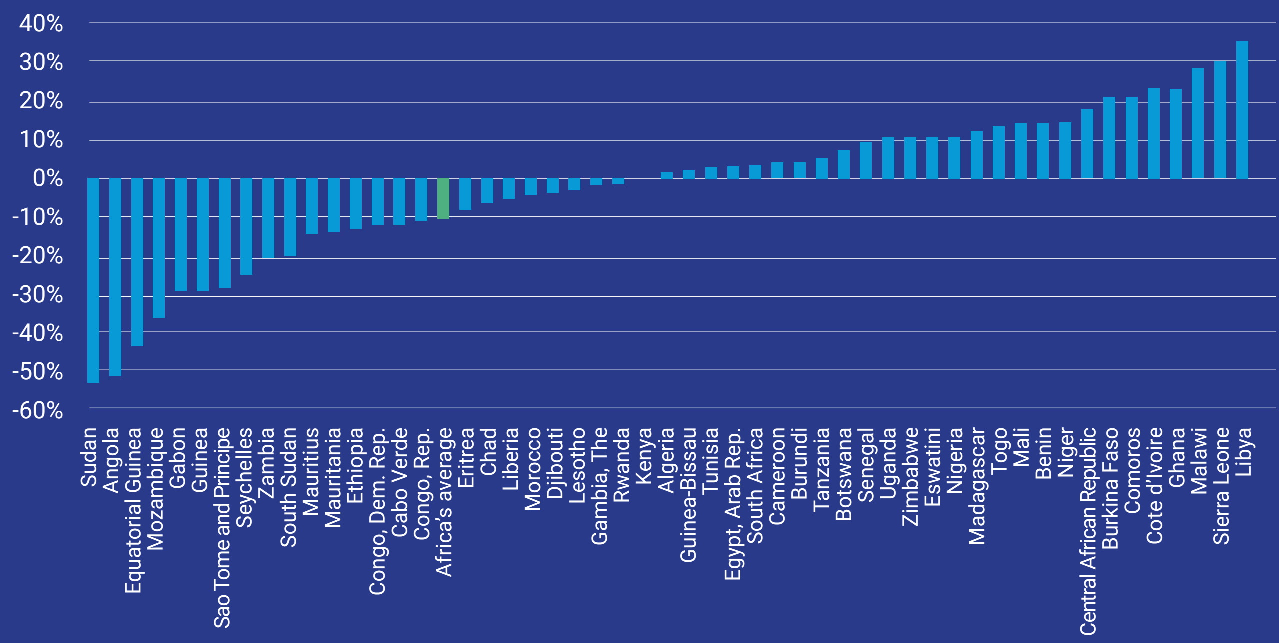
During the last decade, the composition of Africa's debt has changed significantly. African countries' quest for additional financing led to acquiring more private debt at the expense of bilateral debt. The share of commercial debt, including bonds and loans from private lenders, represented 56 per cent of the total debt stock in 2021, up from 27 per cent in 2011[85], reflecting the surge in Eurobond issuance and the growing exposure of many countries to international capital markets. While this led to greater access to finance, the high interest rates have also increased the debt servicing burden. On the other hand, the share of bilateral debt represents only almost a quarter of the total external debt stock, down from 52 per cent in 2000.[86] (Figure 3.3) The rise of creditors, such as China, India and Türkiye, has profoundly transformed the landscape of bilateral creditors. For instance, almost half of Africa's total external bilateral debt is owned by China. Debt financing provided by multilateral financial institutions has remained relatively stable over the past two decades, accounting for about 34 per cent.[87]

The diversity among African debt creditors complicates the situation regarding managing sovereign debt. Most countries are not equipped with adequate legal frameworks and debt reporting practices to deal with innovative and complex debt instruments since their prevailing sovereign lending model is centred around standard concessional borrowing. This situation increases the complexity and cost of debt servicing and, eventually, restructuring. Moreover, some creditors, such as private bondholders and non-Paris Club bilateral lenders, may be reluctant to participate in debt relief initiatives or collective action clauses. This was illustrated by the limited participation of private creditors, holding a significant share of Africa's external debt, in the Debt Service Suspension Initiative (DSSI), which undermined the effectiveness of debt restructuring, relief and resolution processes.

The mismatch between the evolving debt landscape and the outdated debt management and coordination infrastructure in many African countries, especially Low-Income countries (LICs), as well as global coordination mechanisms, hinders debt management. Therefore, African countries must adapt and strengthen their institutions, systems, capacities and legal and operational frameworks to manage diverse debt portfolios effectively.

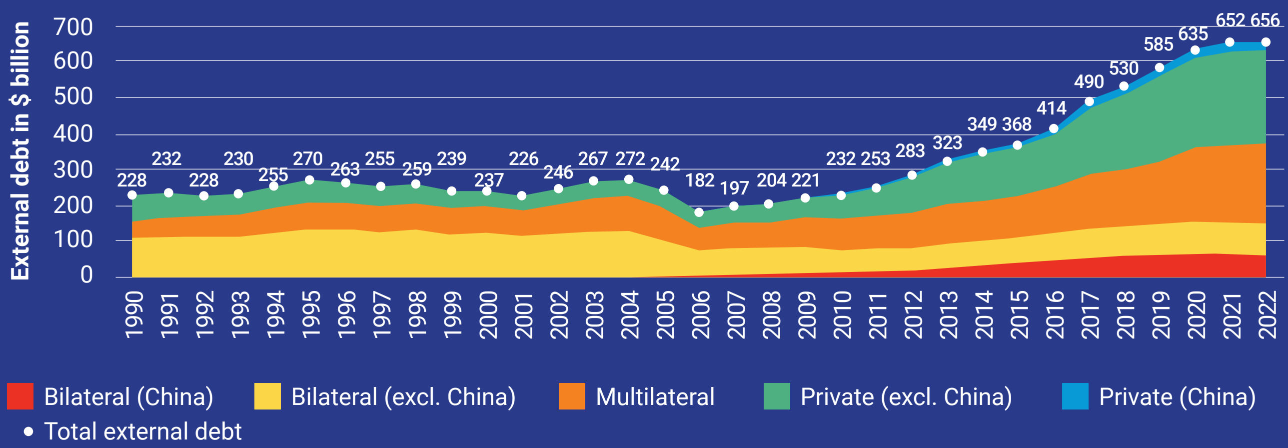
85 World Bank International Debt Statistics.
86 Ibid.
87 Ibid

Figure 3.2 Year over year change in public debt as a share of GDP between 2020 and 2022



Source: OSAA staff calculations based on UNCTAD. (2023).

Figure 3.3 Rapid Evolution of Africa's Debt Landscape and its Compounding Challenges



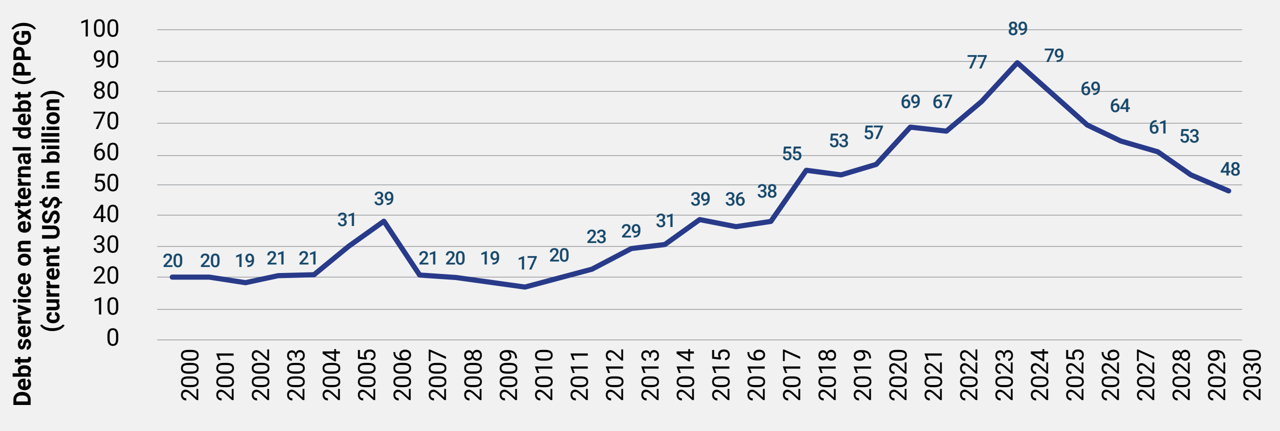
Source: OSAA staff calculations based on UNCTAD. (2023).

3.3 Escalating Debt Service Constricting Fiscal Space

Debt servicing costs have increased substantially, consuming a large share of government revenues and crowding out spending on public services and development priorities. African countries are expected to pay a historic record of $89.4 billion in external debt service in 2024 (Figure 3.4). More than half of this amount is owed to private creditors, while the rest is shared between bilateral and multilateral creditors. Although projections indicate a relatively progressive decline in expected debt service repayment for the following years, they remain substantial. These projections do not take into consideration additional debt to be contracted and its subsequent debt service that will consume an increased share of African countries' revenues.

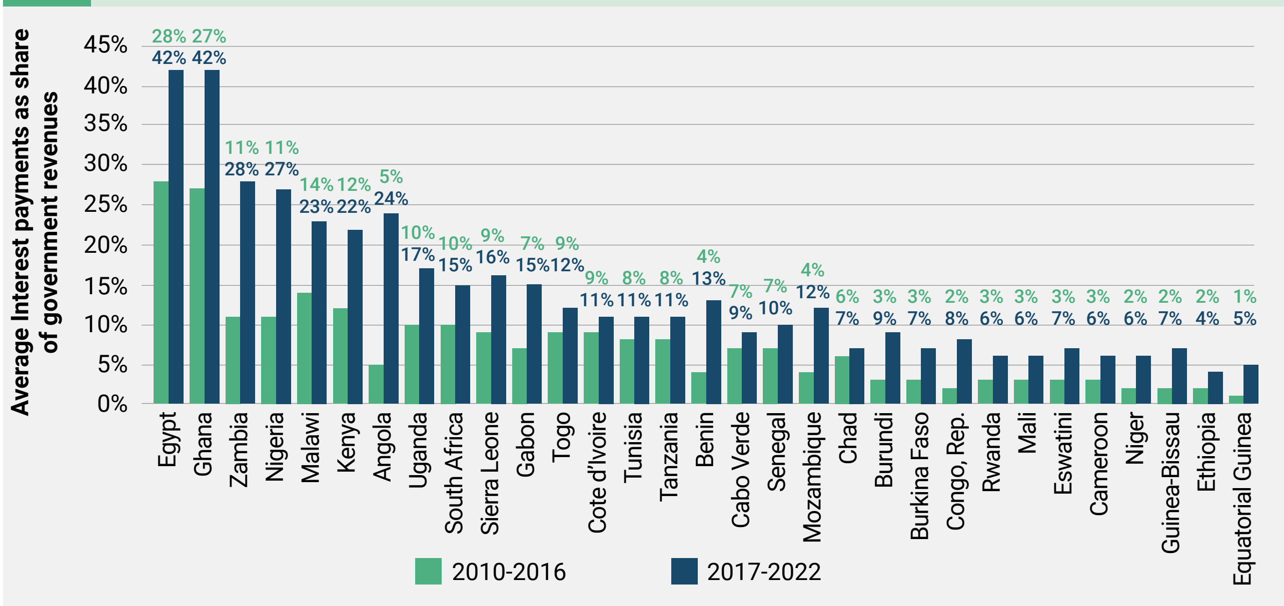
The increase in debt service was mainly driven by high interest rates in the international capital market. Interest payments as a share of government revenues have skyrocketed during the last decade in most countries (Figure 3.5). For example, interest payments consumed, on average, around 42 per cent of government revenues in Egypt and Ghana between 2017 and 2022, a 15 percentage points increase compared to the average between 2010-2016. Predominantly, countries with market access have contracted private debt and have had the highest increase in their interest payments as they are exposed to market conditions. The rest of the countries also saw the share dedicated to interest payments in government revenues increase. This exposed them to a vicious debt spiral characterized by the depreciation of their currencies, slower economic growth, and, therefore, increasing the cost to service their debt.

Figure 3.4 Africa's external debt service will reach historic heights in 2024



Source: World Bank International Debt Statistics, and World Development Indicators.

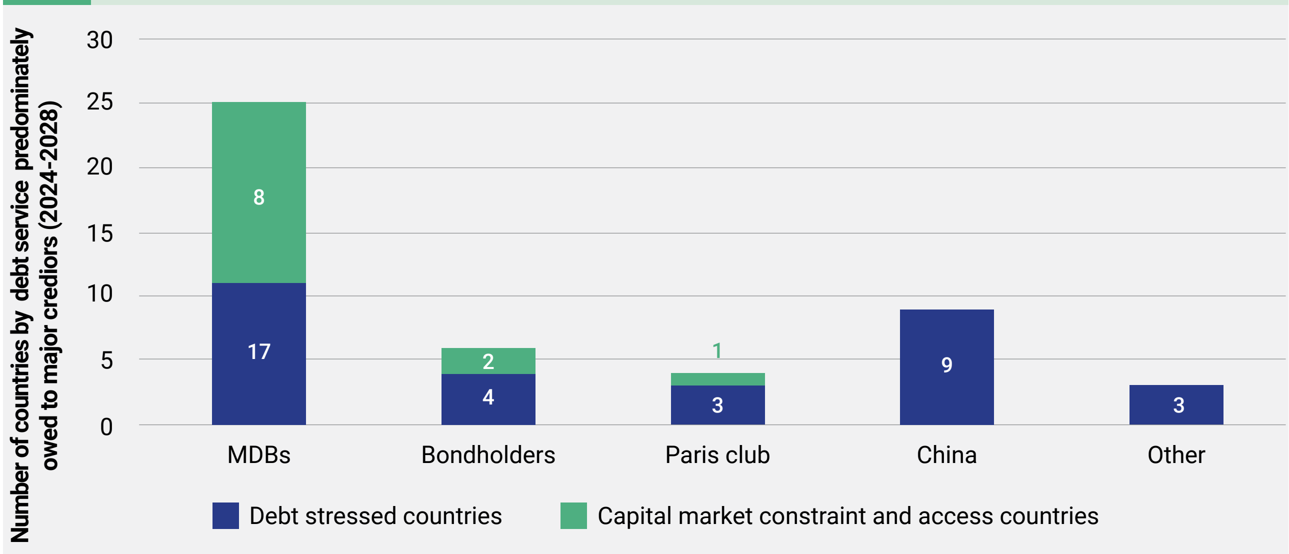
Figure 3.5 Interest payments are consuming an increasing share of government revenues



Source: OSAA staff calculation based on the World Bank International Debt Statistics.

The analysis of Africa's outstanding debt service in the short term provides valuable insights. In the next seven years, African countries are expected to pay back substantial amounts of debt service due to various creditors. On the one hand, most African debt-stressed countries (17 countries) that rely on concessional loans will service their debt mainly to MDBs, whereas nine countries will pay their debt predominantly owned by China, and seven countries will have to pay most of their debt service to bondholders and Paris Club creditors (Figure 3.6). Hence, the policy implications on African debt-stressed countries entail that multiple debt restructuring initiatives should be created, reflecting the change in landscape and consequently expanding African countries space to negotiate. On the other hand, 10 African countries with limited or full access to the international capital market will pay most of the debt service to MDBs and bondholders as they are their primary lenders. This means these African countries may explore better market opportunities to reduce their capital costs through debt exchanges, refinance expensive debt in the international capital market and close deals with their top lenders.

Figure 3.6 MDBs will continue to be the major creditors of African countries between 2024 and 2030



Note: Capital market access is defined by at least one "investment grade" rating by a major credit rating agency and/or dollar-denominated sovereign bond yields below 2023-2030 projected GDP growth rates. (Ray and Simmons. 2024) Debt-stressed countries are classified as either in debt distress or at risk of debt distress.

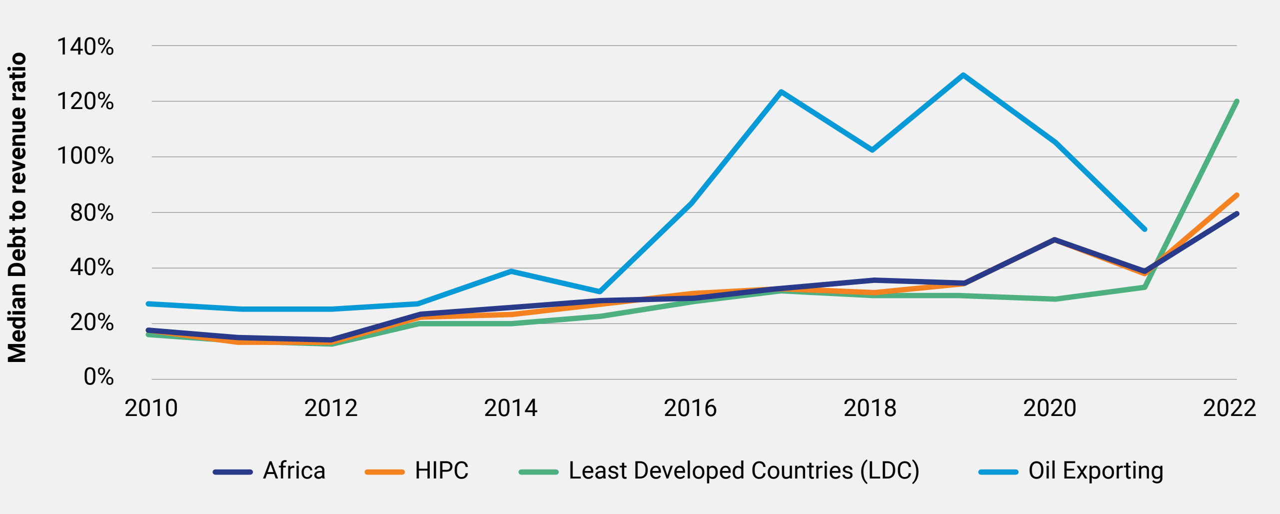
Source: OSAA staff calculation based on Ray and Simmons (2024) and World Bank International Debt Statistics.

In 2022, Africa's total external debt service consumed more than 12 per cent of Africa's exports and almost 15 per cent of government revenues.[88] This aggregate does not reflect the situation among country groups. African Least Developed Countries (LDCs) allocated the highest share of their revenues to debt, estimated at around 25 per cent, followed by HPIC (16 per cent). (Figure 3.7) Debt service burden is consuming an important share of countries' revenues, leaving them in a difficult situation to choose between servicing debt and investing in critical sectors. In 2017 and 2019, oil-exporting countries saw their revenues shrink, and the share allocated to service debt skyrocketed to more than 27 per cent. Since then, commodity prices have picked up and countries are recovering slowly. The trends for all these categories of countries demonstrate the high vulnerability to shocks and the consequent high impact of debt servicing on economic strategies.

88 OSAA staff calculation based on the World Bank World Development Indicators and International Debt Statistics

89 United Nations. 2012.

Figure 3.7 A Significant portion of African countries' revenues is being allocated to debt service



Source: OSAA staff calculation based on the World Development Indicators and World Bank International Debt Statistics.

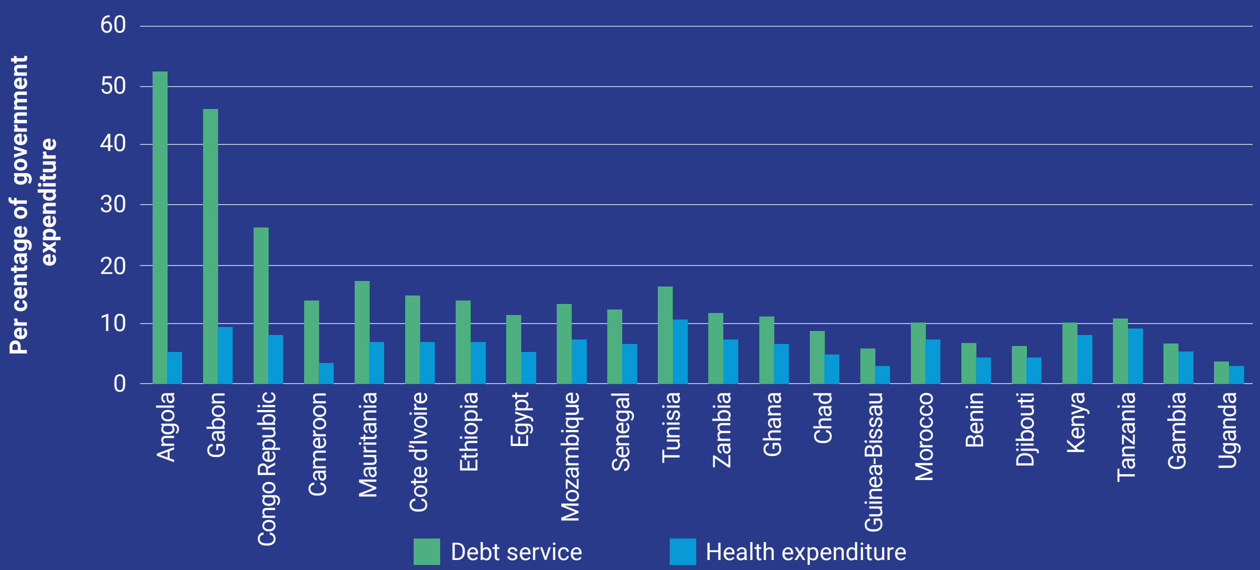
High debt service costs are diverting vital resources away from investment in health, education and other priority sectors. According to the latest data, a glaring development was observed in 2020, when 22 African countries allocated more funds toward debt servicing than spending on health (Figure 3.8). Also, six African countries spent more on debt servicing than investing in education in 2022. Over time, health spending flattened, education expenditures level decreased from more than 17 per cent of total expenditures in 2010 to around 15 per cent in 2020, while debt service share in total government expenditure doubled. African governments are reducing their spending on education in favor of debt servicing (Figure 3.9), putting more than 680 million people residing in these countries at risk. This raises alarms about the long-term impact of such choices on the human capital development and economic growth of these countries. In this respect, debt service repayments should not undermine efforts to realize fundamental economic, social and cultural rights, as provided for in the Guiding Principles of Foreign Debt and Human Rights.[89]

The lack of funding for education often results in overcrowded classrooms, expands the educational opportunity gap and leads to increased school dropouts. Additionally, it can lead to inadequate resources for schools, poor standards of education as well as limited access for marginalized groups, especially women and girls. In such situations, girls may be kept away from school, which may worsen gender inequality. Furthermore, without quality education, opportunities for economic empowerment of women are limited. This raises vulnerability, thus impeding countries' ability to develop an educated and competitive workforce that is essential for driving economic growth and sustainable development.

Similarly, when funds allocated towards healthcare are scarce, it impacts the quality of healthcare delivery, including the ability to tackle infectious diseases, reduce maternal mortality rate and malnutrition, among others. Women and vulnerable members of the population bear the brunt of these deficiencies. This will contribute to increasing gender disparities and the vulnerability of women. Also, the lack of health infrastructure weakens the countries' capacity and resilience to respond effectively to outbreaks and pandemics.

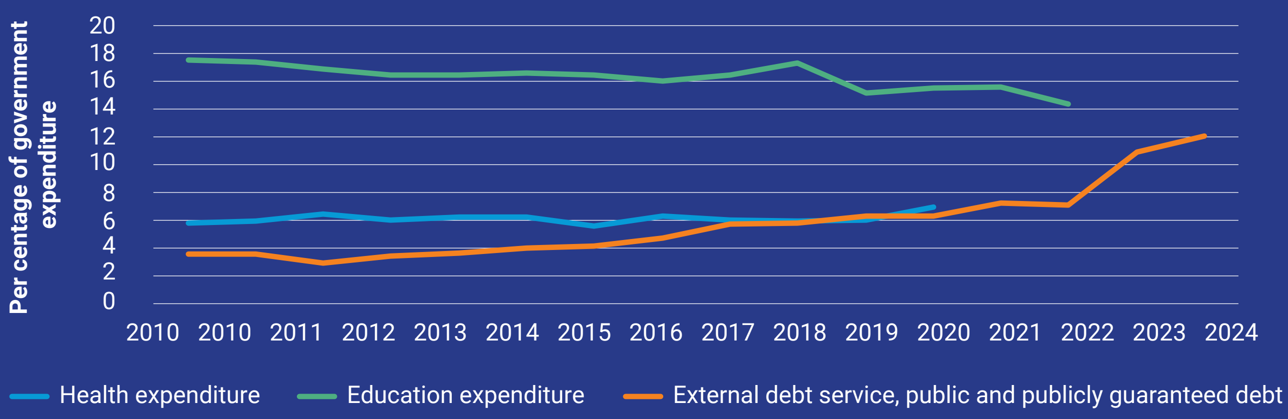
Considering the continent's modest growth forecasts, it is likely that African government budgets will exert additional pressure to mobilize resources to invest further in education and health, which will aggravate their debt situation and intensify fiscal vulnerabilities in the medium term.

Figure 3.8 Forty per cent of African countries spend more on servincing debt than on health in 2020



Source: World Bank International Debt Statistics, and World Development Indicators.

Figure 3.9 Governments are diverting resources away from education toward debt servicing



Source: World Bank International Debt Statistics, World Development Indicators, and UNESCO Institute for Statistics.

3.4 Usage of External Debt and Growth

External debt is considered a significant source of financing. However, its accumulation can pose severe challenges for development, as it may entail high debt servicing costs, crowding out public investment and increased vulnerability to external shocks. Hence, it is crucial to understand the relationship between external debt and economic growth, including the mitigating and exacerbating factors.

The rationale behind government borrowing is grounded in neoclassical growth models, which encourage capital-scarce countries to borrow to boost their capital accumulation and achieve a steady-state level of output per capita.[90] Global economic crises have weakened economies and increased the financing gap, further driving the imperative to borrow, given the necessity for increased expenditure levels and diminishing capital inflows.

Several studies have investigated the impact of external debt on economic growth in Africa using different methodologies and time periods. Research suggests that public debt could positively influence short-term economic growth by stimulating aggregate demand and output, financing public investment and enhancing creditworthiness.[91] This is only achievable if the proceeds from debt are efficiently invested for development purposes to facilitate fostering structural transformation and improve human capital and productivity.[92] Unfortunately, this is not the case for many African countries where public investments did not increase the public capital stock due to government public spending inefficiency and their weak absorptive capacity.[93] In such circumstances, debt could hinder growth and be a source of vulnerability and instability in the short term.

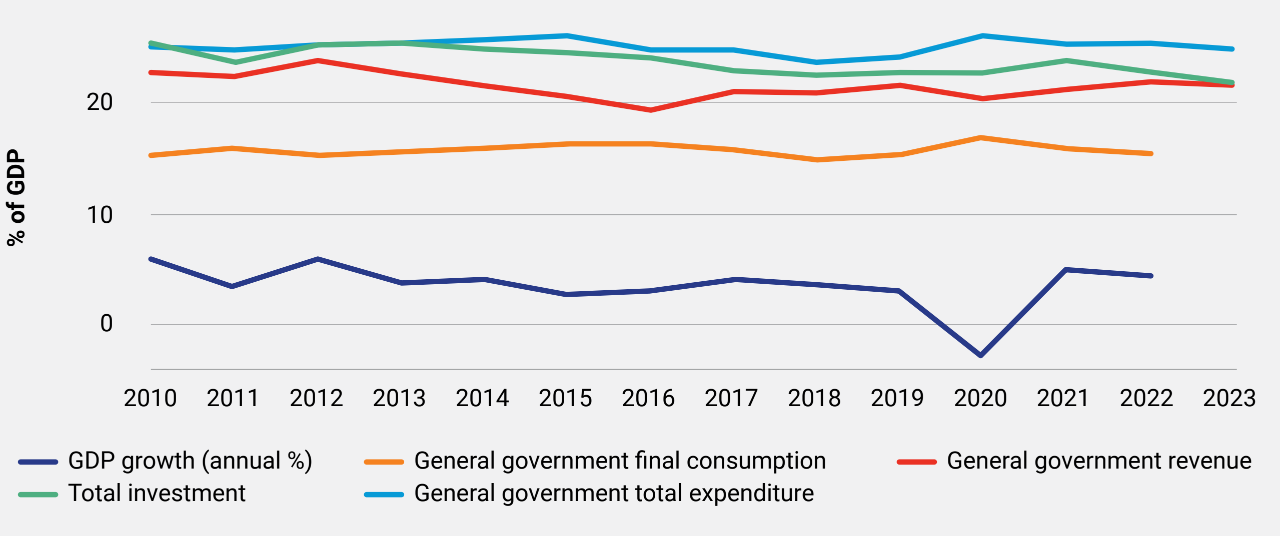
The literature consistently highlights a negative relationship between debt and growth in the long term.[94] For instance, Ehikioya et al. (2020) found that there is a long-run equilibrium relationship between external debt and economic growth in Africa. Similarly, Isubalew et al. (2023) show that a one percentage point increase in total external debt is associated with a 0.65 per cent decrease in growth in the long run. Chowdhury (2004) claims that while high debt hinders growth prospects, debt relief alone is insufficient to enhance growth. Rather, other interventions should be taken to strengthen macroeconomic stability, institutional quality, and human capital.

The mere debt accumulation doesn't necessarily lead to deteriorating macroeconomic fundamentals or indicate poor policymaking. The usage of debt, whether for consumption or investment purposes, is critical in determining the impact of debt on growth.[95] Ideally, since debt will be paid in the future, it should be directed towards growth-generating activities, potentially outweighing the adverse effects of significant indebtedness. Investing in 6 transitions - nature, sustainable energy access, sustainable food systems, inclusive social protection and job creation, transforming education and digital connectivity can provide the impetus for accelerated implementation of the 2030 Agenda.[96]

In 2020, during the beginning of the COVID-19 pandemic, the macroeconomic dynamics indicated that debt was used more for consumption (26 per cent of GDP) rather than investment (22 per cent of GDP). However, when growth picked up in 2021, government consumption stalled and public expenditure decreased (25 per cent of GDP) due to fiscal consolidation efforts. Investment levels also increased (almost 24 per cent of GDP),

90 Madow et al., 2021
91 Ndoricimpa, 2020
92 Ceesay and Njie. 2019
93 Atta-Mensah, J., & Ibrahim, M. 2020.
94 Epaphra, M., & Mesiet, W. 2021.
95 Coulibaly et al. 2019.
96 UN Sustainable Development Group, 2023.

Figure 3.10 Dynamics of macroeconomic variables in Africa



Source: Author's calculation using data from IMF World Economic Outlook Database. April 2024 and World Development Indicator Database.

indicating that debt was primordially used to stimulate investment. After 2021, the proportion of investments to GDP saw a more pronounced decline compared to government spending, while debt service continued to substantially increase. This indicates that debt incurred during these years was not predominantly allocated towards investment, but rather utilized to service existing costly debt. (Figure 3.10)

Low domestic revenues put additional pressure on government fiscal balances and threaten the achievement of debt sustainability. Africa's tax revenue mobilization, accounting for only 16.6 per cent of GDP, is lower compared with the rates in Asia and the Pacific (21 per cent) and Latin America and the Caribbean (almost 23 per cent). Therefore, African countries must implement revenue-enhancing reforms, including expanding the tax base and improving tax compliance. However, such measures must be carefully designed to avoid exacerbating economic inequality or stifling economic growth. Ultimately, the ability of a country to sustain its debt is closely tied to its capacity to enhance growth, initiate governance reforms, improve the quality of institutions, effectively handle public expenditures, prioritize fiscal responsibility, facilitate structural transformations that drive growth and mobilize additional domestic resources. [97] [98]

Literature suggests that the debt-growth nexus is influenced by a wide range of factors, such as the level of investment, human capital, governance and the quality of institutions.[99] Most prominently, governance was identified as critical in mitigating the negative impact of debt on growth by enhancing the government's capacity and accountability. Similarly, Sandow et al. (2022) argued that institutional quality has a positive and significant role in mitigating the negative impact of external debt on economic growth. They found that countries with strong public sector management quality can benefit more from external borrowing and experience higher economic growth than those with weak institutional quality.

Therefore, to moderate the negative impact of high levels of external debt on economic growth, African countries need to implement prudent fiscal and debt management strategies, strengthen governance systems and accountability, prioritize productive investments, diversify revenue sources and establish stronger institutions. However, countries' efforts are hindered by the unfairness of the international financial architecture, notably the unfairness built into credit rating agency methodologies that overestimate the risks in African economies.

97 World Bank. 2018

98 Ghosh et al., 2013

99 Manasseh et al. 2022

3.5 Debt Transparency and African Resource-backed Borrowing

The issue of debt transparency in Africa is a pressing concern for debt sustainability globally. According to World Bank data in 2023,[100] forty per cent of African countries have not disclosed any sovereign debt data and have failed to either possess or publish debt management strategies. (Table 3.1) An equally concerning aspect is that 75 per cent of African countries have not disclosed their debt management strategies and annual borrowing plans. The non-disclosure might signal an absence of these tools or an intentional decision not to disclose to avoid CRA's unfair pressures. In any case, this is a significant deficiency in outlining clear frameworks for managing and servicing debt.[101] In addition, the lack of accurate and timely information on public debt makes comprehending countries' indebtedness and assessing the associated risks difficult. As a result, countries become more vulnerable to uncoordinated and potentially unsustainable debt accumulation risks.

100 Debt Transparency: Debt Reporting Heat Map

101 Ibid.

Table 3.1 Africa's Debt Reporting Heat Map 2023

	Data accessibility	Sectoral coverage	Information on recently contracted external loans	Periodicity	Debt Management Strategy	Annual Borrowing Plan
Benin	Full	Full	Full	Full	Full	Full
Burkina Faso	Full	Full	Full	Full	Full	Full
Burundi	Limited	Full	N.A/ not in place	Partial	N.A/ not in place	N.A/ not in place
Cabo Verde	Full	Full	N.A/ not in place	Full	N.A/ not in place	N.A/ not in place
Cameroon	Partial	Partial	Partial	Full	Full	N.A/ not in place
Central African Republic	Partial	Partial	Limited	Partial	Full	N.A/ not in place
Chad	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place
Comoros	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place
Congo, Dem. Rep.	Full	Limited	Full	Partial	N.A/ not in place	N.A/ not in place
Congo, Rep.	Full	Partial	Full	Partial	Limited	N.A/ not in place
Cote d'Ivoire	Full	Full	N.A/ not in place	Full	Full	Full
Djibouti	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place
Eritrea	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place
Ethiopia	Full	Full	Full	Full	N.A/ not in place	N.A/ not in place
Gambia, The	Full	Partial	Partial	Full	Full	N.A/ not in place
Ghana	Full	Partial	Partial	Full	Full	N.A/ not in place
Guinea	Full	Limited	N.A/ not in place	Partial	Full	Partial
Guinea-Bissau	Full	Partial	N.A/ not in place	Full	N.A/ not in place	N.A/ not in place
Kenya	Full	Partial	N.A/ not in place	Full	Full	Full
Lesotho	Full	Partial	N.A/ not in place	Full	Full	N.A/ not in place
Liberia	Full	Full	Partial	Full	Full	N.A/ not in place
Madagascar	Full	Partial	Full	Full	Full	Full
Malawi	Full	Limited	Full	Partial	Full	Full
Mali	Full	Partial	Full	Full	Full	Full
Mauritania	Full	Partial	N.A/ not in place	Partial	N.A/ not in place	N.A/ not in place
Mozambique	Full	Partial	N.A/ not in place	Full	Full	N.A/ not in place
Niger	Full	Partial	Full	Full	Full	N.A/ not in place
Nigeria	Full	Limited	N.A/ not in place	Full	Full	N.A/ not in place
Rwanda	Full	Full	N.A/ not in place	Full	Full	Partial
Sao Tome and Principe	Full	Full	N.A/ not in place	Partial	N.A/ not in place	N.A/ not in place
Senegal	Full	Full	N.A/ not in place	Full	Full	Limited
Sierra Leone	Full	Partial	N.A/ not in place	Partial	Full	Partial
Somalia	Full	Limited	Not scored	Full	N.A/ not in place	Not scored
South Sudan	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place
Sudan	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place	N.A/ not in place
Tanzania	Full	Partial	N.A/ not in place	Full	Limited	Full
Togo	Full	Partial	Limited	Full	Full	Not scored
Uganda	Full	Full	N.A/ not in place	Full	Full	Full
Zambia	Full	Partial	Partial	Full	Limited	Full
Zimbabwe	Full	Partial	Partial	Partial	Full	Full

Legend:	N.A/ not in place	Limited	Partial	Full	Not scored

Note: This heat map assesses the availability, completeness and timeliness of public debt statistics and debt management documents posted on national authorities' websites. The date of assessment is October 2023.

Source: Debt Reporting Heat Map 2023

THE FUNDAMENTAL PRINCIPLE OF DEBT TRANSPARENCY

IS TO ENSURE ACCOUNTABILITY TO AFRICAN CITIZENS, ENSURING THAT ALL DEBT INSTRUMENTS AND GOVERNMENT DEBT STRATEGIES ARE IN THE PUBLIC DOMAIN.

The fundamental principle of debt transparency is to ensure accountability to African citizens, ensuring that all debt instruments and government debt strategies are in the public domain. Debt transparency is especially relevant in the case of Resource-backed loans (RBLs) that are often not reflected in debt statistics and their collateralization details are generally not disclosed. African resource-rich countries used RBLs as a notable financing option, especially for countries with limited access to traditional capital markets. This provided an avenue to fund critical infrastructure projects, leveraging their natural resources as collateral to secure loans. The advantage of RBLs lies in their perceived cost-effectiveness, where rates are below market rates.[102] Hence, RBLs offer an alternative to conventional sovereign financing methods. Between 2004 and 2018, 14 African countries entered into agreements for 30 resource-backed loans, amounting to $66 billion.[103] Most of the RBLs were directed to infrastructure and energy projects. Angola received the largest share of this amount. RBLs constituted at least eight per cent of total new borrowing in Sub-Saharan Africa during that period.[104] Furthermore, following their signature, these loans accounted for up to 30 per cent of the median countries' total external public debt stock.

While this approach initially seemed promising, the period following the 2014 commodity price crash exposed the vulnerabilities inherent in this type of borrowing. The crash triggered severe debt problems for 10 out of the 14 countries.[105] For instance, the Republic of Congo's external debt, composed of almost 40 per cent of resource-backed loans, spiralled from 70 to 120 per cent of GDP.[106] The dependence on commodity prices for debt repayment exposed these countries to external market fluctuations, making them vulnerable to economic shocks.

The global economy, characterized by a centre-periphery dichotomy, perpetuates Africa's reliance on commodity exports and exacerbates its debt problem. African countries' investments continue to focus heavily on developing the commodity export sectors, which maintain a narrow production and undiversified structures and economies. This dependence on commodities as a primary revenue source persists and shapes debt repayment structures, where future commodity earnings are allocated to service debts. This perpetuates a cycle where priority is given to boosting countries' ability to generate cash flows from these sectors and pay back their debt, leaving little room for diversification or structural transformation. Also, African resource-rich countries are leaning toward managing their rent revenues and undertaking fiscal stabilization rather than diversification.[107] By reinforcing this approach through debt mechanisms and trade agreements, African economies find themselves trapped in a cycle of commodity dependence that hinders their long-term economic development. Moreover, contingent liabilities, particularly those associated with weak-performing State-Owned Enterprises (SOEs) and Public-Private Partnerships (PPPs), represent a significant and often underappreciated risk to the fiscal stability of African countries, resulting in exacerbating their debt dynamics.

African countries often struggle to break free from this pattern of overreliance on commodity exports and diversify their economies. Factors such as restricted access to affordable financing, insufficient infrastructure, policy instability, and a shortage of skilled workers impede diversification attempts. Similarly, frequent external shocks, limited technology transfer, and governance difficulties further complicate the process.

Instead of relying on the resource-backed model, countries need to consider alternative ways of funding their projects, especially in infrastructure. For instance, the new Nairobi expressway in Kenya was constructed by the China Road and Bridge Corporation with a 'build-operate-transfer' agreement worth more than $600 million.[108] Such financing modalities could be adapted and emulated to the context of individual countries.

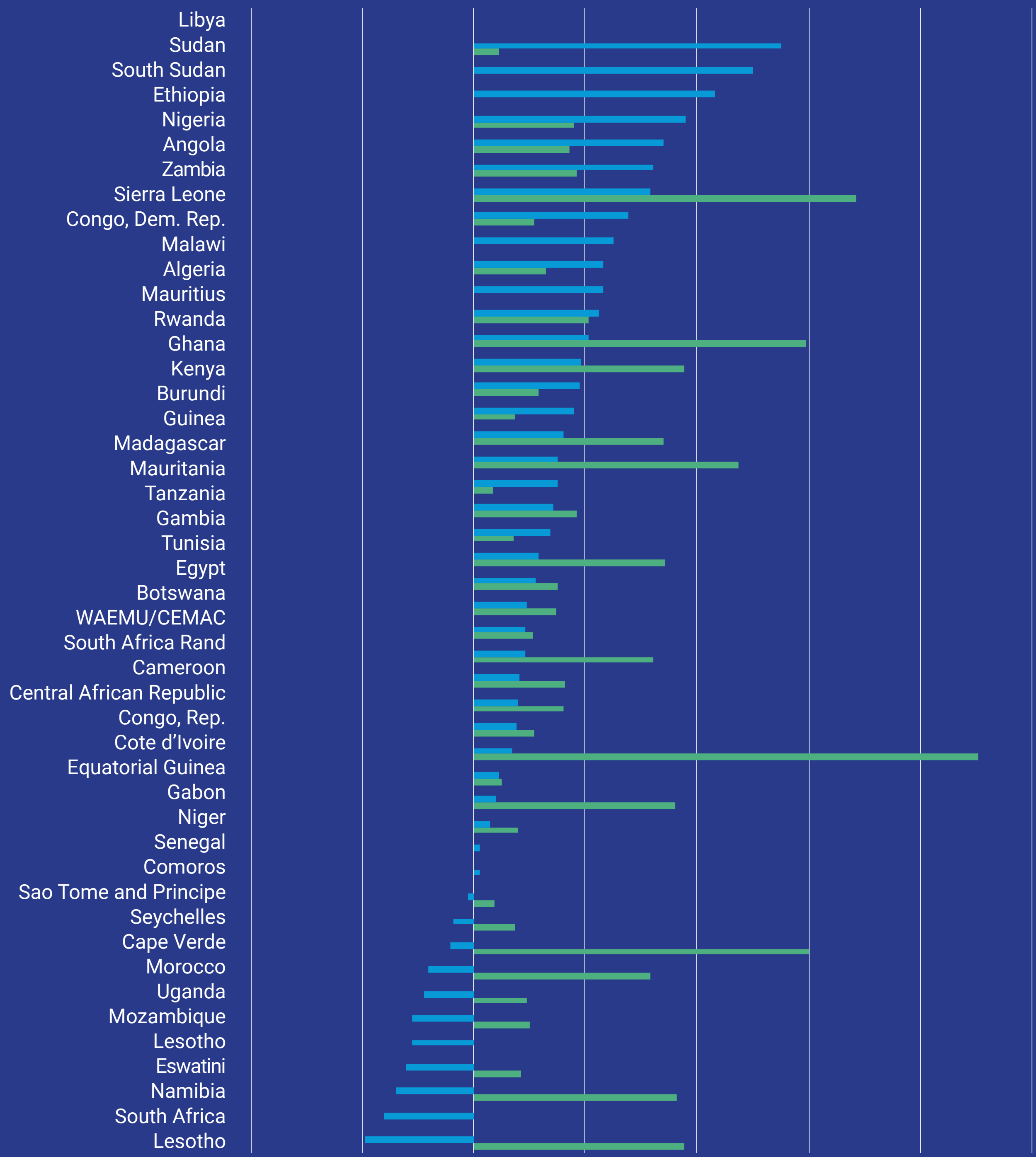
COUNTRIES COULD EXPLORE THE ADOPTION OF STATE-CONTINGENT CLAUSES THAT

REDUCE DEBT BURDEN REPAYMENT

DURING PERIODS OF LOW FISCAL REVENUES BECAUSE OF COMMODITY PRICE FLUCTUATIONS.

102 Mihalyi et al., 2022
103 Editor. 2023.
104 Rivetti. 2021.
105 Editor. 2023.
106 Natural Resource Governance Institute. 2020
107 Chang and Lebdioui. 2020.
108 Eickhoff. 2022.

Figure 3.11 Most African countries still have some borrowing space, however their funding gaps in most cases are wide



Notes: The funding gap refers to the shortfall of actual and projected expenditure compared to the needed public spending to achieve the SDGs by 2030. When a country has a zero-funding gap, it means that the projected spending is aligned with the minimum SDG needs. Sovereign borrowing space is the difference between the present value (PV) of external debt as a ratio of the GDP in 2022 and the country's PV of external debt ratio that would put the country at high risk of debt distress (30 weak -40 medium -55 high), according to the Low-Income Countries Debt Sustainability Framework (LIC-DSF). For countries with market access, the sovereign borrowing space was calculated as the difference between the public debt to GDP in 2022 and the threshold for Emerging countries (70 per cent of GDP) that puts the country under higher scrutiny as per the IMF Market Access Sovereign Risk and Debt Sustainability Framework for Market Access Countries (MAC SRDSF). When the external borrowing space is positive, the country still has the capacity to borrow, while if it is negative, it has no more room to borrow.
Source: OSAA staff calculation based on Kharas H & McArthur J (2019), Chamon, M., Klok, E., Thakoor, V., & Zettelmeyer, J. (2022), World Bank World Development Indicators and World Bank Debt Sustainability Assessment.

Also, countries could explore the adoption of state-contingent clauses that reduce debt burden repayment during periods of low fiscal revenues because of commodity price fluctuations. State contingent clauses could also be applied in anticipation of the impact of natural disasters (such as cyclones/droughts), which often significantly derail economic drivers. This creates counter-cyclical effort and protects countries from eroding fiscal space for investments in productivity and growth due to heightened debt service. Additionally, countries need to prioritize improving governance and transparency. Hence, the potential resource-backed debt pitfalls could be mitigated by implementing robust fiscal management practices, fostering accountability, and ensuring comprehensive and up-to-date information availability.

3.6 Debt Sustainability, Financing Gap, and Borrowing Space

African countries have been grappling with the dual challenge of meeting their development needs and ensuring that debt levels remain manageable. Resolving this dilemma in the African context has proven to be difficult. The structural inequities and unfairness of the global debt architecture and recurring external shocks contributed to this dire situation by consistently pushing African countries into debt distress cycles. The urgency for financing to cope with the negative impact of external shocks puts significant liquidity pressure on countries. However, the misperception of assuming that Africa's debt challenges are related to excessive borrowing and liquidity issues has far-reaching consequences, as the debt situation could quickly evolve into a more intricate issue of insolvency. Consequently, the failure to properly diagnose the root causes of Africa's debt has led to inadequate solutions.

Traditionally, the evaluation of public debt has revolved around the need to maintain short-term sustainability by assuming that an increase in debt is universally harmful to economic growth and stability. However, making such an assumption and generalization could be erroneous and misleading since debt could be growth propulsive in the short term under certain conditions, as presented in section 3.4. The narrow perspective of applying a standardized debt threshold is detrimental to economies as it would restrict the government's ability to access necessary financial resources at affordable terms and hinder optimal development outcomes. Under the current conditions, the Debt Sustainability Analysis (DSA) and its sensitivity scenarios (depreciation, external shocks, etc.…) will always excessively emphasize the vulnerability of African countries since they miss out on other plausible scenarios. The policies advocated by International Financial Institutions aim to achieve short-term debt sustainability by implementing strict austerity measures, often resulting in negative impacts, such as heightened poverty and widening inequality. Recent research by Han et al. (2024) demonstrated that conventional debt analysis is incomplete since it does not consider critical factors, such as the growth of debt and the underlying economic environment. As a result, such a restrictive approach could lead to the adoption of counterproductive and inadequate policies that further hinder debt sustainability efforts.

There were some attempts to challenge the current debt sustainability framework used by the IMF. For instance, a policy paper[109] prepared by five United Nations Regional Economic Commissions proposed an "augmented" approach for public debt sustainability to fill the long-term analysis gap omitted by the IMF frameworks.

109 United Nations. 2023b.

The advantage of such an approach is its capacity to consider the countries' financing needs to achieve the SDGs, including climate finance and the associated government structural development policies. Recognizing the benefits of such elements is crucial for strengthening African economies' stability and solvency in influencing the debt narrative.

Hence, there is an urgency to reevaluate the concept of debt sustainability and its assessment methodologies. By advocating for such reforms, maintaining short-term public debt sustainability will not be the sole objective, and a delicate balance should be maintained with the government's aspirations for achieving the SDGs. By integrating long-term perspectives into the DSA and including additional scenarios where some of the challenges such as trade mispricing are partly tackled, unjustified risk perceptions and unfair interest rates, driven by the CRAs ratings, would be moderated. As a result, costly sovereign risk premiums to African economies would become less sensitive to debt levels.

IMPROVING THE PROSPECTS FOR ACHIEVING THE SDGS IN AFRICA AND ESCAPING THE DEBT TRAP WOULD REQUIRE LARGE-SCALE AND URGENT MOBILIZATION OF ADDITIONAL RESOURCES.

THIS IS THE RATIONALE FOR THE SECRETARY-GENERAL'S CALL FOR AN SDG STIMULUS

When analysing the debt issue in Africa, there is a need to take into consideration countries' national development plans backed by pluri-annual tools such as the Medium Term Fiscal Framework and the Medium Term Expenditures Framework as medium-term windows of Africa's long term financing needs. In this respect, comparing African countries' debt-carrying capacity and their funding gap to achieve the SDGs is critical. OSAA's estimation shows that African countries have a considerable funding gap[110] of around $350 billion annually to achieve the SDGs. Most African countries still have sovereign borrowing space[111], however, in most cases, it falls short of bridging their funding gap for investing in the SDGs. (Figure 3.11) This aligns with previous costing exercises' findings highlighting the sizable funding gap and the challenges in achieving the SDGs, especially in Africa.[112] Fourteen African countries are in a more difficult situation since they have a negative borrowing space. Their incapacity to acquire additional debt to finance development priorities hinders growth perspectives and investment in the SDGs. In addition, more than 60 per cent of African countries don't have the necessary borrowing space to cover their funding needs, putting at risk the achievement of the SDGs in these countries. The rest of the countries still have the capacity to tap into domestic and external debt to finance their financing needs. However, it's important to note that the allocation of funds for SDGs purposes does not necessarily guarantee results and outcomes since the quality of public spending and institutions are critical factors in determining the efficiency of public investments. Improving the prospects for achieving the SDGs in Africa and escaping the debt trap would require large-scale and urgent mobilization of additional resources. This is the rationale for the Secretary-General's call for an SDG stimulus.[113]

110 The funding gap was calculated based on McArthur and Kharas's (2019) back casting methodology that estimates the difference between the actual and projected public spending and the financing needed to achieve the SDGs in 2030. The assessment of needs and gaps was made across the following 10 areas: social spending, agriculture and rural development, health spending, education, water and sanitation, energy, transportation, flood protection, biodiversity conservation, and access to justice.

111 The Sovereign borrowing space is a back-of-the-envelope measure of the difference between the Present Value (PV) of external debt as a ratio of the GDP in 2022 and the country's PV of external debt ratio that would put the country at high risk of debt distress (30 weak -40 medium -55 high), according to the Low-Income Countries Debt Sustainability Framework (LIC-DSF). For countries with market access, the sovereign borrowing space was calculated as the difference between the public debt to GDP in 2022 and the threshold for emerging countries (70 per cent of GDP) that puts the country under higher scrutiny as per the IMF Market Access Sovereign Risk and Debt Sustainability Framework for Market Access Countries (MAC SRDSF).

112 Sachs J et al. 2018, McArthur and Kharas. 2019 and UNCTAD. 2021

113 United Nations. 2023c

3.7 Elevated Perception of African Debt Burden Risks

The global financial system is penalizing African countries by providing capital at a higher cost compared to the rest of the world. The sovereign rating downgrade wave that most African countries experienced starting in 2021 made the debt situation worse, as African countries with low credit ratings had difficulties accessing or refinancing their expensive debt. These credit ratings are crucial in determining the cost of capital for both public and private actors in Africa. For example, it was established that countries with low credit ratings are exposed to interest rates that are about 20 points higher than the average global rate and over nine times higher than those of other developing countries.[114]

The financing cost for emerging markets bond yields doubled between 2020 and 2022.[115] African-issued Eurobonds interest rates were the highest in this period among emerging economies.. These were higher than the peaks reached during the COVID-19 and 2008 global financial crises.[116] As a result, African countries have been locked out of the international capital market for almost two years since April 2022 without being able to issue new Eurobonds. Nevertheless, in early 2024, some countries regained access to the market, benefiting from the appetite of investors interested in Emerging market debt. Cote d'Ivoire was the first African country to re-enter the Eurobond market in January 2024. Meanwhile, Kenya issued a Eurobond of $1.5 billion with a 7-year maturity in February 2024, however, at a significantly elevated interest rate. The bond has been used to refinance its $2 billion bonds maturing in June 2024.[117] While the bond issuance will help the country ease its debt repayment wall in 2024, the concern is that the proceeding will be mainly directed to refinancing debt rather than investment in productive sectors, impacting the country's debt sustainability.

The perceived risk assessed by Credit Ratings Agencies (CRAs) is costly to most African economies. For instance, UNDP[118] estimates that Africa has lost more than $74.5 billion from unfair credit ratings due to excess interest and forgone funding. These are lost resources in addition to the $500-600 billion cost opportunity that the continent is unable to mobilize.[119] This means that without rating idiosyncrasies, African countries studied could have borrowed more competitively and in more significant amounts, availing additional financing for their development and enjoying ample fiscal space to undertake the much-needed structural reforms.

The AU has taken significant strides towards establishing the African Credit Rating Agency (ACRA), as endorsed during the African Union's Specialized Technical Committee in Nairobi, Kenya, in June 2023.[120] ACRA's core objective is to provide more accurate and equitable credit risk assessments for African countries, capture Africa's economic realities and potential and address the limitations of existing CRAs, including the lack of ratings for 22 African countries.

The unfairness of the global financial system is depriving African countries of substantial resources that they urgently need to invest in recovery, resilience to external shocks, climate action and the SDGs. Hence, African countries need to continue engaging CRAs in a structured and formal dialogue to ensure greater transparency. CRAs are called upon to address their ambiguous methodologies and encouraged to issue longer-term ratings that consider the countries' fundamental development needs and recognize the long-term value of productive investment in sustainable development and resilience.[121] This must be complemented by global efforts to increase guidance and regulation aimed at ensuring the credibility of CRAs within the international financial system.

THE AU HAS TAKEN SIGNIFICANT STRIDES TOWARDS ESTABLISHING THE AFRICAN CREDIT RATING AGENCY (ACRA) TO PROVIDE MORE ACCURATE AND EQUITABLE CREDIT RISK ASSESSMENTS FOR AFRICAN COUNTRIES, CAPTURE AFRICA'S ECONOMIC REALITIES AND POTENTIAL AND ADDRESS THE LIMITATIONS OF EXISTING CRAS, INCLUDING THE

LACK OF RATINGS FOR 22 AFRICAN COUNTRIES.

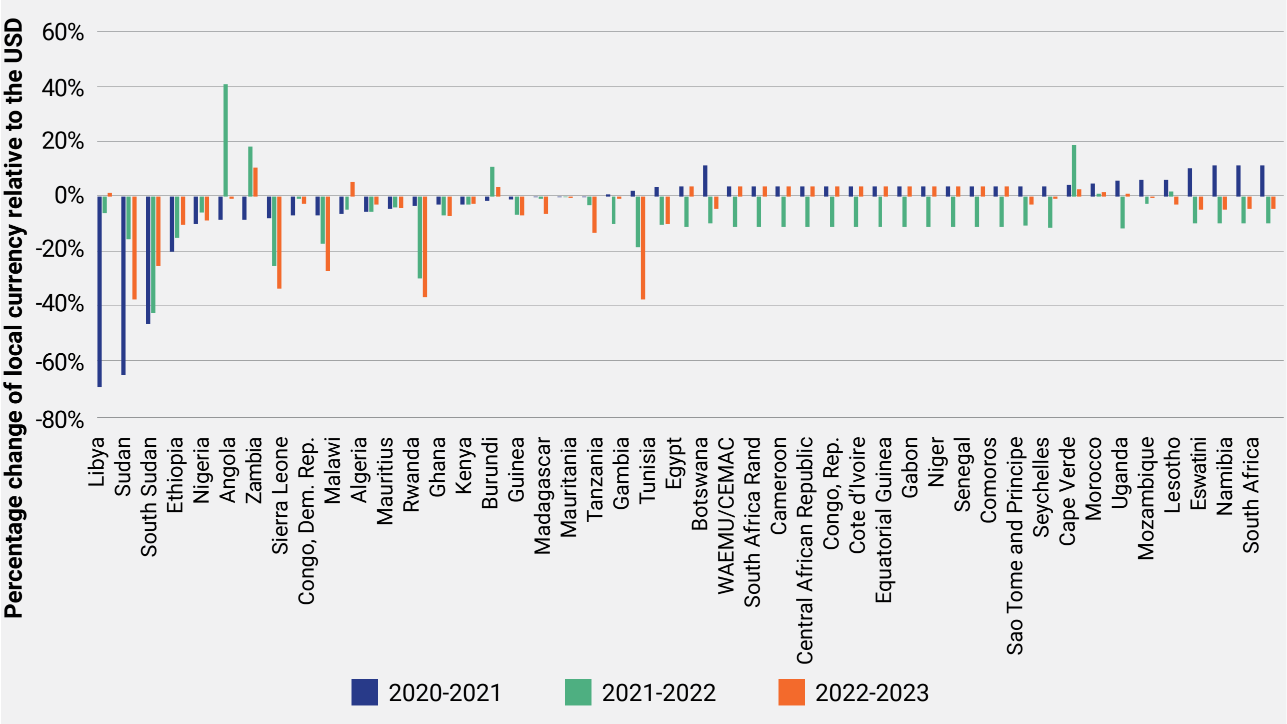
114 Kenworthy, P., Kose, M. A., & Perevalov, N. 2024.
115 African Climate Foundation, 2023
116 AUC & OECD . 2023.
117 Bloomberg.com
118 UNDP. 2024.
119 United Nations. 2023d.
120 APRM. 2024.
121 United Nations. 2023c.

3.8 Local Currency Lending: The Shield Against Exchange Rate Volatility?

Currency risk is a critical factor contributing to the increased cost of debt. According to the AfDB African Economic Outlook report (2023), African debt increased by over 50 per cent between 2013 and 2020 due to currency depreciation. Research shows that high debt levels are highly correlated to currency depreciation (Mauro et al., 2006).[122] Over half of Africa's external debt is in US dollars[123] and countries like Angola, Ethiopia, Ghana, Nigeria, South Africa and Zambia are more vulnerable to currency fluctuations as more than 80 per cent of their external debt is in US dollars.[124]

When the interest rates in the United States increased in March 2022, the dollar got stronger, creating imported inflation, and making many African currencies lose value. (Figure 3.12) For instance, the Kenya shilling lost 30 per cent against the dollar in 2023. Malawi's currency depreciated by 25 per cent and then 44 per cent in 2022 and 2023 because of the decline of foreign exchange reserves.[125] In 2021, Zambia's Kwacha lost around 29 per cent to the dollar but then went up 15 per cent in 2022 after getting a deal from the IMF.[126] Angola's currency also dropped 37 per cent in 2021, but oil price increases helped it recover 27 per cent in 2022.[127] Unfortunately, these cases are not unique, and similar developments are observed in other African countries. When a local currency depreciates, the country's external debt, mainly in foreign currency, becomes more expensive to service, endangering the financial stability and debt sustainability efforts. The currency devaluation impacts trade activities, consumer prices, business operations, and household budgets, leading to further inflation.[128] As a result, people's purchasing power erodes, creating a fertile ground for social unrest and political instability, as witnessed in many African countries in recent years.

Figure 3.12 Many African countries continue to face exchange rate volatility which increases their debt burden

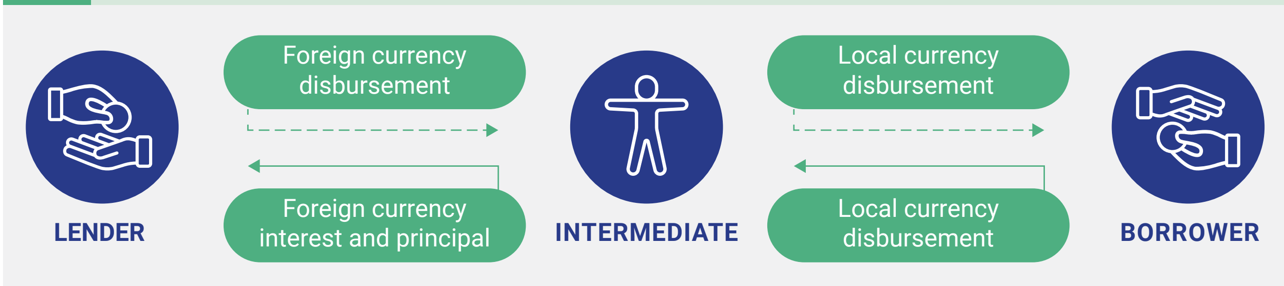


Note: Central African Economic and Monetary Community (CEMAC), West African Economic and Monetary Union (WAEMU)
Source: African Development Bank statistics.

122 Mauro, Sussman, & Yafeh. 2006.
123 AfDB.2024.
124 UNECA. 2023.
125 Reserve Bank of Malawi. 2022
126 Bank of Zambia. 2021.
127 Ibid.
128 Woods, 2022.

In this respect, direct local currency lending by Multilateral Development Banks (MDBs) has the potential to revolutionize the continent's financial landscape, particularly in terms of debt sustainability.[129] Its key strengths rely upon mitigating currency risk and enhancing debt payment predictability. Local currency lending models could be in the form of non-deliverable cross-currency swaps. (Figure 3.13) While the loan is denominated in the local currency, the lender disburses funds to the intermediate, and the borrower receives them in hard currency. The borrower's repayment obligation is fixed in local currency at the prevailing exchange rate but still settled in hard currency. In this model, the borrower has a fixed liability in local currency terms, and the lender is perfectly hedged, as a loss or gain on the loan is offset by an equal but opposite loss or gain on the swap.

Figure 3.13 Local currency SWAPS are critical tools to protect local borrowers against currency risk



Drawing inspiration from the successful experiences of Asian countries, where such tools have proven effective, African countries can bolster their financial ecosystem by leveraging local currency swaps. For instance, the Asian Infrastructure Investment Bank (AIIB) offers sovereign-backed local currency financing products in 21 hard and local currencies, using cross-currency swaps, local currency bonds, and credit enhancements.[130] The Infrastructure Asia initiative plays the role of guarantor by providing guarantees and blended finance to catalyze local currency funding from institutional investors.[131] Although most local currency lending is currently publicly guaranteed, targeting private sector actors, this tool has been extended to sovereign debt in many countries.

Similarly, through its local currency financing scheme, the International Bank for Reconstruction and Development (IBRD) provided financing to non-sovereign entities with revenues in local currency. In Africa, IBRD supported South Africa and provided local currency financing with competitive terms and longer maturities, especially to South African State-Owned Enterprises (SOEs). The latter are highly exposed to exchange rate volatility since around 40 per cent of their total debt is in foreign currency.[132] Between 2013 and 2019, approximately $3 billion worth of South African Rand has been made available to South African SOEs under the IBRD's local currency financing.[133] IBRD has different local currency conversion modalities, including i) the automatic conversion of loan currency (SWAPS), ii) partial amount conversion into local currency at the request of the borrower, and iii) the partial maturity conversion of outstanding amounts.[134]

Exchange rate risk affects all African economies, but some are more vulnerable than others. Most African Low-Income Countries (LICs) debt is concessional, owed by MDBs. The concessional nature of these loans implies that the interest rates are lower than in the international capital market, and the repayment terms are more lenient. However, despite these favourable conditions, these countries are not immune to financial vulnerabilities characterized by their exposure to foreign exchange risk since concessional loans are typically denominated in major hard currencies. As a result, LICs find themselves grappling with increased debt servicing costs, even when the interest rates on the concessional loans remain low. The

129 Rasmussen.1999.
130 Asian Infrastructure Investment Bank. 2024
131 Kumar et al., 2024
132 IMF Country Report No. 16/218
133 World Bank Group. 2019.
134 World Bank. 2021.

challenge becomes more pronounced when these countries heavily rely on exports, as fluctuations may directly impact their revenues in global commodity prices. The current lending practices transfer the responsibility for managing currency risk from well-equipped MDB treasuries to the Debt Management Offices of LICs, which face severe capacity constraints.

In this respect, MDBs should abide by responsible lending principles[135] and prioritize hedged sovereign currency lending as a default option over unhedged foreign currency lending, at least for African LICs. Moreover, unless financed projects can generate foreign exchange, MDBs could extend local currency lending to publicly guaranteed private sector entities. This would scale up finance and improve credit risk margins, investment decisions, and macroeconomic stability. In this regard, MDBs' institutional internal processes, culture, and risk-management frameworks need to be adapted to facilitate local currency lending at a large scale.[136] However, local currency lending has higher initial costs than foreign currency lending with implications for their lending operations, it recognizes that MDBs could manage the currency risks, leveraging their large balance sheets as part of a diversified portfolio and aligned with the principles of the Addis Ababa Action Agenda.[137]

By embracing local currency lending, MDBs could assist African countries in reducing their vulnerability to external economic fluctuations, fostering stability and resilience. By helping manage this risk they also allow more predictable allocation of domestic resources. De-risking development finance in Africa through local currency lending practices that make debt service repayment predictable is indeed aligned with MDBs' mission. Therefore, prioritizing currency risk mitigation and incorporating local currency lending as the major finance instrument should be a key focus in the replenishment strategy of MDBs and policies.[138] Using MDBs balance sheets in this way is one of the least cost ways to boost the resilience of EMDEs in the context of expected continued volatile global economic conditions , marked by the heightened risk of climate-related natural disasters and economic shocks associated with a tense global geo-political environment.

135 UNCTAD .2012.
136 Fink et al., 2023.
137 United Nations. 2023c.
138 Rasmussen. 1999.

BY EMBRACING LOCAL CURRENCY LENDING,

MDBS COULD ASSIST AFRICAN COUNTRIES

IN REDUCING THEIR VULNERABILITY TO EXTERNAL ECONOMIC FLUCTUATIONS, FOSTERING STABILITY AND RESILIENCE.

3.9 Conclusion and Recommendations

Although Africa's recent debt sustainability challenges are a legitimate concern, there is a need to consider the context in which this debt has been accrued. Many African countries face challenges stemming from internal factors like governance, spending efficiency, economic diversification and resource mobilization. However, external factors like the global economy, price volatility, pandemics, climate change, geopolitical tensions, and an unjust financial system were amplifying African countries' debt burden.

These factors result in constraining the fiscal space of numerous African countries and impeding their growth. The nature of debt and its usage for consumption, debt repayment, or productive investments are crucial in comprehending and effectively managing debt. The success of debt sustainability in Africa depends on its intended purpose, whether to sustain countries' short-term capacity to pay back their debt or their long-term capacity to develop. Additionally, reforming the global debt architecture, which often penalizes African countries unfairly, plays a key role in shaping the success of this endeavour.

Despite the challenges, the continent's commitment to achieving the SDGs and African people's aspirations provide a pathway to overcome debt issues. By prioritizing responsible financial practices and promoting economic growth, African countries can ensure that their debt remains a means for development rather than a source of anxiety. However, some countries' sizable funding gaps and limited borrowing space continue to hinder their prospects of achieving the SDGs.

The following key recommendations can be considered:

- African countries need to ensure greater efficiency in government spending by improving public financial management and prioritizing high-quality growth-enhancing public investment measures. Furthermore, directing public spending towards education, skill development and healthcare is crucial to creating a skilled and healthy workforce capable of contributing to the country's development.

- African countries must implement prudent fiscal policies and adhere to fiscal discipline. This includes responsible budgeting, reducing budget deficits, and sustainably managing public debt. Maintaining a stable and predictable monetary policy is essential to control inflation and exchange rate volatility. Strengthening financial institutions and regulatory frameworks is vital to ensure stability, liquidity, and resilience against external shocks. In addition, efforts should be directed toward strengthening budget institutions to improve the implementation of fiscal plans, enhance debt management, ensure fiscal risk monitoring and mitigation and foster accountability and oversight.

- Structural transformation and economic diversification are paramount for growth and debt sustainability. This involves moving away from over-reliance on a few commodities that are subject to price volatility and investing in value-added sectors such as manufacturing, services, and agriculture. Enacting strategic industrial policies to accelerate economic diversification in Africa would limit the effects of recurrent headwinds and the transmission of global shocks to growth.

- Long-standing governance reforms remain critical in African countries, including strengthening debt governance systems and the rule of law, fighting corruption, and promoting government accountability.

- Governments need to be proactive in restructuring their debt portfolios. African countries face a significant funding gap to achieve the SDGs. While most countries still have sovereign borrowing space, the latter falls short in bridging the development financing needs. Improving the prospects for achieving the SDGs in Africa and escaping the debt trap would require the adoption of the SDG stimulus.

- Debt transparency can play an important role in ensuring debt sustainability and efficiency in resource use. It is a critical component in delivering accountability to citizens. It is also the shared responsibility of both borrowers and creditors. African countries should strengthen their institutional, legislative and operational frameworks, including transparent budgetary processes, to enable timely and comprehensive debt reporting. African countries also need to engage in responsible borrowing practices, particularly regarding resource-backed loans, and improve debt management.

- Transparency in debt reporting is essential to avoid over-risk estimation by creditors, resulting in costly African premiums and sovereign downgrades. In this respect, there is a need for CRAs to issue longer-term ratings that consider African countries' developmental needs. A coordinated debt management strategy between official and private creditors is key to avoiding a debt crisis, given tight global financial conditions and elevated debt service payments. Reforming the global financial and debt architecture would accelerate debt restructuring and facilitate debt sustainability in Africa.

- The systematic use of state-contingent clauses to automatically suspend debt repayments for countries hit by external shocks can help reduce the risk perception of vulnerable countries and provide fiscal space and liquidity to respond to these shocks.

- MDBs should advance lending to countries, especially for LICs, in local currencies to reduce the impact of currency-related increases in debt servicing. These debt instruments make debt payments more predictable and manageable. Local currency loans could promote responsible lending practices, support economic stability and help African countries improve their debt sustainability and financial resilience. Governments should further develop domestic capital markets, supported by development partners, to provide a broader range of financing tools denominated in local currencies.

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04

Towards Building a Development-Oriented Global Financial Architecture

In keeping with the present report's emphasis on unpacking Africa's debt with a view to exploring durable solutions, this chapter complements the analysis of Africa's domestic and external debt with a thorough overview of the role that the international financial architecture (IFA) has played in exacerbating the problem of debt sustainability.

The international financial architecture, as it stands today, has several shortcomings that particularly affect African countries. These include a bias towards the developed countries that designed the architecture in the aftermath of the Second World War, favouring their interests over those of developing countries. Similarly, the system is excessively focused on short-term liquidity measures and the debtor countries' ability to pay back their creditors, as opposed to the much-needed emphasis on development that would put Africa back on track to achieve the SDGs.

The chapter argues that the lack of inclusion in the decision-making bodies of key multilateral institutions, such as the IMF and the World Bank, as well as the outsourcing of some major economic decisions to the informal (non-treaty based) groupings, such as the G-20, results in systemic inefficiencies that prevent middle and low-income countries in Africa from accessing both the short term contingency funding and the longer-term development financing that is required at scale.

In order to provide basic services to their populations, African economies have to overcome the systemic bias and inefficiencies of the IFA and are often required to borrow from international markets and bilateral lenders at punitive rates due to excessively high and unrealistic risk perceptions. This creates a vicious cycle of debt with increasingly more onerous conditions, eventually leading debt-service to gain priority over investments in education and health.

Furthermore, the fragmented nature of the IFA results in its inability to address today's challenges with adequate speed and efficiency – as evidenced by the slow and bureaucratic nature of the debt relief initiatives that were deployed in the aftermath of the COVID-19 pandemic. This chapter argues that instead of piecemeal reform efforts to the existing IFA which have yielded mixed and temporary results so far, a comprehensive rethinking of its modus operandi is required. The chapter focuses on systemic issues, such as improving the voice, representation, and accountability within the governance of the key institutions, giving Africa a greater voice commensurate with the continent's growing population and weight in the global economy, making sure that the debt sustainability analyses explicitly account for development priorities, and better linking the financial tools and instruments, including debt-for development or debt-for-climate swaps deployed to address debt sustainability within the broader context of sustainable development. Among other recommendations, it also explores the role of regional institutions as well as national and multilateral development banks with a view to recapitalizing them and leveraging their balance sheets to provide local currency lending that shields African debtors from currency fluctuations.

4.1 Diagnostic of the International Financial Architecture – Status Quo and Main Actors

> **The current international financial architecture was created nearly 80 years ago. It cannot deliver the stable, affordable and long-term financing that is necessary to rescue the Sustainable Development Goals."**
>
> **United Nations Deputy Secretary-General,** Amina Mohammed

Despite increasing awareness about the role of International Financing Architecture (IFA) in discussions about sustainable development, there is no universal definition of the concept. For the sake of pragmatism, the present chapter uses a working definition provided by UNCTAD: "The IFA is a framework of institutions, policies, rules, and practices that govern the global financial system."[139] This definition refers to a vast and complex landscape of financial institutions and arrangements ranging from multilateral to private lenders and lending arrangements, such as bilateral and multilateral swap lines, financial regulators and norm-setters, credit rating agencies as well as formal (treaty-based) and informal groupings of countries and stakeholders. Ideally, the aim of the IFA would be to promote international cooperation to achieve global monetary and financial stability, facilitate cross-border trade and investments, mobilize predictable and long-term financing for development to secure resources for climate change mitigation and adaptation as well as the achievement of SDGs. These economic governance structures have proven more successful in achieving short-term objectives, such as underpinning the stability and smooth functioning of the global financial and monetary system, and less so in achieving medium to long-term objectives, such as achieving the SDGs and combatting the ongoing climate crisis.

This is a problem of design: Conceived by and for the industrialized economies after the Second World War, today's IFA has a complex and eclectic structure that favours the interests of developed countries over those of developing countries. Its origins can be traced back to the United Nations Monetary and Financial Conference that took place in July 1944 in Bretton Woods and its outcome conceptualizing an international financing architecture with the newly minted International Monetary Fund (IMF) and the World Bank at its core was ratified in December 1945. However, there were only 44 delegations present at the conference as opposed to the near-universal membership (190 sovereign members) of the IMF and the World Bank today. As a result, the system that was created was inherently biased at its inception.[140]

Since then, this architecture evolved in an *ad hoc* manner to address increasingly complex and interconnected challenges of today's global economy, often reflecting the policy preferences of developed countries in response to economic and financial crises. These challenges and the frequent exogenous shocks, such as human-made disasters, pandemics, and food and fuel crises, exacerbate growing debt stress and inequalities within and among nations and stretch the international architecture to its limits. In fact, the lacklustre international response to the systemic deficiencies that were laid bare by the COVID-19 pandemic in late 2019 shows that today's IFA is failing the test at a time when it is most needed. A case in point, discussed in more detail later in this chapter, is the emergency issuance of SDRs in 2021 to boost liquidity in the aftermath of the pandemic, which heavily

139 UNCTAD. 2023.

140 Although the membership of the IMF and the World Bank is now near universal, the decision-making power is related to quotas and is heavily weighted towards rich developed countries that participated in the inception of the Bretton Woods institutions.

disadvantaged developing countries and ended up in the financial coffers of countries that least needed the extra liquidity. As such, today's IFA is not only outdated and dysfunctional in general but also inherently unfair to African countries in particular.

The problem that continues to undermine this complex architecture is that it has been reformed on various occasions under the guidance of creditor nations predominantly to protect their short-term financial interests at the expense of developing countries. Typically, these reforms took the form of band-aid solutions in response to past crises and shocks. Since there has been no systems thinking behind the design and reform of this architecture, there is nothing that would guarantee that these efforts would result in an IFA that is inclusive and aligned with the universally agreed norms and standards, such as those encapsulated in the Addis Ababa Action Agenda (AAAA).

Besides being skewed towards protecting the interests of creditors over debtors, the current *modus operandi* of the IFA values liquidity over solvency. It facilitates easy and cost-effective access to finance for the public and private sectors in developed countries while making it costly for their counterparts in relatively poor African countries. Such a system also guarantees that sovereign creditors, such as bondholders, have seniority, i.e. get repaid first in case of insolvencies and defaults, thereby forcing many African governments to prioritize debt service at the expense of cutting down on expenditures on social services, such as health and education, and other growth catalytic sectors.

Hence, the IFA could be considered as a hierarchy that redistributes wealth from the periphery of the global economy towards its core, ironically making some of the poorest and most vulnerable countries act as *de facto* net lenders to the rest of the world economy.[141] With its governance skewed against Africa and developing countries in general, the current IFA amplifies the business cycle rather than acting as a counter-cyclical buffer to smooth out excess volatility. This further exacerbates the adverse impacts of the cascading crises on sustainable development, such as the post-pandemic impact of the worsening peace and security situation around the world leading to food, fuel, and fertilizer crises in Africa.

Such a skewed system intensifies pressures on developing countries by exhausting their respective fiscal spaces and forcing them to borrow, often at punitive costs, for debt service. When the borrowing is not undertaken as part of a comprehensive national development plan with the purpose of investing in Africa's sustainable development, peace, and security, it pushes African governments towards a vicious cycle of debt associated with costlier terms and more conditionalities. This leads to negative externalities, thus increasing the countries' vulnerabilities and making it even harder to resolve debt crises.

During financial and economic crises, the inequalities of the international financial architecture also manifest themselves in the form of capital flight, referred to as global flight to safety.[142] If not addressed through controls on capital flows and profit shifting by African governments, such flights to safety result perniciously in further redistribution of wealth from the periphery to the core and enhancing the concentration of wealth in a handful of developed economies.

4.2 Making the case for an IFA reform that prioritizes Africa's sustainable development

Although the necessity for reform has long been identified with various attempts being made between 2005 and 2015, there have only been improvements at the margin. A comprehensive reform of the IFA has proven elusive so far. To date, Africa's representation in international financial institutions (IFIs), regional development banks (RDBs), and other standard-setting bodies has remained largely unchanged despite the continent's dynamism and growing importance in today's globalized economy. By contrast, leading developed economies continue to dominate decision-making in these organizations. Consequently, it has proven difficult to enact reforms that foresee changes to voting rights and representation in the governing bodies of these institutions.

TO DATE, AFRICA'S REPRESENTATION IN IFIS, RDBS AND OTHER STANDARD SETTING BODIES HAS REMAINED

LARGELY UNCHANGED

DESPITE THE CONTINENT'S DYNAMISM AND GROWING IMPORTANCE IN TODAY'S GLOBALIZED ECONOMY.

141 United Nations. 2023c.

142 For a technical analysis of the link between global flight to safety (GFS) shocks and the business cycle, please see Bodenstein et al., (2023).

This imbalance and unfair representation weigh down on public trust in, and the credibility of these organizations, limiting access to crucial development financing. There is a trade-off between inclusiveness and effectiveness. However, the current structure of the IFA sacrifices representation in favour of effectiveness, which inadvertently promotes the narrow economic interests of a few developed countries, especially failing to provide coherence and coordination in responding to regional and global crises.

A case in point is the coordination of the response to the Great Recession of 2009, which led to the primacy of informal clubs and groupings, such as G-7 and G-20, to make up for the void at the centre of global economic governance. Decisions that should have been taken deliberatively within the context of formal, and therefore, more accountable organizations had to be taken and implemented in these informal fora in the interest of speed and efficiency. Due to the exclusive nature of these informal groupings, the critical socio-economic decisions affecting the path of African economies to recovery were taken in their absence. Although some movement in the right direction has taken place in more recent years, such as the G-20 augmenting its membership with a permanent seat for the African Union, Africa's effective representation in global coordination mechanisms is still less than ideal.

In short, the efforts to reform the IFA thus far, have been piecemeal and inadequate – reinforcing the inherent inequities of the system, especially African countries' limited access to predictable and affordable finance. Most urgently, the current IFA does not allow the deployment of resources required to achieve the goals and aspirations of the 2030 Agenda for sustainable development and Agenda 2063 . There are insufficient mechanisms to provide long-term predictable and affordable debt mechanisms aligned with these agendas, while existing debt resolution mechanisms prioritize the interests of private creditors.

This chapter considers five main areas of reform, building on the requirements of the UN Secretary General's proposed SDG Stimulus[143]:

a. bringing down the excessive cost of sovereign borrowing;
b. increasing access to contingency financing;
c. providing access to predictable long-term concessional finance;
d. rethinking Debt Sustainability Analysis (DSA) frameworks to address development and resilience-building; and
e. moving away from contingency measures to long-term debt crisis prevention and resolution mechanisms.

a). Bringing Down the Excessive Cost of Sovereign Borrowing

Given the deficiencies and shortcomings of the IFA described above, African countries rely on private creditors or bilateral lending arrangements to finance much-needed investments in sustainable development. Chapter 3 has demonstrated that over the past ten years, the portion of external public debt owed to private creditors has risen across all regions, including Africa, coinciding with the rise of new and emerging bilateral donors. Private finance is often more expensive than multilateral and concessional lending. The increasing reliance of African countries on private creditors, such as bondholders, banks, and other financial institutions, has made borrowing prohibitively expensive due to exaggerated risk premia, known as "the Africa premium"[144] as well as exchange rate fluctuations. Furthermore, it makes debt restructuring overly complex, given the heterogeneity of the creditor base compared to debt structuring in a multilateral setting.

143 United Nations. 2023a

144 Please see the in-depth discussion of the outsize role played by CRAs in disadvantaging Africa's access to financial markets in Chapter 3 of the present report.

Figure 4.1 Today's IFA is a relic from another era and fails to do justice to Africa's sustainable development needs

Outdated design
Not fit for purpose of sustainable development

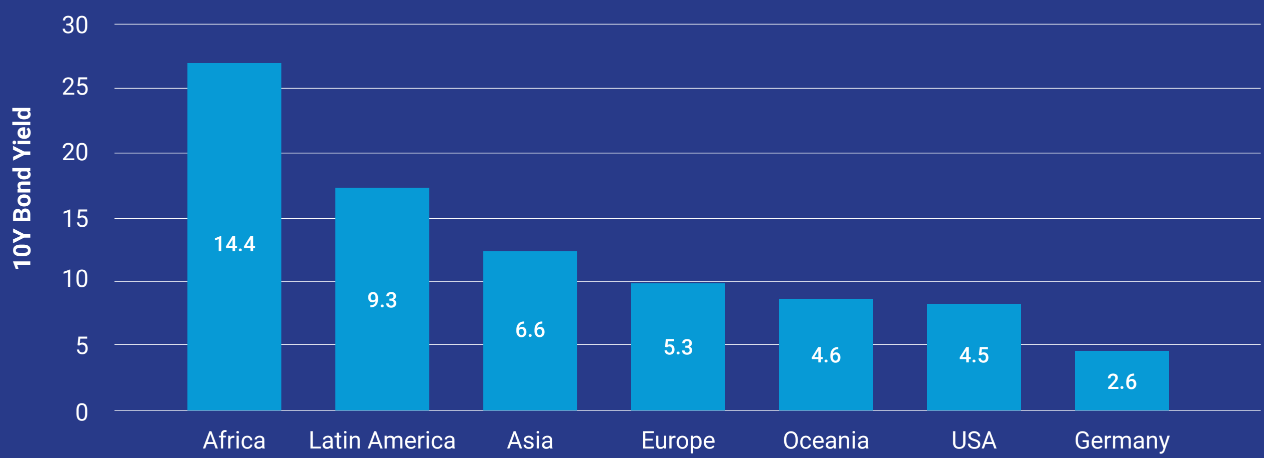
\+

Unfair
Lack of equitable voice and representation

→

IFA fails to help mobilize domestic and international finance for Africa's development

Figure 4.2 "The Africa Premium" – leading to excessive cost of capital for Africa compared to other countries and regions



Source: OSAA staff calculation, accessed on 28 May 2024.

African economies face further “financial injustice” as they typically have to borrow on average at rates that are three to five times higher than those of the United States and Germany. The increase in debt servicing cost partly reflects the asymmetric powers characterising the IFA that subordinates debtor countries to their creditors. This is evidenced in the high interest rates that African countries pay with spreads between average African 10-year government bonds and their US and German counterparts varying between approximately 1,000 to 1,200 basis points (Figure 4.2).

In African economies, CRAs’ one-size-fits-all methodologies often perpetuate a self-fulfilling prophecy, where the expectation of high risk is not aligned with the realities of investment. [145] For example, the analysis provided by Moody’s Analytics shows that as an asset class, African infrastructure projects had a default rate of only 5.5%, compared to 5.9% for Europe and 12.9% for Latin America and the Caribbean.[146] Nevertheless, as demonstrated by Figure 4.2, Africa continues to shoulder an excessive cost differential related to irrational perceptions of the underlying risk in investing in Africa.

In addition, while many African economies have constraints in access to international capital markets due to the high cost of borrowing and sovereign credit rating below investment grade, they still have to meet high climate financing needs especially for adaptation and land conservation.[147]

A systemic approach is needed to provide access to finance for African economies at affordable and fair terms based on economic fundamentals rather than inflated risk perceptions. Mobilizing new funding will require effective debt restructuring and reducing the cost of capital. According to Ramos et al. (2023), these countries will need new liquidity, a significant reduction in their Net Present Value (NPV) of the external public and publicly guaranteed debt, and new financing at a very low cost. The countries that may not need immediate debt restructuring, will still benefit from debt suspension, new liquidity, and credit enhancements to ensure that new borrowing does not jeopardize future debt sustainability.[148] Converting short-term high-interest borrowing into long-term (more than 30 years) debt at lower interest rates will be necessary to reduce African countries’ high cost of borrowing and thereby create the fiscal space for catch-up investments to bring SDGs back on track.

A SYSTEMIC APPROACH IS NEEDED

TO PROVIDE ACCESS TO FINANCE FOR AFRICAN ECONOMIES AT AFFORDABLE AND FAIR TERMS BASED ON ECONOMIC FUNDAMENTALS RATHER THAN INFLATED RISK PERCEPTIONS

145 For a more detailed analysis of the role of credit agencies in Africa’s debt sustainability, please see the United Nations. (2022).
146 Moody’s Analytics, 2021.
147 Ray and Simmons. 2024 and UNCTAD. 2023.
148 Ray and Simmons .2024.

b). Increasing access to contingency financing by enhancing Africa's voice and representation in the IFA

Governance of the Bretton Woods Institutions has significant implications for Africa, especially regarding access to contingency financing and long-term concessional finance. The current IFA lacks an explicit developmental focus to prioritize the interests of the poorest and most vulnerable. With its youthful population and dynamic economies, Africa has been playing a leading role in making the development landscape more universal and equitable and giving more voice to the global South, as encapsulated in Agenda 2063. However, global economic governance has failed to keep pace with these developments, and the IFA remains skewed towards the developed economies as it continues to reflect the structure of the global economy as it was in the post-World War II era.

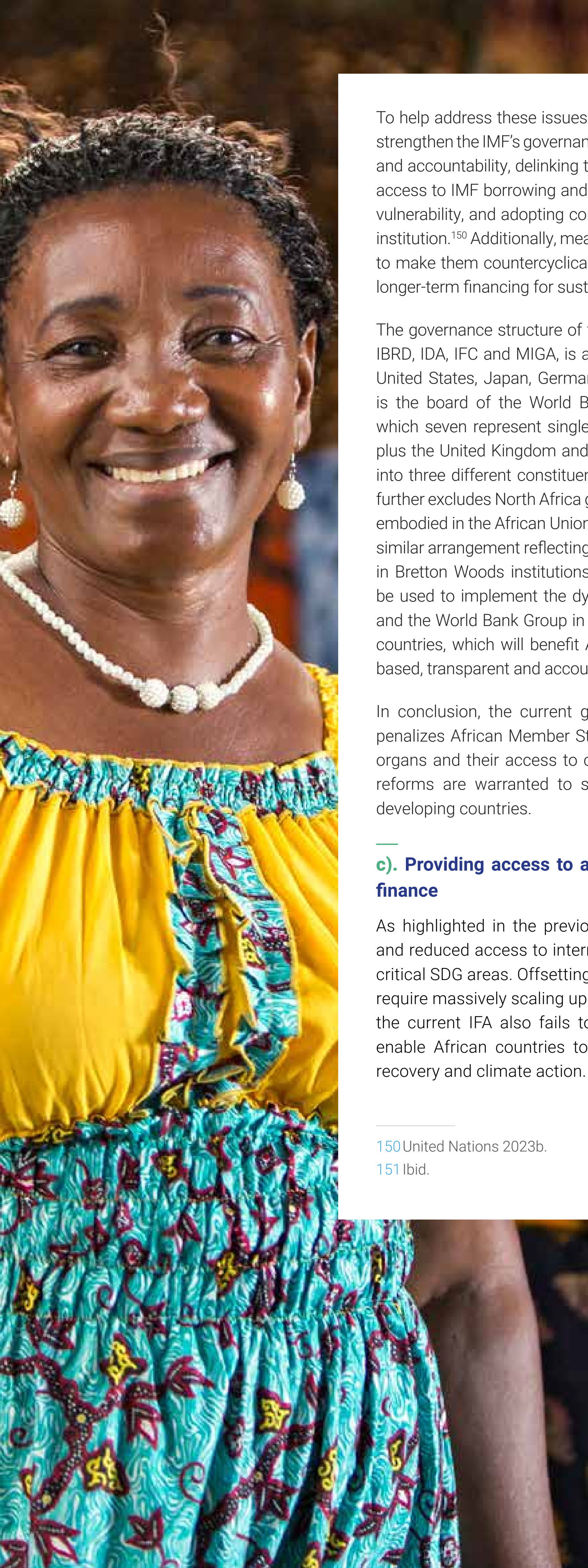
In spite of various calls for and attempts at reform, the governing structures of the Bretton Woods Institutions do not give Africa sufficient voice and representation. Rather, the largest developed economies hold effective veto powers and reform has proven untenable so far. Figure 4.3 below shows the current quota distribution at the International Monetary Fund.

The IMF quotas account for 95% of the voting rights and determine the conditions for access to funding. Currently, quotas are allocated based on a formula, agreed in 2008, weighing several factors, such as GDP (50%), trade openness (30%), capital flow volatility (15%), and level of reserves (5%). This formula favours large and open economies at the expense of smaller ones. Furthermore, the methodology is controversial in two aspects: First, there is no universally accepted proxy for measuring trade openness compatible with today's globalized economy. Second, this formula incorporates both a country's ability to pay back and its probability of requiring financial assistance – although these two are theoretically opposing factors.

As it stands, the governance structure of the Fund remains convoluted as it fails to separate the ability to pay from voting rights and Special Drawing Rights (SDR) allocations. In practice, the SDRs have been linked to the short-term liquidity provision. However, there have been calls in the past to explicitly make the SDR allocations counter-cyclical and link their issuance directly to development lending.[149] Nonetheless, there is no automatic adjustment mechanism to update quota and SDR allocations in response to recent development in the global economy. Consequently, SDR allocations are subject to the dynamics of long and protracted political negotiations that often end in a stalemate. Decisions are taken by simple majority and the amount of borrowing and SDR allocations are still linked to quotas. This also means that in the event of a crisis, often the most vulnerable countries have the least access to the concessional resources represented by SDRs.

Furthermore, access to this multilayered structure remains uneven and continues to disadvantage African economies. For instance, the COVID-19 pandemic required further immediate measures to address the rising healthcare costs while the governments were experiencing declining tax revenues due to the slowdown of economic activity. To bridge some of these gaps and inject liquidity into the system, the IMF Board approved a historic new round of SDR allocations in August 2021. Unfortunately, a critical opportunity was missed as the new round of SDRs were allocated in proportion to countries' quota shares in IMF. This means that although Africa is home to over 1.4 billion people, among which are more than 60% of the world's extreme poor, it received only 5.2% of the latest issuance of Special Drawing Rights (SDR).

149 UNCTAD has been at the forefront of these proposals, for example, envisioning a link between a universal SDR allocation and an automatic allotment to the World Bank earmarked for development lending and investment. Please see Orange-Leroy (2023) for a more detailed discussion.



To help address these issues, the Secretary-General has made a series of proposals to strengthen the IMF's governance, including by revising the quota formula to improve voice and accountability, delinking the ability to pay from voting rights and allocations, basing access to IMF borrowing and SDRs on a needs-assessment contingent on income and vulnerability, and adopting consensus-based decision-making to strengthen trust in the institution.[150] Additionally, measures should be adopted to automate SDR allocations and to make them countercyclical with a view to strengthening the link between SDRs and longer-term financing for sustainable development and climate change.

The governance structure of the World Bank Group, comprised of four entities, namely IBRD, IDA, IFC and MIGA, is also equally skewed. The five largest shareholders are the United States, Japan, Germany, France and China. The highest decision-making body is the board of the World Bank Group comprising 25 Executive Directors (EDs), of which seven represent single countries (the aforementioned five largest shareholders plus the United Kingdom and Saudi Arabia). By contrast, Sub-Saharan Africa is divided into three different constituencies divesting its weight and influence. This sub-division further excludes North Africa grouped with the Middle East. The political unity of Africa is embodied in the African Union which includes all of these sub-regions under one body. A similar arrangement reflecting the continent as one entity would benefit decision-making in Bretton Woods institutions. Furthermore, future rounds of capital increases should be used to implement the dynamic formula, agreed in the annual meeting of the IMF and the World Bank Group in Lima in 2015, to increase the voting shares of developing countries, which will benefit Africa. Decision-making should also be more consensus-based, transparent and accountable.[151]

In conclusion, the current governance structure in the Bretton Woods Institutions penalizes African Member States both in terms of their voice in the decision-making organs and their access to concessional funding through these institutions. Serious reforms are warranted to secure fairness and equity for Africa as well as other developing countries.

c). Providing access to adequate and predictable long-term concessional finance

As highlighted in the previous section, the combined impact of rising debt costs and reduced access to international financing has curtailed domestic investment in critical SDG areas. Offsetting these challenging and difficult conditions for Africa will require massively scaling up predictable long-term concessional financing. However, the current IFA also fails to provide adequate predictable long-term financing to enable African countries to invest in their sustainable development, including in recovery and climate action.

150 United Nations 2023b.
151 Ibid.

Public Development Banks (PDBs) are well suited to provide these types of funding. Hence, concerted efforts at the national and regional levels are needed to enhance the capacity of Africa's public development banks to provide financing at scale and scope for investment in the SDGs, Agenda 2063 and green energy transition. African countries have been pushing for the reallocation of some of the SDRs to regional multilateral development financial institutions to strengthen their lending power. In addition, the reform of the IFA must seek to:

i. optimize PDB and MDB balance sheets by leveraging callable capital and reducing the equity-to-loans ratio,

ii. inject new capital through recapitalization, and

iii. expand financial innovations such as mobilizing hybrid capital, including through recycled SDRs, facilitating risk transfers to both private and public entities to release capital.[152]

Exchange rate fluctuations add an additional risk factor to Africa's debt management efforts. To support the de-risking of African economies, MDBs should aim to lend to countries in local currencies and reduce Africa's debt risk profiles due to exchange rate volatility. MDBs could also promote using state-contingent clauses to suspend loan repayments automatically when countries are hit by external shocks, thereby easing the pressure on debt defaults.

Several countries have pioneered debt swaps to channel additional resources into priorities such as climate resilience. Such swaps have generally been undertaken due to the willingness of a creditor to address certain development and climate policy aims through such transactions or with the support of philanthropic partners for the same aims. Such mechanisms could be further deployed with increased institutional support, and aligned with the SDG stimulus principles, to allow upscaling in a more systematic manner. A concerted effort is required among creditors to move beyond niche swap proposals, to allow for 'debt for development' swaps at scale.[153]

The recent establishment of a task force among Multilateral Development Banks on credit enhancements during the 2023 UN Climate Change Conference (COP28)[154], including for debt swaps, could increase opportunities for using debt swaps for reprofiling expensive debt, and investing savings in SDGs or climate resilience.

d). Rethinking Debt Sustainability Analysis (DSA) to address sustainable development and resilience-building

Furthermore, the tools and instruments used by multilateral organizations, in particular Debt Sustainability Analysis (DSA), act as risk management tools for creditors, focusing on liquidity at the expense of solvency and prioritizing debt servicing over long-term developmental objectives, and resilience-building measures, including adaptation to climate shocks. DSA frameworks should be augmented to properly account for risk reductions that are inherent in SDG-focused and climate-resilient investments.

Further, DSA uses average expected interest rates based on market-determined interest rates for developing countries that have borrowed on commercial terms. Measuring debt sustainability based on market interest rates, without also considering the investment dividends, and increased resilience achieved from sustainable development investments, exaggerates the risk of default for African countries during a liquidity crisis. This is due to increased borrowing costs with unrealistic risk assessments in the African context leading initially to premature default expectations and ultimately to the self-fulfilling prophecy of default. The Secretary-General has called for a "solvency-focused" analysis to complement traditional DSA, for implementing the SDG Stimulus.[155]

SEVERAL COUNTRIES HAVE PIONEERED DEBT SWAPS TO CHANNEL ADDITIONAL RESOURCES INTO PRIORITIES SUCH AS

CLIMATE RESILIENCE

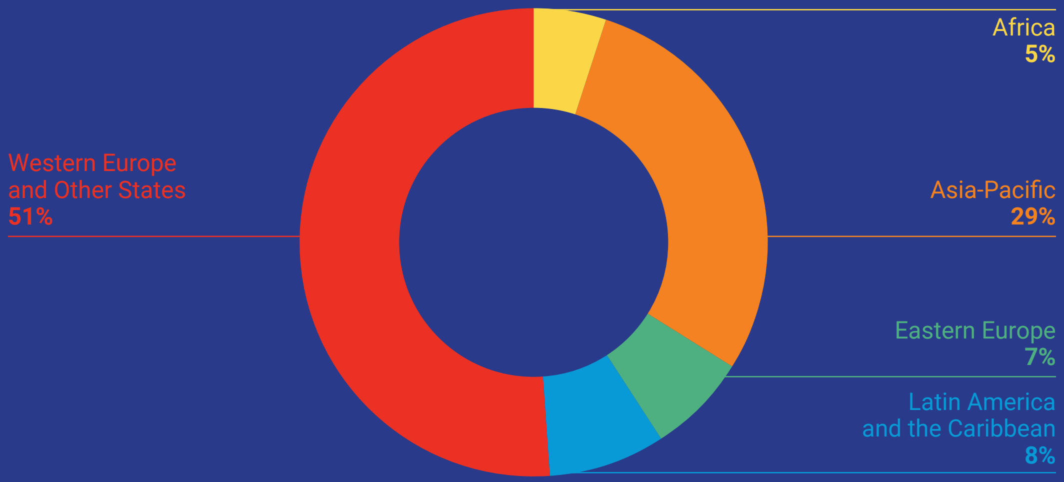
152 United Nations. 2023b.

153 IMF. 2024.

154 Joint Declaration- Regarding Credit Enhancement of Sustainability-Linked Sovereign Financing for Nature & Climate.

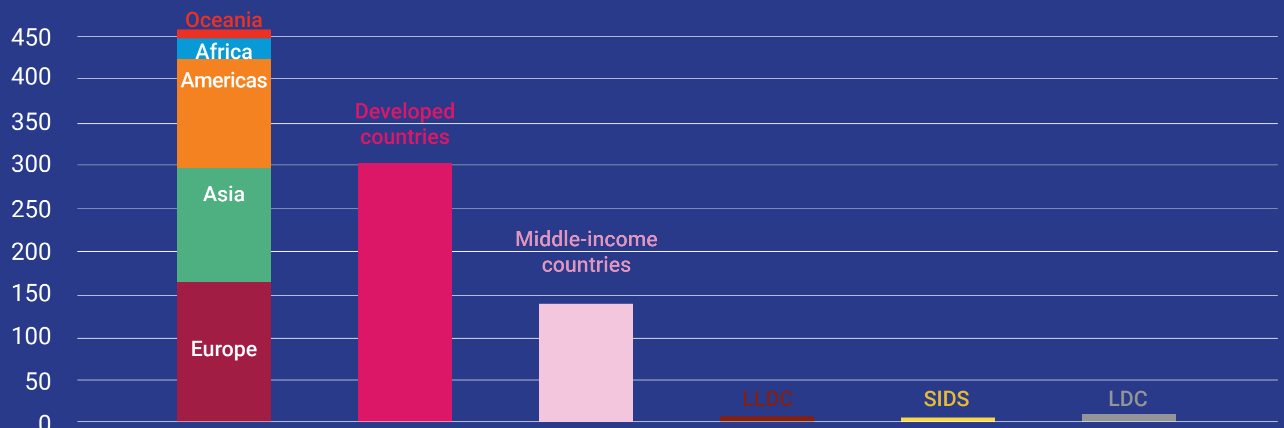
155 United Nations. 2023a

Figure 4.3 IMF Quota Distribution – Status Quo



Source: United Nations. 2023b.

Figure 4.4 Size of 2021 SDR Allocation by region and country group



Source: Adapted from United Nations. 2023b. (Underlying calculations by DESA based on IMF data).

A notable alternative to this restrictive interpretation of debt sustainability is UNCTAD's Sustainable Development Finance Assessment (SDFA), discussed in more detail in Box 4.1. The SDFA explicitly incorporates the financing requirements to achieve the SDGs and considers all sources of foreign currency revenues and external finance comprehensively.[156] Incorporating certain aspects of SDFA into the analysis of Africa's debt sustainability will help mainstream sustainability in the analysis of debt is a promising avenue to better understand the challenges and opportunities facing African policymakers in managing the continent's debt.

Box. 4.1. Mainstreaming sustainability in Debt Sustainability Analyses: UNCTAD's Sustainable Development Finance Assessment (SDFA)

Today's commonly used IMF–World Bank frameworks to assess debt sustainability can be considered essentially as risk management tools that serve first and foremost the interests of creditors. These tools are not fit for purpose for most African countries dealing with debt sustainability issues as they focus narrowly on the ability to repay the creditors and omit critical linkages between debt sustainability and development financing requirements. To address these shortcomings and building on its existing gap analysis frameworks, UNCTAD has developed the Sustainable Development Finance Assessment (SDFA) as a tool for identifying a given country's development finance needs to achieve the SDGs and the objectives of the Paris Climate Agreement, along with pathways to make this compatible with external financial and public debt sustainability. So far, UNCTAD has completed the first phase of the project (Mark 1), which explicitly addresses SDGs 1 to 4, i.e. no poverty, no hunger, access to health services and access to quality education. This phase has been tested in Pakistan and Sri Lanka to assess the long-term debt sustainability in the context of the COVID-19 crisis. As such, the SDFA marks a shift away from sequential prioritization of meeting short-run external debt obligations - which have become even more stressful in the midst of the economic fallout of COVID-19 - to a longer-term debt framework.

The next phase (Mark 2) will expand the analysis to cover SDG 13 as well as the climate-related aspects of all other goals. This phase will enable the assessment of a country's financial needs to undertake the required investments and achieve a climate-resilient and green structural transformation without compromising the sustainability of its external and public sector accounts. The SDFA considers all sources of external financing (foreign direct investment, foreign portfolio investment and external debt) as well as public sector finance (public debt and other public sector liabilities) comprehensively and offers various policy options to maintain financial sustainability while achieving SDGs. In conclusion, the SDFA is built on the premise of ensuring sustainable development goals and aspirations are explicitly considered within fiscal decision-making. This approach is not intended to substitute but rather complement the analytical work carried out by the Bretton Woods institutions regarding countries in debt distress by introducing an additional sustainability perspective. Initial phases of the project have provided valuable additional insights and a much broader perspective in addressing debt sustainability which can be scaled up beyond the pilot countries to cover Africa and other developing regions.

Sources:

1. UNCTAD (2022). UNCTAD Sustainable Development Finance Assessment (SDFA) Framework: Linking debt sustainability to the achievement of the 2030 Agenda.
2. UNCTAD (2023). Trade and Development Report 2023: Growth, Debt and Climate – Realigning the Global Financial Architecture

156 The SDFA has so far been applied in the case of a small number of developing countries but can be scaled up to cover many African economies.

e) Debt Crisis Prevention and Resolution - moving away from contingency measures to long-term debt restructuring and financing needs of Africa

Amid the growing debt vulnerabilities of African and other developing countries, continued efforts are needed to improve debt crisis prevention and resolution. Efforts at national and international levels will be necessary to address liquidity challenges, improve debt transparency, mitigate systemic risk, facilitate smooth debt restructurings, ensure macroeconomic stability and create fiscal space for investment in the SDGs.

The international community experimented with numerous initiatives and mechanisms to address the debt problems of developing countries, including Africa with mixed results. Most of these initiatives have been focused on short-term liquidity issues. As such, they amounted to little more than band-aid solutions, which failed to address the underlying problems. For instance, the Heavily Indebted Poor Countries (HIPC) initiative successfully reduced the external debt burden of African countries in the short term. In theory, this should have freed up resources for investments in infrastructure and social development. However, as the initiative was conditional on governments undertaking austerity measures, often in the form of a series of economic and social reforms and meeting certain economic and management performance criteria, it failed to deliver medium to long-term debt sustainability coupled with poverty reduction. The debtor countries, especially those in Africa that would benefit from the initiative, had little or no say in the initial design and were excluded from the key decision-making processes. This excessive conditionality led to a stigma for participating countries limiting its uptake and efficiency[157].

Table 4.1 A snapshot of the HIPC Initiative as of January 2023

Post Completion Point Countries (36)		
Afghanistan	The Gambia	Nicaragua
Benin	Ghana	Niger
Bolivia	Guinea	Rwanda
Burkina Faso	Guinea-Bissau	Sao Tomé e Principe
Burundi	Guyana	Senegal
Cameroon	Haiti	Sierra Leone
Central African Republic	Honduras	Tanzania
Chad	Liberia	Togo
Comoros	Madagascar	Uganda
Republic of Congo	Malawi	Zambia
Democratic Republic of Congo	Mali	
Cote d’Ivoire	Mauritania	
Ethiopia	Mozambique	
Interim (between decision and completion point) (2)		
Somalia	Sudan	
Pre-Decision Point Countries (1)		
Eritrea		

Source: IMF Factsheet on HIPC Initiative

157 Gunter, B. 2002.

In response to the shortcomings of the early HIPC initiative, further measures were adopted in 2005 to grant debt cancellation to heavily indebted poor countries through the combination of HIPC and the Multilateral Debt Relief Initiative (MDRI), launched by the Finance Ministers of the G-8 countries during the Gleneagles Summit in 2005.

MDRI broadened the reach of the HIPC initiative by providing debt relief to HIPC as well as non-HIPC countries with per capita income of US$380 or less. However, the aforementioned conditionalities remained. A total of thirty-seven countries benefitted from the MDRI over its life span.[158]

In conclusion, the HIPC and MDRI initiatives successfully relieved 37 participating countries of more than $100 billion in debt.[159] Yet, these results proved short-lived as the African Member States faced mounting challenges to debt sustainability as the debt programmes had a short-term focus on the ability to repay rather than putting the indebted countries back on track towards economic growth and poverty reduction. The Initiatives also faced challenges in ensuring full participation by creditors and failed to promote long-term debt sustainability, responsible lending and borrowing, and the structural transformation of the respective economies to benefit from intra-African and global trade.

Debt Service Suspension Initiative (DSSI) and G-20 Common Framework beyond the DSSI

The debt landscape was once again fundamentally altered with the onset of the COVID-19 pandemic, which caused a recession in 2020 and is estimated to have pushed an additional 100 million people back into extreme poverty.[160] This proved to be a serious setback for many African countries, which already had to deal with mounting debt sustainability challenges. In response, the G-20, World Bank and IMF established the Debt Service Suspension Initiative (DSSI) as a short-term emergency initiative with a view to supporting countries undertake the necessary investments to fight the pandemic and save the lives and livelihoods of their most vulnerable populations.

Overall, the initiative ran from May 2020 and December 2021, but only 48 out of the 73 eligible countries availed themselves of the facility with an estimated debt suspension of $12.9 billion.[161] DSSI promoted more debt transparency and disclosure. The G-20 also called on the private sector to participate in the initiative under the same terms, yet this call went largely unheeded. According to the World Bank, only one corporation joined the initiative.[162] The uptake of the DSSI has been slow due to the risk of countries being downgraded.

The G-20 Common Framework for Debt Treatment beyond the DSSI (Common Framework), launched jointly with the Paris Club in November 2020, is an institutional innovation, designed to provide DSSI-eligible countries with debt relief by bringing together multiple creditors and debtors within a common framework. The first countries to join the framework were all African: Chad (January 2021) followed by Zambia, Ethiopia (February 2021) and Ghana (January 2023).

The G20 Common Framework needs to become more effective and fit for purpose. However, it suffers from the shortcomings of the past debt relief initiatives in that it has done too little, too late to provide durable and comprehensive debt relief. The first countries to apply for debt relief from the Common Framework did so in early 2021 and the process has taken upwards of two years with questionable results.

THE HIPC AND MDRI INITIATIVES SUCCESSFULLY RELIEVED

37

PARTICIPATING COUNTRIES OF MORE THAN

$100 BILLION

IN DEBT.

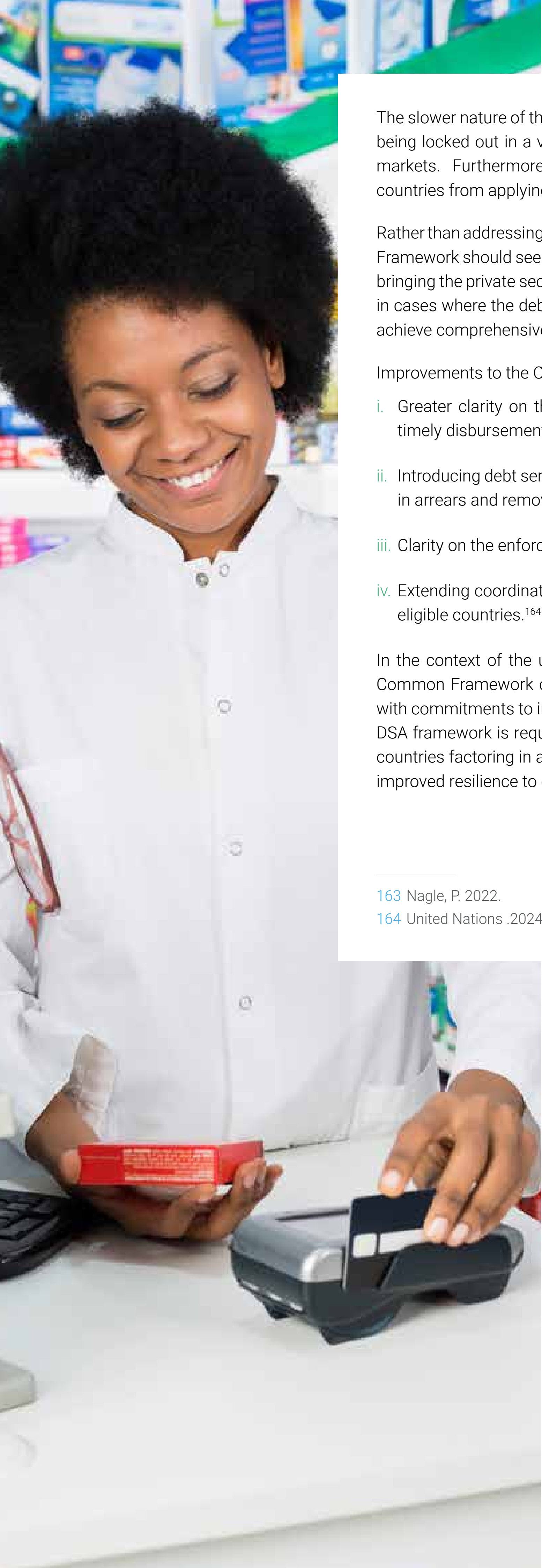
158 Afghanistan, Benin, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Central African Republic, Republic of the Congo, Democratic Republic of the Congo, Comoros, Cote d'Ivoire, Ethiopia, the Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, Tajikistan, Togo, Uganda and Zambia.

159 Heavily Indebted Poor Countries (HIPC) Initiative

160 Debt Service Suspension Initiative

161 Ibid.

162 *Ibid*.



The slower nature of the existing debt workout mechanisms results in debtor countries being locked out in a vicious cycle of debt while losing access to finance and export markets. Furthermore, the Common Framework restricts many middle-income countries from applying, thereby excluding countries with considerable debt.

Rather than addressing the most acute situations on a case-by-case basis, the Common Framework should seek to provide a comprehensive solution to debt sustainability also bringing the private sector to participate in the mechanism to broaden its reach. Finally, in cases where the debt is not sustainable, significant debt reduction is undertaken to achieve comprehensive debt relief rather than temporary improvements in liquidity.[163]

Improvements to the Common Framework are sought along the following areas:

i. Greater clarity on the steps and timelines of the Common Framework to enable timely disbursement of funding and support;

ii. Introducing debt service suspension during the negotiation process to avoid buildup in arrears and remove liquidity constraints;

iii. Clarity on the enforcement of comparability of treatment; and

iv. Extending coordinated debt treatment to highly indebted non-Common Framework eligible countries.[164]

In the context of the urgency of delivering an SDG stimulus, a reformulation of the Common Framework could envisage an immediate suspension of debt repayments, with commitments to invest in SDG priorities. (Box 4.1) Furthermore, a re-design of the DSA framework is required to better account for the development needs of individual countries factoring in a 'resilience dividend' from appropriate investments that provide improved resilience to external shocks.

163 Nagle, P. 2022.
164 United Nations .2024.

THE COMMON FRAMEWORK SHOULD SEEK TO PROVIDE A COMPREHENSIVE SOLUTION TO **DEBT SUSTAINABILITY.**

Box. 4.2. Blueprint towards a debt service suspension for the sustainable development goals (DSSSDG)

Building on the DSSI initiative, which was put in place to tackle the urgency of responding to the COVID-19 pandemic, the UN Secretary General's proposed SDG stimulus calls for a review of the initiative to identify ways in which such suspensions could pave the way for more effective long-term debt solutions.[1]

According to the data in Chapter 3 (Figure 3.4), Africa's debt service between 2024 and 2030 is expected to total 463 billion USD. Hence, a debt suspension for the SDGs could provide a meaningful injection of resources at precisely the time when an urgent acceleration is needed.

Below is a consideration of some possible steps that can be taken to facilitate a debt suspension of debt servicing with a view to accelerating resources available for investing in the SDGs.

It is recognized that countries will require different levels of support and capacity development to be able to implement such a scenario, and the UN system and other development institutions should be prepared to provide appropriate support at the country level.

1) Integrated National Financing Frameworks (INFFs)[2]
86 countries, 36 of which are in Africa, have initiated INFFs, which have aimed to identify potential sources of financing to attain the SDGs, including through the strengthening of DRM capacity and optimization of opportunities to mobilize development financing and private sector investment. Country-specific strategies allow the identification of country-relevant pathways to mobilize the resources required, including the proportion of debt required.

2) Debt Sustainability Analysis to factor in the cost of attaining SDGs
With the support of IFIs, countries should undertake Debt Sustainability Analyses to determine the extent to which debt service may impede investment in the SDGs while also factoring in the resilience-building benefits of SDG realization.

3) Country-led commitment process with 2030 timeline
Countries should be encouraged to make an 'SDG acceleration commitment' linked to a potential investment in transformative sectors. This should also be linked to country-defined Key Performance Indicators (KPIs) and milestones and aligned with internal budgetary processes to ensure domestic ownership.

4) Creditor commitments
On the basis of countries' commitments, creditors can be invited to make a debt suspension commitment for a defined duration linked to the attainment of the KPIs related to the selected SDGs.

5) Implementing Debt Service Suspension
Debtors and creditors implement debt service suspension linked to the attainment of identified SDGs and agreed KPIs based on proposals from debtor countries.

6) Identification of further mechanisms for improved debt sustainability aligned with INFF
During the period of suspension, countries may further seek means of improving their debt sustainability by further exploring mechanisms such as debt reprofiling or debt for development swaps

Sources:

1. United Nations. (2023). United Nations Secretary-General's SDG Stimulus to Deliver Agenda 2030
2. Integrated National Financing Framework Knowledge Platform

4.3 Conclusion and Recommendations

The following key recommendations are proposed:

Increasing predictable access to affordable and concessional finance

- Development partners are urged to deliver on their ODA pledges and ensure aid effectiveness broadly, and specifically by targeting 10 per cent of ODA toward institution and capacity building, including toward digitization to help build strong DRM systems in Africa.

- Reform of the IFA should adopt measures which include positioning the MDBs to focus on long-term lending (with 30 to 50 years maturity), with longer grace periods, increasing MDBs capital by implementing the G20 capital adequacy frameworks, re-channelling SDRs issuing hybrid capital and raising new capital and facilitating risk sharing to between public and private entities. MDB balance sheets should be optimized by leveraging callable capital. MDBs should advance lending to countries in local currencies as a means of reducing the impact of currency-related increases in debt servicing. Governments should further develop domestic capital markets, supported by development partners, to provide a broader range of financing tools denominated in local currencies.

- The IFA lacks an explicit focus on enhancing sustainable development. This calls for the reform of the IFA to provide increased, predictable contingency and long-term concessional financing at scale and speed for sustainable development, including strengthening African countries' resilience to climate change by providing resources for adaptation. Proposed measures include reforming the MDBs to focus on long-term lending -30-50 years, with longer grace periods, increasing MDBs capital by implementing the G20 capital adequacy frameworks review recommendations, re-channelling SDRs, issuing hybrid capital and raising new capital. MDBs should advance lending to countries in local currencies as a means of reducing the impact of currency-related increases in debt servicing. Governments should further develop domestic capital markets, supported by development partners, to provide a broader range of financing tools denominated in local currencies.

High Cost of Borrowing

- Amidst tightening global financing conditions due to the exorbitant interest rates paid by African countries, the external debt burden of African countries has increased substantially, especially since the COVID-19 Pandemic, with 39 African countries facing debt stress. With further sovereign credit downgrades for several African countries, many face constrained access to capital market, while their financing needs have increased (for SDG and climate financing). These countries will require new funding, including through debt restructuring and reducing the cost of capital, a significant reduction in their Net Present Value of the external public and publicly guaranteed debt, and new financing at very low cost, debt suspension, and credit enhancement to ensure that new borrowing does not jeopardize future debt sustainability.

- Converting short-term high-interest borrowing into long-term (more than 30 years) debt at lower interest rates will be necessary to reduce African countries' high cost of borrowing, thereby creating fiscal space for investment in SDGs.

Reform of the Common Framework and support to countries in debt distress

- Many African countries are in debt distress. Solving their debt burden will require a comprehensive yet differentiated approach tailored to each country's situation: African countries in debt distress and with constrained access to international capital markets due to high borrowing costs and sovereign credit rating below investment grade need debt relief, including restructuring, liquidity support, reduction of borrowing cost and credit enhancement, as well as debt write-offs and debt standstills to create the space for investing in the SDGs. Deploying a debt service suspension linked to achieving the SDGs is urgent and essential in view of the rising diversion of resources toward debt servicing.

DEVELOPMENT PARTNERS ARE URGED TO DELIVER ON THEIR

ODA PLEDGES AND ENSURE AID EFFECTIVENESS BROADLY,

AND SPECIFICALLY BY TARGETING 10 PER CENT OF ODA TOWARD INSTITUTION AND CAPACITY BUILDING.

- Efforts are needed to improve the G20 Common Framework to make it more effective and fit for purpose. Beyond expanding eligibility to Middle-Income Countries in debt distress, further steps to improve the effectiveness of the Common Framework include greater clarity on the process and timelines to enable timely disbursement of funding, introduction of debt service suspension during the negotiation process to avoid buildup in arrears and remove liquidity constraints; and increased transparency on the enforcement of comparability of treatment will go a long way toward improving the effectiveness of the Common Framework.

- To further improve the orderly implementation of debt treatment and to ensure that development considerations are prioritized, the creation of a Sovereign Debt Authority within the remit of IFIs could be considered.[165]

- To tackle the urgency of implementing the SDGs, a debt service suspension initiative could be considered to free up fiscal space up to 2030.

Creating fiscal space through financing innovations

- The deployment of financing innovation tools should be linked to the reinforcement of capacities for DRM, situated within coherent INFFs.

- The systematic use of state-contingent clauses to automatically suspend debt repayments for countries hit by external shocks can help reduce the risk perception of vulnerable countries and provide fiscal space and liquidity to respond to these shocks.

- Debt swaps can be used by countries facing fiscal constraints associated with debt servicing due to unfavourable external conditions or the high cost of debt service. They can smooth repayment profiles, reduce currency exposure, and free up fiscal space for investment in the SDGs, e.g., in the form of debt-for-development/nature/climate swaps. Swaps should be situated within a comprehensive DRM strategy to ensure long-term financing.

Regional cooperation to improve access to affordable finance and deepening regional investment

- Additional measures at the regional level would be necessary to further strengthen the financing for development architecture, including eliminating barriers to the cross-border flow of capital, pooling resources for transboundary infrastructure projects to further unlock the benefits of the African Continental Free Trade Agreement (AfCFTA). The ongoing efforts by the AUC to create key Pan-African Financial Institutions such as the African Investment Bank, the African Monetary Fund are notable endeavours in this direction. There is a need to intensify efforts to accelerate the operationalization of these continental financial institutions.

- Existing continental financing MDBs, such as the African Development Bank require strengthening, while regional development banks have a critical role to play in also further delivering capital to Africa's sub-regions.

These recommendations represent practical solutions that can be driven in part by efforts led by African countries themselves. Focusing on domestic resource mobilization can help play a de-risking role for African economies and unlock more predictable financial flows. However, the long-term solutions cannot be divorced from the need to reform the international financing architecture. This requires a reset of the system's fundamentals to be focused on development outcomes. This will mean looking at new flows of finance through MDBs specifically identified to help accelerate attainment of the MDBs, while also addressing debt resolution mechanisms to ensure that debt is not an impediment to development.

165 United Nations. 2023b.

The United Nations' 2030 Agenda for Sustainable Development and the African Union's Agenda 2063 provide the template for the economic transformation required.

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Conclusion

Africa's debt challenges date back to the pre-independence period, yet colonial debt has been given scant attention in the literature. Most colonial debt was transacted primarily to finance infrastructure development necessary to facilitate the extraction and export of Africa's minerals and raw materials. With independence, although many governments invested heavily in social sectors (health and education), and in industrialization (often through import substitution strategies) borrowing did not lead to production diversification and structural transformation.

This lack of economic transformation is in part due to missed opportunities from African governments themselves. Some governments resorted to profligate and reckless spending, in many cases to finance personal aggrandizement of elites. This odious debt has contributed to Africa's indebtedness. Debt relief initiatives have never factored the burden of odious debt of indebtedness and development.

Debt relief efforts have also failed to address the root structural problems of African economies, therefore often leading countries that have benefited in the past from debt relief to be faced with recurrent debt challenges and large scale global shocks. The persistence of the extractive nature of African economies has, in many instances, been reinforced by the evolution of the international financing architecture.

In recent years, there has been an increasing shift towards domestic debt as a means of financing development. This has been true for countries with relatively well-developed financial systems. However, due to their short maturity, domestic debt financing has been costly, posing challenges for macroeconomic and debt management, including the risk of potential crowding out of private investment. African countries tend to use domestic debt financing in an ad-hoc way, mainly for short-term liquidity purposes. It is critical to align lending with defined strategic development priorities centred on attaining the SDGs.

Improved macroeconomic environment and creditworthiness have increased the attractiveness of African countries to international bond markets. Recent external borrowing from African countries has seen a marked increase in debt to private creditors as well as expansion to new bilateral lenders such as China. External debt has increased considerably, but Multilateral Development Banks still hold the most significant portion of African countries' debt. With the tightening of global financing conditions following the COVID-19 pandemic, many African countries saw an increase in their external debt. However, external debt as a percentage of GDP averaged only 28 per cent - considerably below the level for other developing countries in other regions. More disconcertingly, debt servicing costs have increased stratospherically—faster than the growth in export earnings. This is crowding out development spending: more than 40 per cent of African countries allocated more funds to debt service than health expenditures in 2020. The immediate challenge of debt for African countries is not so much the risk of insolvency, but the diversion of resources away from SDG priorities at the time that they are needed most urgently. This diversion is also coinciding with a constrained environment for potential increases in Official Development Assistance

The unfair international financial and debt architecture has heightened Africa's debt vulnerability through very elevated interest rates and prioritizing repayment of creditors at the expense of investment in resilience. With fiscal space already eroded and very high debt service payments coming up amid tightening global financing conditions and liquidity pressures, and without increased financing and support, African countries risk falling further behind in achieving the SDGs. All these challenges underscore the urgency of reforming the IFA to align it with the imperative of boosting investment to accelerate the achievement of the SDGs and the AU's Agenda 2063.

The urgency of action can be summarized in three spheres of intervention:

1. At the national level

African countries need to develop Integrated National Financing Frameworks that allow them to identify potential financial flows and mobilization means. These frameworks must be anchored within national strategies that deliver economic transformation, moving beyond extractive models prioritizing the export of raw materials to integrated domestic and regional value chains that provide resilience to external shocks. The frameworks must also seek to develop Domestic Resource Mobilization as a de-risking tool, allowing for predictable financial flows to be allocated to national priorities. A commitment to debt transparency also allows for increased accountability to African citizens. Meanwhile, debt strategies must be aligned to developmental priorities, avoiding the accumulation of ad hoc debt. Ultimately a majority of African countries still have borrowing space to invest in their priorities. This investment must be done to maximize the transformative and developmental impact.

2. At the regional level

Regional institutions need to be strengthened to support African countries' development ambitions. The availability of resources through the African Development Bank (AfDB) and other regional banks needs to be reinforced- including through the rechanneling of Special Drawing Rights (SDRs). Through continental financial institutions, more engagement with Credit Ratings Agencies (CRAs) on regionally relevant approaches to setting risk premia is required to avoid the continued unfairness of higher cost of capital of investing in Africa. The acceleration of implementation of the AfCFTA can help accelerate the development of regional value chains, contributing to the transformation of Africa's economic model. This includes a focus on tackling the continent's energy and food security needs as the basis for sustainable industrialization.

3. At the Global Level

The reform of the International Financial Architecture is a foremost priority. This includes ensuring that there is a predictable availability of resources aligned to the SDGs, as well as fast-moving and development-centred mechanisms to allow for equitable debt resolution for countries facing debt distress. Multilateral Development banks should consider leveraging their balance sheets to increase the overall amounts of affordable development finance available. They should also take on the cost of increased use of de-risking tools (such as guarantees). They should also look to take on options for local currency lending, recognizing that they are better placed to take on this risk in times of volatility. Perhaps most urgently, an immediate debt suspension should be considered to allow for freeing up fiscal space for African countries to invest in the SDGs.

The United Nations' 2030 Agenda for Sustainable Development and the African Union's Agenda 2063 provide the template for the economic transformation required. The urgency of action is amplified by the continued risks of external shocks evident in the form of global economic uncertainties and the continued unacceptable human cost of climate change on the world's poorest and most vulnerable.

We are nearing the end of a 'Decade of Action' to accelerate the achievement of the Sustainable Development Goals. Urgent action is needed so we do not miss existing opportunities and look back on a 'lost decade'.

These interventions can help frame an approach toward transforming Africa's debt from a recurrent risk to a source of predictable and sustainable investment in Africa's future.

THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

IS A FOREMOST PRIORITY. THIS INCLUDES ENSURING THAT THERE IS A PREDICTABLE AVAILABILITY OF RESOURCES ALIGNED TO THE SDGS.

The United Nations Office of the Special Adviser on Africa (OSAA) is an entity of the UN Secretariat established to enhance international support for Africa's development and security, assist the Secretary-General in coordinating the UN's support to Africa, facilitate inter-governmental deliberations on Africa at the global level and establish a monitoring mechanism for commitments on Africa's development.

OSAA also convenes and chairs the Interdepartmental Task Force on African Affairs (IDTFAA) while providing global advocacy support for the New Partnership for Africa's Development (NEPAD).

The work of the Office is clustered around the six thematic areas of:

Financing for Development;

Sustainable Development to Promote Sustainable Peace;

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Energy and Climate Action.

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