High debt distress risk – a ‘typically’ African problem?

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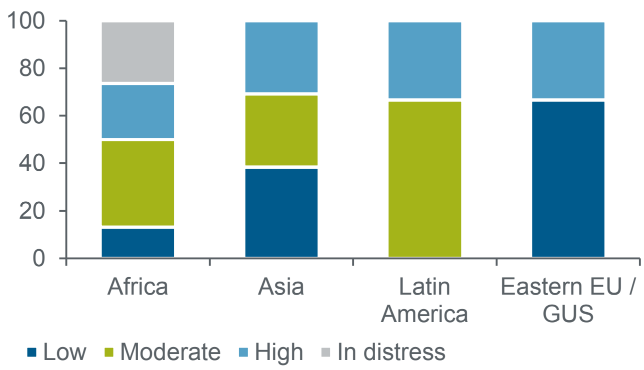
Low-income countries in Africa suffer from high debt burdens relatively more often than countries of the same classification in other regions of the world. Why is this? Governance problems are often cited as being the cause but this correlation applies only to a limited extent when we compare how individual states perform against the customary governance standards. On closer inspection, the reasons indeed appear to be the old familiar ones – irrespective of the overall rating in the governance indexes: excessively generous fiscal policy, inadequate debt management and an insufficient data basis. At first sight, the statement that excessively high debt is the result of overspending may appear trivial. But what plays a crucial role here is the nature of the expenditures, weak revenue collection, a low desire to consolidate and vulnerability to external shocks.

A new old problem

Debt in low-income countries (LICs) has been a focus of discussion again for quite some time now.[1] One aspect that stands out is that according to the IMF, African LICs on average are much more affected by debt distress risks than Asian ones, for example (Figure 1).

Figure 1: Debt distress risks in LICs

In per cent



Source: IMF, KfW Research

The cause: bad governance?

Governance and institutions are regarded as a core problem.[2] However, the picture becomes less clear if we look at various common indicators used to assess governance quality and institutional frameworks (see Figure 2).

No clear link

One would expect states that score poorly on the World Bank’s World Governance Indicators, the Ibrahim Index of African Governance of the Mo Ibrahim Foundation, Transparency International’s Corruption Perceptions Index and the World Bank’s Doing Business Index to also have particularly high debt ratios and debt distress risks and vice versa. That is actually the case for some, as countries such as Chad, Somalia, South Sudan, Sudan, and Zimbabwe exhibit a combination of poor indicator values (mostly ‘red’ in Figure 2) and a poor debt sustainability rating (‘in distress’). Conversely, countries such as Lesotho, Rwanda and Tanzania show the expected combination of low debt sustainability risk and good indicator values (predominantly ‘dark green’).

However, several countries such as Ghana, Mozambique and Zambia disrupt this suspected link between governance and debt sustainability. Despite good to very good scores on the indicators mentioned above, the debt situation is of concern or bad. The South Asian and Southeast Asian countries used for comparison do not fit into the picture in this respect either. Vietnam is still most likely to support the suspected correlation between good governance indicators and debt sustainability, despite achieving modest scores on the Corruption Perceptions Index and the ‘Voice and Accountability’ indicator, while Bangladesh, Cambodia and Nepal deviate from it significantly. Unlike Ghana, Mozambique and Zambia, they obtained good ratings for their probability of debt distress despite satisfactory to modest governance indicators.

Classic governance indicators are of secondary importance

Accordingly, governance – at least in the way it is measured by the World Bank’s indicators – cannot be deemed a crucial determinant of debt distress risk across the board. A closer look reveals that fiscal policy is a particular problem in these countries. Ghana, Mozambique and Zambia have all pursued generous spending policies in the past years. Ghana, for example, had an average budget deficit in excess of 9% of GDP during the period from 2010 to 2016. These expenditures are often not used for productive investment and have therefore insufficiently translated into growth.[3] At the same time, their revenues, especially from taxation, remain below potential.[4] Another problem that makes it difficult to design policies and manage debt is a poor data basis.[5] Fiscal policy cannot be efficiently managed without an appropriate statistical basis. Besides, the absence of data also prevents external observers such as the IMF from making an (early) diagnosis. As a positive example, the IMF has highlighted the fiscal consolidation measures aimed at reducing debt in Nepal.

It's (not only) fiscal policy, …!

What is crucial, therefore, are the countries' capacities in fiscal policy and supporting areas such as statistics. Also helpful is a broad export basis that reduces their vulnerability to external shocks. The Atlas of Economic Complexity[6], which measures the degree of differentiation of national economies on the basis of their exports, among other parameters, lists Vietnam and Cambodia as examples of countries that have significantly improved their position in the ranking in the past years. By contrast, the position of Ghana, Mozambique and Zambia has stagnated or even deteriorated. The diagnosis of growing debt in low-income countries therefore leads to the conventional recommendations: reduce mere consumption expenditure, improve revenues, perform active debt management and broaden the export basis.

This allows the conclusion that the characteristics mapped in the World Bank Governance Indicators, the Corruption Perceptions Index and the Ease of Doing Business Index are rather of secondary importance for debt and debt management.[7] In other words, fiscal and debt management are indeed governance themes but they are only inadequately reflected in the conventional indicators. So in order to assess a country's debt distress risk, what would be desirable is an indicator that combines data on revenues and expenditure and their use with figures showing the degree of differentiation of the export sector including the current account balance. Using such an indicator as a basis, it would then be possible to explore in a more differentiated manner to what extent the causes of growing debt tend to be 'typically' African. ■

[1] Cf. Rehbock, T. and Kramer, A. (2018); **Low-income country debt: the worry lines are not easing off**, Focus on Economics No. 234. KfW Research.

[2] For example: Brookings (2019) Reconciling financing needs and rising debt levels (https://www.brookings.edu/research/reconciling-financing-needs-and-rising-debt-levels/ or https://openknowledge.worldbank.org/handle/10986/31066).

[3] IMF (2018) Macroeconomic Developments and Prospects in Low-Income Developing Countries (https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/03/22/pp021518macroeconomic-developments-and-prospects-in-lidcs).

[4] Brookings (2018) Better tax collection can help tackle rising debt in Africa and the challenge of development finance (https://www.brookings.edu/blog/africa-in-focus/2018/10/22/better-tax-collection-can-help-tackle-rising-debt-in-africa-and-the-challenge-of-development-finance/) and
IMF (2019) Case Studies in Tax Revenue Mobilization in Low-Income Countries (https://www.imf.org/en/Publications/WP/Issues/2019/05/14/Case-Studies-in-Tax-Revenue-Mobilization-in-Low-Income-Countries-46719).

[5] IMF (2018) G20 notes on strengthening debt transparency (https://www.imf.org/external/np/g20/pdf/2018/072718.pdf).

[6] http://atlas.cid.harvard.edu/

[7] However, that does not mean that these governance themes are irrelevant for how debt burdens develop. For example, an improvement in the CPI ranking or the Doing Business Index can bring about more sustainable economic growth in the medium to long term, which can then positively impact on the debt position.

Figure 2: Debt situation and governance indicators

Country	IWF-DSA[1]	IIAG 2018[2] value	CPI 2018[3] ranking	World Bank Governance Indicators[4]: Control of Corruption	Government Effectiveness	Political Stability	Regulatory Quality	Rule of Law	Voice and Accountability	Sum of indicators	Doing-Business[5]: Ranking 2019	Point average 2016–2019
Ethiopia	3	46.5	107	-0.61	-0.60	-1.57	-1.02	-0.68	-1.29	-5.76	159	47.26
Benin	2	58.7	85	-0.61	-0.53	0.29	-0.46	-0.56	0.25	-1.61	153	50.14
Burkina Faso	2	57.1	74	-0.29	-0.60	-0.31	-0.27	-0.43	-0.26	-2.16	151	51.31
Burundi	3	39.8	157	-1.16	-1.21	-1.68	-1.04	-1.18	-1.01	-7.28	168	46.80
Djibuti	3	45.1	122	-0.56	-0.89	-0.25	-0.64	-0.83	-1.23	-4.40	99	52.70
Côte d'Ivoire	2	54.5	103	-0.90	-1.04	-1.48	-0.76	-1.12	-0.90	-6.21	122	53.13
Eritrea	4	29.3	165	-0.66	-1.36	-0.77	-2.07	-1.29	-2.13	-8.29	189	22.75
Gambia	4	54.9	130	-0.65	-0.66	0.01	-0.41	-0.48	-1.02	-3.22	149	51.07
Ghana	3	68.1	81	-0.13	-0.09	0.03	-0.05	0.02	0.43	0.20	114	57.25
Guinea	2	45.9	148	-1.05	-1.10	-1.30	-1.04	-1.35	-1.07	-6.91	152	49.41
Guinea-Bissau	2	40.2	171	-1.28	-1.31	-0.62	-1.13	-1.34	-0.85	-6.53	175	42.00
Cameroon	3	46.2	153	-1.11	-0.83	-0.62	-0.84	-1.08	-1.03	-5.51	166	45.64
Kenya	2	59.8	143	-0.97	-0.51	-1.25	-0.24	-0.77	-0.22	-3.96	61	63.99
Comoros	2	47.5	148	-0.76	-1.62	-0.45	-1.33	-0.99	-0.39	-5.54	164	48.29
Congo, Dem. Republic	2	32.1	161	-1.38	-1.61	-2.17	-1.43	-1.61	-1.42	-9.62	184	36.25
Congo, Republic	4	39.8	161	-1.14	-1.19	-0.65	-1.23	-1.19	-1.09	-6.49	180	39.93
Lesotho	1	57.1	74	0.05	-0.43	0.03	-0.53	-0.19	0.00	-1.07	106	59.48
Liberia	2	51.6	122	-0.78	-1.32	-0.93	-1.20	-1.04	-0.37	-5.65	174	41.99
Madagascar	2	49.0	155	-0.50	-0.86	-0.30	-0.48	-0.64	-0.43	-3.20	161	46.28
Malawi	2	55.8	122	-0.60	-0.61	0.00	-0.61	-0.20	-0.22	-2.26	111	54.90
Mali	2	50.1	122	-0.64	-0.84	-0.66	-0.49	-0.45	0.02	-3.05	145	52.65
Mauritania	3	43.4	143	-0.68	-0.78	-0.59	-0.59	-0.81	-0.88	-4.33	148	49.65
Mozambique	4	51.0	153	-0.60	-0.63	0.02	-0.51	-0.70	-0.17	-2.60	135	54.02
Niger	2	51.2	112	-0.70	-0.68	-0.84	-0.57	-0.60	-0.35	-3.74	143	50.96
Rwanda	1	64.3	48	0.20	-0.17	-0.42	-0.28	-0.37	-1.24	-2.28	29	72.60
Zambia	3	56.2	96	-0.45	-0.71	0.33	-0.51	-0.40	-0.24	-1.97	87	62.04
São Tomé and Príncipe	4	59.2	64	-0.20	-0.71	0.23	-0.76	-0.60	0.21	-1.83	170	44.59
Senegal	1	63.3	66	-0.24	-0.38	-0.18	-0.22	-0.20	0.05	-1.18	141	51.83
Sierra Leone	3	50.9	130	-0.89	-1.20	-0.28	-0.91	-0.94	-0.27	-4.48	163	48.61
Zimbabwe	4	44.7	157	-1.34	-1.27	-0.95	-1.95	-1.65	-1.43	-8.60	155	48.61
Somalia	4	13.6	n/a	-1.69	-2.20	-2.81	-2.33	-2.35	-1.94	-13.32	190	20.14
Sudan	4	30.8	175	-1.35	-1.34	-2.24	-1.39	-1.34	-1.73	-9.40	162	46.22
South Sudan	4	19.3	179	-1.45	-2.03	-2.03	-1.69	-1.70	-1.53	-10.42	185	33.99
Tanzania	1	58.5	103	-0.56	-0.55	-0.34	-0.43	-0.41	-0.24	-2.53	144	52.31
Togo	2	49.1	117	-0.92	-1.36	-0.37	-0.85	-0.89	-0.95	-5.33	137	49.85
Chad	4	35.4	165	-1.39	-1.42	-1.46	-1.09	-1.42	-1.35	-8.14	181	38.49
Uganda	1	55.0	151	-0.92	-0.52	-0.99	-0.20	-0.39	-0.56	-3.60	127	56.20
Central African Republic	3	29.5	156	-1.15	-1.55	-1.87	-1.27	-1.54	-1.16	-8.53	183	34.52
Bangladech	1	n/a	149	-1.08	-0.77	-1.39	-0.92	-0.83	-0.48	-5.47	176	40.99
Cambodia	1	n/a	161	-1.17	-0.85	-0.24	-0.48	-1.11	-0.99	-4.83	138	54.31
Laos	3	n/a	132	-1.11	-0.79	-0.07	-1.03	-0.96	-1.70	-5.65	154	50.50
Nepal	1	n/a	124	-0.72	-0.85	-1.47	-0.67	-0.73	-0.60	-5.05	110	59.12
Vietnam	1	n/a	117	-0.58	-0.21	0.22	-0.57	-0.42	-1.43	-2.99	69	65.64

[1] DSA = "Debt Sustainability Analysis" of IMF determines the probability of a debt crisis with "low" (1), "moderate" (2), "high" (3) or "in distress" (4). (https://www.imf.org/external/pubs/ft/dsa/lic.aspx)

[2] Ibrahim Index of African Governance (http://s.mo.ibrahim.foundation/u/2018/11/27173840/2018-Index-Report.pdf)

[3] Corruption Perception Index (https://www.transparency.org/cpi2018#results)

[4] Average of each year from 2003-2017 (http://info.worldbank.org/governance/wgi/#home) except for "Index", whose value represents the sum of the average values for the respective country.

[5] World Bank Ease of Doing Business Data (http://www.doingbusiness.org/en/data)

[6] IWF, World Economic Outlook, Okt. 2018 (https://www.imf.org/external/pubs/ft/weo/2018/02/weodata/index.aspx)

Source: own rendition based on the sources listed in the footnotes