POLICY ACTIONS TO MITIGATE INCREASING DEBT VULNERABILITIES AND/OR DISTRESS AND THE POTENTIAL FOR DEFAULTS BY AFRICAN SOVEREIGNS

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INTRODUCTION

- Public debt in lower-income economies (LIEs) has risen in recent years, with many countries being at high risk of or already in debt distress. Accommodative global financial conditions and expanded funding from non-Paris club creditors have allowed many low-income countries to mobilize larger volumes of external financing.
- However, the following shocks have exacerbated debt vulnerabilities:
  - Climate change induced droughts and floods;
  - Covid-19 Pandemic;
  - Changes in commodity prices; and
  - Russia/Ukraine war
- The shocks have affected the growth potential of many economies. This has negatively affected debt servicing capacity in these economies, resulting in increasing debt vulnerabilities and debt distress.
- Countries with significant debt burdens continue to face a difficult trade-off between scaling up public investment to meet ambitious development objectives and containing debt vulnerabilities. Going forward, countries need to implement policies to reduce the risks of defaults and debt distress vulnerabilities.

POLICY ACTIONS

1. Prescribing and Adherence to Borrowing Limits

- Countries can come up with legal instruments which prescribe and ensure adherence to borrowing limits to contain debt accumulation. Borrowing limits on Central Government, State Owned Enterprises, Local Authorities and other Agencies should be determined after the following analytical considerations;
  - Maximum sustainable debt based on a public debt sustainability analysis;
  - Medium Term Debt Strategy;
  - Annual Borrowing Plan; and
  - Examining all available financing resources.
- For the case of Zimbabwe, Government through the Public Debt Management Act, prescribed a limit on the public debt sock of 70%. Although this limit is way above the 30% PV of Debt to GDP threshold for low-income countries recommended by the IMF/World Bank, within the Low Income Debt Sustainability Framework, this limit takes into account the need to fund existing arrears and the huge infrastructure gap already existing in the economy as well as the need to limit debt contraction. In addition, the Public Debt Management Act requires Government to prescribe an annual borrowing limit to ensure debt sustainability going forward. The 2021 annual borrowing limit was set at 5.75% of GDP.

POLICY ACTIONS

2. Post-disbursement monitoring

- In order to reduce the risk of defaults and debt distress, there is need to assess the viability of the project as well as continuously monitor the use of borrowed funds through the entire loan and project life cycle. This is critical to ensure that corrective measures are taken to ensure satisfactory performance of the loans. The monitoring of the loans may include regular project site visits, mandatory project implementation reporting, among others.

3. Credit assessment prior to borrowing approval

- In order to reduce default risk, there is need for thorough credit assessment prior to the approval of borrowing to ensure performance of the contracted debt. Credit assessment is critical to ensure that countries borrow for commercially viable projects. In the case of social projects, there is need to finance using own resources or use grants. For borrowing on social projects, only concessional loans should be used.

- Zimbabwe uses the *Framework for Evaluation, Monitoring and Management for Guarantees and On lent Loans*. The framework provides a clear evaluation methodology that involves a credit risk assessment and scoring for determination of relevant fees after taking into consideration the financial performance of the intended beneficiary, project analysis, as well as other non-financial factors, which include, industry prospects, social economic trends, organisational improvements, among others. The Framework is useful to make borrowing decisions in a transparent and objective manner.

POLICY ACTIONS

4. Creation of Debt Management Committee

- It is important to note that borrowing decisions are complex given the quantum of financial resources and fiscal implications involved, hence the decisions can not be done by a single person. As such, there is need for the creation of a Debt Management Committee which deliberates and make recommendations on all borrowing.
- Zimbabwe has the External and Domestic Debt Management Committee (EDDC) which deliberates on requests for borrowing from State Owned Enterprises, Local Authorities, and Government Borrowing. The EDDC has a Working Party which assess all technical issues and make recommendations. The Committee makes recommendations to the Minister of Finance and Economic Development, who has the legal powers to approve on all public sector borrowing and issuance of Guarantees as well as Borrowing Power Authorities, in line with the Public Debt Management Act.

POLICY ACTIONS

5. Creation of Dedicated Sinking Funds

- Creation of dedicated Sinking Funds is critical so that resources realised either from the project or identified revenue sources can be ringfenced for the purposes of servicing loans to mitigate against the default risk. However, it is important to ensure that these dedicated sinking funds are always adequately funded to ensure that enough resources are available for debt servicing.

6. Negotiating for favourable financing terms

- It is imperative to identify sources of financing which offer favourable financing terms, to ensure that debt servicing costs are kept minimal. Countries can come up with loan pricing limits so that if a loan's cost structure is outside the recommended cost range, the loan can be rejected.

POLICY ACTIONS

7. Domestic Financial and Capital Market Development

- There is need to develop the domestic financial and capital markets. If these markets are well developed, Countries are insulated from shocks in the external financial and capital markets, which include exchange rate risk.

8. Full disclosure of Public Debt

- There is need to ascertain the full extent of the public and publicly guaranteed debt. There are cases where other extra budgetary units contract loans, which become known in the event of defaults. This increases the national public debt which was not initially accounted for.

POLICY ACTIONS

9. Improving Parliamentary oversight role

- The Parliament plays a critical oversight role in public finance management. Parliaments can be provided with technical expertise to interrogate borrowing by Government to ensure value for money. The Parliament has a duty to ensure that government borrow for the financing of projects which do not impose excessive fiscal pressure on the budget.

POLICY ACTIONS

10. Implementation of Economic growth enhancing policies and Economic Diversification

- It is critical for countries to pursue private sector led economic growth policies which also focuses on economic diversification. Many developing countries rely on primary products which are vulnerable to external shocks. These shocks affect the debt servicing capacity due to underperformance of tax revenue collections.
- Sustained diversified economic growth increases the economy's productive capacity which is critical to generate resources for debt servicing. Sustained economic growth is associated with generation of additional revenues for the economy which will have a resultant effect of reducing fiscal deficits and debt accumulation. In addition, the generation of sufficient resources is important to meet obligations of existing debts.

CONCLUSION

- It is important that countries develop policies which are aimed at ensuring debt sustainability. Borrowing should be done after careful consideration of the repayment modalities to avoid risk of default and debt distress.
- Countries should borrow from non-concessional sources of financing, only for commercially viable projects

THANK YOU