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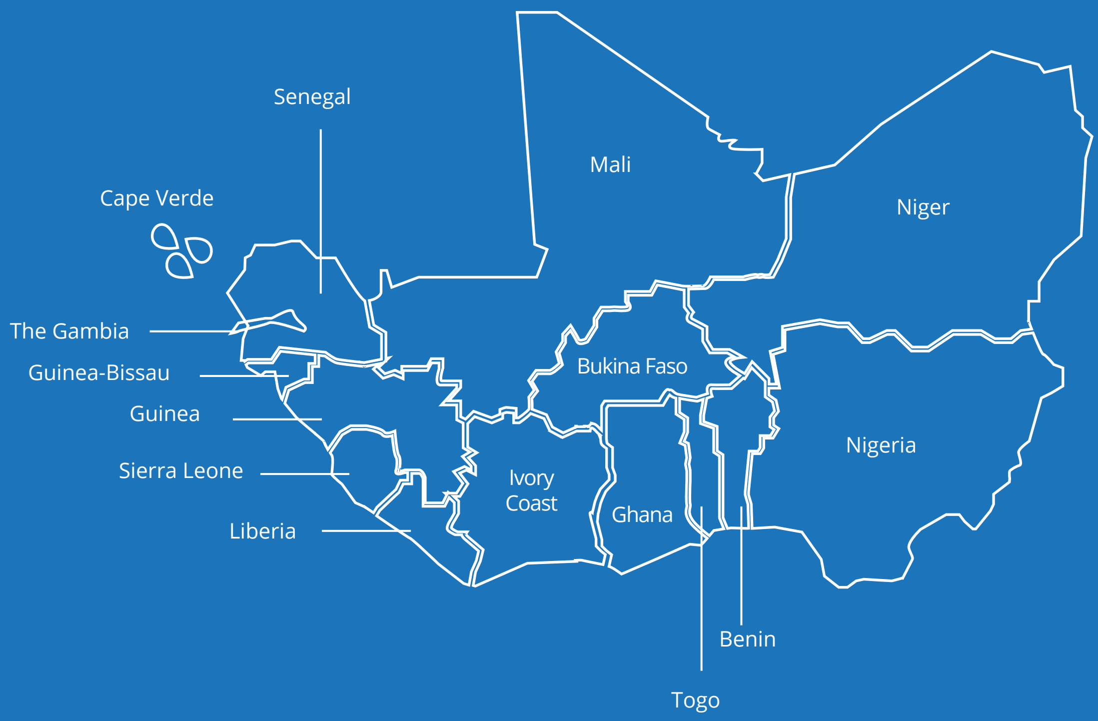

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H O W   S O L V E N T   A R E   E C O W A S

C O U N T R I E S

Executive Summary

Public debt in ECOWAS between 2005 and 2020 has increased by more than four folds from US$58.50 billion to US$296.76 billion, respectively. This is associated with an increase in the debt to GDP ratio from 26.3% in 2015 to 43% in 2020. The debt situation in ECOWAS suggests the imminence of debt overhang and potential debt crises for countries in the region. However, it appears ECOWAS countries have taken the debt sustainability analysis for granted: therefore, they have premised their public debt accumulation decision on solvency thresholds that favour more borrowing, for instance, public debt to GDP ratio. Meanwhile, many ECOWAS countries are already in critical situations relative to other debt indicators. Hence, this study determined the country-specific solvency thresholds from an array of a time-varying debt sustainability index that aggregates all the five debt indicators into a single value.

In light of the aforementioned, this study proposed a single time-varying approach that harmonises the debt indicators into a "Debt Sustainability Index" (DSI). Based on the new approach, 11 ECOWAS countries (Benin, Burkina Faso, Cabo Verde, the Gambia, Ghana, Guinea-Bissau, Liberia, Niger, Nigeria, Senegal and Togo) are already in debt distress, having crossed their distress points using the 2020 data. However, the remaining four countries in the region are at low risk of debt distress, as they are well below their distress points. This study recommends the urgent need for improved revenue generation from taxes in order to narrow the need for borrowing.

1. Introduction

The build-up to the recent episode of debt distress has been alarming for the Economic Community of West African States (ECOWAS). Following the persistently suppressed global commodity prices, government revenue among ECOWAS countries has plummeted. The concerns emanated due to the pace, size, and structure of public debt accumulation. Public debt in ECOWAS between 2005 and 2020 has increased by more than four folds from US$58.50 billion to US$296.76 billion, respectively. This is associated with an increase in the debt to GDP ratio from 26.3% in 2015 to 43% in 2020.

The debt situation in ECOWAS suggests the imminence of debt overhang and potential debt crises in the region. Nevertheless, the tempo of debt accumulation does not suggest any caution as it appears debt sustainability is not taken seriously. Beyond the debt figures, there are numerous indicators of debt sustainability position (Debt to GDP, External Debt to GDP, Debt Service to Revenue and a host of other ratios) in which the IMF has provided benchmarks. However, many countries have based their debt sustainability decisions on debt indicators that give room for more borrowing.

While many of these countries appear in a safe situation, some are already in critical debt condition with debt service to revenue ratio close and over 100%. This is particularly concerning given that debt is serviced with revenue and not the GDP or the exports. The situation is peculiar for Nigeria as she recorded about 80%s debt service to revenue in 2021. Similarly, Ghana and the Gambia recorded a debt service to revenue ratio of 91.7% and 111.3%, respectively, in 2019. By implication, after debt service is deducted from revenue, the government has virtually nothing left to spend on the economy.

Therefore, the oversight on the part of affected countries puts them at high risk of debt distress (or risk of external debt default) as they continue to accumulate debts when they have a weak revenue base and export earnings. Hence, this policy brief seeks to develop a framework that harmoniously assesses the sustainability of debt among ECOWAS countries, the solvency of these countries and ascertains how close they are to a debt crisis.

2. Current State Assessment of Debt Sustainability Analysis

The IMF's current solvency threshold remains the most widely accepted measure of debt distress for countries based on five debt indicators: external debt to GDP, external debt to exports, debt service to exports, debt service to revenue and debt to GDP ratios. Across these indicators, the IMF provided benchmarks for Low-Income Countries (LICs). Hence, they assess a country's solvency and capacity to pay back principal and interest at the end of the debt tenure based on these benchmarks (see Table 1).

Table 1: Debt Burden Thresholds and Benchmarks Under the DSF of the IMF

	PV of external debt in percent of		External debt service in percent of		PV of total pub-lic debt in per-cent of
	GDP	Exports	Exports	Revenue	GDP
Weak	30	140	10	14	35
Medium	40	180	15	18	55
Strong	55	240	21	23	70

Source: **IMF**

The reality, however, shows that many countries are at varying critical levels across the debt indicators relative to the benchmark set by the IMF. Based on the IMF's Solvency Thresholds, a sizable number of ECOWAS countries have well below the 70% threshold for debt to GDP ratio. These countries include Nigeria (35.1%), Guinea (41.4%), Niger (44.2%), Mali (44.1%) and Côte d'Ivoire (45.7%). These countries appear in a safe haven and have more room to expand public debt. This continues to be the yardstick for public debt programmes for these countries while neglecting the sustainability of other indicators.

On the other hand, there are concerns over countries that have exceeded the IMF's 70% solvency threshold, such as Cabo Verde (139.0%), the Gambia (75.8%), Ghana (78.0%), Guinea Bissau (78.1%) and Sierra Leone (71.9%). This in itself is not reflective of debt burden on the countries. Japan remains one of the most leveraged countries in the world, with an estimated debt to GDP ratio of 256%. Despite this height of leverage, Japan is not at any risk of debt distress.

What constitutes debt burden and should matter in debt sustainability analysis is an indicator that measures the extent to which a country can service and redeem its debts at maturity, which is through revenue. However, the revenue indicator is often silent in the conversation of debt sustainability, likewise other indicators. Conducting a debt sustainability analysis using a debt indicator in isolation could put countries at risk of debt distress as governments continue to accumulate more debt.

3. Alternative Assessment of Debt Sustainability: A computed Debt Sustainability Index

This study proposes a Debt Sustainability Index that adopts the five debt indicators provided by the IMF in their Debt Sustainability Analysis (debt to GDP, external debt to GDP, external debt to exports, debt service to exports, and debt service to revenue ratios). As an improvement to the process, the proposed approach compresses the five indicators into a single time-varying "Debt Sustainability Index" (DSI) across the 15 ECOWAS countries between 1990 and 2020 . Instead of considering a country's debt position based on the five indicators, the DSI gives a holistic measure that aggregates the levels of exposure of countries across the indicators. Based on the DSI, this study establishes the solvency threshold or the debt distress point for each country in the ECOWAS region.

The construction of the DSI follows Transparency International's methodology of computing the Corruption Perception Index (CPI). The approach adopted here, however, differ slightly as the debt indicators are weighted based on the peculiarity of ECOWAS countries in terms of the debt indicators that are highly challenging. Specifically, the debt service to revenue ratio carries the largest weight given that it appears the first and best measure of the solvency or distress point of any country. The idea behind the DSI is to establish the country-specific solvency threshold or distress point that measures the optimal debt carrying capacity of each country. Any point above the distress point implies that the country in question is insolvent, does not have the capacity to service its debt and payback principals, and is in debt distress.

Similar to the IMF's Debt Sustainability Analysis (DSA), this study replicates the same to categorise ECOWAS members into three by comparing the computed DSI against the established country-specific solvency threshold. The classification obeys the following rules based on quantile measures: (1) low risk of debt distress implies that a country's DSI in 2020 is less than or equal to 50% of its established solvency threshold; (2) high risk of debt distress implies that a country's DSI in 2020 fall between 51% and 100% of its debt threshold; and (3) a country is said to be in Debt Distress when its DSI in 2020 exceeds its solvency threshold (debt distress point).

Utilising the stated decision rule, our debt sustainability analysis (see Appendix 1 and Figure) is as follows. As at 2020, eleven ECOWAS countries – Benin, Burkina Faso, Cabo Verde, the Gambia, Ghana, Guinea-Bissau, Liberia, Niger, Nigeria, Senegal and Togo – with 72.2, 149.7, 133.2, 192.9, 77.0, 370.1, 938.4, 167.7, 81.2, 62.2 and 126.2 points on the debt sustainability index which

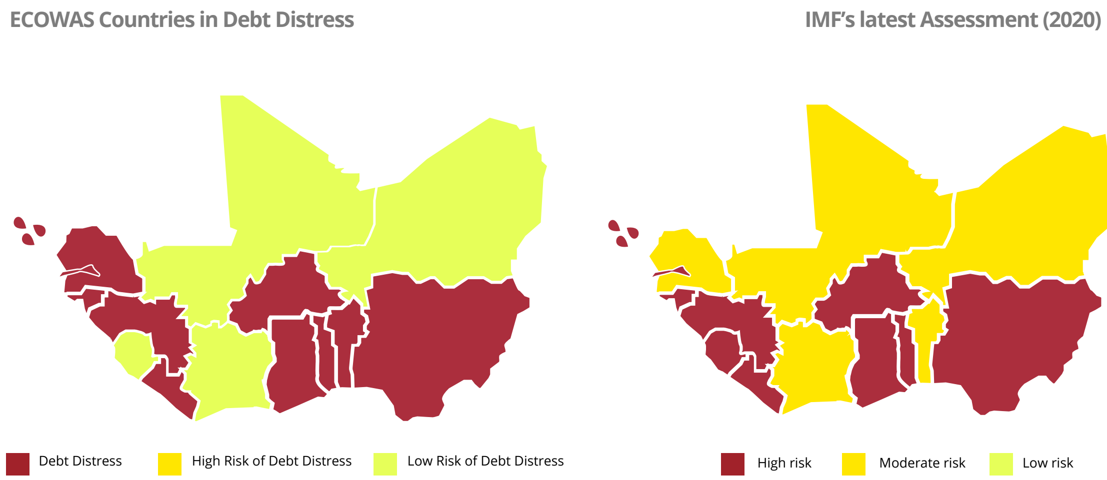
[1] See NESG (2022). Debt Management, Restructuring and Sustainability in ECOWAS.

[2] See Appendix 2 for a graphical representation of the computed debt sustainability index and the distress point or solvency threshold

[3] See NESG (2022). Debt Management, Restructuring and Sustainability in ECOWAS.

have already passed their respective distress points of 39.6, 91.1, 57.9, 103.8, 71.9, 299.8, 938.4, 112.8, 58.1, 47.8 and 74.0 index points respectively. Having crossed their respective distress points, these eleven countries can be said to be in debt distress. However, the remaining four countries – Côte d'Ivoire, Guinea, Mali and Sierra Leone – with debt sustainability index of 23.1, 52.4, 24.9 and 89.8 index points lower than 50% of their respective 49.2, 148.6, 65.5 and 227.6 index distress points are at low risk of debt distress.

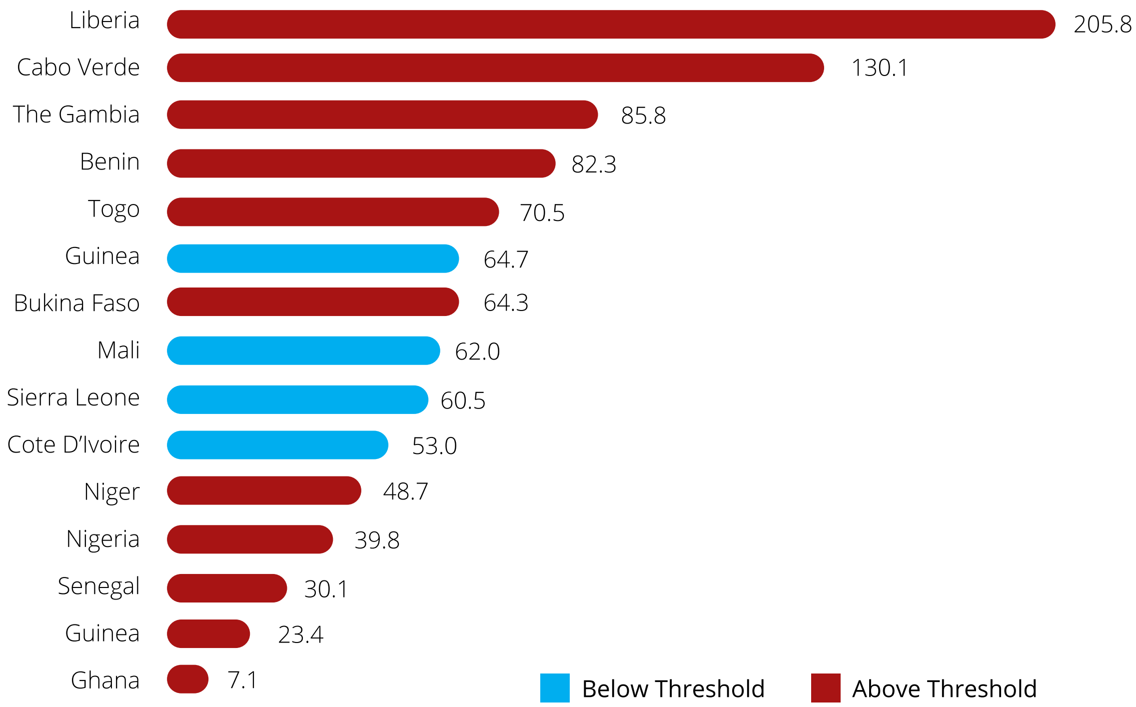
Figure 1: Results of Debt Sustainability Analysis for ECOWAS in 2020



Source: IMF/World Bank Debt Sustainability Report; NESG Research

Figure 2 presents how far off these countries are from their distress point in terms of deviation. The findings show that the likes of Liberia and Cabo Verde have exceeded their debt distress points by over 100% - Liberia by 205.8% and Cabo Verde by 130.1%. Though below 100%, the Gambia, Benin, Togo and Burkina Faso have exceeded their debt distress point by over 50%, while Niger, Nigeria, Senegal, Guinea Bissau and Ghana are still within 50% range away from their debt distress point. However, countries such as Guinea, Mali, Sierra Leone and Côte d'Ivoire are over 50% below their distress.

Figure 2: Deviation of Debt Sustainability Index from Distress Point (%)



Source: NESG Research

There is an increasing need for countries to improve their tax collection rates. More importantly, attention needs to be paid to Nigeria's rising public debt, as it accounts for over 50% of the region's debt portfolio. With revenue to GDP of about 7%, Nigeria needs to boost non-oil revenue and improve domestic resource mobilisation via tax collection in order to rein in the widening debt service expenses. Like other countries with weak revenue mobilisation, Nigeria should learn from other countries' experiences to boost their tax revenue generation, particularly by exploring the e-filling of tax assessments and collection.

4. Conclusions

Following the multiplicity of indicators assessing the sustainability and solvency of debt in ECOWAS countries, this study developed a framework that harmoniously assesses debt sustainability among ECOWAS countries and ascertains how close these countries are to debt distress. This study proposes the harmonisation of the five debt indicators and compresses the same into a single time-varying "Debt Sustainability Index" (DSI) across the 15 ECOWAS countries over 1990-2020. The solvency threshold or the debt distress point for each country in the ECOWAS region is established based on the DSI.

Similar to the IMF's Debt Sustainability Analysis (DSA) usually conducted on LICs, this study replicates the same to categorise ECOWAS members into three by comparing the computed DSI against the established country-specific solvency threshold. Hence, as at 2020, 11 ECOWAS countries – Benin, Burkina Faso, Cabo Verde, the Gambia, Ghana, Guinea-Bissau, Liberia, Niger, Nigeria, Senegal and Togo have already passed their respective distress points. Having crossed their respective distress points, these eleven countries can be said to be in debt distress. However, the remaining four countries – Côte d'Ivoire, Guinea, Mali and Sierra Leone are at low risk of debt distress. The findings further show that two countries in ECOWAS have exceeded their debt distress points by over 100%, three countries exceeded by over 50% (but less than 100%), and five exceeded by less than 50%. Meanwhile, the four countries reported not in distress are over 50% far from reaching their debt distress.

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Appendix

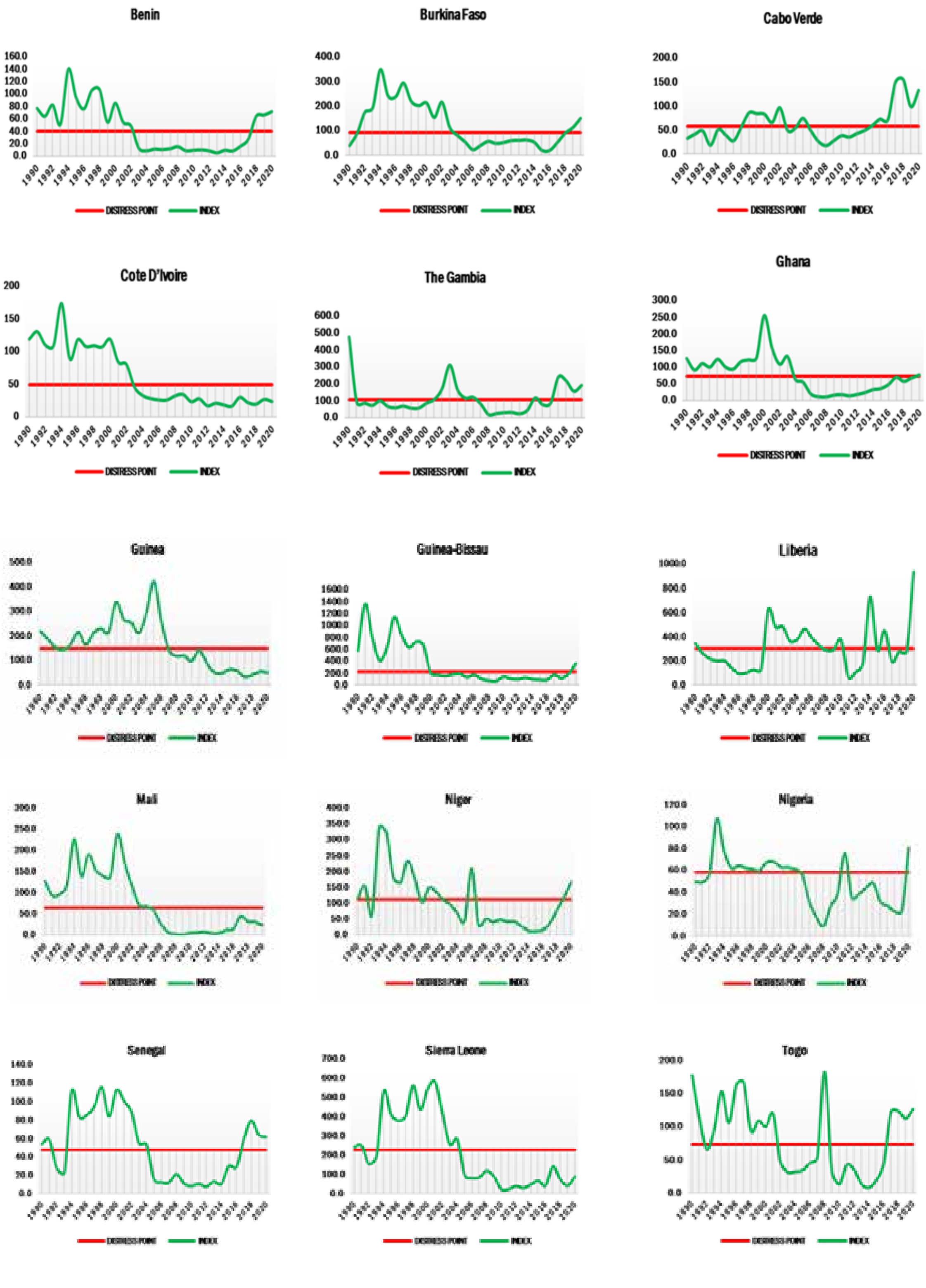
Appendix 11: Nigeria's Financial Linkages with Countries in ECOWAS Region

Country	2020 Debt Index	Debt Distress Point	Remark	IMF's latest Assessment
Benin	72.2	39.6	In debt distress	Moderate risk (May 2020)
Burkina Faso	149.7	91.1	In debt distress	Moderate risk (Nov. 2020)
Cabo Verde	133.2	57.9	In debt distress	High risk (Sept. 2020)
Côte d'Ivoire	23.1	49.2	Low risk	Moderate risk (Apr. 2020)
The Gambia	192.9	103.8	In debt distress	High risk (Apr. 2020)
Ghana	77.0	71.9	In debt distress	High risk (Dec. 2019)
Guinea	52.4	148.6	Low risk	Moderate risk (Dec. 2020)
Guinea-Bissau	370.1	299.8	In debt distress	High risk (Jan. 2021)
Liberia	938.4	306.9	In debt distress	High risk (Jun. 2020)
Mali	24.9	65.5	Low risk	Moderate risk (Apr. 2021)
Niger	167.7	112.8	In debt distress	Moderate risk (Apr. 2020)
Nigeria	81.2	58.1	In debt distress	High risk (Oct. 2020)
Senegal	62.2	47.8	In debt distress	Moderate risk (Apr. 2020)
Sierra Leone	89.8	227.6	Low risk	High risk (May 2020)
Togo	126.2	74.0	In debt distress	High risk (Mar. 2020)

Source: NESG Research; IMF/World Bank's Joint Sustainability Analysis

Note: Decision Rule using Quantile Measures is as follows: (1) Index ≤ 50% of Distress point = Low risk of debt default; (2) 51% ≤ Index ≤ 100% of Distress point = High risk of debt default, and (3) Index > Distress point = In Debt Distress

Appendix 2. **Time-varying Debt Index (1990-2020) and Country-specific Debt Threshold for ECOWAS**



Source: **NESG Research**

ABOUT THE DMR

The Debt Management Roundtable (DMR) on debt restructuring and social financing was instituted in March 2021 by the Nigerian Economic Summit Group (NESG) with the support of the Open Society Initiative form West Africa (OSIWA). The Roundtable is expected to provide insights, evidence and recommendations on debt management and sustainability, with a view to engaging policymakers on debt restructuring and social financing in the West African region, using Nigeria as a case study. Public debts in ECOWAS have spiralled upwards more than four folds since the debt relief period (2005-2006).

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