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# KEY DRIVERS OF PUBLIC DEBT ACCUMULATION IN ECOWAS

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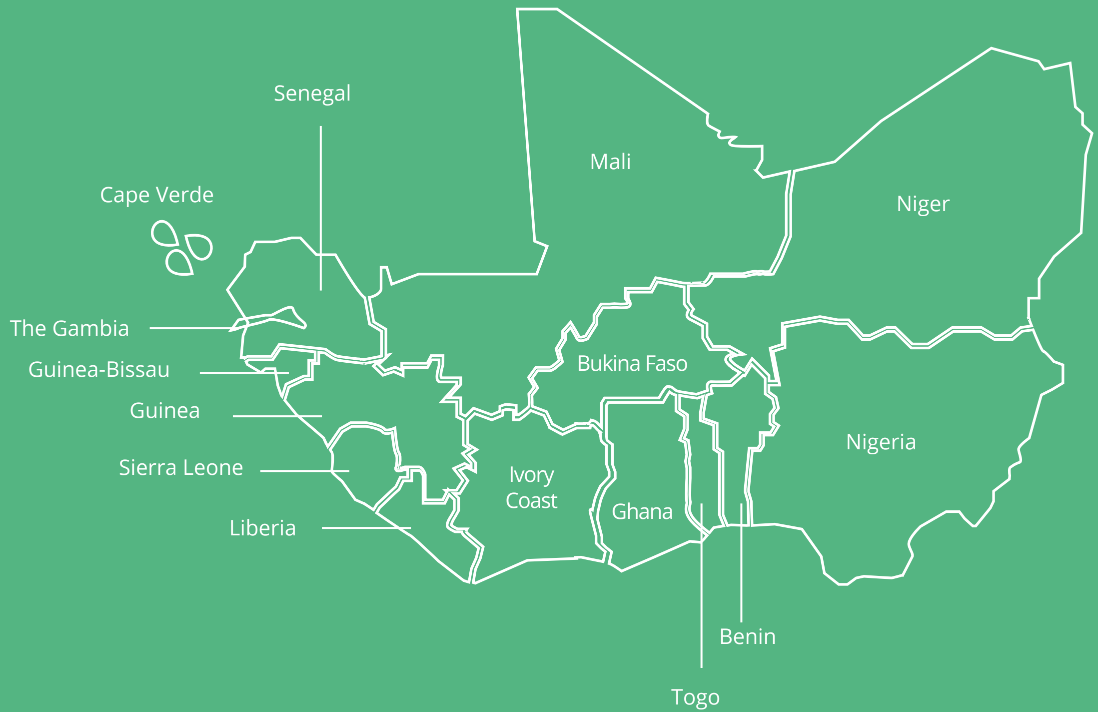


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K E Y D R I V E R S O F P U B L I C D E B T A C C U M U L A T I O N I N E C O W A S

## Executive Summary

The debt level in many ECOWAS countries is increasingly becoming unsustainable in recent years with the ensuing challenges with debt repayment and servicing. This is despite these countries being granted debt relief and some form of debt cancellation just over a decade ago. Against this backdrop, this policy brief investigates the drivers of public debt across the economic and non-economic categorisation of factors. The fiscal deficit, interest rate movements, commodity price shocks, exchange rate volatility, and the external reserves position are major economic drivers. These are affected largely by low revenue mobilisation and unrestrained spending of the government. Non-economic drivers of debt accumulation include environmental factors, political instability, corruption, and debt relief arrangements with creditors. Hence, ECOWAS countries need to pay attention to expanding revenue mobilisation capacity, economic diversification, developing value chains and expanding the tax base, more prudent spending patterns and leveraging concessional debt over commercial debt.

# 1. Introduction

The Economic Community of West African States (ECOWAS) has been at the heart of recent debates on the alarming rate of debt accumulation. Following the persistently suppressed global commodity prices and low tax revenue, government revenue among ECOWAS countries has been highly constrained. This, coupled with the endemic weakness in resource governance among countries in the region, has meant that government spending has maintained an upward trend. Hence, the debt situation in the ECOWAS region is increasingly becoming unsustainable in recent years with the ensuing challenges with debt repayment and servicing. This suggests the imminence of debt overhang and potential debt crises in the ECOWAS region.

The implication of a debt crisis on the macroeconomy is varied. It will adversely impact public and private investment, foreign investment inflows, aggregate demand, and the overall macroeconomy. The dire consequence of the current debt situation in ECOWAS on the socio-economy of the region has given rise to calls for debt forgiveness for ECOWAS countries. It is, however, noteworthy that most ECOWAS countries had been beneficiaries of debt forgiveness during the 2005-2008 wave of debt reliefs. These countries are expected to maintain prudency thereafter. Many have, in actual fact, instituted a debt management framework to ensure the sustainability of public debt. However, just over a decade later, public debts have accumulated and are now approaching a crisis level.

The foregoing suggests that debt relief or the establishment of debt management divisions are insufficient in keeping a sustainable debt level. It further means there is a knowledge gap on why debt keeps growing unsustainably. Hence, there is a need to understand what factors are driving the mounting public debt in ECOWAS. Understanding the forces behind mounting debt in the region is important for predicting the trajectory of debt, managing debt and devising policies to address existing challenges, which are critical for achieving debt sustainability.

## 2. Overview of Drivers of Public Debt

The drivers of public debt in many countries are often country-specific. This could be in the form of governments' economic stabilisation efforts, infrastructural and development spending, and human capital development in some countries (IMF, 2019; World Bank, 2019). It could be driven by unanticipated economic shocks such as the fall in commodity prices and, in more recent instances, government engagement to mitigate the socio-economic impact of the COVID-19 pandemic on households and businesses (AfDB, 2019). For some countries, political instability and crisis are observed to have amplified the rate of accumulation of new debts (IMF, 2019; AfDB, 2021). Further in the literature, a number of other drivers of public debt have been identified (see Figure 1), which can either be economic or non-economic drivers of public debt (Anaya and Pienkowski, 2015; Mothibi and Mncayi, 2019; Nagou, Bayale and Kouassi, 2021).

**Figure 1: Common Drivers of Debt Accumulation in ECOWAS Countries**

## 3. Country-specific Drivers of Debt Accumulation in ECOWAS

***3.1. Economic Drivers of Public Debt in ECOWAS***

Beyond the need to spend for development, the economic drivers of debt accumulation in ECOWAS countries include interest rate movements (domestic and foreign), domestic real GDP growth, fiscal deficit, commodity price volatility/terms of trade shocks, trade and financial deficits, external reserves and exchange rate fluctuations, among others (Anaya and Pienkowski, 2015; IMF, 2019; World Bank, 2019; Mothibi and Mncayi, 2019; Nagou, Bayale and Kouassi, 2021). The following analysis delves into some specifics concerning the economic drivers of debt among ECOWAS countries.

- ***Fiscal deficit:*** The ECOWAS region has been in an uninterrupted fiscal deficit since 2009 with implications for debt accumulation. Prior to the COVID-19 pandemic, only eight ECOWAS countries – Burkina Faso, Ghana, Guinea-Bissau, Liberia, Niger, Senegal, Sierra Leone and Nigeria – exceeded the ECOWAS' fiscal deficit convergence benchmark of 3% of GDP as at 2019. The outbreak of COVID-19 led to an unprecedented increase in fiscal deficit to 6.8% of GDP. This is associated with a 53% increase in fiscal deficit to US$46.22 billion, heightening public debt accumulation. Specifically, the fiscal deficit expanded by 17.6%, 122.4% and 170.1% in Nigeria, Ghana and Côte d'Ivoire, respectively. This makes Nigeria the country with the largest fiscal deficit in the region is 2020, while Ghana recorded the largest increase in the budget deficit in the year. The persistent fiscal deficit among ECOWAS countries has been due to weak domestic revenue, worsened by dependence on a single source of revenue (exports of primary commodities), persistent expansionary fiscal policy and the dominance of recurrent expenditure in government spending (AfDB, 2019).

- ***Interest rate movements:*** This is a typical problem for non-WAEMU ECOWAS countries such as Cabo Verde, the Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone with monetary policy independence. Unlike the WAEMU countries in a monetary union that mandates convergence in interest rates, non-WAEMU countries have control over their monetary policy. They often adjust the interest rates to attract foreign and domestic investors to government securities. Consequently, the interest rate (lending rate) level has risen to as high as 28% in the Gambia, 23% in Sierra Leone, 16% in Ghana, 15.4% in Nigeria, 12.4% in

Liberia, and 9.1% in Cabo Verde. This is in sharp contrast to WAEMU countries with interest rates at below 5%. The high-interest environment, particularly, as experienced in Nigeria, Ghana and the Gambia, translates into high borrowing costs, with a corresponding effect on the debt service burden for these governments. Hence, these countries need to borrow more to service debts. Therefore, the affected countries need to stabilise the domestic interest rate to keep the cost of borrowing at a sustainable level, which will not overwhelm government revenue.

- ***Exchange rate volatility and external reserves position:*** These issues are also particular to non-WAEMU countries with independent monetary policy units that easily adjust the exchange rate as appropriate. Two countries in this group – Nigeria and Ghana – are highly exposed to external commercial debts, particularly Eurobonds (which are foreign currency-dominated debt instruments), jointly accounting for over 20% of total issuance in ECOWAS. Moreover, exchange rates in Nigeria and Ghana depreciated by 34.4% and 24%, respectively, between 2018 and 2021. A weakening local currency against the US dollar would imply a higher external debt service burden for these countries. Also, a weak currency due to insufficient foreign reserves to support the domestic currency, especially Nigeria, has prompted further extensive external borrowing. Specifically, Nigeria in 2020 acquired a US$3.4 billion IMF loan for external balance equalisation to stabilise the exchange rate and foreign reserve depletion rate.

- ***Commodity price volatility/terms of trade shock:*** This is peculiar to resource-dependent countries like Nigeria (oil exporter), as well as Burkina Faso, Ghana, Guinea, Liberia, Mali and Sierra Leone (non-oil exporters). These countries depend on primary commodities as the main source of fiscal revenues and foreign exchange. Hence, a plunge in global commodity prices typically constrains their fiscal space and generates increased borrowing. For instance, the plunge in crude oil prices in 2014 was followed by rising debt in Nigeria. This was further compounded by the COVID-19 induced oil price crash. According to the Debt Management Office (DMO), Nigeria's public debt has increased by 194.5% between 2014 and 2020 following the oil price crash in 2014. Likewise, Ghana being the second-largest exporter of cocoa in the world, has felt the brunt of volatility in cocoa prices. Since these countries barely influence global commodity prices, they need to diversify their revenue and foreign exchange sources, develop value chains, and expand their tax base to increase revenue from non-resource sources.

### *3.2. Non-economic Drivers of Public Debt in ECOWAS*

There are also non-economic drivers of debt accumulation, including environmental factors (issues around climate change etc.), political instability and corruption, debt relief arrangement with multilateral, bilateral and private creditors, habit hypothesis (otherwise known as debt persistence) and the IMF's engagements with developing countries including special monitoring program, extended credit facility (ECF) and pandemic-driven rapid financing instrument (RFI) (AfDB, 2018).

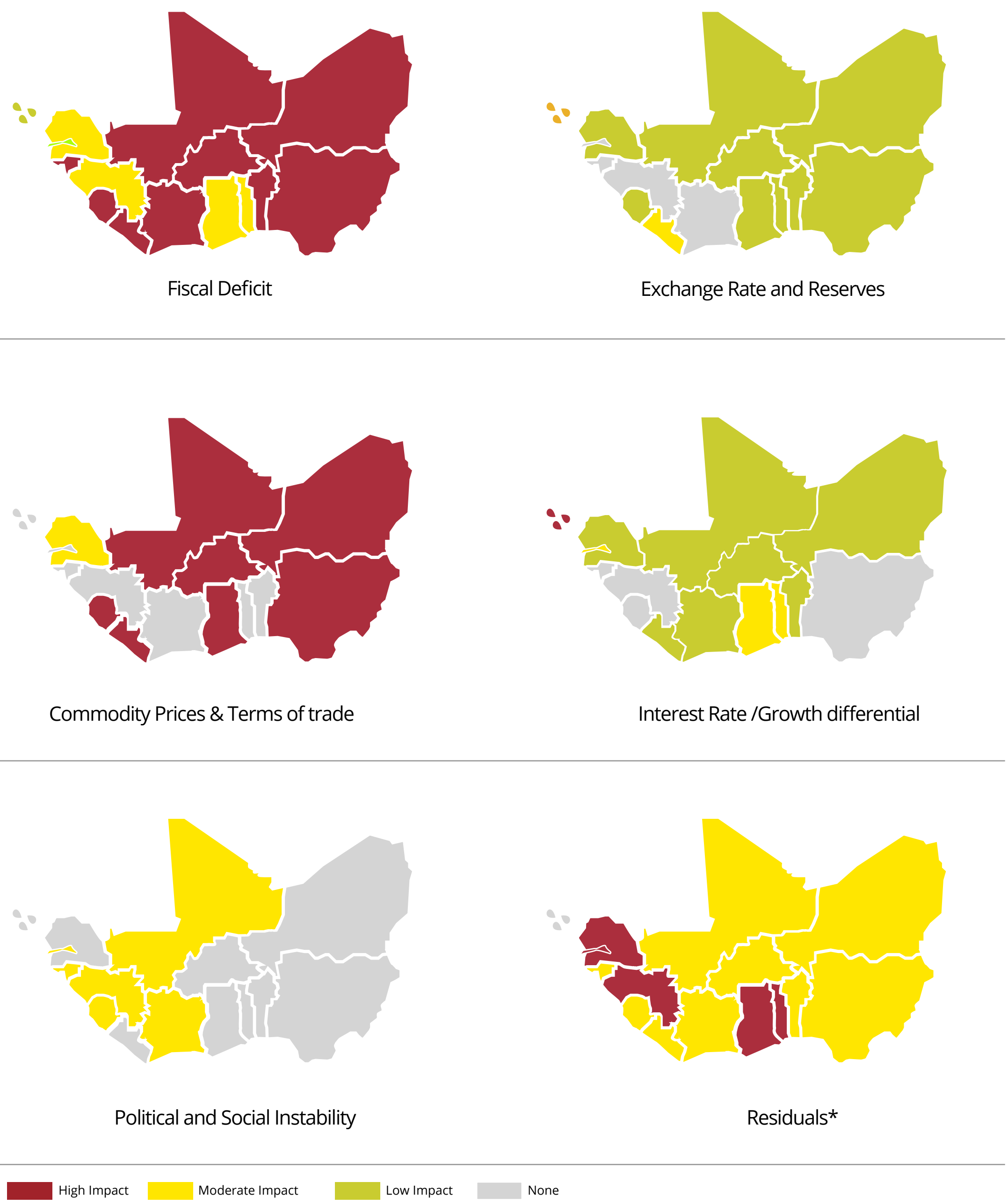
- ***Environmental and social factors:*** Mali and Niger are the most vulnerable countries to environmental crises in ECOWAS. According to scientific findings, these countries are drought-prone and landlocked, with the highest vulnerability index of over 80%. Relative to other countries in ECOWAS, Sierra Leone and Liberia were disproportionately hit by the Ebola outbreak in 2015. The Ebola period was associated with a 26.7 and 14.0 percentage points increase in the debt to GDP ratio to 69.2% and 33.7% between 2013 and 2017 in Sierra Leone and Liberia, respectively. Faced with weak domestic resource mobilisation, these countries would require emergency funds to tackle natural and environmental disasters challenges. Accordingly, these countries often resort to borrowing. Vulnerable countries in the region would particularly benefit from maintaining intervention funds for the prevalent natural occurrence to lessen the impact and reduce the tendency of borrowing during such crises.

- ***Political and Civil Instability:*** The key conflict zones or fragile countries in ECOWAS, according to the IMF, are Côte d'Ivoire, the Gambia, Guinea, Guinea Bissau, Mali, Sierra Leone and Togo. This group of countries, having had one civil conflict or the other over the past decade, are better described as war zones. Likewise, in Nigeria, criminal activities including terrorism, banditry, and kidnapping have been rising, driving up military expenditure over the past decade. In recent years, military take-overs in Mali and Guinea have posed political risks to the ECOWAS region and fiscal disruption. Meanwhile, Mali and other fragile member states require significant military presence, assistance and higher fiscal spending in counter-terrorism efforts. Four of these countries – Côte d'Ivoire, Guinea-Bissau, Mali and Togo, are beneficiaries of French military aid. Others rely on borrowing to secure their countries from social and political disintegration.

- ***IMF Engagements:*** ECOWAS members currently under the economic and financial surveillance of the IMF include the Gambia, Liberia and Sierra Leone. These three countries are currently engaged with the Fund under its Extended Credit Facility (ECF), having earlier been adjudged to be running a high risk of debt distress. This does not come as a surprise as these three non-WAEMU members have a higher exposure to external debts (55%-65% of their total debt stock). Similarly, in response to the COVID-19 pandemic, the IMF also extended some credit facilities to its member-states (ECOWAS countries inclusive) with balance of payments problems, offering them no conditionality and granting them 100% access to their reserves with the IMF. This is not unprecedented as most ECOWAS members had to resort to multilateral loans due to tight global financial conditions.

- ***Debt relief/forgiveness arrangements with multilateral, bilateral and commercial creditors:*** Similar to the Paris Club relief to developing countries in 2005/2006, twelve ECOWAS members have so far benefitted from the COVID-19 pandemic-induced debt Service Suspension Initiative (DSSI). These countries include Benin, Burkina Faso, Cabo Verde, the Gambia, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Senegal, Sierra Leone and Togo. The debt relief arrangement is expected to reduce the debt servicing burden of countries most exposed to external debt accumulation, particularly the WEAMU countries, the main beneficiaries of the G20's DSSI in 2020. While debt reliefs are meant to reduce debt burden either by reduction or suspension of obligations for some time, countries see it as an opportunity to borrow more since some of the existing obligations have been relieved. Hence, debt problems are compounded.

## Figure 2: Schematic Presentation of Specific Drivers of Public Debt in ECOWAS countries




*Residuals cover non-economic drivers, including IMF's engagement, debt relief and environmental and social factors, among other

Source: NESG Research

## 4. Conclusion

As public debt mounts in the ECOWAS region, it is important to have an understanding of the drivers of public debt to support the achievement of debt sustainability. This policy brief highlighted numerous drivers of public debt across economic and non-economic categorisation. Economic drivers of public debt in ECOWAS include the fiscal deficit, interest rate movements (domestic and foreign), domestic real GDP growth, commodity price volatility/ terms of trade shocks. While all ECOWAS countries are exposed to persistent fiscal deficit, non-WAEMU countries are more exposed to interest rate and exchange rate movement. Meanwhile, a sizeable number of the countries in the region are impacted by commodity prices and trade distortions. Non-economic drivers, on the other hand, include environmental factors, political instability and corruption, debt relief/forgiveness arrangements with creditors, and habit hypothesis, among others. Many ECOWAS countries face diverse non-economic drivers of public debt. Irrespective of the categorisation, the impact of these drivers necessitate the need to pay attention to expanding revenue mobilisation capacity, economic diversification, developing value chains and expanding the tax base, more prudent spending patterns and leveraging concessional debt over commercial debt.

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## 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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