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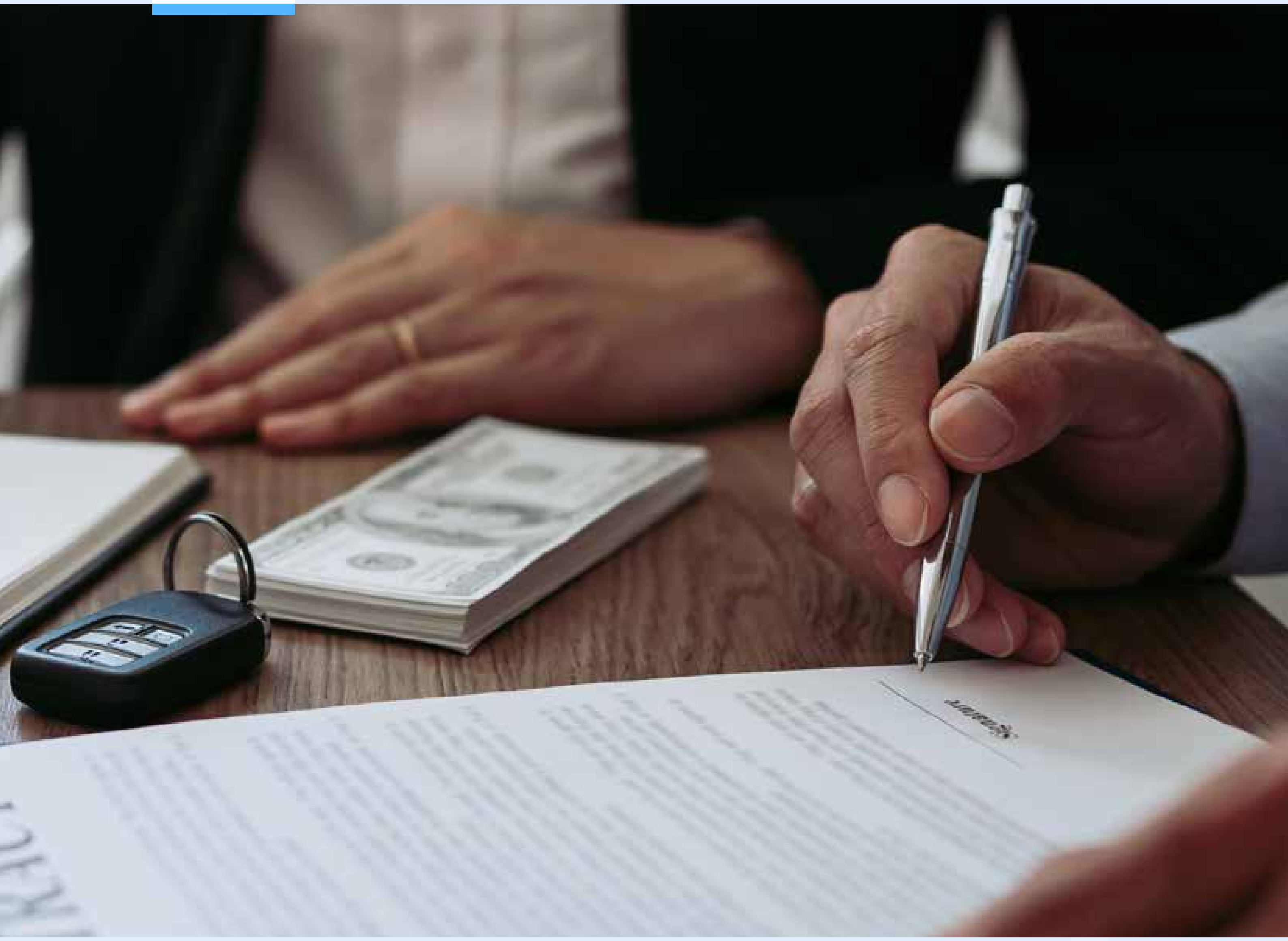

POLICY PRIORITIES FOR DEBT MANAGEMENT IN ECOWAS

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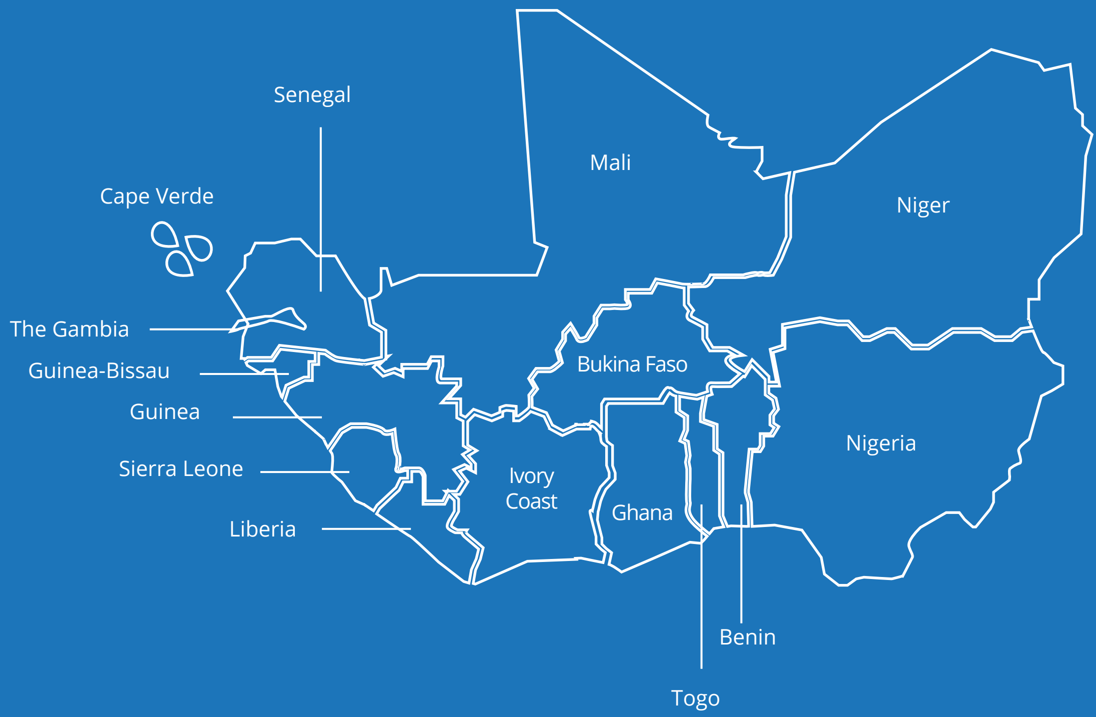

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POLICY PRIORITIES FOR DEBT MANAGEMENT IN ECOWAS

Executive Summary

Public debt in the ECOWAS region is growing unsustainable given its pace, size, and structure. This is coupled with other challenges emanating from debt repayment and servicing. 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 situation is concerning considering debt service as many countries have debt service to revenue ratio close to and over 100%. This suggests the imminence of debt overhang and potential debt crises in the ECOWAS region. Learning from the rueful experience of Greece, some ECOWAS countries are beginning to show early signs of debt distress. Therefore, this policy brief highlights viable policy recommendations for ECOWAS countries to manage public debt sustainably.

The debt situation in ECOWAS reflects a prolonged policy habit fiscal deficit due to government spending excessively and inefficiently way above revenue. This is also a by-product of weak domestic revenue, dependence on a single source of revenue, and dominance of recurrent expenditure, which has motivated an unsustainable increase in public debt in ECOWAS. While previous debt sustainability efforts had concentrated on public debt portfolios and transient in their outcomes, they give little or no consideration for structural and institutional drivers of public debt.

Hence, there is a need for a National Integrated Revenue-Spending-Debt Management Strategy with coordinated approaches for revenue optimisation, expenditure efficiency and debt management and sustainability. Accordingly, a 10 (ten) Point Policy Agenda is recommended with one broad recommendation and three (3) recommendations across the three cardinal areas requiring integrated coordination. This is to address the bedrock of unsustainable growth in public debt and manage the symptoms as reflected in debt burden.

1. Introduction

The debt situation in the ECOWAS region is increasingly becoming unsustainable given the pace, size and structure of public debt accumulation in recent years, alongside the ensuing challenges with debt repayment and servicing. This follows the suppressed global commodity prices, which plummeted government revenue among ECOWAS countries. Hence, public debt in ECOWAS has increased by more than four folds in the past two decades. During the period of debt relief, as at 2005, the total public debt in the ECOWAS region stood at US$58.50 billion. This has expanded to US$296.76 billion as at 2020. Likewise, the debt to GDP ratio of ECOWAS expanded from 26.3% in 2015 to 43% in 2020. This is alarming as the rate of growth in public debt surpasses the growth rates of the economy, export and revenue altogether.

While the debt to GDP ratio might appear in the safe situation for some countries in ECOWAS, the debt service condition suggests many countries are already in critical condition, with debt service to revenue ratio close to and over 100%. This is concerning given that debt is serviced with revenue and not GDP or exports. The situation is peculiar for Nigeria, recording about 80% debt service to revenue ratio in 2021. Also, countries such as The Gambia, Ghana, Guinea Bissau and Niger have debt service to revenue ratios close to 100% in 2019. By implication, after debt service is deducted from revenue, the government has virtually nothing left to spend on the economy.

This suggests the imminence of debt overhang and potential debt crises in the ECOWAS region. The economy-wide implications of unsustainable public debt accumulation include macroeconomic instability, constrained fiscal space, private crowding out effects (real sector investment and capital inflows), financial and capital market distortion; foreign exchange risk exposure; and Inflationary risks. Learning from the rueful experience of Greece, some ECOWAS countries are beginning to show early signs of debt distress. Hence, there is a pressing need for remedial actions to ensure efficiency in debt management, debt sustainability and avert the impending debt distress. Therefore, this policy brief highlights viable policy recommendations and action points for ECOWAS countries for sustainable public debt management.

2. Setting the Context for Policy Interventions

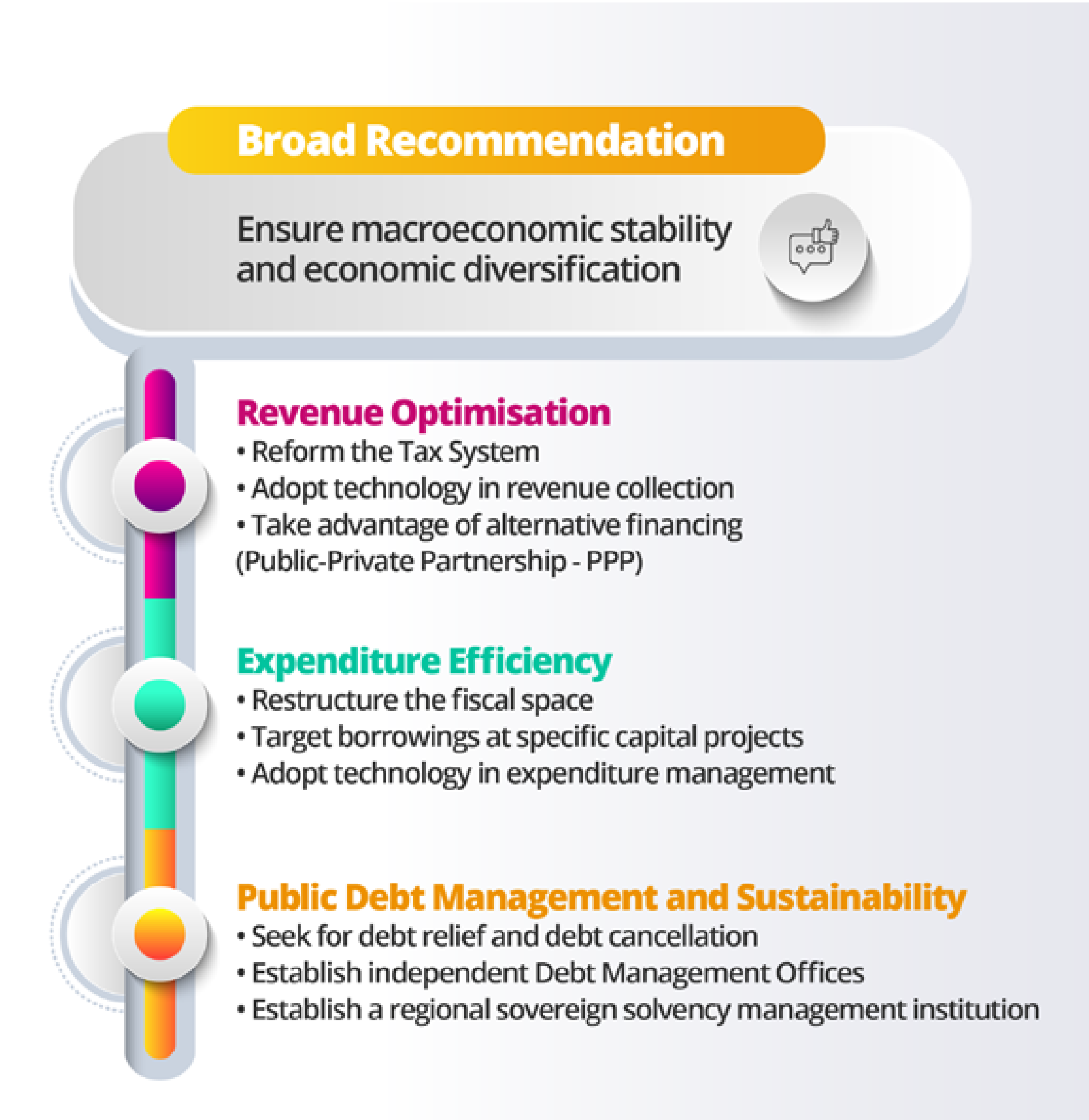
A review of the debt situation in ECOWAS reflects a prolonged policy habit of excessive spending with over a decade of uninterrupted fiscal deficit since 2009. This is due to a persistent bloated and inefficient government spending way above revenue mobilisation capacity. The persistent fiscal deficit was due to the weak domestic revenue, intensified by dependence on a single source of revenue (exports of primary commodities) and persistent expansion and dominance of recurrent expenditure in government spending (AfDB, 2019). Also, the private sector's limited capacity and policy reluctance to implement difficult tax reforms to end costly government subventions have hampered efforts to diversify revenue sources. This culminated in the unsustainable upward trend in public debt in ECOWAS.

Traditionally, at this point, African countries seek relief through debt restructuring with various classes of creditors: multilateral institutions – IMF, World Bank and AfDB; bilateral lenders (Paris Club and non-Paris Club creditors). They have also restructured private foreign debt through swaps, buybacks and the "London Club" (an informal group of commercial banks informal institutions) (Brooks et al., 2014). These led to initiatives such as the Heavily Indebted Poor Countries (HIPC) Initiative in 1996 and the Multilateral Debt Relief Initiative (MDRI) in 2006. However, these efforts have proven transient for public debt sustainability as countries continue to accumulate debt unsustainably.

The drawback of previous debt sustainability efforts is that they were concentrated on public debt portfolio adjustment. Meanwhile, there was little or no consideration for the structural and institutional drivers of public debt related to how spending, resource mobilisation, and fiscal governance culminate into a debt distress situation. Hence, there is a need for a National Integrated Revenue-Spending-Debt Management Strategy with coordinated approaches for revenue optimisation, expenditure efficiency and debt management and sustainability. This will give room to address the bedrock of unsustainable growth in public debt and manage the symptoms as reflected in the debt burden.

3. Ten Policy Action Points for Integrated Management of Debt in ECOWAS

Following the need for a National Integrated Revenue-Spending-Debt Management Strategy to manage the debt situation in ECOWAS, this policy brief presents a 10 (ten) Point Policy Agenda with one broad recommendation and three (3) recommendations specific to each of the three cardinal areas that require integrated coordination: (1) policy actions for revenue optimisation; (2) policy actions for government expenditure efficiency; and (3) policy actions for public debt management and sustainability.



3.1. Broad Recommendation

Ensure macroeconomic stability and economic diversification: Broadly, the soundness and resilience of the economy feed into the public debt characteristic of a country. Due to the dependence of many ECOWAS countries on commodities export, their macroeconomic spaces have been highly susceptible to commodities price shocks. In essence, ECOWAS countries need to diversify their economy and increase productivity across the sectoral composition of the industrial and service sectors to diversify export and expand sources of foreign exchange earnings and revenue. Also, ECOWAS countries need to ensure sound macroeconomic management for a stable business climate. Especially in debt management, the macroeconomic situation influences public debt pricing. The pricing on debt in the capital market is often very high in a highly volatile macroeconomic space, resulting in debt service burden and refinancing risk for the country. Structural issues such as insecurity, infrastructural deficit, and harsh policy and regulatory environment have been major drivers of macroeconomic instability in the ECOWAS region, which need to be addressed. Most importantly, sustained and inclusive (socially and sectoral) economic growth remains the bedrock for expanding government revenue and favourable pricing of public debt.

3.2 Revenue Optimisation

Revenue optimisation is the strategic management of all the channels of government revenue sources to maximise and guarantee revenue growth over the long term. It involves diversifying revenue sources, taking full advantage of sources and overall growth in government revenue. Expansion in government revenue is the most important way to ameliorate public debt pressure in short to medium term in ECOWAS. However, revenue mobilisation in ECOWAS countries is among the lowest in the world, especially as low as 6% of GDP in Nigeria. Hence, the following are three (3) policy interventions to drive revenue optimisation in ECOWAS.

» ***Reform the tax system:*** The major downside to revenue growth among ECOWAS countries is leakages in the pipeline of revenue mobilisation. In the taxation framework of many ECOWAS countries, there are often too many government agencies involved in revenue collection from households and businesses. This has led to multiplicity and duplication of taxes and levies. With such an arrangement, a substantial part of the revenue would have gone into administrative cost, and very little ends up with the government. Hence, ECOWAS governments need to harmonise taxes; broaden the tax base; convert informal taxes and implicit taxes into formal government revenue; introduce fiscal incentives that would encourage the transition of informal micro-enterprises into the formal economy; and recalibrate the incentive management system to roll back incentives not yielding meaningful result in growing the economy and focusing on getting the right set of people to pay tax.

» ***Adopt technology in revenue collection:*** With the growing complexity in the economy and market structure, the ECOWAS governments need to introduce technology in revenue collection. This is important to reduce the cost of revenue mobilisation, ease the process of revenue collection for both government and the taxpayers, streamline the parties involved, gather more commitment from taxpayers, engender transparency in revenue collection, and track defaulters (e.g. tax evasion/avoidance, delay in remittance of royalties, rent etc.).

» ***Take advantage of alternative financing:*** ECOWAS governments need to also tap into the savings of households and firms and channel their excess earnings into productive social investments. This can be done through several Public-Private Partnership (PPP) arrangements such as equity financing, infrastructural funds, crowdfunding and a host of others. The income generated from charges from the project will be used as a return on investment. However, the headwinds to PPP in ECOWAS are the weak institutions around PPP, lack of trust in the system, and uncertainty around the government's commitment to contracts. Hence, ECOWAS governments need to provide institutional backing, perhaps legislative sign-offs on PPP projects, to avoid any form of political interference or abrupt termination of contracts and provide confidence in PPP projects in the region.

3.3. Expenditure Efficiency

Expenditure efficiency involves the strategic allocation of government resources to priority areas in order to achieve the maximum possible outcome given a limited amount of resources. In ECOWAS, government expenditure relative to GDP is among the lowest in the world (at 12% in Nigeria in 2020). However, much government would like to spend, the level of spending needs to consider the macroeconomic stability and the country's resource mobilisation capacity. Hence, the growth of government expenditure needs to be fiscally sustainable, efficient and limited. The following are three (3) policy areas for interventions to ensure expenditure efficiency in ECOWAS.

» ***Overall restructuring of the fiscal space:*** Over the past two decades, most ECOWAS countries have maintained an incremental budget system; persistent fiscal deficit position; and lopsided expenditure structure towards recurrent expenditure (overhead cost and debt services) over the past two decades. Also, the government spending budgeting process in many ECOWAS countries has been marred by budget padding, project cost inflation, provisions for dead and redundant projects, and high overhead cost. Hence, the ECOWAS governments need to restructure the fiscal space for efficient spending. This will include cutting down the cost of governance across the tiers and levels of government, observance of fiscal discipline, adoption of zero-based budgeting to prioritise spending, and privatisation of redundant and moribund assets.

» ***Target borrowings at specific capital projects:*** In the light of infrastructural deficit and the need to continue to support the recovery of economies, government borrowing going forward should be project tied. This is alongside the efficient implementation of a working framework for PPP with a few government borrowing focusing on health, education, and other capital projects that cannot be covered by PPP but are important for future growth. Also, to work toward sustainability, the government must adopt an optimal national financial net-worth balancing approach to ensure that increase in government outstanding is at least offset by a commensurate increase in the national asset that can yield returns to services the debt - or better, lead to an increase in national net worth.

» ***Adopt technology in expenditure management:*** A substantial part of resource leakages occurs during resource allocation. Due to the multitude of government programmes and the manual processing of annual budgets, it is difficult to track the effectiveness of disbursements. Hence, from budgeting to the final contractors, every aspect of expenditure planning needs to be electronically processed. This helps the government to track allocations across MDAs, programmes and projects. It will also help with matching cost to project and matching allocations to contractors.

3.4. Public Debt Management and Sustainability

The traditional debt restructuring mechanism adopted by most developing countries is fast fading away as the debt structure of ECOWAS countries has been changing with increased capital market activities. As it stands, the stock of public debt in ECOWAS counties cannot be instantaneously reduced; rather, it can be managed to ease the debt service burden on countries. Hence, the three (3) policy areas for public debt management and sustainability interventions in ECOWAS are as follows.

- ***Seek debt relief and debt cancellation:*** Due to the devastating effect of COVID-19 pandemics on ECOWAS countries, they compounded their debt burden by borrowing more. ECOWAS countries need to seek further debt relief from both private, bilateral and multilateral debts, much longer, perhaps, until COVID-19 is faced out. However, mere debt relief could prove ineffective in easing the burden on ECOWAS countries. Therefore, ECOWAS countries should seek debt cancellation where possible, especially from bilateral and multilateral sources.

- ***Establish independent Debt Management Offices:*** The current debt management arrangement in all ECOWAS countries are subservient to either the finance ministry or the monetary authority. ECOWAS countries need to establish autonomous and independent debt management units strengthened to rationalise government borrowing plans in the face of the sustainability of the current public debt portfolio and macroeconomic outcomes. More than just borrowing, the unit will be empowered to develop debt sustainability plans, de-risk government debt, establish timely and transparent debt recording system, improve transparency and accountability in debt procurement and disbursement, drive policy coordination for fiscal, monetary and financial outcomes, ensure proper pricing of government debt and instruments and institute good governance structure to manage public debt.

- ***Establish a regional sovereign solvency management institution:*** As public debt distress among ECOWAS countries is gradually becoming an episodic issue of every decade, ECOWAS needs to establish a regional sovereign solvency management body that will, in conjunction with national debt management units, monitor the trend of public debt and sustainability in member countries. They will be saddled with the responsibility of articulating strategies to survive debt distress and fiscal policy coordination. It will also advise ECOWAS governments on expanding revenue base and expenditure management. This will strengthen the effectiveness of the national debt management units and immune them to fiscal policy discretionary actions; ensure adherence to national and regional fiscal rules; ensure resolution of public debt distress in an orderly manner (especially with the growth of private debt), and pave the way for a more flexible path for debt relief and cancellation.

4. Conclusions

Following the increasing concern about the sustainability of public debt accumulation among ECOWAS countries and the ensuing challenges with servicing, this policy brief seeks to identify workable policy actions to ensure sustainable public debt management in the ECOWAS region. This brief recognises that there are structural and institutional drivers of public debt beyond the public debt portfolio. Particularly, this relates to how governments spend, generate revenue and the overall fiscal governance sum up into an unsustainable debt level for ECOWAS countries. Hence, the debt situation in ECOWAS requires a National Integrated Revenue-Spending-Debt Management Strategy with coordinated approaches for revenue optimisation, expenditure efficiency and debt management and sustainability. In accordance, a 10 (ten) Point Policy Agenda is recommended to address the bedrock of unsustainable growth in public debt and manage the symptoms as reflected in debt burden.

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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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