Bolstering the path out of the debt crisis in africa through domestic resource mobilization

PETER DANIEL ONIMISI (Ph.D.)

The percentage of Africa's debt to GDP has been steadily increasing in recent years, exacerbated by the fact that the increase in borrowing has not been matched by an increase in revenue. The total amount of external debt held by governmental and private sector organizations in Africa exceeded US$1 trillion in the last decade, and the associated yearly service expenses crossed US$100 billion for the first time. Only nine nations hold two-thirds of the total external debt stock in Africa as of 2021, with South Africa having 15% of the total external debt in the continent, followed by Egypt (13%), Nigeria (7%), Angola (7%), Morocco (6%), Sudan (6%), Tunisia (6%), Kenya (4%), and Zambia (4%).[1]

African governments' debt that is held domestically climbed from an average of 15% of GDP to 30% between 2010 and 2020, while the public debt as a proportion of GDP in sub-Saharan Africa was 56% in 2022[2]. Debt-to-GDP ratio in Egypt, South Africa, and Nigeria were fast approaching 100%[3], 70%[4], 35%[5] in 2022, respectively. Additionally, 40% of Africa's debt was in foreign currencies, rendering its nations vulnerable to exchange rate fluctuations.[6]

Low domestic saving rate, one of the reasons for the rise in debt levels, has made, African nations resort to borrowing from various sources, including domestic markets, international debt markets, and multilateral institutions, to support the growing needs for infrastructure and other economic programs. Low global interest rate regime, which has forced private markets to seek better-paying assets, has also contributed to the continent's rising debt levels.

Rising budget deficit, political instability, financial mismanagement, and decline in key commodity prices made it difficult for African countries to service their external debt. For instance, debt servicing in Nigeria and Ghana stood at about 96.3[7] and 70%[8] respectively in 2022. Moreso, to tackle the threat presented by inflation, Western central banks have started a cycle of tightening monetary policy, which would increase borrowing costs and decrease available financing for certain African nations. In 2022, the Federal Reserve (Fed, the US central bank) increased its main policy target rate by a total of 250 basis points, and it's projected to get to 257.75 basis point representing a 3.1% raise by the end of 2023.[9]

The short-term outlook for Africa shows a combination of increased debt-service costs and an increase in already high levels of external debt as global inflation, interest rates, and risk

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[1] https://country.eiu.com/article.aspx?articleid=982147881&Country=Nigeria&topic=Economy&subtopic=Outlook&subsubtopic=Financial

[2] https://www.economist.com/middle-east-and-africa/2023/05/16/africa-faces-a-mounting-debt-crisis

[3] https://www.reuters.com/world/africa/north-africa-backslides-toward-swirling-debt-troubles-2023-05-11/

[4] https://allafrica.com/stories/202211030018.html

[5] https://nairametrics.com/2023/01/06/nigerias-debt-to-gdp-ratio-is-35-2-as-total-public-debt-stock-rises-to-n67-58-trillion/

[6] https://www.economist.com/middle-east-and-africa/2023/05/16/africa-faces-a-mounting-debt-crisis

[7] https://businessday.ng/news/article/96-of-nigerias-revenue-spent-on-debt-servicing-in-2022-world-bank/

[8] https://www.reuters.com/world/africa/who-holds-ghanas-debt-what-restructuring-is-planned-2022-12-09/

[9] https://country.eiu.com/article.aspx?articleid=982147881&Country=Nigeria&topic=Economy&subtopic=Outlook&subsubtopic=Financial

premiums rise. African currencies depreciated against major trading currencies, and some credit lines have become more difficult to access. As energy, industrial material, and agricultural product prices fall from the highs of 2021–2022, international commodity markets will offer considerably less of a financial lifeline to large commodity merchants. Also, financial strain brought on by excessive debt and a hefty debt-service load will impact economic stability and growth in several nations, including those that are now on the list of nations that are either in great danger or are already in debt difficulty.

To mitigate this eminent debt crisis, there is a need for Domestic Resource Mobilization (DRM). DRM is the long-term way to finance sustainable development. DRM not only provides governments with the cash they need to alleviate poverty and perform public services but is also a key step toward independence from aid. DRM enables nations to avoid the trap of currency risk and mismatch in funding development projects. It is important to highlight that DRM does not always imply imposing new taxes or increased tax rates. Improved audits, processes, or efficient filing processes may also result in increased revenue for governments. DRM is critical to long-term economic growth, development, and transformation in all economies, particularly in Africa. The onset of the global financial and economic crisis has emphasized the importance of African countries stepping up efforts to adopt strategic policies for mobilizing local resources for long-term economic growth.

Furthermore, reliance on domestic resources fortifies governance, fiscal, and capital market institutions, as well as the social and fiscal contract between the government and its population. African governments must become more pragmatic to boost domestic resource mobilization by doing the following:

- More capital investment should be encouraged within the continent.
- More attention to be paid to product sales as opposed to produce sales.
- African countries should be more willing to lend to other African countries.
- Borrowing should be done in local currencies, rather than foreign currencies.
- Stronger business relationships between African countries should be encouraged.
- African countries should be more vigorous in strengthening their capacity for revenue collection and management.
- African countries should work on moving from tax exemptions and concessions to tax harmonization.
- African countries should improve the business environment to promote private investment and encourage Foreign Direct Investment.
- Quick adoption and implementation of the Pan-African Payment and Settlement System (PAPSS) proposed by Afreximbank. This will enable 42 African local currencies to be convertible among themselves, thus domesticating intra-African payments and saving about 5 billion Dollars.[10]

Policy Recommendation

[10] https://www.afreximbank.com/pan-african-payment-and-settlement-system-launched-by-president-akufo-addo-foreseeing-5-billion-annual-savings-for-africa/

This paper outlines a few policy suggestions that might aid African nations in strengthening fiscal capability and DRM.

- An effective, equitable, transparent, and accountable system for the use of tax dollars is necessary for increased DRM to boost voluntary compliance.
- Trade liberalisation and tariff-reduction initiatives may increase the need for funding to improve fiscal capacity. Thus, the required encouragement might be offered via the African Continental Free Trade Agreement.
- A reliable database that enables the identification and location of people, businesses, or real estate properties on which to assess taxes is necessary for effective DRM. Therefore, nations must invest in well-managed property, company, and civil records in addition to effective address systems.
- Given the vast number of subscribers, digital technology has a significant opportunity to strengthen DRM in Africa and also presents a chance for improved DRM.
- The fact that many African nations still need to implement best practices in their tax administrations suggests that there is room for technology transfer and capacity building in this sector and public financial management (PFM) more broadly.[11]

About Author
Dr. Daniel Peter Onimisi, holds a Ph.D. Applied Economics and a consultant to AADFI.

[11] https://www.afdb.org/sites/default/files/documents/publications/aeb_volume_11_issue_3_mobilizing_domestic_resource_in_africa_for_inclusive_growth.pdf