The Looming Debt Crisis in Eastern and Southern Africa: What it Means for Social Sector Investments and Children

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The Looming Debt Crisis in Eastern and Southern Africa:
What it Means for Social Sector Investments and Children

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<tr>
<td>AU</td>
<td>Africa Union</td>
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<td>AUC</td>
<td>African Union Commission</td>
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<td>CCRT</td>
<td>Catastrophe Containment and Relief Trust</td>
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<td>CRC</td>
<td>Convention on the Rights of the Child</td>
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<td>CSO</td>
<td>Civil society organisation</td>
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<td>DSSI</td>
<td>Debt Service Suspension Initiative</td>
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<td>ESA</td>
<td>Eastern and Southern Africa</td>
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<td>EU</td>
<td>European Union</td>
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<td>ECD</td>
<td>Early childhood development</td>
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<td>ECF</td>
<td>Extended Credit Facility</td>
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<td>EFF</td>
<td>Extended Financing Facility</td>
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<td>G20</td>
<td>Group of Twenty</td>
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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<td>GNI</td>
<td>Gross national income</td>
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<tr>
<td>HIPC</td>
<td>Heavily Indebted Poor Countries</td>
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<td>IBP</td>
<td>International Budget Partnership</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IFI</td>
<td>International financial institution</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>LIC</td>
<td>Low-income country</td>
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<td>LMIC</td>
<td>Lower-middle-income country</td>
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<td>OBS</td>
<td>Open budget survey</td>
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<td>OBI</td>
<td>Open budget index</td>
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<td>Official development assistance</td>
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<td>ODI</td>
<td>Overseas Development Institute</td>
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<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<td>PEFA</td>
<td>Public expenditure and financial assessment</td>
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<td>PEFF</td>
<td>Pandemic emergency financing facility</td>
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<td>PER</td>
<td>Public expenditure review</td>
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<td>PPP</td>
<td>Purchasing power parity</td>
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<td>RCF</td>
<td>Rapid credit facility</td>
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<td>RFI</td>
<td>Rapid financing instrument</td>
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<td>SDR</td>
<td>Special drawing rights</td>
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<td>SSA</td>
<td>Sub-Saharan Africa</td>
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<td>UMIC</td>
<td>Upper-middle-income country</td>
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<tr>
<td>UNECA</td>
<td>United Nations Economic Commission for Africa</td>
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<td>WASH</td>
<td>Water, sanitation and hygiene</td>
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<td>WEO</td>
<td>World Economic Outlook</td>
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Executive Summary

This working paper discusses the impact of worsening debt levels due to COVID-19 on child well-being in Eastern and Southern Africa (ESA). Specifically, it investigates the implications of the changing size and composition of debt on social sector spending. The paper aims to stimulate discussion among governments, UNICEF country offices and development partners, including financial institutions, on how the potential negative impacts of a debt crisis can be mitigated to safeguard public investments to tackle child poverty in all its manifestations.

Key findings

▪ COVID-19 sparked an accelerated build-up of government debt across ESA, which grew from 60 percent of GDP in 2018 to nearly 70 percent in 2021, on average. At present, two out of three countries are in or near debt distress.
▪ The composition of debt is shifting from largely concessional loans provided by bilateral and multilateral development agencies to private loans, which makes borrowing more expensive.
▪ Debt servicing costs rose significantly before COVID-19, tripling from 5 to 15 percent of government expenditure between 2009 and 2019, on average. At that point, governments were spending 3.5 times more per person on debt service than on education, health and social protection combined. The surge in debt since the onset of the pandemic and the need to repay maturing obligations mean that domestic revenue will increasingly be directed to debt service.
▪ Debt relief by some creditors, including by the Group of Twenty (G20) countries under the Debt Service Suspension Initiative (DSSI), has freed some resources to safeguard social spending during the current crisis but remains very limited when compared to spending needs.
▪ The pressure to repay debt has already led some governments in ESA to introduce fiscal austerity measures aimed at containing spending and increasing revenue, which can pose serious risks to vulnerable households and children.

Recommendations

To ensure responsible lending and borrowing and also to safeguard public spending on social services required to break the intergenerational cycle of poverty, bold and decisive actions should be taken now within a framework of international cooperation. This requires efforts by governments in the region, creditors, the international community, as well as UNICEF and development partners as outlined below.

To governments in the region

▪ Governments in debt distress or in a high risk of debt distress are encouraged to move swiftly with debt restructuring discussions with their creditors to mitigate the risk of defaults and a regional debt crisis. They should also seek more grants and concessional loans from donors and international financial institutions to support pro-poor social sector spending.
▪ Finance ministries and Parliaments should commit to strengthen debt management policies, including full transparency in the procurement and management of borrowed funds.
▪ Governments should also ensure that borrowed funds are efficiently and equitably utilized to spur human and sustainable development while minimizing leakage and corruption.
▪ As part of COVID-19 recovery strategies, governments should strengthen measures to improve domestic revenue mobilization through progressive taxation, tackling tax evasion and
avoidance, and enhancing tax collection capacity while improving efficiency in the utilization of available resources.

To creditors and the international community

- Public and private creditors should consider transformational debt relief to the region, including an extension of debt moratoriums through at least 2023, debt swaps in favor of social sector spending, and complete debt forgiveness for fragile countries with serious fiscal pressures.
- The global community, particularly G20 countries, should commit to a voluntary reallocation of a portion of their new Special Drawing Rights (SDRs) to those governments most in need.
- The G20 should accelerate the implementation of the common framework for debt resolution and ensure that all interested governments in ESA participate.
- The international community should work together to strengthen the international debt restructuring architecture, ensuring that it reflects the diverse situations of developing countries and builds on the principles of responsible sovereign lending and borrowing developed by UNCTAD.

To UNICEF and development partners

- Support efforts by governments in ESA to enhance their capacity for prudent debt management by strengthening debt institutions, policies and transparency mechanisms.
- Provide technical assistance to governments for them to explore non-debt creating external financing opportunities, including grants and public-private partnerships.
- Advocate for the use of new SDRs to safeguard critical human capital and pro-poor spending during the pandemic.
- Advocate with creditors for them to provide debt relief to fragile countries in debt distress or at high risk of debt distress.
- Closely monitor policy discussions that potentially threaten child well-being, including spending cuts, wage bill freezes, new taxes and cost recovery initiatives.
Chapter 1: Introduction

The COVID-19 pandemic has triggered an unprecedented fiscal crisis and a range of socioeconomic impacts. In 2020, the economy of sub-Saharan Africa contracted by an estimated 1.9 percent (IMF, 2021d). This decline in output led to a deterioration of public finances, with ESA countries estimated to have lost approximately US$35 billion in potential domestic revenue in 2020 (Muchabaiwa, 2020). The underperformance of domestic revenue has dampened prospects by most ESA countries to achieve Sustainable Development Goals (SDGs) (United Nations, 2021b).

On the other hand, gross financing needs of governments have increased significantly since the start of 2020. Falling revenue has forced most governments to resort to borrowing in order to address spending demands. Based on IMF projections, net lending/borrowing by governments in Eastern and Southern Africa (ESA) will worsen from an average of -4.3 percent of GDP in 2019 to -5.7 percent in 2021 (Figure 1). This trend is likely to continue.

![General government net lending/borrowing, 2019 and 2021, (as a % of GDP)](image)

Source: IMF, World Economic Outlook Database, April 2021 Update

The fall in government revenue amidst a surge in financing needs has necessitated a new wave of borrowing. However, if loan procurement is not done prudently and debt levels become unsustainable, there may be severe macro-economic consequences that can damage public investments in children. Previous analyses by UNICEF have revealed that heavy debt burdens often negatively impact social sector spending by constraining fiscal space (Cummins, 2020; Agg, 2021). With the size of government debt in ESA countries rising each day, the risk of a regional debt crisis looms large.

This working paper discusses the potential impacts of a regional debt crisis triggered by COVID-19 on social sector spending and children. Specifically, it investigates the implications of the changing size and composition of government debt on spending on health, education and other social sectors, as well as the dangers of certain debt management strategies to vulnerable households and children.
1.1 The link between debt and children’s rights

The size, composition and management of government debt have direct impacts on child well-being. To start, on a positive note, borrowing is often necessary to sustain investments in the delivery of essential services when governments are faced with fiscal constraints. It is perfectly normal for governments, all over the world, to borrow from domestic and international sources if available revenues are insufficient to meet their expenditure needs. Arguably, borrowing, especially on concessional terms, can be the difference between life and death in times of severe economic shocks such as the coronavirus pandemic. General Comment No. 19 of the Committee on the Rights of the Child (CRC) presents borrowing as one strategy of mobilizing resources to invest in the development and protection of children. But, while borrowing is often unavoidable, it should be done prudently to avoid negative consequences (Jolly, 2012; Fore, 2020).

The impact of piling debt can be catastrophic for children. An increase in the debt repayment burden is often associated with a slowdown in social sector spending as debt service costs reduce the available fiscal space (Agg, 2021). The crowding out of social sector spending has been observed in several ESA countries in recent years. In Angola and Zambia, for example, cuts in social protection and health spending in 2019 were partly triggered by a heavy debt repayment burden (Chen et al., 2020). Pressure to mobilize resources to repay growing debt often leads to more taxes, some of which may be regressive (Ortiz and Cummins, 2019).

Moreover, if the debt situation is not managed carefully, the risk of defaulting and accumulating arrears to creditors is high. This in turn precludes governments from accessing new financing. Zimbabwe, for example, has not been able to borrow from the IMF or the World Bank because of arrears to other bilateral and multilateral creditors, including the African Development Bank (Government of Zimbabwe, 2020). Also, defaults in debt repayment usually lead to the downgrading of sovereign credit ratings, which makes it more costly to service existing debt and take on new debt (Hill and Mitimingi, 2020).

Debt policies and practices are, therefore, not neutral when it comes to their impact on children. How debt situations are managed ultimately has a bearing on the amount of resources available to finance the delivery of services to children. This directly affects the ability of governments to achieve development goals, including most of the SDGs (United Nations, 2021b). Additionally, unsustainable debt situations may have other macroeconomic effects, including inflation and currency devaluation, with the potential to affect household income and consequently children.

1.2 Methodology

The paper is based on a desk review of international debt statistics, economic outlook reports and social sector spending trends. Debt statistics were drawn from the IMF’s World Economic Outlook database (April 2021) and World Bank’s International Debt Statistics. Several indicators were considered in this analysis including gross government debt as a percentage of GDP, total debt stock of public and publicly guaranteed debt, total debt service as a percentage of gross national income (GNI), total debt service as a percentage of exports of goods, services and primary income, and total external and domestic government debt in local currency and United States dollars (current prices). Data on social spending trends were also drawn from multiple sources. Data on health spending were derived from the World Health Organization’s Global Health Expenditure Database, education
spending from UNESCO’s Institute for Statistics and social protection spending from Government Spending Watch. Additional information was weaved from a review of recent literature on debt as well as the latest budget statements and debt management reports by finance ministries in ESA.

**Simple correlation analysis is used to estimate the relationship between debt service costs and social sector spending.** Using historical data between 2000 and 2019, the paper assesses the extent to which changes in per capita debt service costs are associated with a certain level of per capita spending on health and education by ESA countries. In analysing the association, the study did not consider other factors, which may have a bearing on the size of social sector spending, such as advocacy by non-state actors, pressure from donors, and the influence of regional and international spending benchmarks.

### 1.3 Structure

The rest of the paper is structured as follows. Chapter 2 discusses the size and composition of debt in ESA before COVID-19, focusing on the period 2000-2019. Chapter 3 examines the debt situation during COVID-19 through 2026, including current national and global policy responses to the debt crisis. In Chapter 4, the paper explores the impact of rising debt on government spending on social services using historical data. Chapter 5 outlines key conclusions and recommendations for governments, creditors, the international community, UNICEF country offices and development partners.
Chapter 2: Rising Debt Before the Pandemic

This chapter examines the debt situation before COVID-19. It starts by presenting information on the size and composition of government debt by ESA countries between 2000 and 2019. In the second section, the composition of government debt is assessed by looking at sources of government debt. This is followed by an overview of the level of debt distress before the pandemic. The chapter concludes with a few key takeaways.

2.1 Overall debt levels

The decade before COVID-19 was characterized by a major increase in debt across most of the region. The increase in debt levels is on account of several factors including expansionary fiscal policies evidenced by a surge in infrastructure projects, fall in official development assistance (ODA), and growing appetite for costlier bilateral and private credit. At the end of 2019, the average general government gross debt was estimated at 66 percent of GDP, up from 39 percent in 2009 (IMF, 2021d). In total, the debt burden nearly tripled from an estimated US$131 billion in 2000 (in current prices) to US$557 billion in 2019, excluding Somalia and South Sudan (Figure 2).

![Figure 2: General government gross debt in ESA countries, 2000-19](image)

Going back to the 2000s, overall debt in the region was on a downward trajectory due to debt relief initiatives as well as the global push for prudent debt management. Between 2000 and 2009, 30 countries in sub-Saharan African benefitted from debt cancellation under the Heavily Indebted Poor Countries (HIPC) initiative and the Multilateral Debt Relief Initiative (MDRI). During this period, the average general government gross debt fell from just under 90 percent of GDP in 2000 to 39 percent in 2009. Ever since, ESA countries have procured more debt, increasing the debt-to-GDP ratio considerably as highlighted in Figure 2.

Source: IMF, World Economic Outlook Database, April 2021
Notes: Data excludes Somalia and South Sudan
The size of government debt varies considerably across ESA countries. Going back to the pre-crisis period, in 2019, Botswana had the lowest amount of government debt relative to the size of the economy at 15 percent, with Eritrea carrying the heaviest burden at 189 percent (Figure 3). However, in per capita terms, South Africa had the highest debt burden at US$3,715 while South Sudan had the least at US$110.

![Figure 3: General government gross debt in ESA countries, 2019 (in per capita US$ and as a % of GDP)](image)

Source: Author, based on data from the IMF, *World Economic Outlook Database, April 2021*

The debt burden in economic terms is highest among the poorest countries in ESA. As of 2019, general government gross debt for LICs was estimated at 74 percent of GDP compared to 66 percent for LMICs and about 46 percent for UMICs, on average (Figure 4). The debt burden for LICs is approximately 1.6 times more than upper-middle-income countries (UMICs). In Botswana, borrowing is legally constrained by the borrowing limits imposed by the Stocks, Bonds and Treasury Bills Act (2005) which states that government debt and government guaranteed debt must not exceed 20 percent for each category of domestic and external debt.
The rising debt burden has increased the risk of debt distress, especially among LICs and LMICs. Before the first case of coronavirus was discovered in ESA, four countries (Eritrea, Mozambique, Somalia and Zimbabwe) were in debt distress and another four were at high risk of debt distress (Angola, Burundi, Ethiopia and Zambia). Only Botswana, Tanzania and Uganda were assessed to have a low risk of debt distress, with the rest assessed to be facing a moderate risk of debt distress. As countries procure new debt to cover widening fiscal deficits, the risk of debt distress has heightened as the next chapter will show. This trend shows that debt was piling up well before the pandemic.
Rising debt levels caused a significant increase in debt service costs long before the arrival of COVID-19. Debt service costs for ESA countries more than doubled between 2009 and 2019, going from 1.5 to 3.5 percent of GNI, on average. In total, debt service costs for ESA countries increased from an estimated US$11 billion to US$42 billion (based on current prices). As a share of total government expenditure, debt service costs trebled from an estimated 5 percent in 2009 to 15 percent in 2019, on average (Figure 6). In Malawi, for instance, debt service costs shot up from approximately 12 percent of the total government budget in fiscal year 2014-15 to nearly 20 percent in fiscal year 2018-19 (UNICEF Malawi, 2018).

There are, however, big variations in debt repayment across countries. In 2019, Angola spent as high as 57 percent of its total annual government budget on debt service compared to 3 percent for Botswana and the Union of Comoros, according to data from the World Bank (2021). As a percentage of GNI, in the same year, Angola also spent the highest on debt service estimated at 12.1 per cent percent with the Union of Comoros spending the least at 0.7 per cent percent of GNI (Figure 7).
Debt service costs are commonly met at the expense of investments in human capital sectors. In Angola, for example, rising interest payments led to a 17 percent cut in the social protection budget in 2019, with debt service costs consuming close to 60 percent of the 2020 budget (UNICEF Angola, 2020). In Zambia, public spending on debt service led to reductions in social welfare spending in 2018 and 2019 (ZIPAR, 2019). Ethiopia currently spends double on debt service than on health despite having one of the highest under-five mortality rates in the world (Ahmed, 2020a).

2.2 Composition of external debt

Total external debt for ESA countries is shifting towards the costlier debt from bilateral and private creditors. This shift is particularly pronounced in LMICs and UMICs. The share of total external debt in ESA (excluding Namibian and South Sudan) sourced from private creditors doubled over the past decade from approximately 22 percent in 2000 to about 50 percent in 2019 (Figure 8). Zambia is a classic example of a country that has shifted to costlier debt. The country has Eurobonds worth US$750 million due in 2022, another US$1 billion in 2024, and a third one worth US$1.25 billion due to be paid back in installments in 2025, 2026 and 2027. The government also owes a mixture of official and private lenders from China an estimated US$3 billion (Economic Intelligence Unit, 2021c).

**Figure 8: Composition of total external debt for ESA countries by creditor, 2000-2019**

(in billions of US$ current prices)

Note: Namibia and South Sudan not included in the analysis due to unavailability of data

The share of concessional finance has declined for all income groups. As of 2019, concessional debt as a percentage of total external debt was estimated at 39 percent, down from 49 percent in 2000 for ESA countries, on average (Figure 9). As expected, UMICs have the lowest share of concessional loans followed by lower middle-income countries.
In recent years, China has become one of the most significant lenders to many ESA countries. Based on latest available data from the Johns Hopkins China-Africa Research Initiative, the total amount of debt provided by China to ESA countries exponentially increased from US$19 million in 2000 to US$2.3 billion in 2019, down from a peak of US$24 billion in 2016 (Brautigam et al., 2019) (Figure 10). Chinese loans increased at an average annual growth rate of 29 percent between 2000 and 2019. In Angola, more than 40 percent of the country’s bilateral debt is estimated to be owed to China, much of it collateralized against oil assets (Economic Intelligence Unit, 2021b). The total

Figure 10: Total Chinese loans to ESA countries, 2000-2019
(in billions of US$, current prices)

Source: Johns Hopkins SAIS China-Africa Research Initiative (Brautigam et al., 2019)
Most of the loans from China are earmarked for infrastructure projects. As of 2019, 69 percent of the loans were to support mining, power and transport related capital projects (Brautigam et al., 2019). Out of this, 30% of the loans were for transport including construction of airports and rail transport projects. A considerable size of the loans was obtained through the Export-Import Bank of China and the China Development Bank (Ibid).

### 2.3 External vs domestic debt trends

The domestic share of total debt continues to increase in the region. Relative to the size of the economy, this increased from an average of 13 percent in 2009 to 27 percent in 2019 (Figure 11). In 2019, South Africa had the highest proportion of domestic debt as a percentage of total debt stock followed by Namibia (Figure 12). In some countries, Zimbabwe, for example, the domestic debt market is the major source of financing of the budget deficit because access to external sources remains constrained due to the accumulation of external debt arrears to creditors (Zimbabwe Public Debt Management Office, 2019). Although denominated in local currency, domestic debt tends to be costlier and short-term in nature.

**Figure 11: Domestic vs external public debt as, 2000-2019 (as a % of GDP)**

![Graph showing domestic vs external public debt as a % of GDP from 2000 to 2019](https://pubdocs.worldbank.org/)


*Note: Eritrea, Namibia, South Sudan, Somalia and Tanzania not included due to unavailability of data*

**Figure 12: Domestic vs external debt, 2019 (as a % of total)**

![Graph showing domestic vs external debt in 2019](https://pubdocs.worldbank.org/)

*Source: Various - Ministries of Finance, IMF Debt Sustainability Analysis and World Bank, 2021*

*Note: Eritrea, South Sudan, Somalia and Tanzania not included due to unavailability of data*
Although the increase in the domestic share of loans is more pronounced in middle income countries, LICs are also following suit. In Mozambique, for example, domestic debt as a percentage of GDP increased by 80 percent between 2009 and 2019. Other LICs whose domestic debt grew significantly during the same period are Burundi (60%), Rwanda (56%) and Uganda (53%) (Figure 13).

Figure 13: Domestic debt in ESA countries in 2009 compared to 2019 (as a % of GDP)

Source: Author based on data from IMF’s World Economic Outlook Database, April 2021
Note: No data for other ESA countries.

2.4 Key takeaways

- COVID-19 exacerbated pre-existing debt vulnerabilities in most places due to rising domestic and external debt.
- The changing composition of debt towards costlier bilateral and private debt partly accounts for the increase in annual debt repayment costs.
- Domestic debt has also trended upwards over the past decade.
Chapter 3: COVID-19 and Worsening Debt Ratios

This chapter discusses how the coronavirus pandemic has accelerated the accumulation of debt among ESA countries, which was already on an upward trajectory. The chapter is divided into three sections, with the first presenting global estimates from the IMF (2021) on the projected size of the debt stock during the pandemic. The second section briefly examines the debt sustainability situation, looking at the latest debt distress levels, while the third section reviews policy responses to the debt crisis. The chapter concludes with a few takeaways.

3.1 Debt build up during COVID-19

COVID-19 has sparked an accelerated build-up of debt in most ESA countries. General government gross debt, as a percentage of GDP, increased by nine percentage points from 60 percent in 2018 to an estimated 69 percent in 2021, on average (IMF, 2021d). Compared to the pre-pandemic situation (2018), 17 out of 21 ESA countries witnessed a surge in the size of debt (Figure 14). Only Ethiopia, Eritrea, Somalia and Tanzania are projected to have smaller debt levels in 2021 compared to 2018 relative to the size of their economies. Somalia is expected to have the largest decline mainly because of the HIPC debt relief initiative.

![Figure 14: General government gross debt for ESA countries in 2018 and 2021 (as a % of GDP)](source: IMF, World Economic Outlook Database, April 2021 update)

The increase in debt stock varies widely across countries depending on macro-economic circumstances. The highest percentage change in gross government debt between 2018 and 2021 was experienced by Botswana, which experienced a 78 percent increase, followed by Comoros (61 percent) and Eswatini and Zambia (just over 50 percent). Countries that were already in debt distress before the pandemic, including Angola, Eritrea, Mozambique and Zambia, are estimated to have the lowest increase in debt stock. This reflects their very low sovereign credit ratings, which has made it impossible for them to access international credits markets.
The growth in debt is due to falling revenues and surging financing needs to respond to the pandemic. On the spending side, this includes the rollout of relief and fiscal stimulus packages to cushion households and failing businesses from the impact of the pandemic as well as health sector responses to prevent and treat the coronavirus. On the revenue side, the contraction of economic activity and international trade led to serious declines. For natural resource-intensive countries such as Angola, Botswana, Namibia, South Sudan and Zambia, the situation was worsened by a fall in the demand and prices of commodities during 2020, such as crude oil, diamonds and other minerals.

3.2 Growing risk of debt distress

COVID-19 has elevated the risk of debt distress for many ESA countries raising fears of a new regional debt crisis like the 1980s. At the end of August, 14 countries were assessed to be in a high risk of debt distress or already distressed compared to 8 in 2018. Out of the 14 countries, 10 faced a high risk of debt distress with 4 already in debt distress, well before the pandemic (World Bank, 2021b). While in 2018, 13 of the 21 ESA countries were assessed as having low or moderate risk of debt distress, in 2021 the number of countries went down to 7 (Figure 15).

![Figure 15: Debt distress levels of ESA countries in 2018 compared to 2021 (in number of countries)](chart)

Source: World Bank Debt Sustainability Analyses and IMF Article IV Reports

The rising risk of debt distress is not only confined to ESA. Globally, over half of least developed and low-income countries are now assessed as being at a high risk of debt distress or in debt distress (IMF, 2021). At the same time, more than a third of emerging market economies are at high risk of fiscal crises (United Nations, 2021a).

A weak debt policy environment is likely to prolong the period of debt distress for some countries. Of the 17 LICs and LMICs countries in ESA, only 7 scored more than 3 on the Country Policy and Institutional Assessment (CPIA) on debt policy (Figure 16). This assesses whether the debt management strategy is conducive to minimizing budgetary risks and ensuring long-term debt sustainability (World Bank, 2021d). Some of the common weaknesses in debt management include limited capacity to negotiate loans, low debt transparency, lack of fiscal rules related to debt ceilings, weak debt policies and institutional environment. Lackluster macroeconomic performance in fragile countries, such as Burundi and South Sudan, also influences public debt dynamics.
3.3 Increasing debt defaults and credit rating downgrades

COVID-19 has made it difficult for most ESA countries to honor their debt service obligations. This has triggered debt defaults and sparked credit rating downgrades in several countries. Zambia was the first country to default on its overdue interest repayments to foreign bondholders valued at US$42.5 million in November 2020 (Hill and Mitimingi, 2020). As a result of the government’s suspension of debt service payments to creditors, Zambia’s credit rating was lowered to selective default from CCC-/C (Jariel, 2020). In May 2021, Moody’s downgraded Ethiopia from B2 to Caa1 in response to the uncertainty over debt restructuring discussions (Rutter, 2021). In March 2021, Kenya’s credit rating was downgraded to ‘B’ by Standard & Poor (S&P), due to rising fiscal and external pressures (Okoth, 2021). At the close of 2020, Fitch Ratings downgraded South Africa’s Long-Term Foreign-Currency Issuer Default Rating to ‘BB-’ from ‘BB’ because of high and rising government debt (Fitch Ratings, 2021).

Downgrades in credit ratings have serious fiscal implications. To start, they make it difficult for countries to access relatively cheaper international loans in credit markets. Second, they push up borrowing costs, especially for developing countries. This, in turn, increases the pressure to resort to unsustainable debt policies. Many countries are doing all they can to avoid downgrades including through inclusive debt restructuring discussions with creditors. Fearing downgrades in credit ratings, some countries were reluctant to participate in the Debt Service Suspension Initiative (DSSI). The DSSI, to be discussed in the section which follows, is a debt relief mechanism established by the G20 for the purposes of offering poorest countries temporary suspension of debt-service payments owed to their official bilateral creditors. It is coordinated by the World Bank and the International Monetary Fund (IMF).
3.4 Global responses to unsustainable debt levels

The international community moved swiftly to respond to the fiscal constraints faced by most developing countries, but action has been insufficient. In April 2020, African states signaled that they needed help to stop the looming debt crisis from turning into a human tragedy (Rutter, 2021; AFDB, 2021). In a passionate appeal for help, the Prime Minister of Ethiopia, for example, said that debt service relief in 2020 by all its lenders could have potentially saved the country US$1.7 billion and US$3.5 billion if the moratorium were extended to the end of 2022 (Ahmed, 2020b). Key policy responses to the debt problem are discussed below.

Debt relief

Debt relief, mostly in the form of moratoriums, was the immediate response by IFIs and other creditors. This allowed eligible governments to use funds that they had reserved for debt repayment to address urgent financing needs. As early as April 2020, the IMF was amongst the first lenders to approve immediate debt service relief to 25 low-income countries, eight of which are from ESA (Comoros, Madagascar, Malawi, Mozambique and Rwanda). Through the Catastrophe Containment and Relief Trust (CCRT), the IMF covered the payments due for an initial period of six months (IMF, 2020). As of June 2021, the eight countries in the region had benefitted from US$206 million in support (Figure 17).

Figure 17: Debt Relief to ESA countries through the CCRT, April 2020 to June 2021

![Figure 17: Debt Relief to ESA countries through the CCRT, April 2020 to June 2021](image)

Source: IMF COVID-Lending Tracker

The Group of 20 (G20) countries also offered time-bound suspension of debt service payments for the poorest countries. This was done under the auspices of the DSSI, introduced in the preceding section. As part of the DSSI, all low-income countries that are eligible, and applied to participate, received temporary suspension of debt-service payments owed to their official bilateral creditors (G20, 2020b). Unfortunately, some of the poorest countries in ESA, such as South Sudan, have not yet taken advantage of this initiative. In April 2021, the G20 announced that it would extend the debt relief to December 2021. The 12 ESA countries participating in the DSSI were relieved of US$6.5 billion in DSSI savings by June 2021 (World Bank, 2021a). This is equivalent to 1.1 percent of GDP, on average (Figure 18). The debts will, however, have to be paid in full over a maximum of six years once the suspension expires (Wheatley, 2021).
Fortunately for Somalia, the IMF and the World Bank approved debt relief under the enhanced Heavily Indebted Poor Countries (HIPC) Initiative at the onset of the pandemic in 2020. Through the HIPC Initiative, Somalia’s debt will be reduced from US$5.2 billion in 2018 to about US$557 million in net present value (NPV) terms once it reaches the HIPC Completion Point in about three years’ time (World Bank, 2020). Somalia also benefitted from other support from the IMF and the World Bank. For example, in June 2020, the World Bank approved a US$55 million grant to support Somalia’s economic recovery from COVID-19 as well as fiscal and other economic policy reforms to strengthen fiscal management and promote inclusive private sector-led growth (World Bank, 2021c).

China creditors have also offered some debt relief to countries that requested it. For example, two official Chinese bilateral creditors (Eximbank and CIDCA) provided about US$1.3 billion in debt relief to 23 countries worldwide, including 16 African countries under the DSSI. Within ESA, according to the official information they released about G20 debt relief, Zambia benefitted from US$110 million and Kenya US$378 million. It is further estimated that Chinese lenders have provided at least US$12.1 billion in global debt relief in 2020 and 2021 (Acker, Brautigam and Wang, 2021).

To some degree, debt relief and other fiscal packages offered by IFIs and donors have helped some ESA countries to avoid cuts in social spending during the pandemic. An analysis of budget briefs produced by UNICEF Country Offices shows that 15 of the 21 countries maintained or increased total spending in at least two social sectors during their 2020 fiscal years, especially health and social protection.

Regrettably most private creditors have not publicly disclosed their position on debt relief nor are they part of the DSSI. Individual governments have been left to themselves to negotiate with their private creditors. A more coordinated and harmonized approach to debt restructuring is required. The G20 has been unequivocal about this, calling for all creditors to be involved in debt relief and restructuring discussions. It is a condition of the Common Framework that all creditors participate on the same basis for burden sharing.
The DSSI and other international efforts have not been adequate to address the looming debt crisis in all countries. For instance, most of the multilateral and commercial debt has been excluded from the DSSI (UNDESA, 2020). Moreover, upper middle-income countries (UMICs) such as Botswana, Namibia and South Africa are not included in the DSSI. The debt standstill is only for a short period, hence the demand for the extension through to 2023 by some governments. Abiy Ahmed, the Prime Minister of Ethiopia, for example, called upon the G20 and other creditors to consider cancelling some debt while extending the existing moratorium to 2023 (Ahmed, 2020b).

Besides debt standstill, there is minimal discussion about other forms of debt relief, most notably debt swaps. Through debt swaps, creditors allow debt service payments to be invested in human capital development. There is also potential for swapping outstanding debt into COVID-19 bonds (UNDESA, 2020).

Concessional emergency financing

Although not exactly a debt response mechanism, concessional emergency financing from IFIs is helping to ease debt burdens. As of June 2021, the IMF had approved around US$250 billion (a quarter of its US$1 trillion lending capacity) to member countries globally (IMF, 2021b). However, only a small fraction was extended to the region, which amounted to approximately US$11 billion to 14 countries, mainly through the Rapid Credit Facility (RCF) and the Rapid Financing Instrument (RFI). Moreover, within ESA, close to 70 percent of the support went to two countries: South Africa (US$4.3 billion) and Kenya (US$3 billion).

The World Bank approved around US$160 billion in emergency funding support globally along with US$12 billion to help countries purchase COVID-19 vaccines (World Bank, 2021c). The Bank also indicated that it would avail US$195 million to 64 of the world’s poorest countries with reported cases of COVID-19 under the Pandemic Emergency Financing Facility (PEFF). In total, between March 2020 and June 2021, the World Bank made available about US$24.7 billion for Africa to respond to the COVID-19 crisis through a combination of new operations in health, social protection, stimulus packages to private sector, as well as redeployment of existing resources. Eight countries from ESA (Burundi, Eswatini, Ethiopia, Kenya, Lesotho, Malawi, Rwanda and Somalia) have benefitted from this financing. Kenya is the biggest beneficiary, having received about US$1.7 billion in assistance as of June 2021 (World Bank, 2021d).

The African Development Bank (AFDB) is also providing up to US$10 billion to support African countries to respond to the pandemic through its COVID-19 Response Facility (AFDB, 2021b). At the end of April 2021, the AFDB had approved a total of US$4.1 billion with about US$3.7 billion having been disbursed (AFDB, 2021c). About two-thirds of ESA countries have benefitted from this support, with South Africa getting the highest loan approval of US$288 million, followed by Kenya at US$222 million and Ethiopia at US$165 million.

Concessional loans and grants from IFIs have helped reduce the pressure to take on expensive loans but remain inadequate to meet the growing financing needs. Given this scenario, many ESA countries will be forced to further exploit domestic borrowing opportunities or resort to costlier loans from international credit markets, where possible. Kenya, for example, has already raised US$1 billion in a Eurobond issuance at an interest rate of 6.3 percent. This is the fourth sovereign bond floated by the government since 2014 (Amboko, 2021).
At a time when many countries are procuring new loans, debt transparency has remained weak. In most ESA countries, scanty information is being shared by governments on loans being procured besides what is made publicly available by IFIs. Debt transparency is a major problem in most countries. Poor debt transparency makes it difficult for citizens to hold governments to account for their borrowing decisions. Also, evidence from Mozambique shows how secret loans can come at a heavy price for the country’s people and the economy (Jubilee, 2016).

IMF Special Drawing Rights
In August 2021, the IMF approved a new allocation of Special Drawing Rights (SDR) to help its member countries recover from the COVID-19 crisis. The SDRs, which are equivalent to US$650 billion, will help meet a long-term global need to supplement existing reserve assets in a manner that avoids stagnation and deflation as well as excess demand and inflation (IMF, 2021c). In total, US$12.2 billion in new SDRs were credited to central banks in ESA, which amounts to around US$23 on a per capita basis (IMF, 2021a). The new SDRs can be used as governments desire, with the main options including: (i) storing as additional central bank reserves to strengthen balance of payments and financial sector stability; (ii) using to pay down bilateral and/or multilateral debt held in foreign currencies to lower levels of debt distress; and (iii) exchanging to international currencies to allow for greater spending on COVID-19 recovery plans.

Common Framework for addressing debt concerns
The G20 proposed a ‘Common Framework on Debt Treatments Beyond the DSSI’ in December 2020 to address debt problems. The framework, which was also adopted by the Paris Club, aims to facilitate timely and orderly debt treatment for DSSI-eligible countries, with broad creditors’ participation, including the private sector. The framework emphasizes the need for “all G20 and Paris Club creditors with claims on the debtor country, as well as any other willing official bilateral creditor with claims on the country, to coordinate their engagement with the debtor country and finalize jointly the key parameters of the debt treatment, consistent with their national laws and internal procedures” (G20, 2020a: 01). The framework is underpinned by the principle of burden sharing to avoid a situation whereby debt relief is effectively facilitating the continued payment of private creditors.

Coordination in debt restructuring negotiations, however, remains weak in ESA. While the African Union and its sub-regions have been calling for a coordinated and continental approach, the reality on the ground is that individual governments have continued to negotiate debt workouts with their creditors. Angola, for example, renegotiated some of its debt, most of which is owed to Chinese banks (Economic Intelligence Unit, 2021b). Encouragingly, at the end of June 2021, two ESA countries, Ethiopia and Zambia, had asked for debt treatment under the Common Framework.

Overall, the international debt governance system requires further strengthening. This is the reason why negotiations for debt workouts have been haphazard and conducted on a case-by-case basis. A coordinated and harmonized approach is long overdue. Such a system should be underpinned by principles of responsible sovereign lending and borrowing developed by UNCTAD and emphasized in the 2015 Addis Ababa Action Agenda on Financing for Development (United Nations, 2021b). The principles state that “undisciplined, ineffective, abusive or non-cooperative behavior on the part of both creditors and sovereign debtors should be prevented in order to minimize sovereign insolvencies and their negative consequences” (UNCTAD, 2012: 02).
3.5 Key takeaways

- Macro-economic policies in the recovery period should pay attention to worsening debt sustainability assessments due to a spike in the size of debt and defaults in payments.
- Debt relief measures have provided some breathing space to ESA countries, but much more needs to be done to avert a regional debt crisis, including extending relief measures to upper middle-income countries.
- It is important for private creditors and rating agencies to be involved in policy discussions to restructure sovereign debt.
- ESA governments should take advantage of the new allocation of SDRs and other non-debt creating flows to finance their COVID-19 recovery plans.
Chapter 4: The Potential Impact of a Debt Crisis on Children

Debt policies and practices are not neutral when it comes to their impact on children. Reflecting this reality, this chapter discusses how heavy debt burdens can affect public investments in children’s services in ESA. It is divided into two main sections. The first section presents a historical overview of how debt service costs crowd out social sector spending. The second section then highlights macroeconomic problems that are caused by heavy debt levels and how these reverberate on vulnerable populations, including children.

4.1 Reduction in social sector spending

High debt service costs

High debt repayment costs reduce the amount of domestic revenue available to finance the annual budget or support emergency measures. This will, in turn, hamstring the capacity of many ESA countries to finance the delivery of social services to children. Over the past decade, total debt service costs as a percentage of total revenue in ESA countries trebled from an estimated 7 percent in 2010 to 22 percent in 2019, on average (Figure 19). At 22 percent of government revenue, debt servicing costs in ESA are just under the 25 percent median value for middle-income countries across the world (UNDESA, 2020).

Figure 19: Average government revenue and debt service costs in ESA countries, 2000-2019 (in billions of US$ and as a % of total revenue)

Increasing debt service costs take a large share of export income. In 2019, total debt service costs consumed nearly 13 percent of income from exports of goods and services of ESA countries compared to about 6.2 percent in 2009 (Figure 19). In Kenya, spent the highest share of its export revenue on debt service at 38.2 percent, followed by Zambia at 31.2 percent, Ethiopia 28.9 percent, and 27.4 percent (Figure 20)
Between 2010 and 2019, total debt service costs increased at a faster rate than government revenue, which is likely to continue for the foreseeable future. The average annual growth rate of debt service costs for ESA countries (15 percent) was five times more than for government revenue (3 percent), on average. During this period, Zambia, Ethiopia and Kenya had the highest average annual change in debt service costs at 32, 28, and 27 percent respectively (Figure 21). In Zambia, between 2018 and 2019 alone, total debt service costs increased by approximately 24 percent from US$760 million to US$944 million (Ministry of Finance Zambia, 2019).
Figure 22: Average annual growth rate of revenue compared to debt service costs for ESA countries, 2010-2019 (in growth rate, as a %)

Source: Author calculations based on data from the World Bank (Debt Service costs) and from the IMF (Total Revenue)
Notes: Data exclude Eritrea, Namibia, Somalia, and South Sudan where data was unavailable.

Debt service costs as a percentage of total government revenue are highest in LMICs. In 2019, Zimbabwe had the highest share of expected total debt service costs as a percentage of government revenue, estimated at 58 percent, followed by Angola at just below 55 percent, Zambia at slightly above 54 percent, and Kenya at 26 percent (Figure 22). Due to weak economic performance, it has been difficult for Zimbabwe to service its debt resulting in accumulation of arrears.

Figure 23: Debt service in ESA countries, 2010 and 2019 (as a % of total revenue)

Source: Author based on data from World Bank, International Debt Statistics, 2021 and IMF, WEO, April 2021 Update
Notes: Data unavailable for other ESA countries

Debt service costs outweigh social sector spending in the poorest countries in the region. In 2018, 14 LICs and LMICs spent an estimated US$353 per person on debt service compared to US$100 on social protection, health and education combined, on average (Figure 23). This means that they spent 3.5 times more on debt repayment than on human capital investments.
Figure 24: Debt service in relation to social spending for LIC and LMICs in ESA, 2018
(in per capital US$, current prices)

Source. Author calculations based on data from World Bank International Debt Statistics, Government Spending Watch, and UNESCO Institute for Statistics
Note: Data not available for other ESA countries

Reduced access to borrowing
As earlier indicated, debt defaults, piling of arrears and credit rating downgrades hinder governments from accessing international capital, which tends to be cheaper. The case of Zimbabwe is illustrative of how failure to clear arrears can block access to new financing. For several years now, Zimbabwe has not been able to access loans from the IMF and the World Bank because of arrears owed to other creditors (Zimbabwe Public Debt Management Office, 2019). Failure to access cheaper international finance often leads to costly borrowing from domestic markets and quantitative easing. These policy responses have implications on inflation, household income and child well-being.

Shift in government spending priorities
A heavy debt repayment burden often forces governments to reprioritize available resources, sometimes at the expense of children. History shows that human capital projects tend to be chopped in times of fiscal stress (Jolly, 2012). At the height of the pandemic in 2020, most countries stalled capital projects, including construction of classrooms and clinics, to reallocate their limited budgets towards COVID-19 responses (Muchabaiwa, 2020). Unfortunately, halting social sector infrastructure projects like school blocks, clinics, childcare centers and water systems derail progress towards human capital development. These investments are critical if the region is to reap the demographic dividend and to maximize returns on investments by prioritizing the early years of life.

4.2 Austerity measures

Several ESA countries have announced austerity plans (also known as fiscal consolidation) to keep debt within sustainable levels. In Eswatini, the government laid out a three-year Fiscal Adjustment Plan (FAP) to stabilize and consolidate the country’s public debt. It is believed that the FAP is a precondition by the IMF for the US$110.4 million of budgetary support provided under the
RFI, which was approved in July 2020 (Economic Intelligence Unit, 2021a). The fiscal consolidation, among other measures, will include efforts to contain the wage bill. In Eswatini, public wages are by far the largest single expenditure item, despite the implementation of a hiring freeze since 2018/19.

Some austerity measures may be catastrophic to children. For example, measures such as freezes in recruitments and lower-than-inflation salary adjustments compromise the quality of service delivery to children in that they spur protests and strikes by civil servants with knock-on effects on service delivery and national productivity. Other measures, such as cuts in social spending, halting major infrastructure projects, cost-recovery mechanisms and the introduction of new taxes, often hit the most vulnerable groups the hardest (Ortiz and Cummins, 2019). The risk of governments cutting back some of the social protection initiatives introduced in 2020 to mitigate the impacts of COVID-19 also remains elevated. Moreover, some governments in ESA, including Kenya and South Africa, have already reversed tax relief measures put in place in 2020 in response to the pandemic.

Fiscal consolidation is likely to endure for years to come. A recent analysis shows that budget cuts and other austerity measures are intensifying during 2021 and may last at least until 2025 (Ortiz and Cummins, 2021). The move towards fiscal consolidation will continue to be elevated in the next 3-5 years when debt standstills are lifted. In Angola, for example, total debt service to the IMF will peak in 2026 at 3.2 percent of exports (IMF, 2021b).

Lastly, contractionary fiscal policies associated with fiscal consolidation may reduce taxable economic activity. Cuts in government expenditures and capping of wage bills, for instance, curtail economic growth and lower tax revenue. In countries where government expenses constitute a greater share of GDP, such as in Eswatini, contractionary fiscal policies will have serious implications on sustainable development.

4.3 Key takeaways

- Borrowing can be great for children if carefully managed and invested well; the opposite is also true.
- Big increases in debt service costs that are not accompanied by corresponding increases in revenues threaten social sector spending. Ultimately, this has a direct impact on child well-being as access to essential services is compromised.
- Debt management measures can hurt domestic revenue flows and effectively reduce funding for social services and children.
- Fiscal consolidation policies, if not carefully considered, can also have detrimental impacts on the economy, the availability and quality of social services, and child well-being.
- To avert catastrophic outcomes for children in their moment of great need, governments in ESA should do everything possible to safeguard social spending in the looming era of austerity.
- The international community has a critical role to play in supporting the poorest countries to sustain social spending during this time of the pandemic.
Chapter 5: Conclusions and Recommendations

5.1 Conclusions

This working paper reflects on the debt situation in ESA and its implications on children. From the foregoing discussion, COVID-19 has elevated the risk of debt distress across much of the region. As of August 2021, 14 ESA countries were in or near debt distress, which was nearly double the number back in 2018. Between 2010 and 2019, debt stocks increased exponentially due to expansionary fiscal policies – largely focused on supporting infrastructure projects, a reduction in official development assistance (ODA), and increasing credit worthiness and hence access to private credit. At present, widening fiscal deficits, due to the fall in domestic revenue and an increase in financing needs in response to COVID-19, mean that governments have few options but to keep borrowing. However, they must do so in line with international principles on responsible borrowing. Lenders also have a critical role to play: to ensure responsible and transparent lending.

The paper also shows that higher debt service costs reduce the amount of domestic revenue to invest in children. At a certain level, a huge debt repayment burden crowds out social spending, which directly impacts services for children. Pre-pandemic, debt payments were 3.5 times more than spending on education, health and social protection combined in many countries. Debt service costs were also growing at a faster rate than government revenue, on average, which already pointed to debt sustainability concerns. For many ESA countries, debt service costs now consume about a fifth of total government revenue. Such a situation is not conducive for human capital development and the attainment of SDGs.

Policies to manage fiscal deficits and unsustainable debt situations can also be harmful to children. Most notably, austerity measures to reduce fiscal deficits and raise revenue to repay debt burdens can be regressive with the potential to further reduce investments in health, education and other sectors that drive child well-being. Certain fiscal consolidation measures also hurt both the macroeconomy and household economies, with strong spillover effects on children.

5.2 Recommendations

To ensure responsible lending and borrowing and also to safeguard public spending on social services required to break the intergenerational cycle of poverty, bold and decisive actions should be taken now within a framework of international cooperation. This requires efforts by governments in the region, creditors, the international community, as well as UNICEF and development partners as outlined below.

To governments in the region

- Governments in debt distress or in a high risk of debt distress are encouraged to move swiftly with debt restructuring discussions with their creditors to mitigate the risk of defaults and a regional debt crisis. They should also seek more grants and concessional loans from donors and international financial institutions to support pro-poor social sector spending.
- Finance ministries and Parliaments should commit to strengthen debt management policies, including full transparency in the procurement and management of borrowed funds.
Governments should also ensure that borrowed funds are efficiently and equitably utilized to spur human and sustainable development while minimizing leakage and corruption.

As part of COVID-19 recovery strategies, governments should strengthen measures to improve domestic revenue mobilization through progressive taxation, tackling tax evasion and avoidance, and enhancing tax collection capacity while improving efficiency in the utilization of available resources.

To creditors and the international community
- Public and private creditors should consider transformational debt relief to the region, including an extension of debt moratoriums through at least 2023, debt swaps in favor of social sector spending, and complete debt forgiveness for fragile countries with serious fiscal pressures.
- The global community, particularly G20 countries, should commit to a voluntary reallocation of a portion of their new Special Drawing Rights (SDRs) to those governments most in need.
- The G20 should accelerate the implementation of the common framework for debt resolution and ensure that all interested governments in ESA participate.
- The international community should work together to strengthen the international debt restructuring architecture, ensuring that it reflects the diverse situations of developing countries and builds on the principles of responsible sovereign lending and borrowing developed by UNCTAD.

To UNICEF and development partners
- Support efforts by governments in ESA to enhance their capacity for prudent debt management by strengthening debt institutions, policies and transparency mechanisms.
- Provide technical assistance to governments for them to explore non-debt creating external financing opportunities, including grants and public-private partnerships.
- Advocate for the use of new SDRs to safeguard critical human capital and pro-poor spending during the pandemic.
- Advocate with creditors for them to provide debt relief to fragile countries in debt distress or at high risk of debt distress.
- Closely monitor policy discussions that potentially threaten child well-being, including spending cuts, wage bill freezes, new taxes and cost recovery initiatives.
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