PUBLIC DEBT CONTRACTS IN AFRICA - ARE THEY A TRAP?

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Outline of Presentation

- Introduction to public debt
- Why public debt
- Public debt contracts
- Challenges to DRM in Africa (Case of IFFs)
- Conclusion
- Recommendations

Public Debt..??

- Public debt– the total of the nation's debts; debts of local and state and national governments; an indicator of how much public spending is financed by borrowing instead of taxation.
- The imbalance between the government spending and its revenues is called the government, or fiscal deficit.
- It is the cumulative sum of all previous deficits.

Kenya's Public Debt (Facts& Figures)

- By September 2018, public debt stood at Ksh 5.15 trillion; domestic debt Ksh 2.54 trillion and external debt Ksh 2.61 trillion
- Public debt per capita in 2018: Ksh 108,500
- Domestic debt proportion increased from 47% to 49% in the period March 2017 to March 2018
- Debt Strategy target is a mix of domestic (40%) and external debt of 60%
- Upward trend of nominal Debt to GDP from 48.4% in 2013/14 to 58.1% in 2017/18

Understanding Public Debt..??

- Public debt goes up when there is a deficit and comes down when there is a surplus.
- If revenues and spending are equal, the government is running a balanced budget and the debt goes neither up nor down.
- The primary deficit is the deficit net of interest payments.
- Deficit can go up even if your revenues and primary spending do not change. It goes up because interest payments accumulate and keep rising as long as debt rises

Understanding Public Debt..??

- Governments borrow by selling securities to investors.
- The securities with a maturity of up to one year are often called Treasury bills, while other securities are referred to as government bonds
- These securities are sold primarily through auctions, and the yield that each security bears depends on the result of the auction
- The yield of public debt is determined by the interaction of many investors through the auction mechanism.

Understanding Public Debt..??

- In a country, you can find different levels of government i.e Local Governments (such as municipalities); Central Government or, Federal Government.
- The different entities may run deficits and borrow by issuing securities and in the case of municipalities may borrow from banks.
- Others hold securities issued by other government entities i.e. common for social security administrations which often buy paper issued by the central government

Public Debt & Risks….

- Securities of governments of advanced economies are often regarded as risk- free. They are able to offer much lower interest rates than securities issued by the private sector
- Here public debt is desirable precisely because economies need a steady supply of risk- free assets whereby investors can hold the assets with a low yield but also at no risk.
- In the 1990s, during the Clinton Administration, many were worried that the stream of budgetary surpluses would deprive the US & the world, a

Public Debts & Risks....

- It is not possible to state that government securities really risk- free. Governments can have challenges raising revenue t repay debt
- It can be a challenge raising taxes particularly during or when a country is nearing elections.
- There are cases of countries defaulting on its debt

Features of Public Debt & Risks….

- The larger the size of public debt, the higher the tax revenues needed to service it, and thus the more the government will be tempted to declare bankruptcy
- The risk associated with a certain amount of debt depends on the amount of national resources that could potentially be taxed.
- A good indicator for these resources is given by a country's gross domestic product (GDP).
- It makes it easier to compare levels of public debt across countries and over time.

Features & Risks….Cn'td

- The composition of those who buy government securities; whether investors are domestic or foreign residents.
- If public debt is held primarily by foreigners; the risk that the government will be unable to roll over its debt is higher because foreigners are often the first to run if there are doubts about the government's willingness to repay its debt.
- Foreigners do not vote, and thus negative impact of public debt repudiation on the national economy is smaller

Features of Public Debt & Risks….

- Average maturity: securities are to be repaid in a few months, 2 years, 25 years or longer
- The shorter the average residual life, the greater is the amount of securities that will mature every month and that will have to be rolled over
- The government's gross borrowing requirement: the total amount of securities that must be sold, or the sum of what needs to be rolled over and what is needed to finance the new deficit

Features of Public Debts….

- The larger the gross borrowing requirement, the higher is the potential pressure that could arise in the government paper market should investors start doubting the government's willingness to repay its debt i.e. Stronger risk
- Currency denomination: A country can issue securities denominated in its own currency, or in the currency of another nation.
- Many developing countries issue securities denominated in $; €; ¥ because they believe they can more easily attract investors

Features of Public Debts….

- The currency denomination strongly affects the risks associated with public debt
- The interaction between the government and its central bank and to how, directly or indirectly, the government can finance its deficit by borrowing from outside the public sector or by printing money.
- If the government finances its deficit by issuing securities on the market, it needs to make interest payments and to worry about rolling over the securities when they come to maturity.

Features of Public Debts….

- If the government finances its deficit by borrowing from its central bank, it does not need to worry about all this
- Central Banks create money not just by printing banknotes; they also create electronic money i.e. when they buy a government security from a commercial bank, they pay by crediting the account of the commercial bank at the central bank
- Electronic money is treated like the ordinary money

Dangers of Printing Money to Pay Public Debts....

- Governments shouldn't finance deficit by printing money. This will amount to abuse of power
- The public are willing to use money for their transactions because they have confidence that the pieces of paper will maintain their value over time
- With too many of the pieces of paper are floating around, people will realize that they are going to be flooded with pieces of paper because the government has a huge deficit to finance
- They lose confidence in the value of money and try to get rid of it as soon as they receive it by buying

Dangers of Printing Money to Pay Public Debts….

- This drives up the prices of goods and services, as well as asset prices, and ultimately could even lead to a switch to a different currency
- Ecuador and Zimbabwe are countries where this has happened. They abandoned their currency and they "dollarized," i.e. substituted the U.S. dollar for its own currency.
- The main episodes of hyperinflation in history, including Germany's post– World War I inflation, have all been linked to abuse by the government of its power to print money

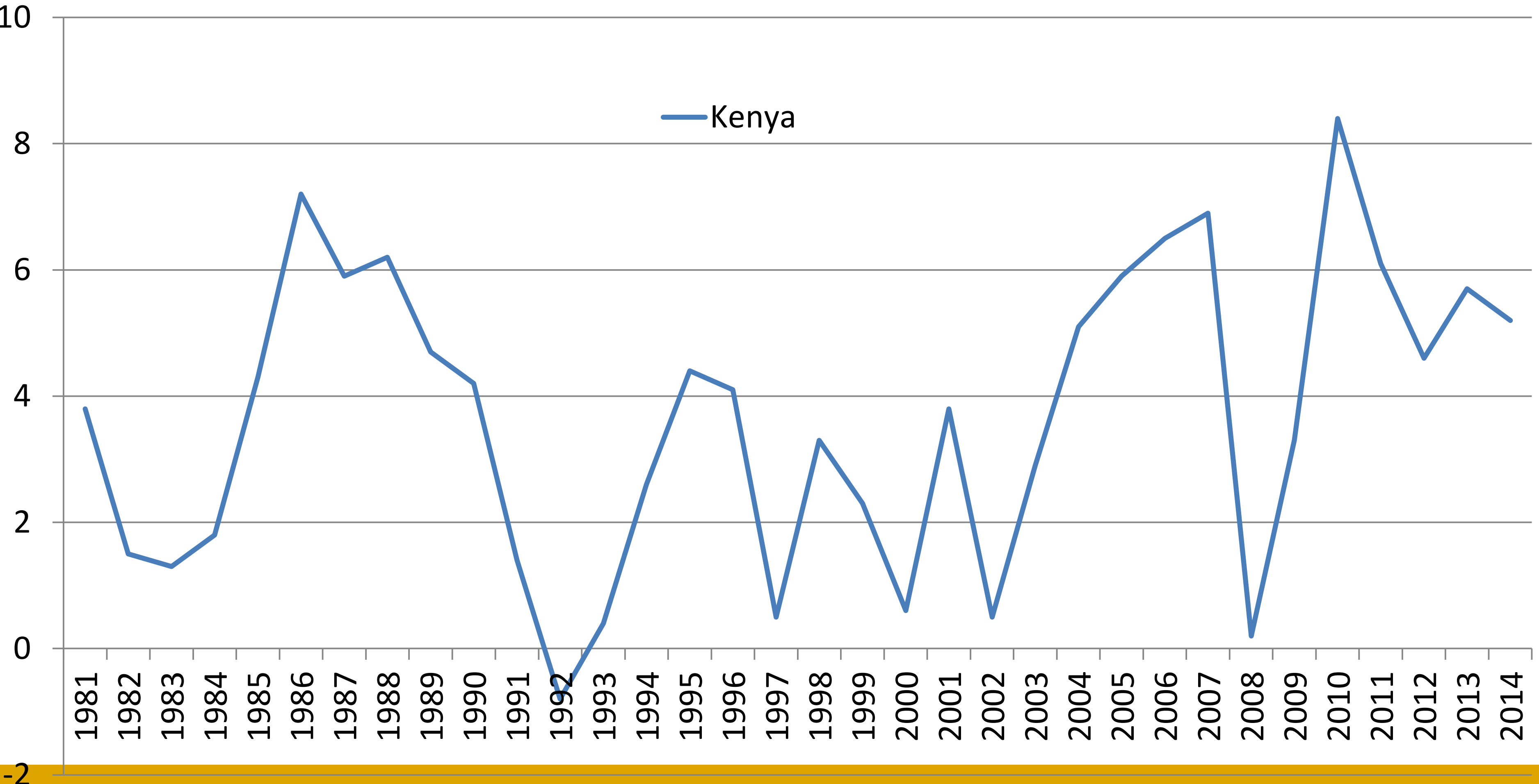
Dangers of Printing Money to Pay Public Debts….

- Public debt data include both the money that has been borrowed from private investors and that which has been borrowed from the central bank
- From an accounting point of view, the money borrowed from the central bank is formally a liability
- There is need to distinguish between what the government has borrowed in domestic currency or in foreign currency.
- If it has borrowed in domestic currency; the debt may be repaid by printing money

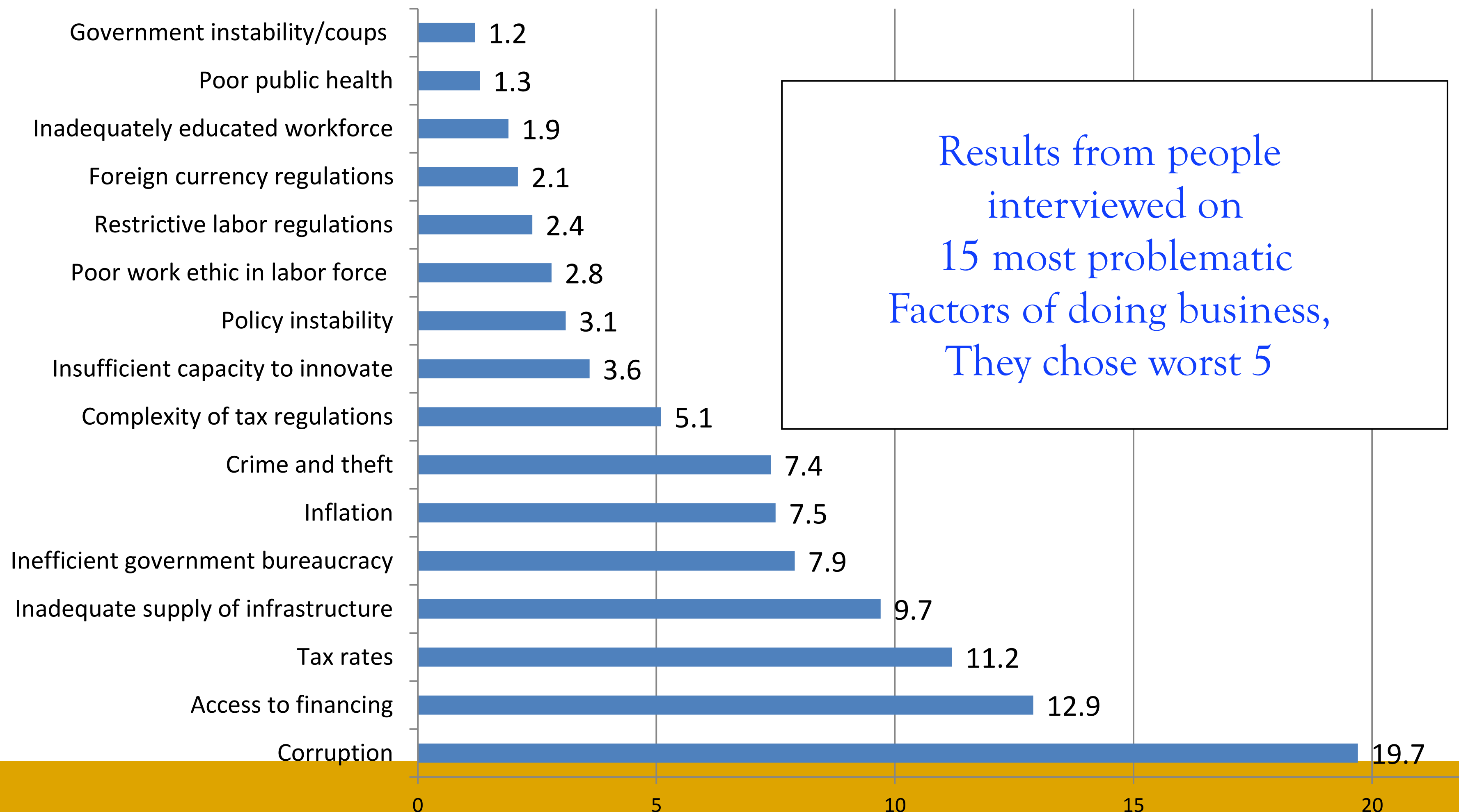
Dangers of Printing Money to Pay Public Debts….

- When a country has borrowed in foreign currency and cannot print it to repay its debt, there is a higher risk that it will be unable to pay. - the "original sin"
- There are two important items are not usually included in the standard definition of public debt:
- One:- the debt that arises from derivative contracts the government has signed with financial institutions
- Two; - social security (or "pension") debt. Pension debt is related to the payments that the government through its social security institutions must make in the future as a result of existing pension legislation

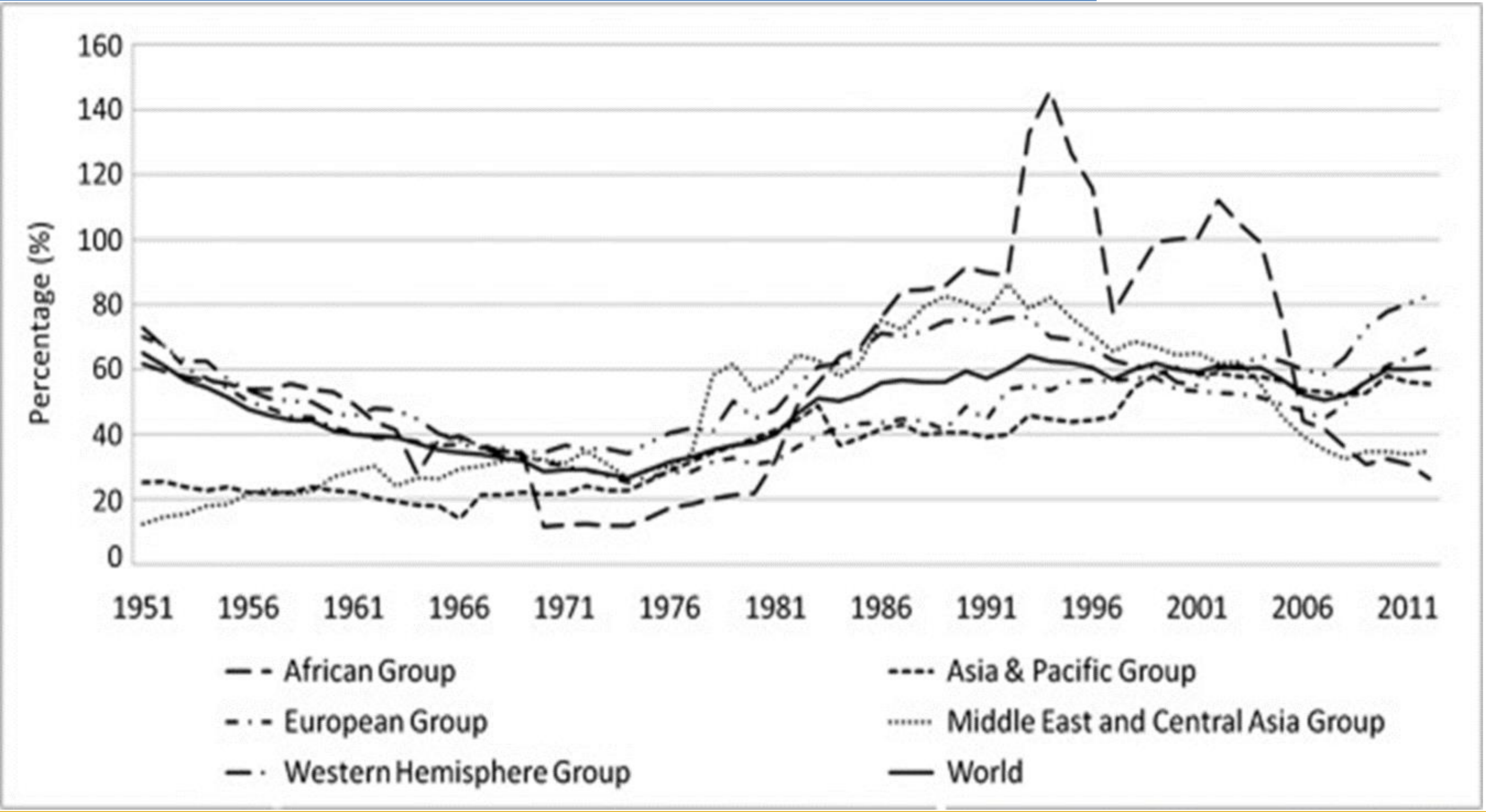
GDP Growth Rate Kenya 1981-2014

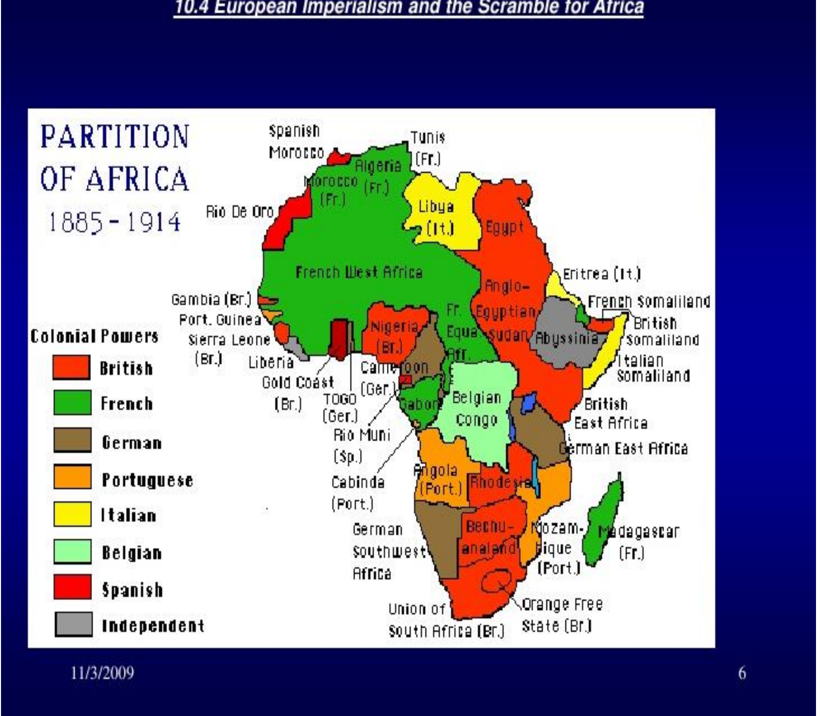


Most problematic factors of doing business in Kenya ?.

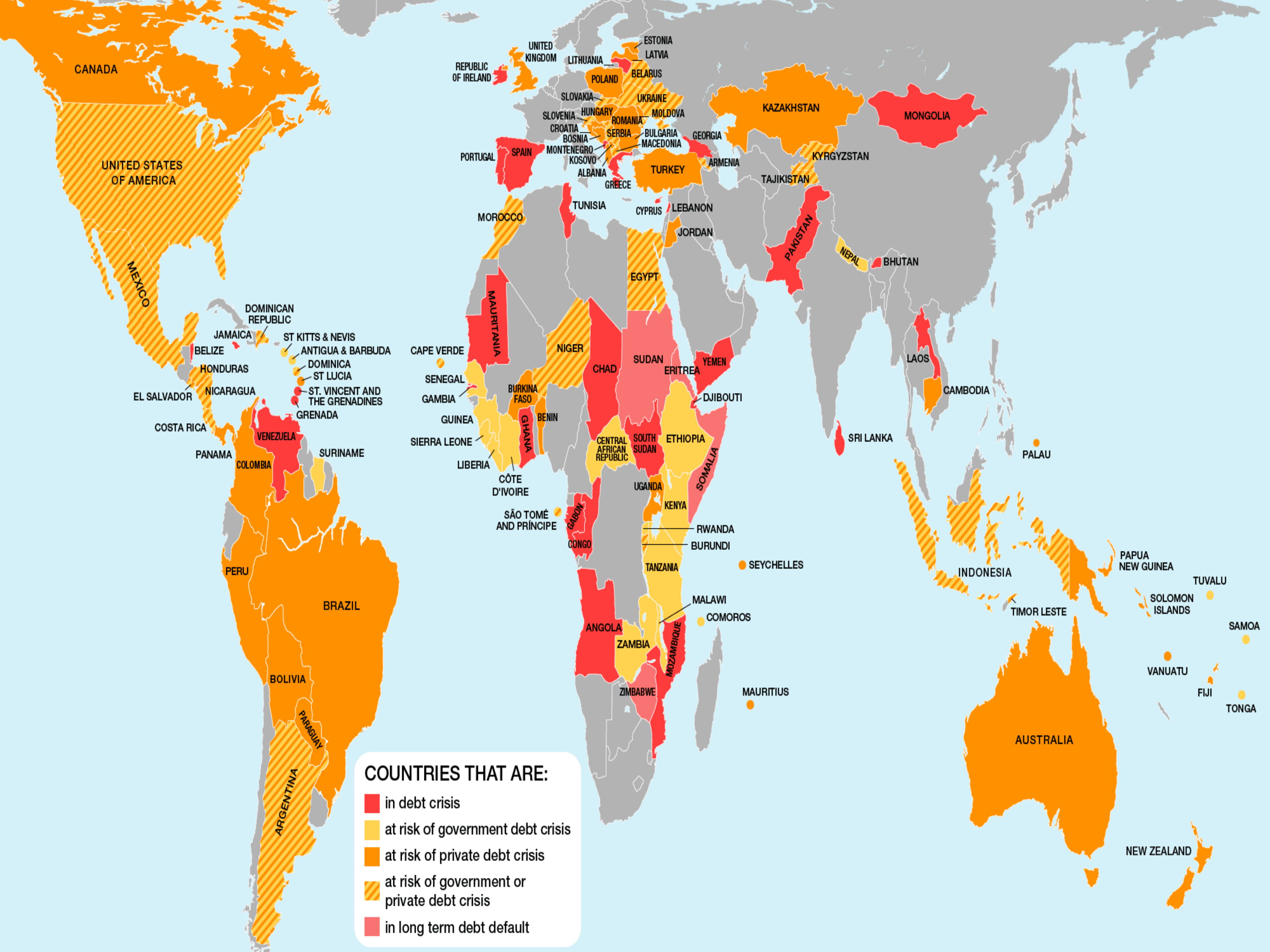


Debt as % of GDP: World Regions [IMF]

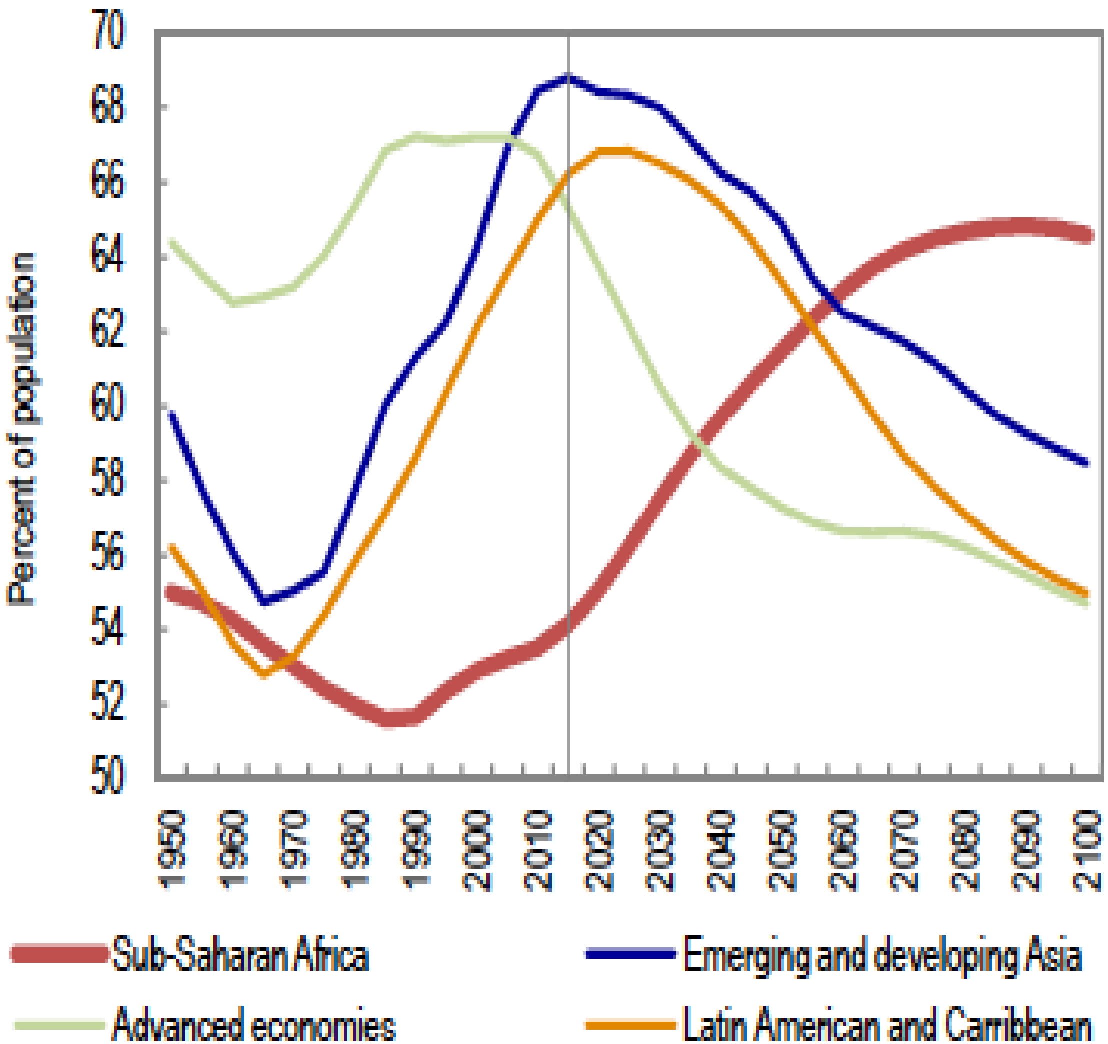




- First Scramble - 19th century European colonists carved up the continent and seized Africans' land and resources
- Second - during the cold war; East and West vied for the allegiance of newly independent African states; the Soviet Union backed Marxist tyrants while America propped up despots who claimed to believe in capitalism
- Third - surge now under way; Governments and businesses from all around the world are rushing to strengthen diplomatic, strategic and commercial ties. This creates vast opportunities.
- If Africa handles the new scramble wisely, the main winners will be Africans themselves. Critical to examine how the continent handles this new phase
- From 2010 to 2016 more than 320 embassies were opened in Africa
- Russia has signed 19 military deals with African states since 2014


COUNTRIES THAT ARE:
in debt crisis
at risk of government debt crisis
at risk of private debt crisis
at risk of government or private debt crisis
in long term debt default
CANADA
UNITED STATES OF AMERICA
MEXICO
DOMINICAN REPUBLIC
JAMAICA
BELIZE
HONDURAS
EL SALVADOR
NICARAGUA
COSTA RICA
PANAMA
ST KITTS & NEVIS
ANTIGUA & BARBUDA
DOMINICA
ST LUCIA
ST. VINCENT AND THE GRENADINES
GRENADA
VENEZUELA
COLOMBIA
SURINAME
PERU
BRAZIL
BOLIVIA
PARAGUAY
ARGENTINA
REPUBLIC OF IRELAND
UNITED KINGDOM
PORTUGAL
SPAIN
LITHUANIA
ESTONIA
LATVIA
POLAND
BELARUS
SLOVAKIA
UKRAINE
HUNGARY
MOLDOVA
SLOVENIA
ROMANIA
CROATIA
SERBIA
BULGARIA
BOSNIA
MACEDONIA
MONTENEGRO
KOSOVO
ALBANIA
GREECE
GEORGIA
ARMENIA
TURKEY
CYPRUS
LEBANON
JORDAN
KAZAKHSTAN
MONGOLIA
KYRGYZSTAN
TAJIKISTAN
PAKISTAN
NEPAL
BHUTAN
MOROCCO
TUNISIA
EGYPT
CAPE VERDE
MAURITANIA
SENEGAL
GAMBIA
GUINEA
SIERRA LEONE
LIBERIA
CÔTE D'IVOIRE
BURKINA FASO
GHANA
BENIN
NIGER
CHAD
SUDAN
ERITREA
YEMEN
DJIBOUTI
CENTRAL AFRICAN REPUBLIC
SOUTH SUDAN
ETHIOPIA
SOMALIA
UGANDA
KENYA
RWANDA
BURUNDI
SÃO TOMÉ AND PRÍNCIPE
GABON
CONGO
TANZANIA
SEYCHELLES
MALAWI
COMOROS
ANGOLA
ZAMBIA
MOZAMBIQUE
ZIMBABWE
MAURITIUS
LAOS
CAMBODIA
SRI LANKA
PALAU
INDONESIA
TIMOR LESTE
PAPUA NEW GUINEA
TUVALU
SOLOMON ISLANDS
SAMOA
VANUATU
FIJI
TONGA
AUSTRALIA
NEW ZEALAND

Global trends in the share of the working age population (1950 – 2100)



Source: United Nations, World Population Prospects, 2012.

- SSA working age pop is increasing the continent's productive potential
- Advanced economies are facing aging populations
- SSA's share of the global labor force is thus projected to double from 10% 2010 to 20% by 2050

Demographic dividend: Lessons for Africa from East Asia ?

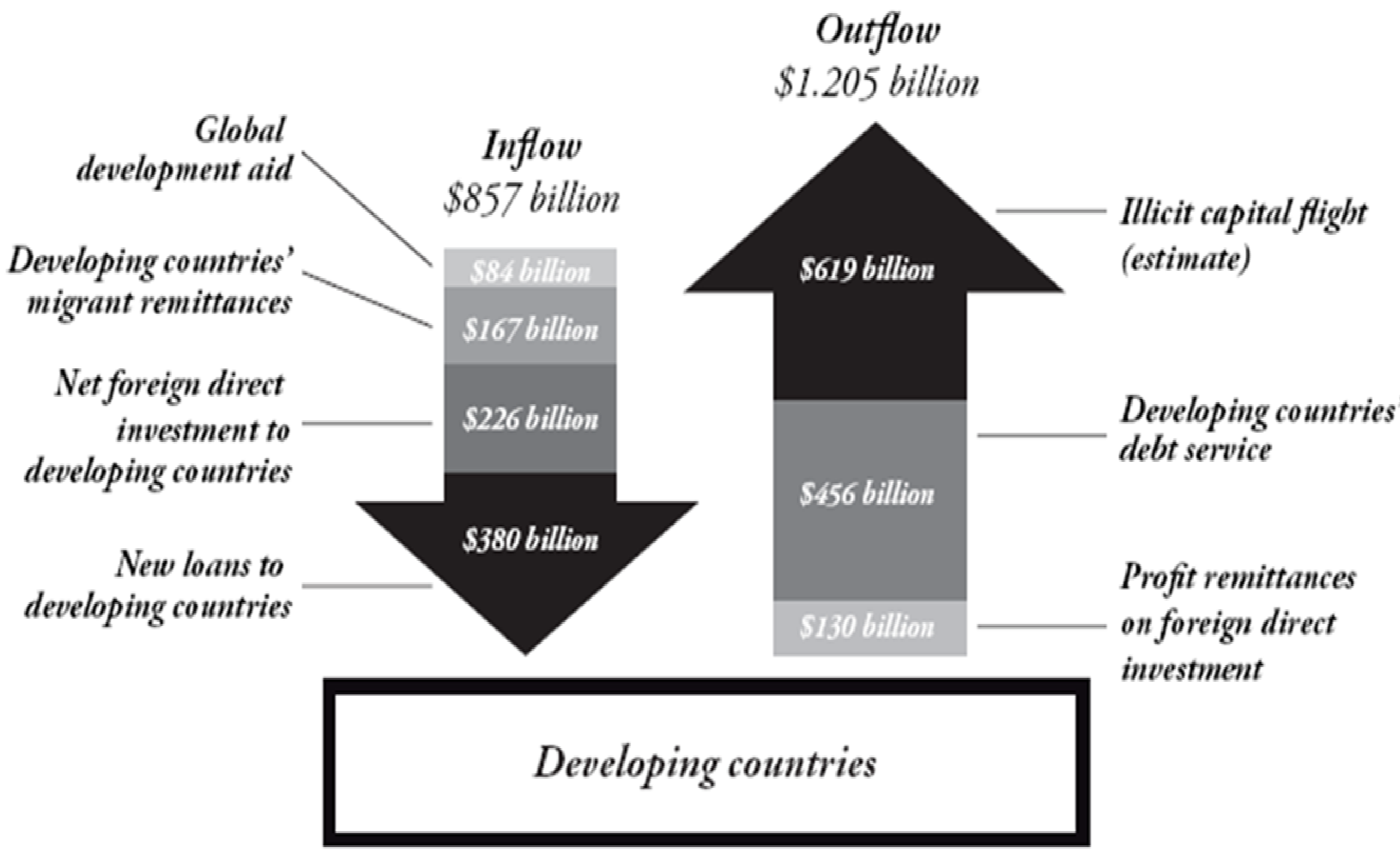
- High investment in human capital: education and health contributed to higher productivity by improving skills hence meeting the needs of growing and diversifying economies
- Faster demographic transition policies like family planning initiatives
- Job creation through growing a labour-intensive manufacturing and labour market flexibility by reducing the income gap between the formal and informal sectors hence social stability and creating an environment for growth
- Trade integration enabled technology transfer & increased job creation
- Adopting tax policies that promoted investment and kept the relative price of capital goods low hence high capital accumulation by citizens

Scope of IFFs – Outflows & Inflows ?

- Developing countries lost USD 100 billion on profit shifting through tax havens in 2014 (UNCTAD)
- The hidden wealth in tax havens account for at least USD 7.6 trillion (EU Aid Explorer). This does not count physical assets such as art and gold
- Proportion of wealth in tax havens: 4% in US & Asia; 10% in Europe; 22% in Latin America; 30% in Africa and 50% in Russia
- HLP report estimates IFFs from Africa at USD 50 billion (January 2015)
- Global Financial Integrity (2017) estimates that IFFs from Africa to have reached USD 75billion
- HLP & GFI indicate that commercial component represents 60% - 80%. The estimates are conservative as they don't include cash movements; criminal activities; misinvoicing of intangibles & services

Scope of IFFs in Africa Cnt'd

- Inflows – trade misinvoicing done to minimize custom duties & VAT Taxes on imports
- GFI estimates illicit inflows to Africa at USD 120 billion (larger than outflows)
- Businesses bring illicit money and have a parallel means of taking money out
- Illicit outflows + illicit inflows = USD 195 billion
- Outflows represent 6% of Africa's GDP (most negatively affected)
- Comparison – Asia 3.8%; Latin America 3.6%; Middle East 2.3%



Source: Eurodad fact sheet 'Capital flight diverts developing finance'. The image is based on data from the OECD and the World Bank as well as estimates of illicit flows compiled by Eurodad.

Impact on Taxes

- Governments collect approximately 15%-30% of GDP as taxes. Africa looses approximately USD 29 - 58 billion
- The impact of the funds on health, education; infrastructure and environment could be significant if the amounts remained
- Even if the figures were wrong; the levels of impact of IFFs in Africa are severe. We have to address it to maximise DRM and thus address poverty; inequality and give value to Africans (1 billion people)

Pitfalls of Public Debts and Private Contracts….

- Public debt contracts are hard to enforce. No court can make a sovereign do as it is told, since national borders and sovereign immunity shield its assets and keep its officials out of jail. Argentina's case dragged on 15 years
- Bond contracts are notoriously hard to change. Standardized contracts are "sticky," slow to assimilate new terms even if they would improve on the status quo
- Unlike statutes and treaties, contracts are made behind closed doors between debtors and creditors, some of whom happen to be sovereign governments

Pitfalls of Public Debts and Private Contracts....

- Decentralization, lack of information, and coordination problems among governments and market participants make contracts an awkward policy vehicle on balance
- Contracts remain popular nonetheless because they can deliver some of the creditor collective action benefits of bankruptcy without arousing the same level of political hostility
- Sovereign debt is a complex political institution, which cannot be reduced to creditor coordination or any other contract problem
- Pressing policy challenges beyond the four corners of the contract include, among others, public sector creditors—governments, central banks, and sovereign wealth funds—that may be driven by non-commercial motives and have non-contractual means of influencing the debtor.

Pitfalls of Public Debts and Private Contracts….

- Single-minded focus on private contract design also tends to sideline questions of public accountability and debt legitimacy, which have surfaced prominently in Venezuela.
- President Nicolas Maduro has long failed to meet the basic human needs of the population—people are starving, hospitals are out of medicine—but, until recently, had continued to borrow and to service its bonds.
- The elected legislature was disbanded, replaced by a captive assembly allied with the government. U.S. sanctions have sought to cut off the regime’s funding options, but have also served as a foil to deflect domestic criticism, divide and repress the opposition. Russia and China have kept the regime afloat in exchange for cheap oil and strategic assets

Pitfalls of Public Debts and Private Contracts….

- Defining a consensus legitimacy standard would be hard, but the current alternative of ad hoc intervention by individual foreign powers looks worse by the day.
- Contract reform can never be a complete response to sovereign debt problems, where the debtors have vast numbers of domestic and foreign constituents who are not parties to the contracts, and have no means of affecting or even knowing their terms
- Public debt problems could get worse before they get better, as old restructuring institutions lose influence, and new actors with at-best provisional stakes in the system rise in importance.

Pitfalls of Public Debts and Private Contracts….

- Public debt is bigger than any one contract dispute. It has too many core constituents outside the four corners of the contract, including taxpayers, pensioners, government workers, bank depositors, and other governments
- It is not a complex/controversial insight, but turning it into tractable policies is technically daunting and politically risky
- It is time to recognize this as a false alternative: even if it makes good sense as a matter of contract design and helps buy time for political compromise, it can never be that compromise, for the simple reason that public debt is irreducibly public

Actions – Continental Level

- **Broadening Tax base** - Tax policy and legislative loopholes need reforms and strong regulatory framework built to tackle harmful tax exemptions and tax dodging.
- **Implement the recommendations of the High Panel on Illicit Financial Flows** - HLP report's recommendations should be implemented and anti-IFF strategies should be geared towards increased transparency especially with country by country reporting, automatic exchange of information between countries and publicly available registry beneficial ownership.
- **Role out and implementation of African Mining Vision and African Mining Governance Framework** - The extractive industry, which is a key part of the commercial sector, is the biggest contributor to IFFs, the Panel emphasised

Actions – Continental Level

- We should stop treating IFFs as a statistical issue. It is causing poverty and directly hurting real people ("the poor of the world(Africa) cannot wait for perfection of data" – Tom Cardamone, WB
- Policy & institutional interventions
- Greater transparency in financial dealings both inside and outside Africa
- End tax havens i.e. end secrecy of ownership structures
- International banks should know the natural persons owning accounts
- Pass legislations to end trade misinvoicing and enforce them
- Greater collaboration among government tax authorities though information sharing

World Bank Guidelines for Public Debt Management

ICPAK
Uphold Public Interest

They were adopted in 2001 and amended in 2003. They are a set of voluntary principles to assist debt managers in improving their debt management practices and reducing financial vulnerability.

1. Debt Management Objectives and Coordination
2. Transparency & Accountability
3. Institutional Framework
4. Debt Management Strategy
5. Risk Management Framework
6. Development and Maintenance of an Efficient Market for Government Securities

Governance & Debt

- We have to address the things that undermine DRM
- Improve transparency and accountability on public debt and borrowing.
- Establish Fair and Transparent international public debt restructuring mechanisms
- Ensure that there is inclusive, transparent and accountable public debt borrowing and loan contraction processes
- Public participation in public debt management

Recommendations

- Fiscal consolidation
- Parliament to oversight borrowing
- Executive to enhance prudence in the management of funds


Great leaders don't tell you what
to do....they show you how its done

Comments and Questions Welcome!

THANK YOU FOR YOUR ATTENTION!

GOD BLESS