Africa's Chronic Liquidity Challenges and the Role of SDR Allocations

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Motivation

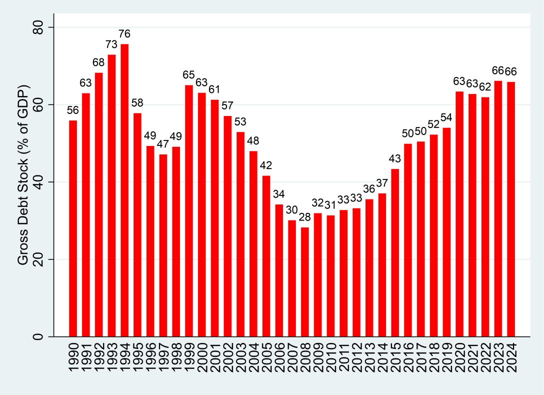
- Africa has been confronted with **overlapping, compounding shocks:**
  - COVID-19 pandemic
  - Russia–Ukraine war
  - Climate-induced disasters
  - Inflation & FX depreciation
- Result: **acute liquidity pressures,** slowing growth, mounting debt burden, and increased macro-vulnerability.
- The global context demands **rethinking SDRs** as countercyclical, developmental instruments.

Africa's Liquidity Problem Today

- Rising **debt-service to exports and revenue** ratios.
- High borrowing costs: several countries effectively **shut out of markets.**
- Most debt stress reflects **liquidity,** not solvency problems.
- SDRs offer a unique **non-debt-creating, reserve-enhancing** tool.

Evolution of the Debt Burden

Figure 1: Evolution of gross debt % of GDP in Africa [weighted average]



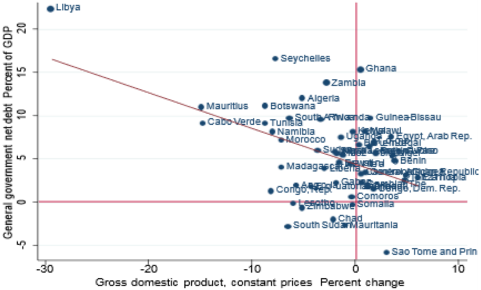
Key takeaways:

- The Covid-19 pandemic was followed by the largest single year increase in debt burden in Africa in the last decade, signifying the fiscal consequences of this and subsequent shocks.
- Shift toward **domestic debt** and **private creditors,** away from concessional sources.
- Structural vulnerabilities amplify exposure to global shocks.

COVID-19 Shock and Debt Dynamics

- Sharp fall in GDP $\rightarrow$ automatic rise in debt/GDP.
- Additional emergency borrowing contributed to **double-digit increases** in debt ratios for many countries.
- Liquidity—not fiscal irresponsibility—drove the spike.

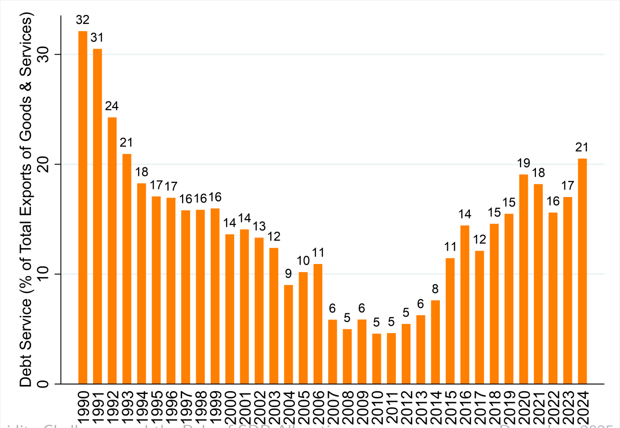
Figure 2: Growth–debt relationship during 2020



Debt Service and FX Pressures

- As a result of mounting debt burden, debt service continued to erode liquidity and reserves

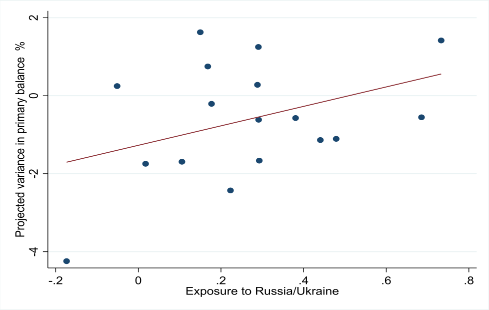
Figure 3: Debt-service to total exports and services ratio [weighted mean]



Exposure to the Russia-Ukraine Shock

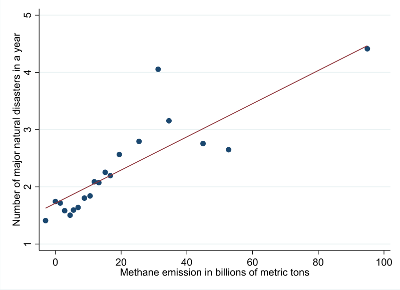
Worsened Fiscal Vulnerabilities

Figure 4: Variance in pre-and-post war projections of primary balance by the IMF

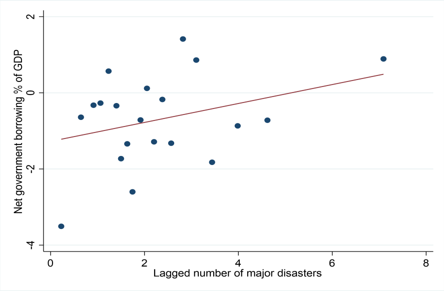


- Heavy import dependence on wheat, fertilizer, fuel.
- Terms-of-trade shock amplified fiscal deterioration.
- Recovery remains slow and uneven.

Climate Change Compounded Debt Burden



CO2 emissions and frequency of annual major natural disasters in Africa



Change in debt and major natural disasters in Africa

- Extreme weather events rising in frequency and cost.
- Climate shocks directly worsen fiscal balances and **drive next-year debt increases.**
- Africa's climate risk = macro-fiscal vulnerability.

Investment Gap: Why Domestic Mobilization Alone Is Insufficient

Table 1: Correlations between investment, real GDP growth and net debt in Africa: 1990-2022

Dependent variable: Investment as a share of GDP	
Real GDP growth	0.35***
	(10.54)
Tax to GDP ratio (residual)	0.09*
	(2.11)
Change in debt to GDP ratio (residual)	0.05**
	(2.78)
Number of observations	1089
Number of countries	49
R-square	0.14

Key result from panel regression:

- Growth, taxes, and debt all positively correlate with investment but with small elasticities.
- To meet SDG & energy-transition needs, investment must rise from **24% → $\sim 37\%$ of GDP.**
- Domestic sources alone **cannot** meet this scale.

Structural Sovereign Rating Penalties

Table 2: Dependent variable: residual from the regression of sovereign ratings on macroeconomic fundamentals.

Variable	Effect on Rating Gap
Control of corruption	0.0314**
Government effectiveness	-0.0348**
Political stability	0.0305***
Regulatory quality	0.0881***
Voice & accountability	-0.0466***
Rule of law	-0.0157
Oil exporter	2.511***
Frontier-market dummy	No significant effect
Fragile state	No significant effect
Unemployment rate	0.0688***
Constant	-3.533***
N	126
R-sq	0.64

Evidence from the paper:

- Credit ratings often **diverge from fundamentals.**
- Governance and structural variables (informality, stability, regulatory quality) explain large residuals.
- This contributes to an **“African premium”** in borrowing costs.
- Access to global finance is constrained **beyond what is warranted by fundamentals.**

Why SDRs Matter

- SDRs are **reserve assets,** not debt.
- They ease FX constraints, reduce rollover risks, and enhance macro-stability.
- A systemic tool to offset **perception-driven rating gaps** and procyclical capital markets.
- 2021 issuance helped—but Africa received only **$33 billion.**

Channels for Improving SDR Use

Key options:

- New SDR allocations (most impactful)
- Bilateral rechannelling
- PRGT (low interest but limited eligibility)
- RST (climate-focused but requires IMF upper-tranche program)
- SDR-backed Hybrid Capital for MDBs (AfDB proposal)
- Liquidity & Sustainability Facility (UNECA)
- Global Mitigation Trust proposal

Policy Recommendations

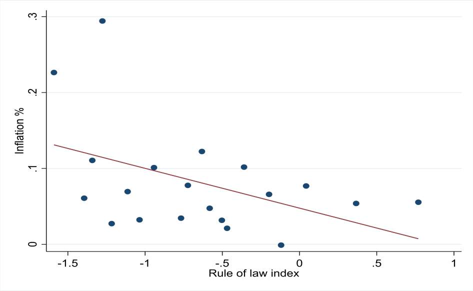
Global Finance Reform:

- New SDR allocations under "unexpected major developments"
- Built-in SDR re-channelling rules
- Zero or simplified SDR interest rate structure
- Expand MDB balance sheets via SDR-backed hybrid capital
- Reform IMF instruments (PRGT, RST) to reduce procyclical conditionality

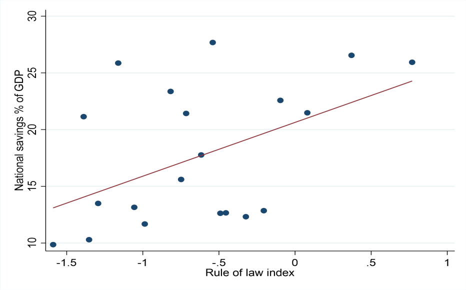
Domestic Reform Priorities:

- Strengthen governance, rule of law, and macro-management
- Improve public financial management & transparency
- Mobilize domestic resources strategically
- Link SDR use to investment-led recovery models

Governance & Macroeconomic Stability



Rule of law and persistent inflation in Africa: 1996-2019



National savings (% of GDP) and rule of law in Africa: 1996-2019

- Rule of law is strongly correlated with low inflation.
- Institutional strength could promote domestic savings.
- Governance → macro stability → lower cost of capital.

Concluding Messages

- Africa's debt crisis is fundamentally a **liquidity crisis**, not a solvency crisis.
- SDR reform is essential to unlock reserves and reduce liquidity traps.
- But SDRs alone are insufficient → broader GFA reform is needed.
- Combining **global reforms + domestic governance improvements** can close the continent's liquidity and development financing gaps.