AFRODAD

“Current proposals towards responsible lending and borrowing to prevent unsustainable debt situations and its negative social impacts and lead discussion of possible debt resolution mechanism”.

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Introduction

- A sharp increase in the foreign debt of developing economies has raised concern that another crisis is looming. This is particularly true in Africa, where external debt in many countries has reached unsustainable levels.
- The countries of sub-Saharan Africa are now struggling to service external debt that in many cases has risen above 90 percent of GDP. An IMF debt sustainability analysis (2018) lists 14 African countries in distress or at high risk of distress, including Burundi, Cameroon, the Central African Republic, Chad, Ghana, Sudan, and Zimbabwe.
- Developing economies in Africa and elsewhere benefited from debt relief under two programs sponsored by international lending institutions— the 1996 Heavily Indebted Poor Countries Initiative and the 2005 Multilateral Debt Relief Initiative. When debt relief allowed low-income countries to resume borrowing, they quickly took advantage of low global interest rates to sell securities on international capital markets. But the sharp decline in commodity prices has dealt a financial blow to countries that depend on exports of farm products, oil, gas, and other natural resources to generate the revenue they need to repay their obligations.
- The world's developing countries are increasing their borrowing at a worrying pace and face the mounting risk of debt crises the IMF has warned.
- IMF board members have expressed "serious concern" about the debt build-up and concluded that there was an "urgent need for fiscal prudence and improved debt management"

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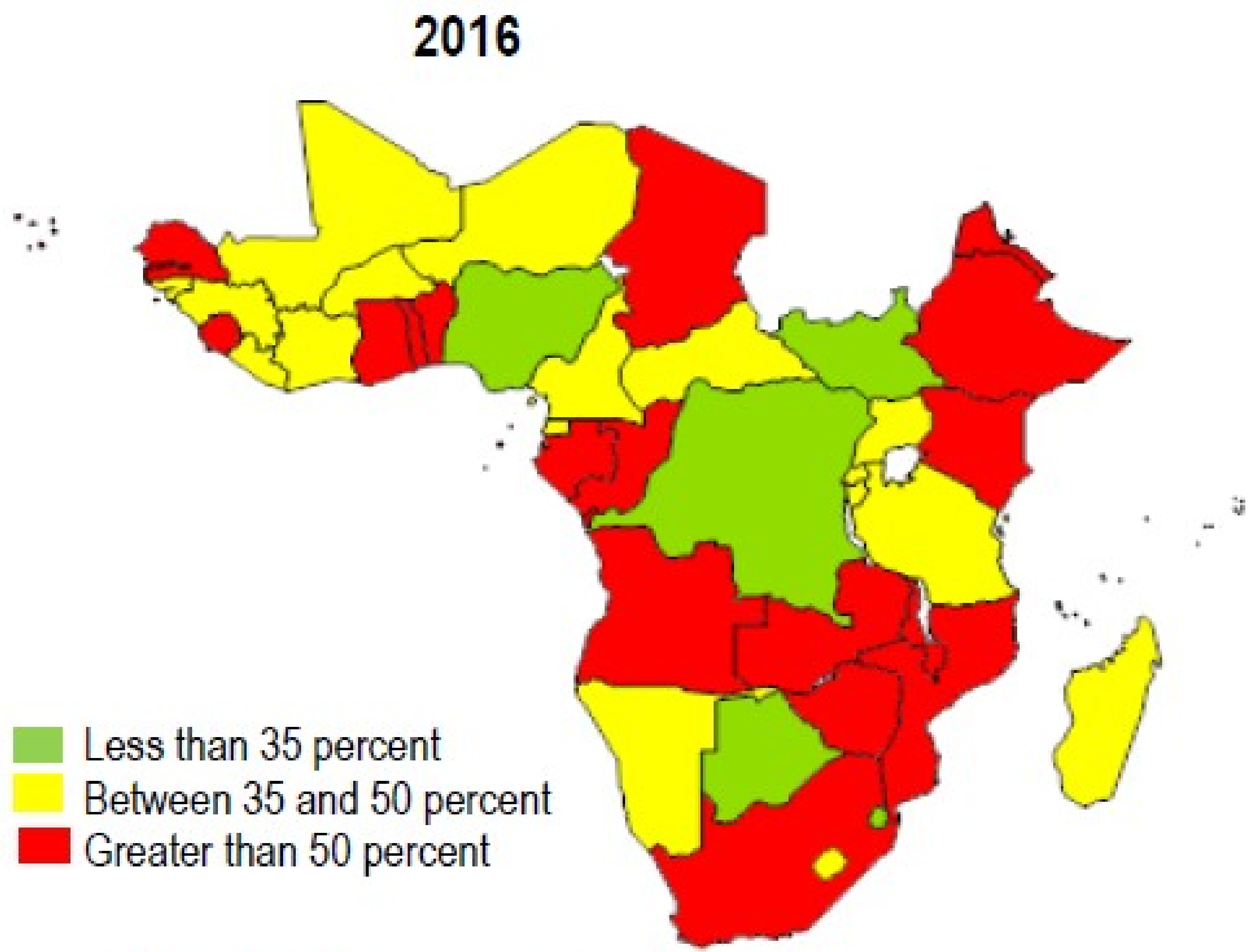

Source: IMF, World Economic Outlook database.

- Unsustainable debt burden contribute, among other things, to fiscal un-sustainability, decline in social indicators, decline in industrial output and undermined development institutions. Broadly it compromised poverty reduction efforts too .
- The decline in ODA and the shrinking space for concessional finance have led African countries to increasingly. African countries that have graduated into Medium Income Country status (such as Zambia, Ghana, Senegal) are no longer able to access concessional loans from regional Banks and the International Development Association (IDA) and are therefore resorting to other forms of development finance.
- Some projections indicate that over the next twenty years, concessional finance will not be available to most African countries. For that reason, there is going to be an increasing shift to market based financial instruments including sovereign Bonds, public private partnerships, blended finance and new bilateral lenders especially China.

Eurobond issuances

- Recent increases in borrowing from the new sources that pose a risk largely because African countries are still fragile: they have weak infrastructure, narrow production bases and mostly still highly dependent on commodities, shallower financial markets, weak institutions (including project and debt management), limited administrative capacity, less efficient tax systems as well as weak legal frameworks.
- In more recent times a number of African countries have increasingly turned to issuing international sovereign Bonds. The World Bank IDS (International Debt Statistics) show that sub-Saharan Africa's bonds issued to private creditors (without making the distinction on whether on domestic or international markets) rose from $18.3 billion in 2008 to $77.5 billion in 2016. It is estimated that around US$ 25 billion is set to mature in 2018 and some African countries (reportedly Ghana, Mozambique, Zambia, Rwanda, Senegal and Tanzania) are already contemplating seeking refinancing.
- There may be some advantages to Eurobonds: Governments have more control and flexibility of the use of the debt proceeds as the terms and conditions are generally more favourable than other external debt instruments. For that reason, these bonds have been issued for various reasons including deficit financing.
- The Bonds could also potentially strengthen macro-economic discipline, transparency and accountability if used properly as they could be under the watch of citizens and the international market participants. Equally, if used properly they could be used for long term investments which traditional ODA is insufficient or not able to accessible.
- There are however, many risks associated with Eurobond issuances: these include the fact that repayment is at maturity and not amortized. In the absence of a viable sinking Fund, the debt may be unsustainable. Secondly as the Bonds are denominated in US$, there are foreign exchange risk where any forms of devaluation could generate more debt; interest rates can change increasing the cost of the debt. Eurobonds are also more difficult to restructure due to the large number of creditors involved in the deal.

- Public Private Partnerships (PPPs) are increasingly becoming popular with African governments as it is possible not only to leverage the abundant private sector resources for large scale infrastructure projects which governments themselves may not be able to embark on but also share project risks between the public and private sectors.
- There are many risks associated with PPPs which governments will need to examine based on experiences in other countries. Fundamental to those that are those associated with issues of transparency and accountability in particular around the costs associated with the associated debt especially given that they are treated as off-budget transactions.
- There are also other sources of financing development which have an impact on debt sustainability. One important one is the non-traditional lenders under the South-South Cooperation of which China, India and Brazil are significant. These in themselves pose other risks.
- It should be noted that while the last debt relief was possible to the HIPC and MDRI, as it stands today there are no new mechanisms for debt relief. The Sovereign Debt Restructuring Mechanism proposed in 2001 by the International Monetary Fund was opposed by the US government and is therefore moribund. In 2014, the UN General Assembly adopted a resolution "towards the establishment of a multilateral legal framework for public debt restructuring processes." Little has happened since then as the resolution is non-binding.
- Fiscal instability has been a major feature of African economies directly related to the debt issues. Lack of fiscal discipline in African countries has led to persistent budget deficits and mounting debt stock .
- Sub-Sahara Africa has equally shown a decline in budget transparency, participation and oversight. The Open Budget Survey of 2017 shows that of the 27 countries in Africa is less open about their fiscal activities than other countries in the world. In the Open Budget Index 2017 Sub-Sahara Africa scored 29 as compared to 73 by Western Europe and United States of America . Lack of transparency and accountability contributes to persistent budget deficits and debts.
- Given that African countries are dependent on volatile commodity revenues, making their budgets vulnerable to fiscal pressures, there is a need for a Legal framework which will call for Fiscal discipline.

Challenges

- Despite countries having done much to improve their debt management capacity since the Heavily Indebted Poor Countries Initiative. They have computerized debt records, established debt management offices that consolidate previously scattered functions, adopted medium-term debt management strategies, improved analytical capacity in debt sustainability, and attempted to develop domestic debt markets.
- Low-income countries are still struggling though. Revenue shortages keep them from paying down debt, which forces them to borrow even more to meet basic needs. Budget cuts only make matters worse by slowing economic growth, thereby reducing tax revenue.
- The next crisis will be more difficult to prevent and resolve than the last one because the debt landscape has grown more complex. In the past, developing economy debt was held mainly by sovereign creditors represented by the Paris Club and by international lending institutions, so negotiating debt relief was relatively straightforward.
- Today, debt is held by private, bilateral, and multilateral creditors, and there are new financial instruments to contend with. Speculators target countries in crisis, which has forced nations such as Ghana, Zambia and Mozambique to return to the IMF for help.
- Countries that enter into debt restructuring agreements are at risk of attack by so-called vulture funds, which buy distressed bonds at a discount on the secondary market with the aim of forcing the debtor nation to pay a larger sum, as was the case with Argentina and Greece.
- Historic methods of resolving sovereign debt crises, such as the Paris Club forum for wealthy creditor nations, are becoming more difficult, given an increasing proportion of low-income countries' debt is bought by other types of investors. There is a diminished role of traditional creditor forums.
- The IMF, which historically has often taken the lead in dealing with such crises, expressed its concern that this development could undermine the role of western-oriented institutions in resolving such problems in the future.
- The IMF notes that "The enhanced reliance on commercially priced debt has translated into higher debt servicing costs and risks, while the shift in the composition of the creditor base creates challenges for potential debt resolutions."

What needs to be done

- More important is an urgent need for an international mechanism to restructure sovereign debt. The lack of such a mechanism represents a severe gap in the international financial architecture. A fair and orderly mechanism could prevent debt crises by addressing unsustainable debt early, or at least mitigate the damage when a crisis is underway.
- Such a mechanism is critical to halting predatory behaviour by creditors, promoting financial stability, reducing debt burdens, and encouraging responsible borrowing and lending.
- The mechanism should be supplemented by a set of lending and borrowing principles intended to prevent future debt crises and increase transparency and accountability. Preventing reckless lending and borrowing requires a major change in the standards both sides must follow and how these are implemented.
- Transparency in the debt management key - revelations of the $2bn secret loan arranged in 2013 by Credit Suisse and VTB to agents of the Mozambican government, or the funds hurriedly borrowed in Ghana and the current confusion over Zambia’s debt.
- In particular, any decision to borrow must be approved by democratic institutions. Loans must comply with national and international laws, consider the debtor country’s ability to pay, charge reasonable interest and fees, avoid harmful policy conditionality, prevent future predatory debt litigation, and support development strategies.
- Debt restructuring must also protect human rights, promote economic growth, and allow for
- Public spending on essential services. A fair and rapid debt workout process would bring significant benefits not just to the debtor country, but also to the poor, women, and children, who are affected the most.

What needs to be done

- Private sector creditors to states and government-guaranteed agencies, public sector creditors and public sector borrowers must agree to transparent lending and borrowing principles astonishingly not already in place — and implement them by publishing key data on sovereign lending to states, through open and accessible platforms.
- This will enable citizens, legislative oversight bodies and the media to scrutinise the detail of debts a government incurs in their name, for it is their taxes that must pay them back. Centres of capital such as the City of London, which manage the majority of developing-country bondmarkets, should expect legislation enforcing such transparency of debt data.

THANK YOU!