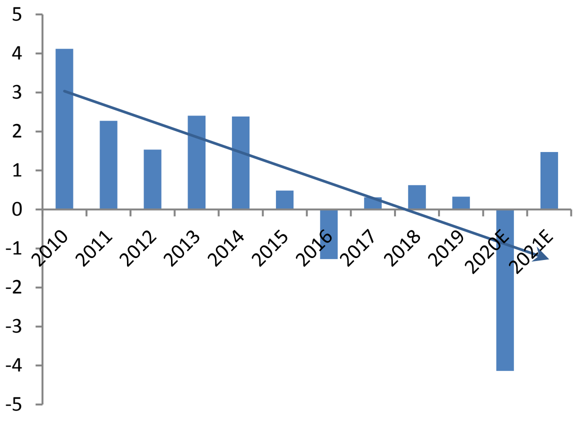
JOHN OSHILAJA 2 August, 2020

Debt-Relief for Africa In the Time of Covid-19

Covid19 caseloads and mortalities have been mercifully lower in Africa than in many other regions. However—as with everywhere else—none of its countries have been spared the pandemic's economic predations. The IMF expects nominal GDP in Sub-Saharan Africa (SSA) to contract by at least 3% ($243 billion). [1] The expected contraction is less than in the EU, UK, or USA. SSA however has more to overcome than viral epidemics.

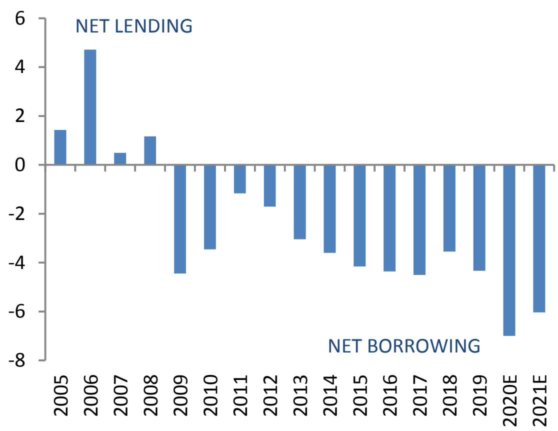
The region as a whole has been getting poorer for a decade (fig. 1). Before the Covid19 pandemic, unemployment and inequality were also on the rise. After wholesale cancellations of the region's official bilateral debts, its continuing predisposition to state-led development models also gave rise to a renewed build-up of State debt (fig. 2). Before the pandemic, 20 out of 54 African states were considered by the IMF to be in or near debt distress. Clearly, state debts in Africa were already souring.

Fig. 1 SSA GDP PER CAPITA GROWTH (%PA)



Source: IMF, World Econ. Outlook Database, April 2020

Fig. 2 GOVTS. NET LENDING/BORROWING (%GDP)



Half of the world's 77 poorest countries are in Africa. So when G20 official creditors answered calls for debt-relief they undoubtedly expected their Debt Service Suspension Initiative (DSSI) to benefit mostly African countries. Yet, only half applied to the program (i.e. 19 countries).[2] Reactions to the DSSI were notable also for the absence of states deemed to be at high risk of distress over either foreign or overall indebtedness. States such as Ghana, Kenya and Nigeria did not apply. The response of private creditors invited to join the DSSI was unambiguous. Inaction has been their reaction to official calls.

Private creditors clearly find the G20's program wanting. But what prompted some of the region's most at-risk borrowers to leave money on the table? This brief argues for fixes allowing official creditors to maximize participations and the impact of their debt initiative on finances of affected African countries.

Where DSSI Relief Falls Short

The DSSI was designed with expectations that all members would abide by Paris Club debt-disclosure rules and standards of cooperation. However, competing terms emerged to erode the DSSI's appeal. The G20's goal was to temporarily permit poorer countries in need to divert funds from settling debt service obligations to pandemic relief—ideally without triggering adverse credit events or further distress. Administered by the Paris Club, the DSSI aimed to temporarily release at least $25 billion in debt service countries were already obliged to pay bilateral official and private creditors combined.[3]

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[1] IMF, SSA Regional Economic Outlook, June 2020 Update

[2] World Bank Briefing 19 June 2020; [COVID 19: Debt Service Suspension Initiative](), updated as of 24 Aug 2020

[3] By OECD calculations

The Unchallenged Weight of New Players in IDA

It seems G20 policy planners did not sufficiently consider and accommodate aims and characteristics of newer players in international development assistance (IDA): China and bond investors.

China is a member of the G20, and while not a member of the Paris Club it is granted observer-status. Led by its superpower aspirations, however, China has become a global systemically important development partner, viz. a "G-SID". Beijing and its agencies are reportedly owed more official debt (from developing countries) than the IMF, World Bank and Paris Club combined. By one calculation, China is owed at least three times more than the Paris Club and 70% of debt service due from SSA this year.[4]

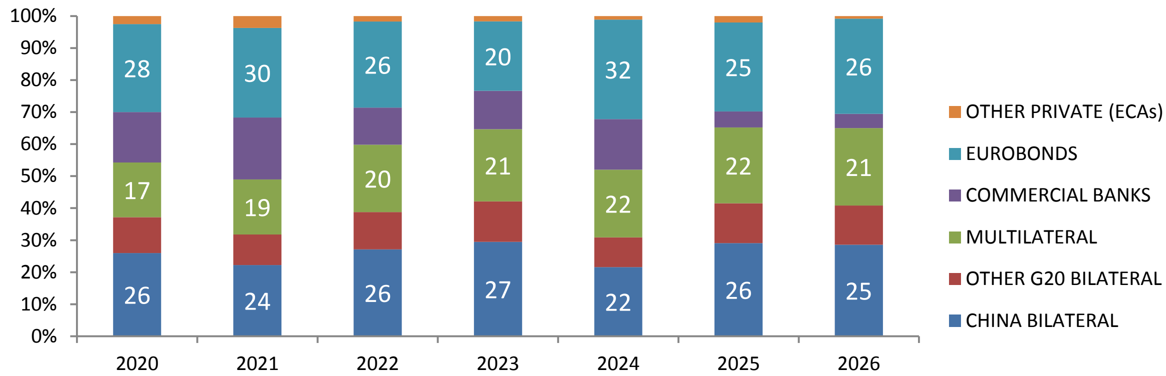
Had the rest of the G20 tacitly managed China's systemic significance, they might have (perhaps) mandated the country to lead the initiative—with the active support and cooperation of the Paris Club.

The G20's failure to contain China's hegemony allowed Beijing officials to exclude undisclosed but material amounts of Chinese loans from DSSI treatment. These exclusions were premised on credit classifications understood to markedly differ from those used by other official bilateral creditors.[5] Definitional semantics aside, the result was that China set its own terms on excluded debts. It even went on—at a later summit with African states—to announce the cancelation of all interest-free Chinese loans.

The Lowest Stake in The Game

Exclude debt service due China and the amount of relief the G20 was actually offering drops considerably; another factor undermining the DSSI's effectiveness (see Fig.3).

Fig. 3 SSA ANNUAL DEBT SERVICE (% Distribution)



Source: Author's calculations based on World Bank Int'l Debt Statistics

The above calculations of debt service from SSA countries reveal private bondholders to be due the most, followed by China and multilateral finance institutions. Out of a total of $11.5 billion in official bilateral debt service, relief available to eligible states in Africa this year amounts to about $5.3 billion. Half of this amount is due to China (from Angola). Hence the G20's bilateral debt relief (ex-China) amounts to just $2.6 billion out of a possible $4.1 billion had all eligible SSA states applied.[6]

Divergent Expectations and Capabilities

It is unrealistic to expect private and official creditors to offer comparable forms of debt-relief from claims that are not directly comparable.

Private creditors such as bond investors are a welcome presence in markets for developing country debts. They bring long term liquidity and price discovery to borrowers in exchange for financial transparency

[4] Breugel Institute blog: Debt relief for Sub-Saharan Africa: what now?; Bery et al, 14 July 2020
[5] Except for China EXIM Bank, other policy bank and state-owned enterprise loans were not classified as official bilateral credit and therefore excluded.
[6] World Bank International Debt Statistics database.

and predictable contractual returns. Since the Global Financial Crisis (GFC) however, safe-haven assets have become more susceptible than usual to momentum (herd) investing, inflated pricing, and violent swings in sentiment—the unintended side-effects of QE policies of safe haven central banks. Rationally responding to liability costs (e.g. pensions) that do not re-price or mature as quickly as assets do, normally conservative bond investors began venturing further into speculative higher-risk territories in a global search for yield. For most private creditors, the type of forbearances and concessions the DSSI sought compounds this problematic mismatch.

Private claims on state obligors also markedly differ from those of official creditors in other critical ways. They are reliant—for enforceability— on commercial contract Law. And private creditors are not granted the Preferred Creditor status (PCS) states customarily accord official creditors under superseding Bilateral Treaties.

Zero Offers of Permanent Financing

The DSSI also comes up short in failing to offer countries permanent financing. Debt suspensions allow governments to reorder spending priorities but the financing this provides is temporary.

Governments everywhere else are paying for the large and novel demands of the Covid-19 pandemic by either substantially widening fiscal deficits, or capitalizing on low borrowing rates to tap global markets for international liquidity. These options tend to be closed to lower income countries facing liquidity crises. Most African governments lack the fiscal space, cannot borrow foreign currencies locally, and simply lack the wherewithal to comfortably weather the sudden stops in credit that typically follow large unexpected spikes in risk.

Truncated Market Access

While debt suspensions are in effect, the G20 also wants curbs placed on borrowing states' use of non-concessional debts (meaning private commercial borrowing). But where G20 creditors saw curbs for debt sustainability's sake, some African state-borrowers apparently saw quarantines barring them from alternative funding sources. Hence, some chose to leave the DSSI's relief on the table.

African officials also understandably reason that accepting DSSI terms would significantly impair their countries' access to alternative sources of credit well before any such curbs could be breached. The cascade of credit defaults[7], rating agency downgrades and other credit events triggered by agreeing to suspensions would be damaging enough.

Modifications to DSSI

Poor countries very quickly lost vital foreign currency reserves to disengagements prompted by Covid19. To help stem such losses, international financial institutions (IFI's) such as the IMF and World Bank rapidly disbursed emergency loans. $10 billion of such loans were extended by the IMF to African countries, and in a number of countries the Fund augmented pre-existing Program Facilities. Nonetheless, the Fund estimates a shortfall of $44 billion out of $110 billion SSA countries will need in 2020[8].

Partial Debt Cancellations

Therefore, rather than standstill agreements on terms that put debtor-states in straightjackets, the G20 should instead partially cancel African debts by cancelling service payments falling due in coming months (or years). Over this "cancellation period", official bilateral creditors should also offer bridging-loans on concessional terms pending these states' resolution of vulnerable private claims. These loans would keep state obligations to private creditors current.

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[7] Cross defaults provisions afforded to commercial creditors.
[8] SSA Regional Economic Outlook Update, June 2020

Partial debt cancellations inject permanent financing into eligible countries. By also conferring certain rights on the creditor in exchange, the funds deployed could be narrowly and transparently targeted.

Leveraging Global IDFI Capital

Rather than waiting on unresponsive private creditors, the G20 could instead press International and Development Finance Institutions (IDFI's) into further constructive service.

Official creditors could call on IDFI's to mitigate risks on distressed private loans to states now seeking remediation. Risk mitigations must be conditioned, however, on firm undertakings by the countries to implement IMF-monitored debt-sustaining policy reforms. For such countries, IDFI-issued risk mitigants (e.g. partial risk guarantees and hedges) would preserve market access, promote fiscal space and lower servicing costs on resolved private credits. Mitigating sovereign credit risks would also elevate weakened ratings on a debt-specific basis, attract longer duration funding and facilitate the migration of exposures across investor groups—e.g. from high yield to investment grade investors.

Deploying IDFI capital this way crowds private capital into policy reforms tied to official assistance. Benefits for states choosing to pursue desirable structural reforms would be proximate and visible, while terms of the program mitigate against moral hazards to official creditors. The status quo remains the alternative for distressed states: rising debt costs, revenue deterioration, fiscal stress, degraded market access, and policies that cede economic competitiveness to more serious rivals.

IDFI's should not be undercutting private creditors during crises but should be skillfully co-opting them instead. The comparatively limited capital of IDFI's would be more impactful if deployed in conditional confidence-building market interventions. It is time IDFI support stopped stigmatizing state-clients. Follow the lead of G7 central banks. When markets are disrupted, these policy banks now put their balance sheets to work to keep them operating functionally. IDFI's could do likewise for fragile client-states. Most developing countries cannot use home-grown domestic balance sheets to intervene against international market disruptions because—except for China's—their central banks do not issue globally accepted reserve currencies.

Africa's Sovereign Borrowers Also Need to Step Up

The interest African governments now take in global debt markets should also not be taken for granted. Market access was not gifted these borrowers. They once steered difficult policy reforms through painstaking negotiations with challenging stakeholders and, in their view, continue to pay for access they are now afforded. Seen in this light, their reluctance to turn their backs on hard-won benefits has merit.

Global financial markets are as much a public good as the local financial markets African states are, themselves, developing at home. As such, states also bear responsibilities for actively cultivating and nurturing global markets for their debts; more so with capital-starved African states. But their focus so far seems to have been on simply milking foreign markets for QE-fuelled liquidity. It is time these states started focusing on promoting new borrowing templates aimed at establishing terms better suited to their macroeconomic circumstances, vulnerabilities and needs. But this comes only if states challenge advisors and bankers to arrange borrowings that offered more equitable distributions of risk.

Take, for example, global commodities market risks to which the region's export revenues are highly exposed. Borrowers and their creditors profit when commodities bull market cycles fuel investment and economic expansions. Although creditors can also sustain sizeable losses, it is debtor-states that tend to be hardest hit when downside market risks materialize. Their pricing power is limited and economies are broadly synchronized to foreign economic cycles. Yet, any influence states exert on policies affecting external demand for their exports is negligible.

A healthier and more sustainable balance of risk-bearing would be struck if such countries, for example, issued “state-contingent” debt contracts. Under such contracts creditors receive more (in debt service payments) during bull markets, and contractually less from a country during bear markets for principal exports. By promoting fiscal spaces needed to implement countercyclical policies in times of crisis, state-contingent obligations, also strengthen existing economic stabilization mechanisms against adverse external shocks.

Countries have successfully linked debt obligations to economic performance; such as to their GDP, Income, and other macroeconomic variables. Examples include marketable international bonds of Costa Rica, Bulgaria, and Bosnia and Herzegovina in the 1980s and 1990s and, more recently, Argentina, Greece, and Ukraine. In exchange for private lending concessions, a borrowing government commits to make pre-determined bonus payments to creditors, provided that the economy achieves agreed thresholds of performance over the life of the obligation. Investors are attracted by lower default probabilities and potentially asymmetric returns on investment. Governments are attracted by the automatic stabilization and resilience of such debt in downturns, which promotes sustainability[9].

GDP-linked bonds, however, are presently not widely distributed across global capital markets. This is in part because state-contingent contracts have tended to originate out of debt-restructuring negotiations. An increasing number of such negotiations are in the offing in coming months. Such bonds would be more effectively mainstreamed by increased issuances, supported by IDFI’s and coordinated efforts of coalitions of willing issuers.

Conclusion

The rest of the official bilateral creditors in the G20 (“G20 ex-China”) brought a knife to a gunfight. Without China and bondholders on-side, they lacked the firepower needed to safeguard against circumvention of the DSSI. China had the debt volumes and political will needed to offer debtors more accommodative terms. The appeal of the initiative was weakened at the outset. The G20 ex-China might have reined in Chinese hegemonic behavior by preemptively offering debtors permanent finance at a cost of just $4-5 billion in partial debt cancellations. Possibly because they sought leverage from subsequently unconvinced private creditors, this initiative too was lost.

But the opportunity to set a more transformational debt-relief agenda in Africa need not be abandoned. Tremendous roles exist for IDFI’s and private creditors to play in reinvigorating flagging debt policy and structural reforms that could be tied to wider debt-relief once more. Official creditors seeking to increase private involvements in debt-relief initiatives, need not venture far for inspiration. Debt-relief provisions once led SSA states to build domestic government bond markets. Today, much of their $110 billion needs will be met by local bondholders. Official resources on both sides would be better focused on IDFI’s given charges to crowd international private capital in to explicitly funded, longer dated reform programs.

African states also need to step up by pivoting market development efforts towards international arenas. It is time for them also to start insisting on external financing terms that share investment risks more equitably given their macroeconomic circumstances, vulnerabilities and needs. State-contingent foreign liabilities are an example of types of financing they should pursue. Continuing to simply milk liberally provided liquidity from yield-starved investors is unsustainable. It inexorably leads to unaffordable market disruptions followed by debilitating restructuring negotiations. Relative to other regions, the pandemic may seem to have dealt SSA a glancing blow. But Covid19 undeniably ups the ante for African policymakers and development partners.

[9] Sovereign GDP-Linked Bonds: Rationale and Design, various authors, March 2018, CEPR Press

About the Author:

John Oshilaja was one of the architect-developers of local markets for Nigerian government securities. A global markets banker, he also promoted market solutions for public debts in Kenya, Ghana and Zambia, and has worked extensively on foreign debt reschedulings and restructurings in Latin America and Africa.