# An urgent plan to avert the debt crisis

Twenty-three African countries are now either bankrupt or at high risk of debt distress.[1] Africa's debt remains at its highest level in over a decade. With debt service sucking up increasingly large proportions of budgets and revenues, a wave of defaults in the world's most vulnerable countries is likely to occur even faster than expected.

As a result of COVID-19 and the Russian invasion of Ukraine, the situation has gotten much worse. With international attention elsewhere, we ignore debt issues at our peril.

The reality is that international efforts have failed to deliver a solution. The G20's Debt Service Suspension Initiative (DSSI) offered some limited breathing room for select countries struggling with the aftershocks of the pandemic but expired last December. Its successor the G20 Common Framework for Debt Treatments has all but failed - offering no solution to the three countries - Chad, Zambia and Ethiopia - that applied almost one and half years after its adoption.

The 2022 Spring Meetings of the International Monetary Fund (IMF) and the World Bank Group may be the last opportunity to avert a debt crisis before, for some, it is too late.

**What is the Common Framework?**
As a follow on from the DSSI, the Common Framework was formed in November 2020 by the G20. Whilst the DSSI freed up some intermediate cash for government, the Common Framework proposes a permanent solution to structural debt problems and a path back to sustainable development.
***Pros****: First multilateral system to have China on board, Africa's biggest bilateral lender, solves structural problems, avoiding huge fallout.*
***Cons****: No incentive for private sector to participate, limited country coverage, unclear process, no successful cases a year later, reluctance of borrowers to apply for fear of compromising new lending.*

## WHAT YOU NEED TO KNOW

- → **20:** million additional people at risk of extreme poverty if Africa's 16 riskiest countries fall into debt distress.
- → **$64 billion:** African debt payments due in 2022 (almost twice bilateral aid to Africa in 2021).[2]
- → **59:** percent of African countries assessed are bankrupt or at high risk of debt distress.[3]
- → **23:** percent of the 2022 Nigerian federal budget will be spent on debt service; almost twice as much as will be spent on health and education combined.[4]
- → **9:** percentage points increase in debt to GDP for low and middle-income countries in 2020 (which was just 1.9% the decade beforehand).[5]
- → **8:** percent of GDP paid in interest payments by emerging markets in 2020 (1% in advanced economies).[6]
- → **5:** years to recover from a debt default[7] which can wipe out a decade of economic and social progress.[8]
- → **41:** percent of African countries downgraded during the pandemic (6% in advanced economies).[9]

## WHY ARE WE FACING ANOTHER DEBT CRISIS?

Even before the pandemic, African finances were tight and debt was high. Covid-19 triggered two years of further economic hardship, with an enormous need to secure financing to lessen the impact on citizens and the economy, but few options to do so. Even so, African governments kept up debt payments, returning 97% of what was owed in 2020 - despite the G20's **Debt Service Suspension Initiative** (DSSI) being in effect. The DSSI has now expired and its successor, the **Common Framework**, is unusable in its present state. Not one of the three applicants has received relief 18 months later, providing little incentive for others to follow suit.

## THREE CONVERGING CRISES

1. **Russian invasion of Ukraine**: The war in Ukraine will lead to greater global instability, have knock-on effects on key commodities, food supply and prices, global supply chains, and inflation. Households in rich and poor nations alike are facing higher energy bills and pump prices. 0.5% has been slashed off global growth.[10] Countries that import commodities will face increased import bills - and even commodity exporting countries may see their windfalls offset by increased food and energy prices. Unknowns, such as global supply chains disruptions, inflation, monetary policy and market sentiment, present downside risks for Africa.
2. **Increased global interest rates**: A few weeks ago our greatest worry was an increased cost of borrowing from US interest rate hikes.[11] Although these have already started happening,[12] they may not be at quite the unexpectedly fast rate we were bracing ourselves for. Nonetheless, a higher cost of borrowing foreign currency harms Africa more than other countries,[13] driving up inequality. Continued US interest rate rises could spark another 'taper tantrum' further driving up the cost of debt for Africa's emerging economies.[14]
3. **COVID-19, Climate Change and the threat of future pandemics**: The risk of these huge global shocks occurring remains high. Large amounts of finance are needed to prepare and adapt to protect our world against them, which will be cheaper than enduring their catastrophic impacts.

## THREE AFTERSHOCKS FOR AFRICA

1. **Higher cost of borrowing**: Interest rates from the easing of stimulus in the US, and credit rating downgrades as countries struggle to repay debt could drive up the cost of borrowing. Between February 2020 and March 2021, 41% of African countries were downgraded, relative to 6% in Advanced Economies.[15] Eroded currencies mean that foreign currency is expensive, making it harder to pay for service. This could result in a downgrade which makes the cost of borrowing higher: a vicious cycle.
2. **Investor skepticism**: Emerging market debt is already less attractive as investors become more risk averse[16] (though some early evidence suggests this might be less the case for at least some African countries).[17]
3. **Inequality and instability**: Higher food and energy prices mean a higher import bill for precious foreign currency needed to service debts. With food and fuel making up a larger share of their consumption, the poorest countries and people will feel the impact of the crises most. An estimated 40 million people will be pushed into extreme poverty as a result of price spikes in 2022.[18] This is likely to generate greater instability and could drive more people to migrate to Europe.

# THE LONGTERM PROGNOSIS

These global challenges make dealing with debt more critical than ever for borrower countries - but also for creditors and advanced economies. Failure to manage this proactively and smartly will come at a high cost.

## 1. A Wave of Defaults

**Likelihood**: MEDIUM[19]
**Impact**: HIGH
**Ability to change outcome**: HIGH

A wave of defaults happens when multiple countries can no longer pay their debts, now or in the future, triggering a wave of simultaneous defaults. These have a myriad of economic consequences that take years to overcome and create a spiral of even bigger development deficits - more people living in poverty, fewer jobs, less investment, etc. All other efforts to recover from the pandemic, reduce poverty and invest in health systems are paused/set back.

| Financial cost | Poverty Cost | Cost to the Global Economy |
|---|---|---|
| Sovereign debt distress or defaults often coincide with several economic problems that may include output collapses, financial crises, currency crashes, and high inflation, which disproportionately affect the poor.[20] The costs are high- restructuring wipes 2% points off GDP growth per year on average.[21] Yet disorderly defaults cause greater output losses,[22] higher borrowing costs and a 30% point higher cost to creditors.[23] | Large drops in output caused by defaults directly impact poverty. Data from the 1980s and 90s show an increase in poverty by as much as 25% during large contractions in output.[24]<br><br>That's 20 million more people pushed into poverty if Africa's 16 riskiest countries went into debt distress.[25] Not surprisingly, aggregate economic shocks that weaken the government's ability to provide public goods, such as health care and education, are also associated with a deterioration in human development and social indicators.[26] | Pension funds lose more money than they could have done if they just accepted a fast and predictable restructuring. On average, 30% more of an investment is lost when a restructuring happens after a country can't pay, rather than before.[27] The long run prosperity of an emerging market economy, which pays much higher returns than those in European and North American markets, is better for investors and pension holders alike.[28] |

## 2. Deteriorating Global Economic Conditions

**Likelihood**: HIGH
**Impact**: HIGH
**Ability to change outcome**: LOW

Russia's invasion of Ukraine impacts the main commodities that they export, namely wheat and grain, and oil and gas- increasing their price. Other supply constraints and bottlenecks are likely and will contribute to higher prices. This increases inflation, import bills for gas and food prices and creates a reluctance to invest in riskier markets like Africa. These economic challenges disproportionately affect the poor, who spend a higher proportion of their incomes on food items.[29] Other impacts of US monetary policy tightening on interest rates are likely to happen at a slower pace than expected. With limited ability to predict or contain the impact of these outcomes, fixing the debt challenges to allow countries to better weather these storms becomes increasingly important.

| Commodity Price Cost | Market Sentiment Cost | Contagion cost (unlikely) |
|---|---|---|
| Net oil and gas exporting countries might have more forex to service debt due to rising commodity prices, yet the opposite is true for net importers. Net importers South Africa, China and Egypt are among the top 10 'biggest losers' from higher oil prices.[30] In the medium term, it will mean better investments in Africa's gas- the 40% of European gas imports that come from Russia can be met by Algerian, Nigerian, Tanzanian and Mozambican reserves.[31] | Greater market volatility will affect emerging market funds, driving higher borrowing costs at least in the short term. There is also the prospect of greater risk aversion to emerging market debt (making it more expensive), although this historically has been short-lived. | Russia is likely to default on its $60billion external debt due to sanctions, but this is too small to have any impact globally. Already Russian bond values have tumbled to 33 cents on the dollar as S&P downgrade them to 'junk' status. Likely to see further economic fallout in Russia as a result of the default. |

### 3. Long-term challenges and contagion

**Likelihood**: MEDIUM
**Impact**: HIGH
**Ability to change outcome**: MEDIUM

It can take over five years to recover from a disorderly debt default.[32] Some impacts can wipe out a decade of progress.[33] Countries on the brink of default will have few options to invest in pandemic response and preparedness, with limited-to-no resilience for years to come for future shocks like climate change. Failing to address the debt crisis critically undermines other important areas, including investment in health systems, education or the ability to mobilise other forms of finance. Debt challenges are not going away, whilst the impact of inaction is growing.

| Another lost decade | More Pandemics, less control | Uninhabitable countries |
|---|---|---|
| We've been here before. The 80s are often referred to as the lost decade of development, largely because we couldn't sort out debt. | COVID-19 has taught us just how interconnected the world is. We don't know what the next pandemic might be, but efforts required to prevent and control it will be just as global. | Be it through an inability to adapt to climate change, conflict and increased instability, or pure lack of economic opportunity - more people will want to leave. Refugees and migrant numbers could boom. |

## AN ACTION PLAN FOR 2022

### Avert the immediate crisis and fix the Common Framework

1. **G20: Should ease liquidity challenges and incentivise participation**
   - → Provide debt standstill from all creditors upon country application to the common framework.
   - → Explore and provide concrete options to bring private creditors to the table, such as lending into arrears policies or domestic legislation.
2. **IMF and World Bank: Should support countries facing liquidity challenges**
   - → On application to the Common Framework, inject immediate liquidity through Multilateral Development Banks or the IMF.
   - → Implement lending into arrears policy for Common Framework Applicants, push for countries in G20 to do the same.
3. **IMF and G20: Should incentivise Common Framework participation and application, take steps to prove that it works, speed it up and support borrowing countries**
   - → Push for publication of eligible debt relief, as estimated by the IMF and World Bank using their Debt Sustainability Framework, to incentivise participation of all creditors and borrowers.
   - → Set a timeline and outline the process for treatment under the Common Framework to promote accountability and quick resolution.
   - → Support borrower countries to effectively negotiate for their interests and coordinate. Borrowers can get all creditors in one room and their national law supersedes Chinese debt contracts.

# ENDNOTES


1. 59% of the 39 PRGT-eligible African countries with a LIC DSA https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf (Jan 2022), https://www.one.org/international/blog/6-reasons-africas-debt-crisis/
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