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Olatundun Adelegan
Risto Herrala

Debt in developing countries

Expert views from Sub-Saharan Africa

Ministry for Foreign
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Abstract

The study presents the views of selected experts from Sub-Saharan Africa on the problems many countries in the region face with debt. The debt burden is a critical macroeconomic challenge in the region, as one third of SSA countries are classified either as debt distressed or in high risk of debt distress. The paper details the situation based on the latest data from the main international organisations. It reviews the academic and policy-oriented literature about the debt problems from a macroeconomic perspective, with special emphasis on private debt. Based on a structured survey of specialists from the SSA region, the paper sheds light on the reasons for, the economic impact and the outlook of debt problems. An overarching message from the survey is that economic policies play a key role in shielding against debt problems.

Provision

This report is commissioned as part of UniPID Development Policy Studies (UniPID DPS), funded by the Ministry for Foreign Affairs of Finland (MFA) and managed by the Finnish University Partnership for International Development (UniPID). UniPID is a network of Finnish universities established to strengthen universities' global responsibility and collaboration with partners from the Global South, in support of sustainable development. The UniPID DPS instrument strengthens knowledge-based development policy by identifying the most suitable available researchers to respond to the timely knowledge needs of the MFA and by facilitating a framework for dialogue between researchers and ministry officials. The content of this report does not reflect the official opinion of the Ministry for Foreign Affairs of Finland. The responsibility for the information and views expressed in the report lies entirely with the authors.

Keywords	debt, developing countries, international financial system		
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Kuvailulehti
13.11.2023

Velka kehittyvissä maissa
Asiantuntijanäkemyksiä Saharan eteläpuolisesta Afrikasta

Ulkoministeriön julkaisuja 2023:17
Julkaisija Ulkoministeriö

Tekijä/t Olatundun Adelegan ja Risto Herrala
Kieli englanti **Sivumäärä** 41

Tiivistelmä

Tutkimuksessa esitellään valittujen Saharan eteläpuolisen Afrikan asiantuntijoiden näkemyksiä monien alueen maiden velkaongelmista. Velkataakka on kriittinen makrotaloudellinen haaste alueella, sillä kolmasosan Saharan eteläpuolisen Afrikan maista luokitellaan joko olevan velkavaikeuksissa tai hyvin riskialttiita joutumaan velkavaikeuksiin. Tilanne esitetään tutkimuksessa yksityiskohtaisesti tärkeimpien kansainvälisten järjestöjen tuoreimpien tietojen perusteella. Siinä tarkastellaan velkaongelmia käsittelevää akateemista ja talouspoliittista kirjallisuutta makrotaloudellisesta näkökulmasta painottaen erityisesti yksityistä velkaa. Tutkimus valottaa Saharan eteläpuolisen Afrikan alueen asiantuntijoille suunnatun kyselytutkimuksen avulla velkaongelmien syitä, taloudellisia vaikutuksia ja näkymiä. Kyselytutkimuksen kantava viesti on, että talouspolitiikalla on keskeinen rooli velkaongelmien torjunnassa.

Klausuuli Tämä selvitys on tilattu osana ulkoministeriön (UM) rahoittamaa UniPID Development Policy Studies (UniPID DPS) -tutkimusta, ja sitä hallinnoi yliopistojen kehitysyhteistyöverkosto (UniPID). UniPID on suomalaisten yliopistojen verkosto, jonka tavoitteena on vahvistaa yliopistojen globaalia vastuullisuutta ja yhteistyötä globaalin etelän kumppanien kanssa kestävän kehityksen tukemiseksi. UniPID DPS -instrumentti vahvistaa tietoon perustuvaa kehityspolitiikkaa etsimällä sopivimmat käytettävissä olevat tutkijat. Näin pyritään vastaamaan makrotaloudellisen rahoitusavun ajankohtaisiin tietotarpeisiin ja luomaan puitteet tutkijoiden ja ministeriön toimihenkilöiden väliselle vuoropuhelulle. Selvityksen sisältö ei edusta ulkoministeriön virallista näkemystä. Vastuu selvityksessä esitetyistä tiedoista ja näkemyksistä on täysin sen tekijöillä.

Asiasanat velka, kehittyvät maat, kansainvälinen rahoitusjärjestelmä.

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Skuldsättning i utvecklingsländer
Experters syn på Afrika söder om Sahara

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Referat

I denna studie ger utvalda experter från Afrika söder om Sahara sin syn på den skuldproblematik som många länder i regionen står inför. Eftersom en tredjedel av länderna i Afrika söder om Sahara klassificeras som antingen kraftigt skuldtyngda eller i riskzonen för att bli detta, är skuldbördan är en allvarlig makroekonomisk utmaning i regionen. Situationen beskrivs utifrån aktuella data från viktiga internationella organisationer. Studien är en forsknings- och policyöversikt kring skuldsättning ur ett makroekonomiskt perspektiv, med särskilt fokus på privat skuldsättning. Baserat på en strukturerad enkät till experter från Afrika söder om Sahara belyser studien skuldproblemens orsaker, dess ekonomiska konsekvenser och framtidsutsikter. Ett övergripande resultat från enkäten är att ekonomisk politik spelar en nyckelroll för att motverka problemen med skuldsättning.

Klausul

Rapporten har tillkommit på uppdrag av UniPID Utvecklingsstudier (UniPID DPS), finansieras av finska utrikesministeriet (MFA) och ingår i Finlands universitetspartnerskap för internationell utveckling (UniPID). UniPID är ett finskt universitetsnätverk som syftar till att stärka universitetens globala ansvarstagande och samarbetet med deltagare från det globala Syd, som stöd för en hållbar utveckling. UniPID Utvecklingsstudier syftar till att stärka kunskapsbaserad utvecklingspolitik genom att utse de mest lämpade forskarna för att svara på utrikesministeriets aktuella kunskapsbehov. Avsikten är också att skapa förutsättningar för en dialog mellan forskare och tjänstemän på ministeriet. Innehållet i rapporten motsvarar inte det finska utrikesministeriets officiella hållning. Författarna till rapporten ansvarar fullt ut för den information och de åsikter som presenteras i rapporten.

Nyckelord	skuldsättning, utvecklingsländer, internationella finansiella system.		
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Contents

FOREWORD

In recent years, the debt situation in many developing countries has deteriorated, making them vulnerable to debt distress or approaching debt distress. With the turn of the century and as a result of the restructuring programmes, the situation improved. However, the situation has seriously worsened and has become one of the most critical causes hindering countries from attaining sustainable development goals.

In international discussions, solving the situation of countries in debt distress has become central. Discussions are ongoing in the United Nations, in International Financing Institutions and in Multilateral Development Banks, besides the discussions held between the creditors and the debtors.

The composition of the debt has also changed considerably in the last 20 years, with the number of debtors growing significantly and private creditors having a major role besides public creditors - making discussions on debt restructuring or other arrangements much more complicated than before. While there is ample information available on the debt owed to the traditional creditors, particularly of the Paris Club members (Finland among them), information on other debt and especially private debt is hard to come by.

Intending to have a more comprehensive picture of the situation of countries in debt distress, the Ministry for Foreign Affairs of Finland commissioned this study, which focuses particularly on private debt and Africa. Independent experts conducted the study, and the views and opinions expressed are exclusively theirs.

The study includes views from African economists, based on a survey and interviews, on the causes and consequences of the current situation in a manner in which such views have not been presented before.

I hope the study provides insights into the debt situation in various African countries and how African economists perceive the situation.

Riikka Laatu
Ambassador, Financing for Sustainable Development
Ministry for Foreign Affairs of Finland

ABBREVIATIONS

ADF African Development Fund

AERC African Economic Research Consortium

AFEA African Finance and Economic Association

DSA Debt sustainability analysis by the IMF and the World Bank

DSSI Debt service suspension initiative

Eurobond Bond issued in some other currency than the debtor's home currency

GDP Gross domestic product

GNI Gross national income

HIPC Highly indebted poor country

HIPC Initiative Debt relief under the heavily indebted poor countries initiative

IDA International Development Association, a member of the World Bank group

IFC International Finance Corporation, a member of the World Bank group

IFI International financial institutions

IMF International Monetary Fund

LCM Lower-middle income developing countries

LIBOR Interest rate at the London interbank market

LIC Low-income countries

MDRI Multilateral debt relief initiative

PPG Public and publicly guaranteed debt

PPGE Public and publicly guaranteed external debt

SSA Sub-Saharan Africa

USD United States dollar

1 Introduction and executive summary

This paper studies debt problems in developing countries. Its main contribution is a survey of 42 experts representing 18 countries in Sub-Saharan Africa (SSA). The experts elaborate on the causes, consequences and resolution of debt problems in the SSA region, as well as the long-term outlook. The survey of African experts is supported by a review of the recent literature, and the latest data from the main international organisations. Special emphasis is placed on private debt, which plays an important role in the ongoing debt dynamic. The study is financed by the Ministry of Foreign Affairs in Finland and conducted under the Finnish University Partnership for International Development (Unipid).

A review of the literature and the latest data reveals a rapid increase in external debt in developing countries since the start of the millennium. At the time, the debt of many developing countries was largely forgiven to achieve sustainable debt levels. From a historical perspective, the subsequent credit boom in the developing world is distinguished by the prominent role played by private creditors and China. Many developing countries tapped into private credit from international banks and bond markets. China emerged as the main sovereign creditor for the developing world, on a par with all Paris Club[1] countries combined.

The increase in debt has been accompanied by significant debt servicing problems. In low-income countries (LIC), arrears on external debt already exceed the annual debt service costs. While the debt problems are not yet as extensive as during past major crisis episodes, there are significant concerns that debt service payments are crowding out other forms of government spending, including on social programmes and the environment, and that debt problems put the Sustainable Development Goals at risk.

A survey of 42 experts from 18 countries sheds light on the situation in Sub-Saharan Africa, where many countries are currently experiencing debt problems (Annex 1). While the survey shows a variety of views on the issues, it also establishes common ground among many experts in the region.

1 The Paris Club is an informal group of official, mostly western, creditors,

As regards the cause of debt problems, many experts point to ill-advised policies and corruption as the main culprits. They indicate that debt problems negatively impact macroeconomic developments, also including the private sector. The impact propagates through various channels such as a tightening of public finances and the crowding out of private investment. Debt problems exacerbate the need for development aid to care for the poor.

Experts in countries that are currently in debt distress reveal significant challenges with the main international debt resolution mechanism, the Common Framework (CF), which places the difficult challenge of coordination across creditors in the hands of the debtor country. Recently, Zambia managed to become the first country to reach agreement about significant debt relief with creditors under the CF.

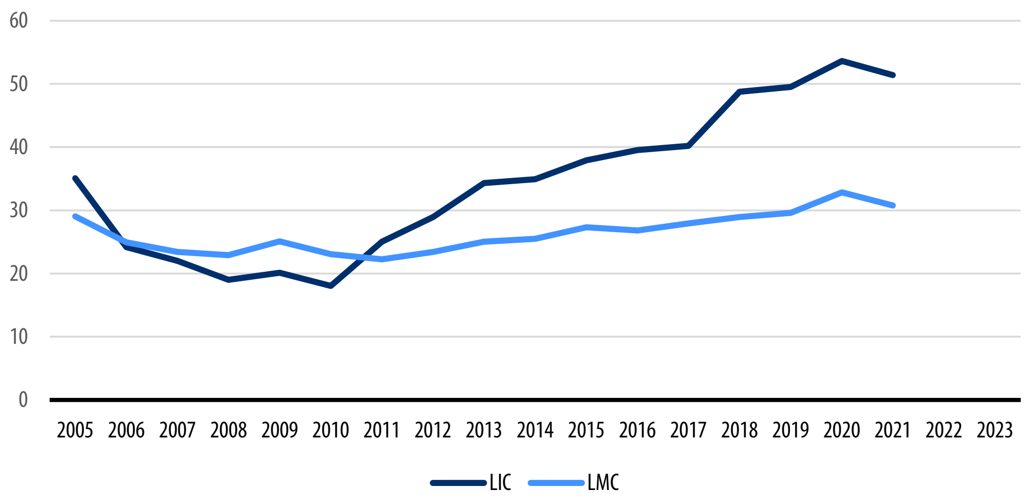
Experts predict a future of debt problems during the upcoming decades in the SSA region. While the views on the future are mixed, the balance is to some extent on the side of pessimism. The negative perception reflects the corruption and poor governance that persists in many countries in SSA. Some experts are, however, hopeful that a long-term resolution to debt problems can be found, pointing to the huge development potential. All in all, the survey indicates that a long-term solution to debt problems in SSA should involve strengthening the institutions to help the countries reach their economic potential.

2 The debate on developing country debt

2.1 Developing country debt increased in the past decade

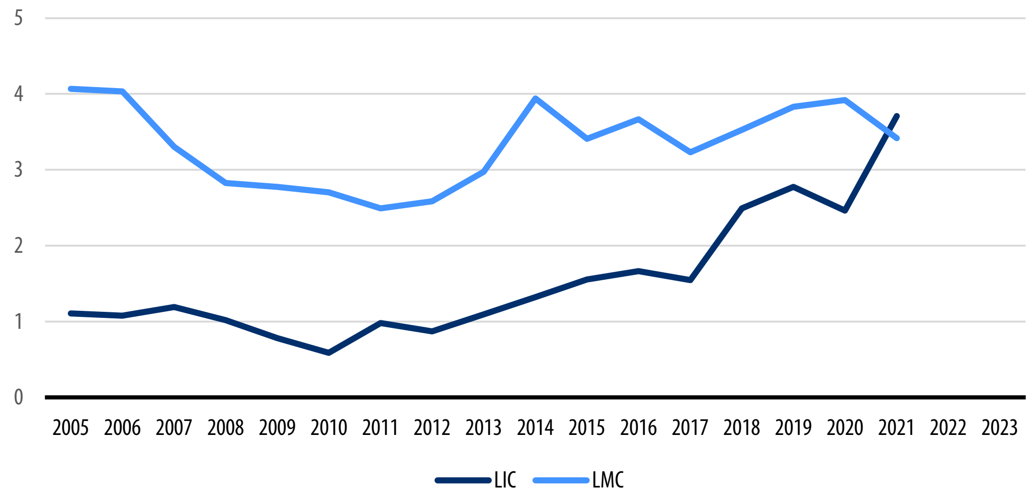
The past decade has seen a marked increase in the external debt of low-income countries (LIC). The debt boom was preceded by a sharp fall in the external debt of LICs in the early 2000s, mainly reflecting debt forgiveness by international creditors to achieve sustainable debt levels (Figure 1, Adelegan and Radzewicz-Bak, 2009). Subsequently, LICs increased external borrowing sharply from around 20 per cent of gross national income (GNI) in 2010 to 60 per cent in 2021. In lower middle-income countries (LMC), external debt also grew, albeit more slowly. With the rise of external debt, debt service costs increased in LICs and LMCs to around 3–4 per cent of GNI in 2021 (Figure 2).

Figure 1. External debt in Low Income (LIC) and Lower Middle-Income (LMC) countries, % of GNI



Note: GNI=gross national income.
Data source: World Bank International Debt Statistics.

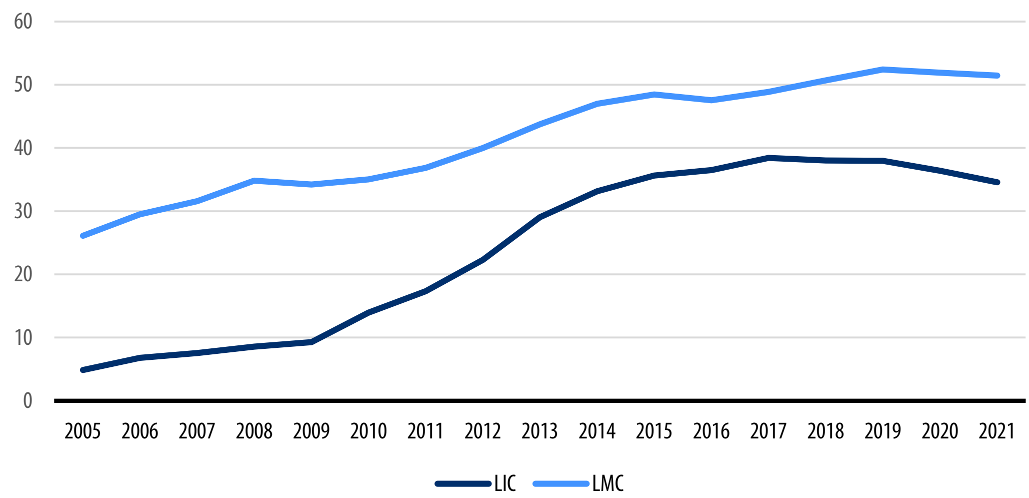
Figure 2. Service cost of external debt, % of GNI



Data source: World Bank International Debt Statistics.

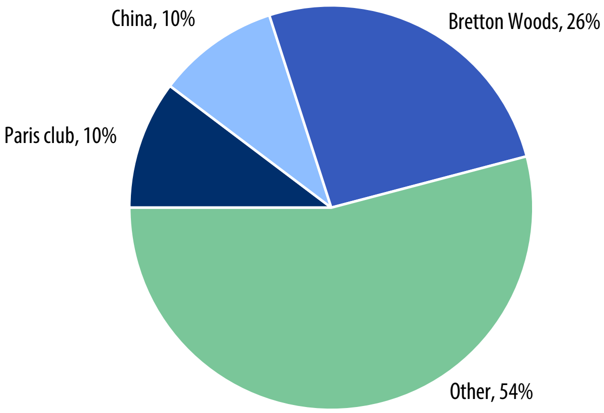
Much of the credit boom was financed by private creditors and China. While previously multilateral institutions and Paris Club countries were the dominant sources of external debt for developing countries, the past decade has witnessed a sharp increase in the share of private creditors. In LICs, the share of private creditors rose to about a third of external debt in 2005–2021 (Figure 3). In LMCs, about half of external debt is from private creditors. Apart from the rise of private creditors, another notable trend was the emergence of China as the largest sovereign creditor. In 2021, it covered a tenth of all LIC external debt (Figure 4, see also Box 1).

Figure 3. Share of private creditors (bonds and bank loans), % of external debt



Data source: World Bank International Debt Statistics.

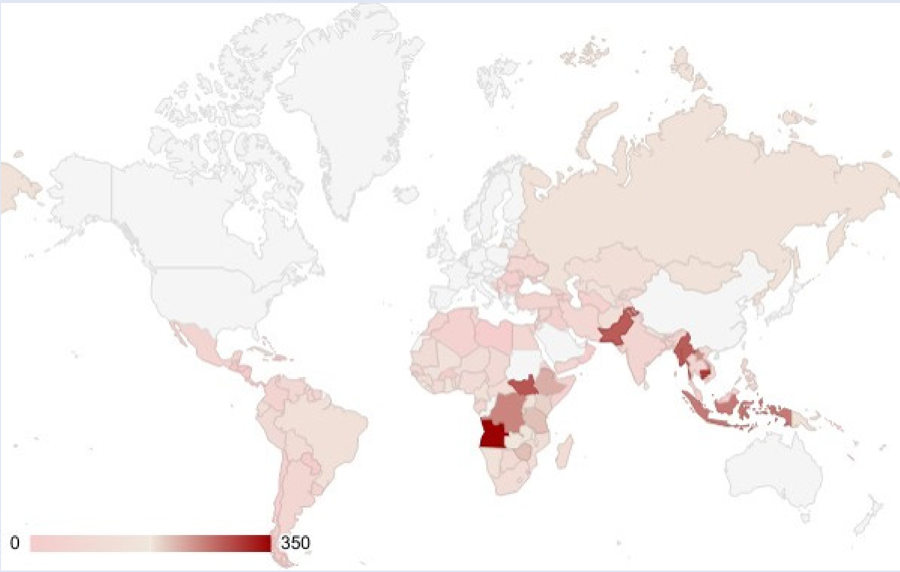
Figure 4. Sources of external debt for LICs in 2021, % of external debt



Notes: The Fig. shows the shares in percentages. Bretton Woods refers to the IMF and the World Bank group.
Data source: World Bank International debt statistics.

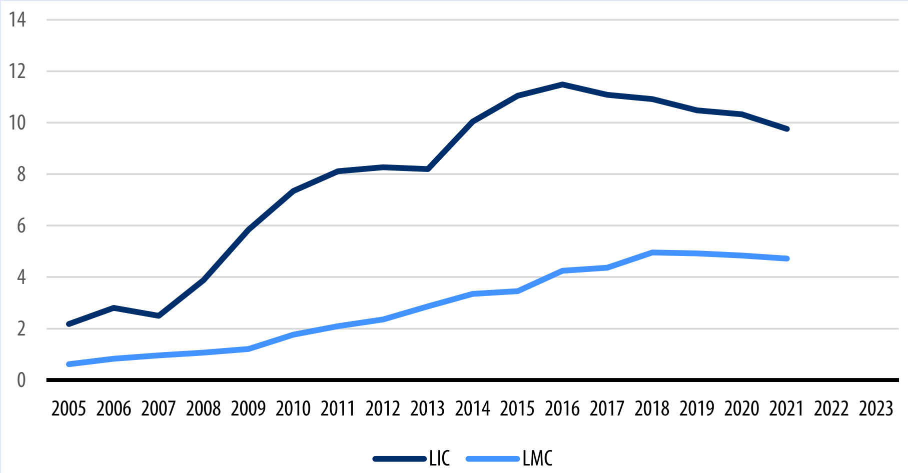
BOX 1 China's emergence as the leading lender of the developing world

Figure 5. Chinese projects (2000–2017) in developing countries



Notes: The colouring indicates the number of rows in AidData by country, Version 2.0. Each row details a Chinese project in developing countries.

Figure 6. Share of China, % of external debt



Data source: World Bank International Debt Statistics.

Throughout the last few decades, a persistent and large current account surplus has accumulated foreign assets for the Chinese. China has thereby emerged as a leading global financier, including in the developing world.

Chinese credit has been used by many developing countries to finance numerous infrastructure-related development projects, which China has undertaken throughout the developing world (Figure 5). It has participated in building roads and railways, ports, factories, and many other types of infrastructure of potentially great development value for the host countries.

China presents such activities as 'Belt and Road'. In his opening speech at the Belt and Road forum for international cooperation in 2017, President Xi explained that China does not want to reinvent the wheel (of development policy) but, rather, to complement the development strategies of countries involved by leveraging their comparative strengths.

The financing of Belt and Road projects is largely opaque to the outside world. Recent research (Horn et al., 2021) indicates that China's state-driven lending typically resembles commercial rather than official lending, and that the most widely used statistics substantially underestimate China's lending due to the data disclosure restrictions imposed by China on its borrowers. Much of its lending appears to be channelled via its two development banks, the Export-Import Bank of China, and China Development Bank, which operate under China's State Council (Dreher et al., 2022).

Recent research (Horn et al., 2022) has found that China's lending to developing countries is contributing to debt distress. Given the secrecy surrounding Belt and Road, defaults may remain hidden as missed payments and restructuring details are not disclosed. These default events are surprisingly frequent, exceeding the number of sovereign bond or Paris Club restructurings. Horn et al. (2023) find that China extends emergency funding to distressed governments via its central bank swap line network.

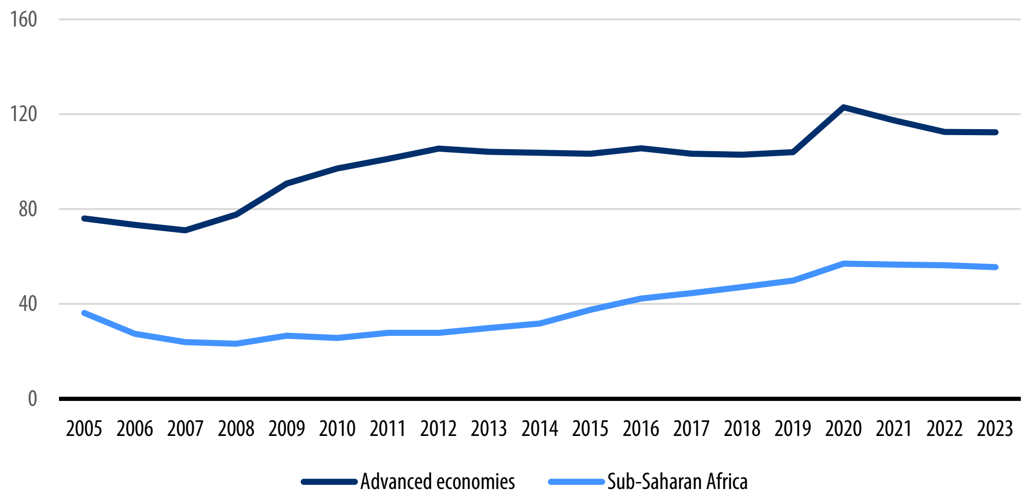
Recently, the Chinese Belt and Road projects have declined (Figure 6). Given the willingness of the Chinese to engage in development projects that impose only weak conditionality on the host country, Chinese withdrawal may lead to a significant tightening of access to development finance, and therefore a decline in development projects in the short term. In the long run, strong conditionality may be desirable for developing countries to achieve economic growth and stability.

2.2 Debt service problems are increasing

Compared to advanced economies, debt levels in developing countries are low. For example, in Sub-Saharan African countries, public debt remains, on average, around 50 per cent of GDP, which is less than half of the average in advanced economies (Figure 7). The reason why even relatively low levels of debt can create problems is borrowing costs, which tend to be much higher for a developing country compared to an advanced economy (Jensen, 2022; Presbitero et al., 2015). For example, the yield of a 10-year USD-denominated Nigerian government bond is currently around 11 per cent, while that of US government bonds is at 4 per cent. The high interest rate reflects, in part, the perceived lower institutional quality and therefore higher default risk of a developing country relative to an advanced economy.

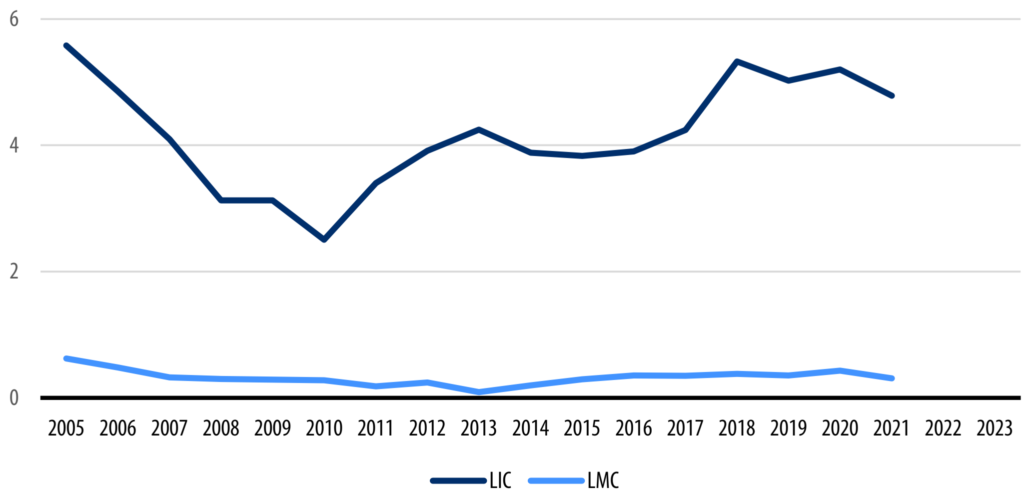
The accumulation of debt during the past decade has been accompanied by an increase in debt service problems. In LICs, delayed debt service payments (arrears) are rapidly increasing, reaching 5 per cent of GNI in 2021 (Figure 8). The cumulative shortfall in debt service payments therefore already exceeds the annual debt service burden, indicating considerable and long-standing difficulties with debt service. As of July 2023, the World Bank classifies nine developing countries as being in debt distress and about 30 more at high risk of distress.[2]

Figure 7. General government gross debt, % of GDP



Data source: IMF WEO database, April 2023.

Figure 8. Official and private arrears, % of GNI



2 The information is updated by the World Bank at Debt Sustainability Analysis (worldbank.org)

Data source: World Bank International Debt Statistics.

By historical standards, debt problems are not yet at major crisis levels. Large-scale debt crises are nothing new in the developing world. The past half a century has seen at least two major crisis episodes: one in the early 1980s and another around the turn of the century (Kose et al., 2019). In both cases, a borrowing surge was followed by defaults in many developing countries. Chuku et al. (2023) compare debt vulnerabilities in LICs today versus those during the previous major developing country debt crisis episodes. They conclude that while solvency and liquidity indicators in most LICs have steadily worsened in recent years, they remain on average markedly better today than they were during the previous crises. If current trends persist, debt vulnerabilities in LICs could reach levels comparable to the previous crises over the medium- to long-term.

Assessment of the current situation is somewhat challenged by quality issues with international debt statistics. Horn et al. (2022) find that the most widely used statistics substantially underestimate credit from China, the largest creditor country, due to the tight data disclosure restrictions China imposes on borrowers (also see IMF 2023a). Such problems may persist even though improving the quality of debt data has been high on the agenda of the main international organisations in recent years. The World Bank debt transparency reports (World Bank, 2021), and the OECD Debt Transparency Initiative (OECD, 2022) are examples of ongoing efforts to improve the consistency, comparability, scope and frequency of international debt statistics.

Debt problems may already carry a heavy human cost. Jensen (2022) shows that while the countries with debt problems may not be globally systemically important – they only account for 3 per cent of the global economy – the debt problems target the most vulnerable. He finds that one fourth of all countries are experiencing severe debt problems, and they account for half of the people living in extreme poverty.

The increasing debt service burden may be threatening social and environmental goals. Chuku et al. (2023) warn about the re-emergence of the so-called 'debt overhang syndrome', whereby the debt service burden crowds out other spending. The gap between the share of social spending and debt service as a share of GDP in LICs has been declining, suggesting that debt service payments may be crowding out social spending. More generally, significant concerns have been voiced that debt service problems are threatening the ability of many developing countries to attain their Sustainable Development Goals (Antoniades and Antonarakis, 2020; Lane and Harris, 2018).

2.3 Debt crises arise from debt-driven growth

Many drivers have been identified for the debt accumulation and problems in developing countries. Chuku et al. (2023) show that the debt build-up has been mainly driven by fiscal deficits and exchange rate depreciations. Their analysis therefore indicates that both internal and external factors may be at play. However, it leaves open the deep 'root causes' of the developing country debt dynamic.

Various negative internal and external shocks have been implicated. These include changes in commodity prices, natural disasters, epidemics and civil conflict (IMF, 2022; Zhang, 2018). Developing countries with poorly diversified economies are especially vulnerable to such shocks. Debt problems may also be associated with poor fiscal management. Robust empirical evidence about the drivers of developing country debt is hard to come by. In much of the empirical work (see Mijiyawa, 2022 for a recent survey) study designs are a challenge and the results are therefore often weak.

Economic theory suggests that debt crises may be symptomatic of a trade-off between debt-driven growth and debt crises. As a financial instrument, debt is by nature 'information insensitive': relative to other forms of financing, a debt contract between a developing country and international investors does not require that the investors know very much about the country. Information insensitivity is achieved by various means, such as by the use of collateral and by setting the interest rate high enough so that the returns from debt during normal times are expected to safely cover losses during crisis events. Information insensitivity makes debt an ideal instrument to finance economic growth during normal times. At the same time, however, debt accumulation increases the risk of systemic debt crises, where all creditors are at risk at the same time (Holmström, 2015 and 2022).[3]

2.4 Resolution of debt crises builds on conditionality

The resolution of debt crises is achieved via sometimes arduous negotiations between debtors and creditors. In the 1980s, many developing countries, especially in Latin America, had large credits from international commercial banks, which they were unable to service. The negotiations initially resulted in relatively minor adjustments in the debt servicing burden, and so the debt servicing problems persisted.

3 Herrala (2003) makes the theoretical argument that in a competitive setting (such as the global financial market), there is a tendency for debtors to overlook the possibility of crises. The reason is that, when a crisis occurs, the loss is in part borne by the creditor.

By the 1990s it had become increasingly clear that substantial concessions from creditors would be required to achieve debt sustainability in highly indebted developing countries. Crisis resolution built on the so-called Brady Plan, which traded off significant concessions from the creditors with economic reform in debtor countries. The IMF played a crucial role as the lender-of-last-resort of the defaulted governments, which oversaw that the reform plans were implemented (Weeks-Brown and Muhleisen, 2019).

The lessons from the Latin American debt crisis contributed to the Highly Indebted Poor Countries Initiative (HIPC Initiative), which the IMF and the World Bank launched in 1996. The objective of the still-ongoing initiative is to reduce the debt burdens of highly indebted developing countries to sustainable levels. Participation in the HIPC initiative is conditional on demonstrated commitment by the debtor country to economic reform, which is mainly overseen by the IMF.

Many highly indebted developing countries have benefited from the HICP Initiative. Mainly due to the concessions given to HICP countries under the Initiative, external debt in LICs fell considerably around the turn of the century (Adelegan and Radzewicz-Bak, 2009; Fig. 1). By the end of 2022, 36 developing countries had achieved eligibility for the HIPC Initiative.

Other debt relief schemes supplement the HIPC Initiative. In 2005, the IMF, the International Development Association (IDA) and the African Development Fund (ADF) decided to furthermore grant full (100 per cent) debt relief for all countries that are eligible under the HIPC Initiative, as well as the poorest countries that do not qualify under the initiative. This supplemental relief is called the Multilateral Debt Relief Initiative (MDRI). During the COVID crisis (2020–2021), the Bretton Woods institutions and various sovereign creditors suspended debt service requirements altogether for 48 developing countries under the Debt Service Suspension Initiative (DSSI).

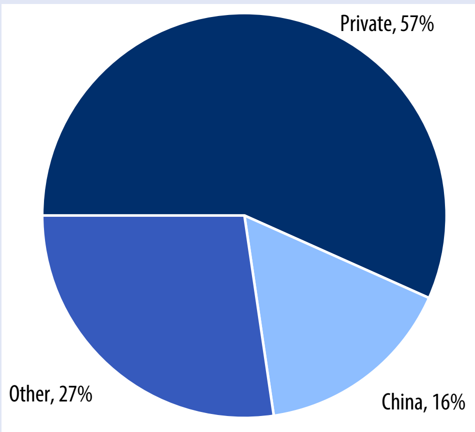
Debt relief builds on the voluntary participation of creditors, and the HICP Initiative is no exception. Based on experience (IMF, 2019) the multilateral creditors (the IMF, the World Bank, development banks and regional development funds) as well as Paris Club creditors (22 governments) have mainly fully participated in debt relief. However, private creditors and non-Paris Club public creditors such as China have not always been willing to contribute similarly.

The increasing share of external creditors that are not willing to cooperate under the HICP Initiative has generated the need to further develop the global debt resolution framework. To this end, the G20 Common Framework (CF) was introduced in 2020 to improve creditor coordination in debt relief.

Under the CF, the Paris Club creditors and other significant sovereign creditors agree to debt relief conditional on equal treatment by other creditors, such as private creditors. The common framework leaves it up to the debtor countries to negotiate equal treatment (Rivetti, 2022). Achieving creditor coordination has been a difficult challenge for debt-distressed developing countries under the G20 Common Framework. In 2023, Zambia became the first developing country to reach agreement with its creditors about significant debt relief (Box 2).

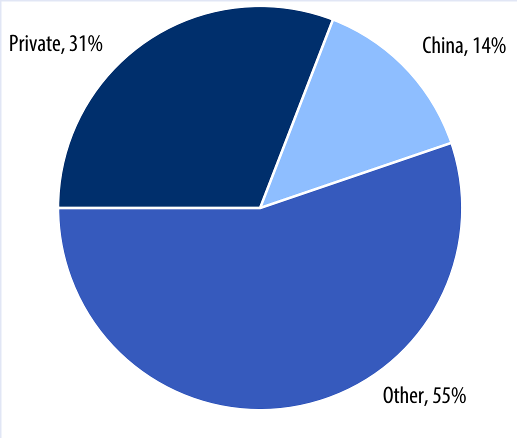
BOX 2 Debt distress in Zimbabwe and Zambia

Figure 9. Creditor structure of Zambia, %



Notes: Possible overlap between private credit and credit from China ignored.
Data source: World Bank International Debt Statistics.

Figure 10. Creditor structure of Zimbabwe, %



Notes: Possible overlap between private credit and credit from China ignored.
Data source: World Bank International Debt Statistics.

Zambia and Zimbabwe have both been in debt distress during recent years (Annex 1). Zambia defaulted around 2020 on its Eurobonds. Zimbabwe's debt distress originates from uncleared arrears that date back to the turn of the millennium. Both countries have significant debts from China and private creditors (Figures 9 and 10). This box details some of the experience of these countries based on expert interviews conducted in August 2023.

Based on an interview with a Zimbabwean expert, the country has turned to creditors from Asia to avoid the conditionality attached to Western credit. Notably, China has granted many resource-backed loans to Zimbabwe under non-transparent conditions. The expert suspects that Zimbabwe's debt problems have to do with corruption in government circles: "envelopes changing hands under the table". In the past, a specialised government unit disclosed suspicious activities, but the government did not show much interest in following up with further investigations. The expert did not see signs that the government would be ready to submit to the disciplining conditions of Western finance. He was cautiously optimistic that geopolitical tensions (the competing interest of East and West) would allow Zimbabwe to somehow navigate under its debt distressed condition.

Developments in Zambia offer hope for debt resolution. On June 2023, Zambia became the first country to reach agreement with creditors about debt restructuring under the Common Framework (IMF 2023b). The agreement, and the Zambian government's strong performance in economic reform, have paved the way for funding from the IMF. In its reform efforts, Zambia benefits from an expert governance and anti-corruption assessment (IMF 2023c).

Based on interviews with experts, Zambia's debt problems arose from a combination of partly good-faith efforts by local politicians to build important infrastructure such as airports and railways, and ample credit supply from international private creditors and China. Zambia was an early defaulter under the CF, and the debt restructuring negotiations have been difficult. One expert expressed the hope that Zambia's efforts and the subsequent success with creditors paves the way for other countries to also achieve positive outcomes. In their view, important lessons from the Zambian experience under the CF framework include the importance of demonstrated economic reform, and transparency towards all creditors. Solid outside advice is also a key contributor to success. To achieve a lasting long-term solution to debt problems, the informants emphasised the need for transparency about debt levels and conditionality to fiscal prudence.

3 The debate on private debt

A distinctive characteristic of the ongoing build-up of developing countries' debt problems is the role played by the private sector. Private sector involvement is notable on both the creditor and the debtor side. Below, these phenomena are discussed in turn.

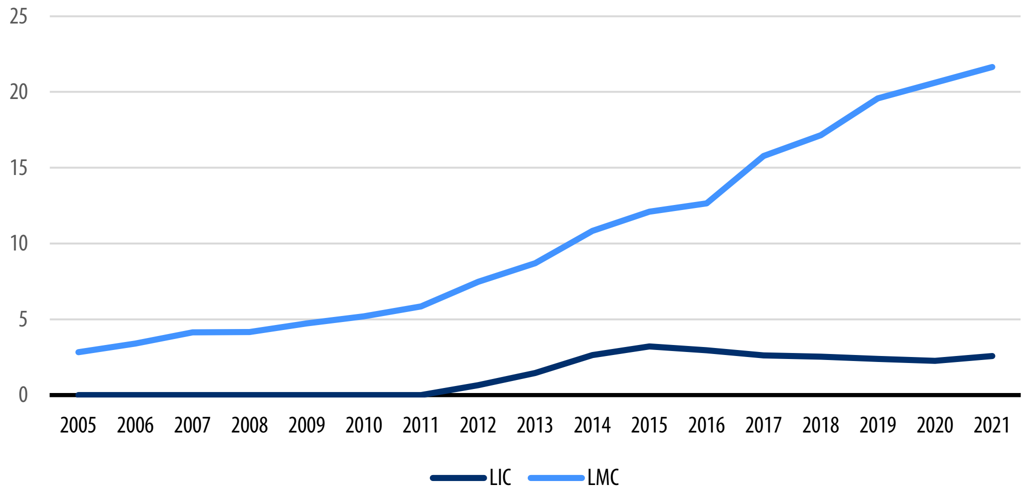
3.1 The rapid rise of private creditors

The past decade has seen a marked increase in lending from private creditors to low-income countries. In 2005–2021, the share of private creditors of external debt more than doubled, reaching 30 per cent in LICs and almost 50 per cent in LCMs (Figure 3). The willingness of international private creditors to lend to developing countries is a positive signal of institutional strength in these countries.

The interest among private creditors of developing countries has been driven by many factors. The returns on financial investments in advanced economies were remarkably low for over a decade, prompting private investors to seek alternative sources of revenue from the developing world. Development efforts by governments in developing countries had strengthened macroeconomic policies and the financial architecture in many developing countries, thereby boosting investor confidence (World Bank, 2004).

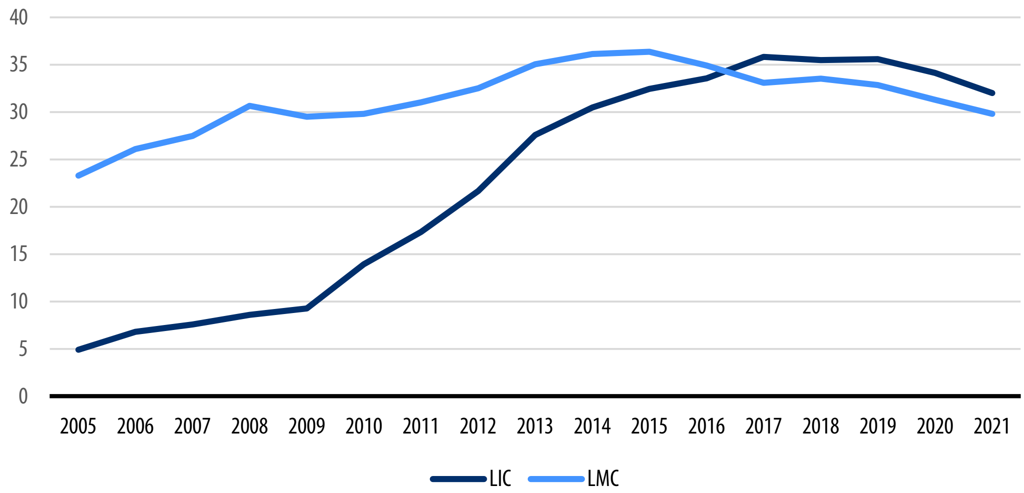
Private financial flows to developing countries are usually intermediated by large global banks. Two main types of debt instruments are widely in use in channelling credit, namely bank loans and bonds. In principle, the main difference between the two is that loans tend to be tailored to the specific needs and circumstances of the creditors and the borrower, while bonds are more 'one size fits all' instruments that can be resold on markets to any creditor. Loans can be used in a wider and more challenging set of circumstances than bonds, but they require more effort from the creditor.

Figure 11. Share of bonds, % of external debt



Data source: World Bank International Debt Statistics.

Figure 12. Share of commercial bank loans, % of external debt



Data source: World Bank International Debt Statistics.

Many developing countries issued bonds during the past decade. In 2021, the share of bonds in external debt was about 3 per cent in LICs and 22 per cent in LMCs (Figure 11). In 2004–2018, close to 100 developing countries issued more than 750 Eurobonds (van der Wansem et al., 2019). The average number of issuing countries was around 60 per year, and the average issue size was around USD 1 billion, reaching a cumulative funding volume of USD 760 billion over that period.

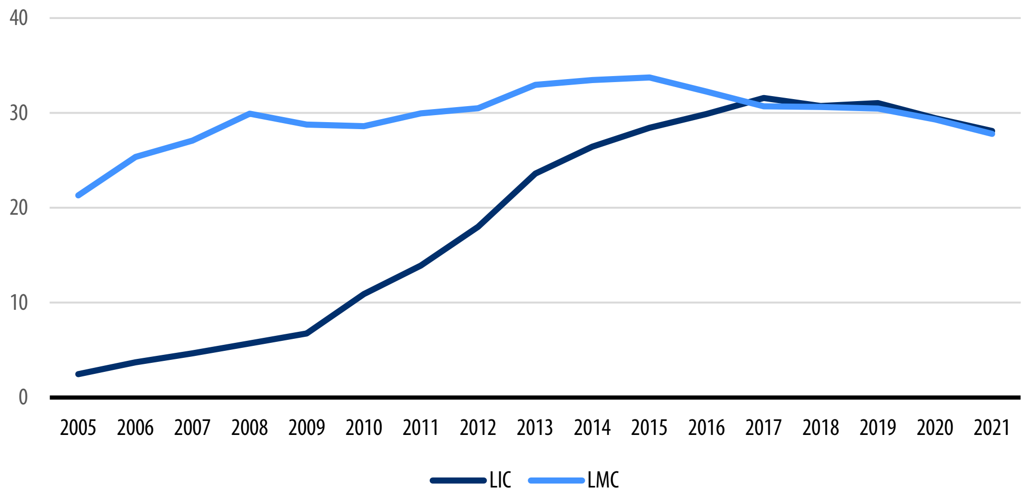
'Eurobond' is a generic term that refers to bonds issued in some other currency than the debtor's home currency. Bond financing for developing countries from the international markets is predominantly in USD-denominated Eurobonds, which in 2021 was used in two-thirds of emerging economy Public and Publicly Guaranteed (PPG) bonds. To issue a Eurobond, a developing country borrower would typically approach a large international bank, which distributes the bond possibly via other banks for issue at financial centres around the world. Part of the deal may be that the lead bank commits to underwrite the residual amount of issue that is not sold on the market, thereby guaranteeing to the borrower that the whole issue is sold.

Loans come in many flavours. While bank loans are still more used than bonds as an instrument of debt financing for developing economies, their share is declining (Figure 12). It is more difficult to try to summarise developments in bank lending than on the bond markets, given the diversity of the loan instrument. In development finance, loan syndication is often used, which means that the loan is extended to the borrower by multiple lenders (Lee et al., 2016). Often the interest rate of such loans is floating, meaning that it is tied to some benchmark interest rate, such as the LIBOR rate. In the last decade, there has been significant interest in so-called resource-backed loans where, one way or another, the debtor country pledges income from its natural resources (such as oil) as collateral for the loan (Estevao et al., 2022).

3.2 Private debtors in complex environments

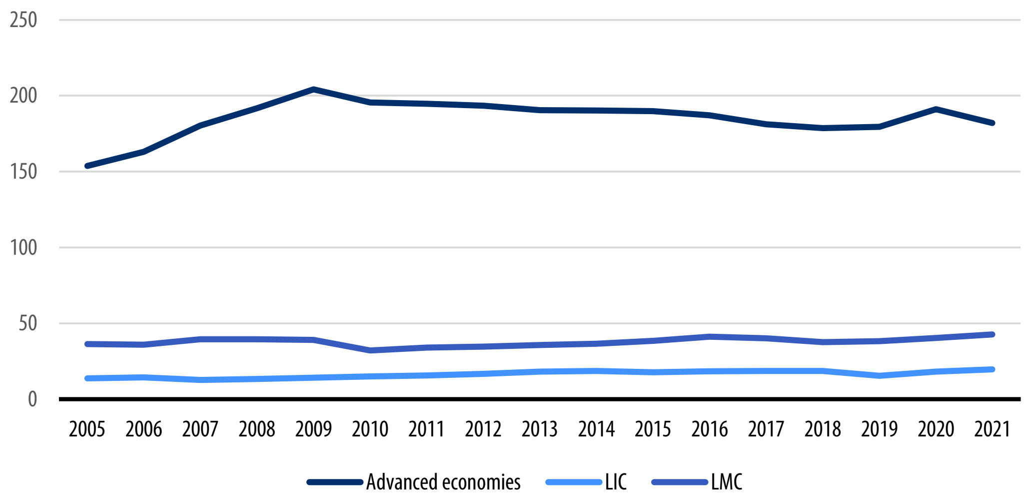
Private debtors are responsible for almost a third of external debt in developing countries (Figure 13). The share of private debtors in total external debt increased rapidly during the past decade. Private firms predominantly borrow from international creditors by taking loans from international banks. While some developing country firms issue Eurobonds, the volume of such issues is small.

Figure 13. Share of private debtors, % of external debt



Data source: World Bank International Debt Statistics.

Figure 14. Debt of private debtors, % of GDP



Data source: IMF Global Debt Database.

In LIC and LMC countries, the debt of private debtors to GDP ratios have been increasing during the past decade, but still remain at very low levels relative to advanced economies (Figure 14). Debt from international creditors is an important funding source for private debtors in developing countries. In 2021, it covered approximately three quarters of the total debt of private debtors in LICs. The high share of international creditors reflects the underdevelopment of financial systems in LIC.

The financial systems of developing countries tend to be undeveloped, both from legal and institutional perspectives. Access to loans from domestic financial institutions may be uneven so that some firms have priority access, while others may lack access to financial services altogether (Demirgüc-Kunt et al., 2008). Domestic financial markets may be non-existent or undeveloped, making it difficult for firms to tap financial markets domestically. Bankruptcy regulations may be undeveloped, making it hard for creditors to deal with debtor default. Priority lending by financial institutions and weak bankruptcy laws may contribute to the significant presence of "zombie firms" with extensive debt levels (OECD, 2017). Foreign borrowing and access of foreign financial institutions to the local markets may be restricted by current account restrictions (Herrala, 2020).

While access to international financial markets is important for firms in LICs, granting unrestricted access to global financial markets is not a risk-free proposition. Previously, capital account liberalisation was promoted as desirable for economic development. Building on lessons learnt from emerging market debt crises, views on this matter have recently become more nuanced. At present, the prevailing view is that capital account liberalisation should be preceded by a strengthening of macro-financial institutions, such as banking supervision and the central bank. In the absence of capital controls, a strong institutional base is needed to maintain macroeconomic stability against shifting conditions on the global financial markets (Adrian et al., 2022).

International financial institutions assist countries in developing their financial systems (IFC, 2021; Bossu et al., 2020). Many IFIs channel part of their development finance directly to the private sector. For example, the International Financial Corporation (IFC), a member of the World Bank group, is specialised in private sector financing. Much of its financing goes to banks in developing countries, which channel it further to firms based on agreed principles. Through banks, international financial institutions can in principle even reach small firms in the developing world. The IFC also engages directly with larger firms in developing countries.

4 Expert views from Africa

4.1 The survey

The views of African experts on ongoing debt problems were investigated by an online survey of 15 questions (Annex 2). It was targeted at experts of African economies and the financial system. The link to the survey was sent to all members of the African Finance and Economic Association (AFEA) and the African Economic Research Consortium (AERC) by email and LinkedIn from 8 to 24 July 2023. In total, 42 experts responded, representing 18 SSA countries (Table 1). Most of the 18 countries are either in debt distress or at high risk of distress, based on the latest World Bank DSA ranking (Annex 1). Most survey participants are economists, work for the government, and are in researcher or expert positions (Table 2).

Table 1. Participants by country

DSA rank	Country	Nr
In distress	Democratic Republic of the Congo	2
In distress	Malawi	1
In distress	Zambia	2
In distress	Zimbabwe	2
High risk	Comoros	1
High risk	Ethiopia	2
High risk	Ghana	4
High risk	Kenya	1
High risk	South Sudan	1
Moderate risk	Benin	1
Moderate risk	Côte d'Ivoire	3
Moderate risk	Guinea	1
Moderate risk	Lesotho	1
Moderate risk	Rwanda	1
Moderate risk	Senegal	1
Moderate risk	Uganda	2
Other	Nigeria	16

DSA rank	Country	Nr
Total number of survey participants	-	**42**

Notes: The table shows the number of participants in the survey by the country they responded for.
Source: Survey question 4.

Table 2. Participants by profession, sector and position

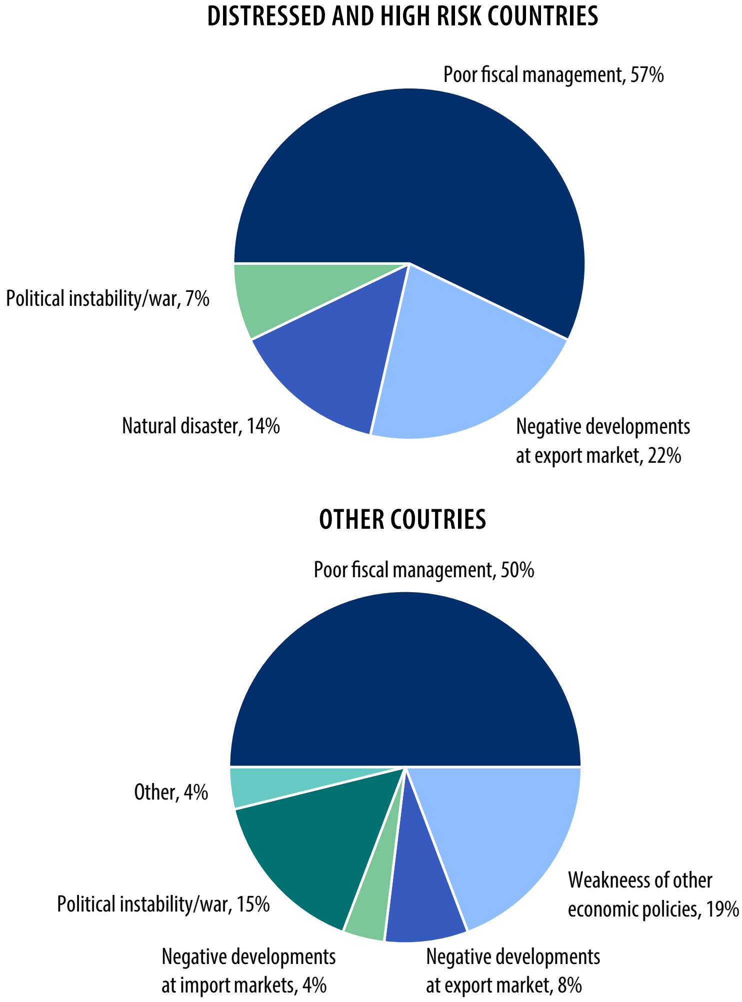
Profession	No.	Sector	No.	Position	No.
Banker or central banker	5	Government	23	Manager or executive	10
Capital market operator	1	University	2	Researcher or expert	27
Economist	30	Financial sector	4	Other	5
Asset manager	1	Other	13		
Corporate finance professional	1				
Professor	1				
Researcher	1				
PR consultant	1				
Other	1				

Notes: The table shows the number of participants in the survey by profession, sector and position.
Source: Survey questions 1 and 2.

4.2 Reasons for the debt crisis

Poor fiscal management stands out as the primary reason for debt problems. The survey participants were asked to rank a list of eight possible reasons for the country's debt problems. Poor fiscal management was selected as the primary reason by 57 per cent of respondents in countries that were in distress or at high risk of distress, and by 50 per cent of respondents in other countries (Figure 15). Negative developments on the export markets, and political instability/war also ranked highly in both country groups as the primary reason. In the group of distressed and high-risk countries, natural disasters were ranked as the primary reason in 7 per cent of the cases (one respondent).

Figure 15. Primary reasons for debt problems



Notes: The numbers are in %.
Data source: Survey question 5.

The respondents were asked to not only take a stand on the primary reason, but also rank the reasons from the most important to the least important (Figure 16). We used the responses to construct an overall ranking of reasons for the debt crisis, where the primary reason gets the highest weight, the second most important reason a somewhat lesser weight, and so on (the weight diminishes with rank). The resulting overall ranking of reasons for debt problems are:

(1) poor fiscal management
(2) weakness of other policies

(3) negative shocks on the export market
(4) negative shocks on the import market
(5) natural disasters
(6) tightening conditions on the international financial markets
(7) political instability/war

Corruption contributes to debt problems. The respondents also had the possibility to give other reasons for the debt problems in the countries they represented. In the elaborations, corruption was mentioned by nine respondents (21 per cent of responses). The issue of mismanagement, including in state-owned enterprises, and weak institutions also came up in many responses.

Figure 16. Other causes of debt problems

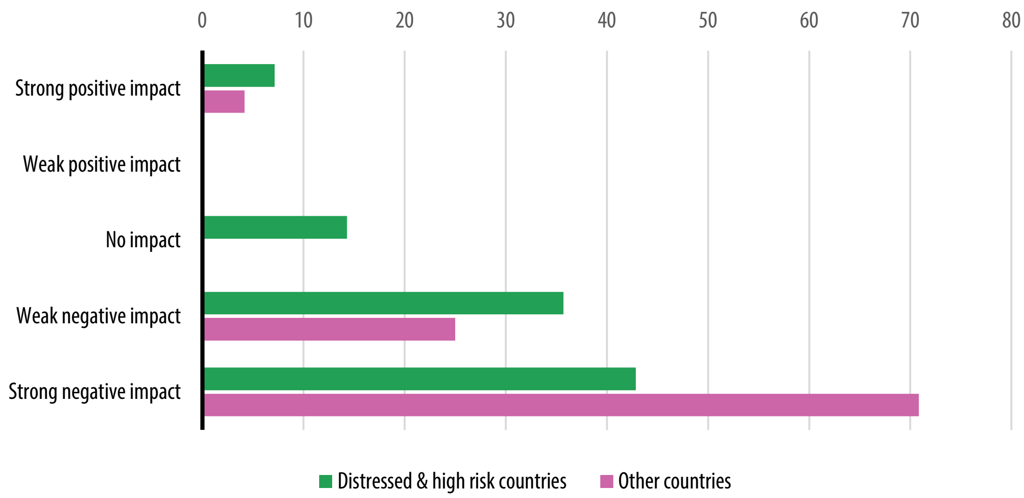
Notes: The Fig. shows the textual analysis of other reasons for debt problems using Wordcloud, with some respondents giving multiple reasons.
Source: Survey question 6.

4.3 Effects of the debt crisis

Debt problems negatively affect firms. The respondents were asked about their views on how the debt problems were affecting private firms in the country they were responding for. The responses are heavily skewed towards a negative impact (Figure 17). In countries that are in debt distress or in high risk of distress, the responses were almost evenly divided between strong and weak negative impact. As regards the other countries, the balance is overwhelmingly skewed towards strong negative impact. We interpret that the latter result reflects the respondents' views on what would happen if their country ended up in debt distress.

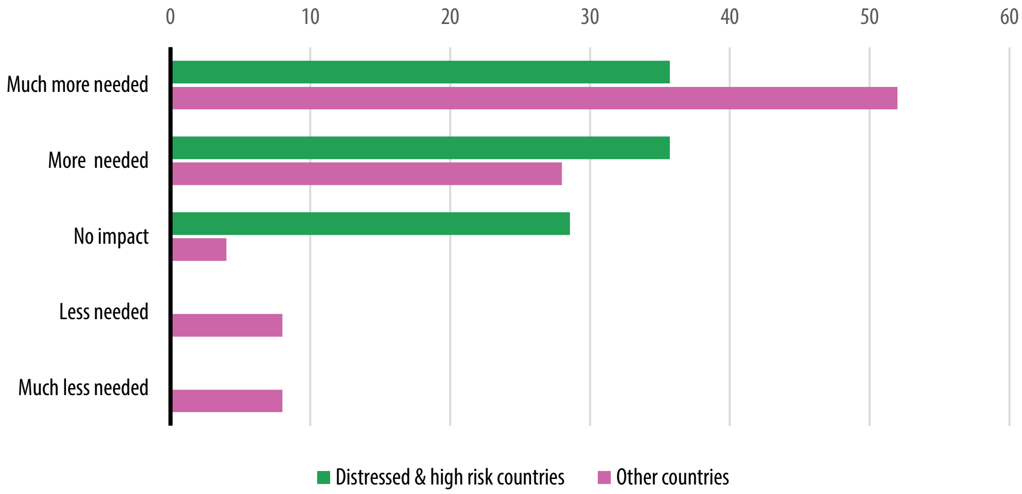
Debt problems impact private firms via many channels. The respondents were asked to elaborate on the channels of impact of debt problems on private firms. Five respondents indicated crowding out effects, for example that the low level of forex reserves makes it impossible for firms to import machinery. The negative effects on firms of high tax rates and fiscal austerity were mentioned by many respondents. An increase in economic uncertainty was also mentioned by some respondents.

Figure 17. Effects of debt problems on private firms



Notes: Horizontal axis in percentages.
Data source: Survey question 7.

Figure 18. Effects of debt problems on need for development aid



Notes: Horizontal axis in percentages.
Data source: Survey question 11.

Debt problems increase the need for development aid. The respondents were asked about whether debt problems contribute to an increase or decrease in the need for development aid. The balance of opinions was heavily skewed towards the need for more development aid (Figure 18). The result holds among experts of distressed and high-risk countries, and other countries. The respondents were asked to elaborate on their response. Many of them pointed out that debt problems result in fiscal austerity, thereby adversely impacting fiscal transfers to the needy.

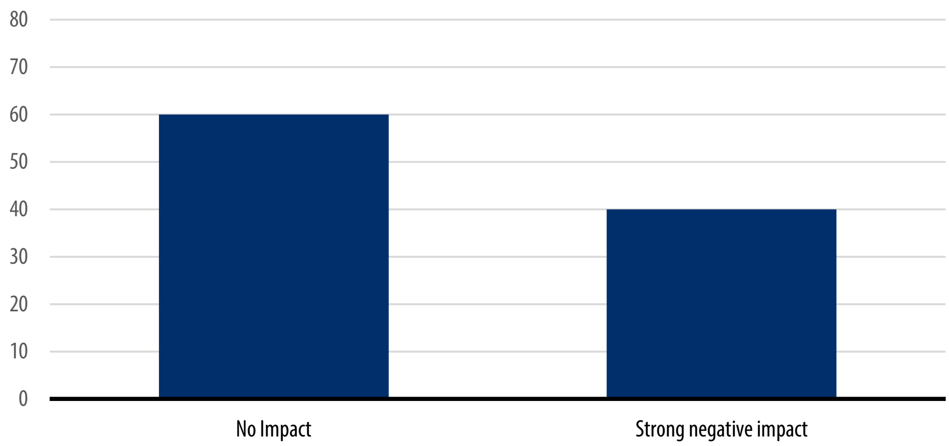
4.4 The debt resolution process

The impact of private creditors on debt resolution is negative in countries where private creditors hold a significant share of external debt. Among the experts of countries that are in distress, three out of five indicate that the presence of private creditors does not impact resolution, while two indicate a strong negative impact. The responses show strong consistency within countries, which may explain the mixed views (Figure 19). The two negative responses refer to the case of Zambia, where private creditors account for almost a third of all external debt (Figure 9).[4]

4 The responses from Zimbabwe were lost due to a technical issue.

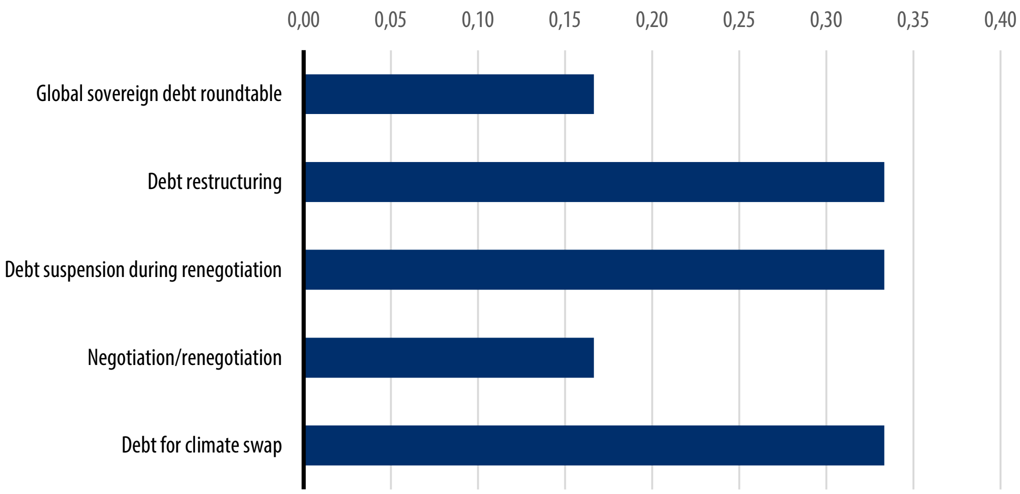
The two respondents from Zambia elaborate that it is hard to coordinate between the many private creditors, and that most of the time private creditors are not willing to restructure debt. The three responses indicating null effect are from Malawi and Congo, where private debt is shown as missing in the debt statistics, possibly indicating that it is at a very low level and therefore not relevant for the resolution process. This interpretation is further supported by the elaboration of the three experts about their response.

Figure 19. Impact of private creditors on debt resolution in distressed countries



Notes: Horizontal axis in percentages.
Data source: Survey question 9.

Figure 20. Options for crisis resolution



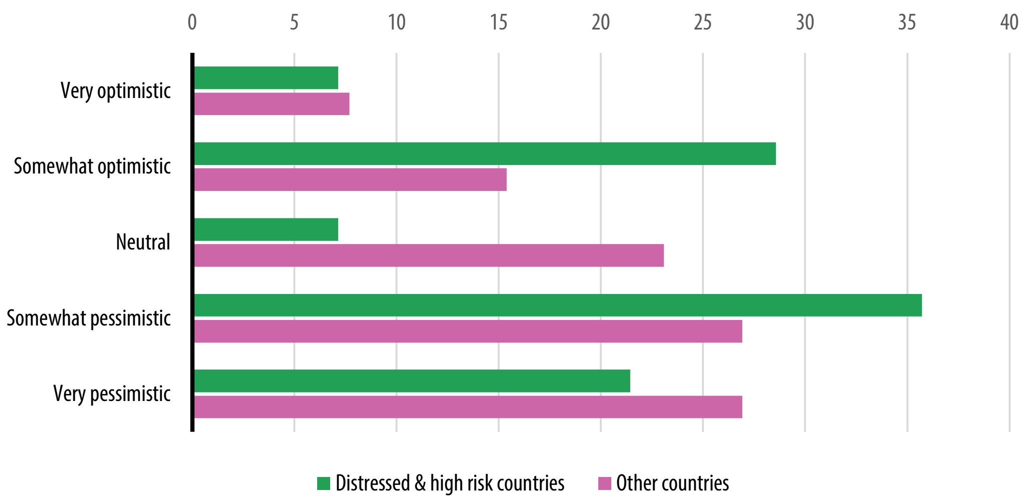
Notes: Horizontal axis in percentages. The Fig. summarises answers from countries that are in distress.
Data source: Survey question 13.

Experts from distressed countries have mixed views on available resolution options. The respondents were asked to select from a list of five resolution options (Figure 20). Two of the six respondents from the four distressed countries selected the debt for climate swap, debt suspension during renegotiation, and debt restructuring as valid options. One selected negotiation/renegotiation and a global sovereign debt roundtable as an option. We interpret that the mixed views on debt resolution reflect a lack of universally applicable options to resolve debt problems. This interpretation is further strengthened by their lack of elaboration on resolution options.

4.5 The long-term outlook

The experts were asked to express their degree of optimism that debt crises can be avoided in the forthcoming decades. Overall, the balance of responses is on the pessimistic side (Figure 21). In the group of experts of distressed and high-risk countries, the most common attitude is 'very pessimistic', while among the other countries 'somewhat pessimistic' is the most common view. However, some respondents do also express optimism, even strong optimism, about the future. When asked to elaborate on their answer, many respondents point to corruption and, more generally, poor governance as contributing to their pessimism. The optimists point to the potential of African countries to achieve development and strong finances with the help of well-considered policies.

Figure 21. Degree of optimism that debt problems can be avoided in future decades



Notes: Horizontal axis in percentages.
Data source: Survey question 14.

5 Concluding remarks

While problems with debt servicing are becoming more common and the situation is critical for some developing countries, the scale of debt problems is not yet very large by historical standards. Given recent historical experiences, the current debt accumulation is characterised by the high share of private debt and the prominence of China as the main creditor country. Sub-Saharan Africa is a geographic focal point, as many countries in the region are experiencing debt problems.

The survey of experts from Sub-Saharan Africa therefore offers a valuable perspective on the debate. The experts shed light on the reasons for the debt problems in SSA countries, their impact, and problem resolution. They project the long-term outlook for debt problems in the SSA region. While the survey shows a variety of views, it also reveals agreement on key issues. Many experts in the region view the debt problems as emerging from ill-advised policies driven, in part, by corruption. This suggests that any long-term resolution should involve institutional development to root out corruption, thereby promoting better policies.

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Annex 1. Debt distress in SSA

Country	Risk of external debt distress	Risk of overall debt distress
Malawi	In distress	In distress
Mozambique	In distress	In distress
Zambia	In distress	In distress
Zimbabwe	In distress	In distress
Burundi	High	High
Cameroon	High	High
Central African Republic	High	High
Chad	High	High
Comoros	High	High
Ethiopia	High	High
Ghana	High	High
Guinea-Bissau	High	High
Kenya	High	High
Sierra Leone	High	High
South Sudan	High	High
Benin	Moderate	Moderate
Cabo Verde	Moderate	High
Côte d'Ivoire	Moderate	Moderate
Guinea	Moderate	Moderate
Lesotho	Moderate	Moderate
Liberia	Moderate	High
Madagascar	Moderate	Moderate
Mali	Moderate	Moderate
Niger	Moderate	Moderate
Rwanda	Moderate	Moderate
Senegal	Moderate	Moderate
Tanzania	Moderate	Moderate

Togo	Moderate	High
Uganda	Moderate	Moderate

Data source: World Bank Debt & Fiscal Risks toolkit
Debt Sustainability Analysis (worldbank.org).

Annex 2 The survey

1. What is your profession?
2. Which institution do you work for?
3. What is your position?
4. Which SSA country are you answering for?
5. We are interested in your views about the underlying causes of the country's debt problems. Please rank the following causes from the most important=1 to the least important=7. Use each number only once: Poor Fiscal Management/Weakness of Other Economic Policies/Political instability,war/ Natural disaster (pandemic, drought,..)/Negative development at the country's export market (such as fall in export prices)/Negative development at the country's import market (such as fall in import prices)/Tightening conditions at the international credit markets/Other
6. Write down other underlying causes of the country's debt problems.
7. Do the country's debt problems significantly impact private firms?
8. Please elaborate on why you think so.
9. Has the presence of private creditors impacted the debt restructuring process?
10. Please elaborate on why you think so.
11. How do debt problems impact the country's need for development aid?
12. Please elaborate on why you think so.
13. What are the different options to reduce the debt crisis?
14. How optimistic are you that similar debt problems can be avoided during the upcoming decades?
15. Please elaborate on why you think so.

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