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Debt Dilemmas in Sub-Saharan Africa: Some Principles and Trade-offs in Debt Restructuring

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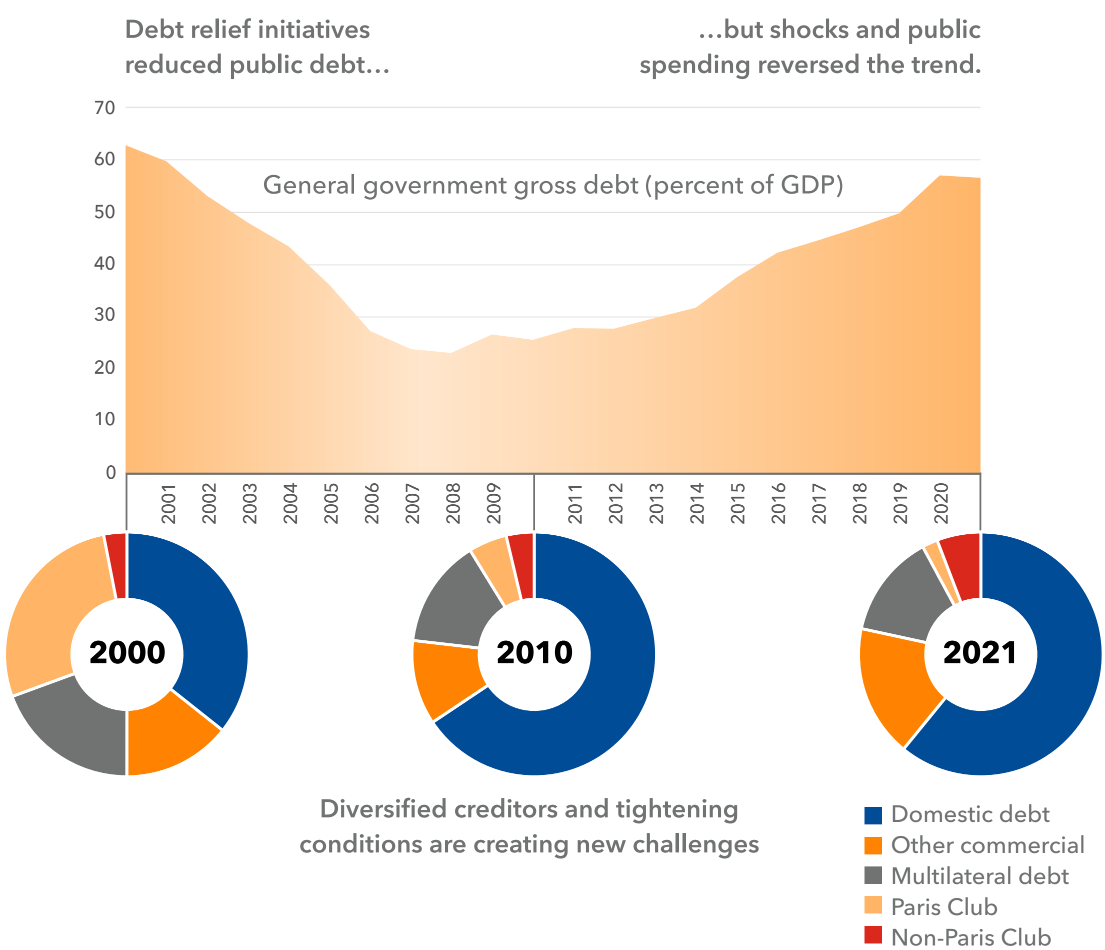
Debt Dilemmas in Sub-Saharan Africa: Some Principles and Trade-Offs in Debt Restructuring

Public debt in sub-Saharan Africa increased significantly over the last decade. Countries' fiscal and public investment plans to meet development needs, fiscal slippages, and a series of shocks including the COVID-19 pandemic, climate-related events and natural disasters, and high international prices for food, fuel, and fertilizers after Russia's invasion of Ukraine, all led to rising debt. More recently, market financing for many sub-Saharan African countries has dried up or become very expensive as advanced economies have raised interest rates to fight inflation and international investors grew more risk averse. Official financing flows are also trending downward relative to country economic size and financing needs. Scope to roll over maturing debt has reduced sharply, forcing countries to make difficult policy choices. In this context possible debt restructuring has come into focus for some countries managing debt vulnerabilities and risks to debt sustainability. This note describes the rise in debt and its changing features and explains the challenges and trade-offs in embarking on debt restructuring.

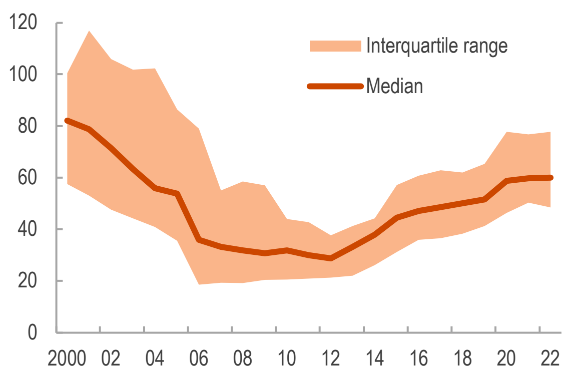
The changing landscape of sub-Saharan African debt:



A decade of rising public debt in sub-Saharan Africa

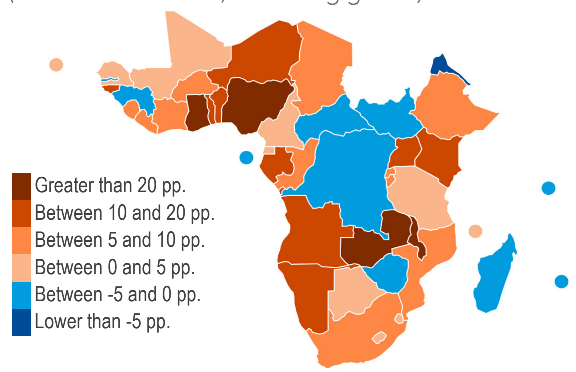
Public debt ratios have increased in sub-Saharan Africa. From 2012 to 2022 the median public debt to GDP ratio increased by about 30 percentage points, from 28.8 percent of GDP to 59.1 percent (Figure 1). This increase followed a decade of sharp decline attributable to the Heavily Indebted Poor Countries (HIPC) debt relief initiative and the Multilateral Debt Relief Initiative. The increase in debt ratios has been widespread, occurring in all but four countries of the region, although the pace has varied widely: six countries experienced an increase from 1 to 20 percentage points, 29 had an increase between 20 and 50 percentage points, and the ratio rose by more than 50 percentage points in five countries. The interest burden on public debt also increased, reducing resources available to finance development needs, from a median of 4.6 percent of government revenues (excluding grants) at the end of 2012 to 10.4 percent at the end of 2022. The share of government revenues (excluding grants) spent on paying interest increased in 34 sub-Saharan African countries during the period, and this increase was greater than 10 percentage points in 13 countries (Figure 2).

Figure 1. Public Debt Ratio
(Percent of GDP)



Sources: IMF, World Economic Outlook database; IMF staff calculations.

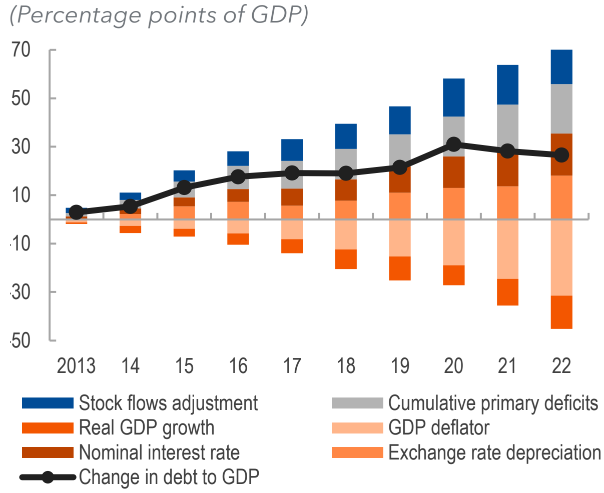
Figure 2. Change in Interest Payments on Public Debt, 2012–22
(Percent of revenue, excluding grants)



Sources: IMF, World Economic Outlook database; and IMF staff calculations.
Note: pp = percentage points.

The rise in public debt was driven mainly by fiscal deficits (before interest payments) and the impact of exchange rate depreciations. Economic growth has helped alleviate debt pressures (Figure 3), while adjustments to stock of debt recognized have raised debt, and point to the importance of comprehensive, transparent debt data Both public debt ratios and external public debt service remain below the levels they reached in the late 1990s before HIPC and the Multilateral Debt Relief Initiative (Chuku Chuku and others, 2023 discuss the situation in low-income countries). Nonetheless, they have attained levels that pose risks to debt sustainability in several countries (Figure 4) generating debate about potential debt restructuring. Concessional financing from official sector partners in relation to economic size and financing needs has also been in a longer-term decline. International financial conditions have tightened recently, with market financing for many sub-Saharan African countries drying up or becoming very expensive, increasing rollover risks as debt matures and forcing

Figure 3. Cumulative Contribution to Public Debt Accumulation
(Percentage points of GDP)

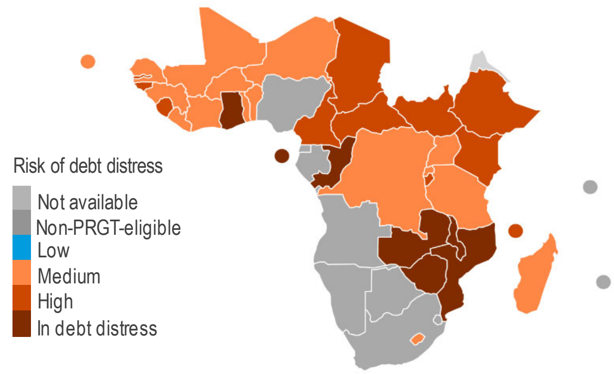


Sources: IMF, World Economic Outlook database; and IMF staff calculations.

countries to make difficult policy choices to remain current on debt payments (see April 2023, *Regional Economic Outlook: Sub-Saharan Africa*).

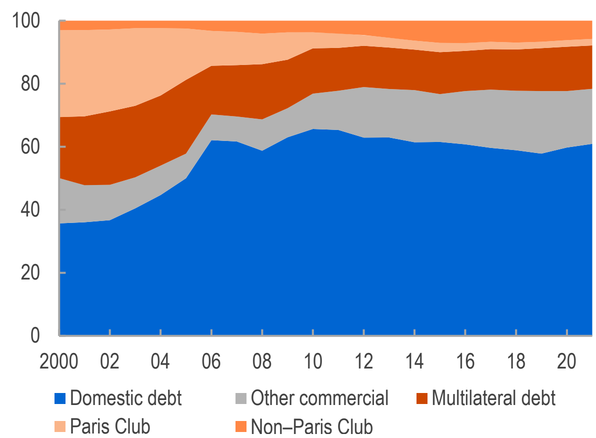
The region's creditors have also changed over time, bringing advantages, but also introducing some new complexities to potential restructuring. The shares of domestic debt and commercial debt in the total for sub- Saharan African countries have increased since the early 2000s, increasing the number and types of investors on which countries can draw, while the share of bilateral and multilateral debt has shrunk from 50.0 percent in 2000 to 21.6 percent in 2021 (Figure 5). Domestic and commercial debt are on non- concessional terms and therefore have higher interest rates, shorter maturities, and more uncertain rollover. They also typically involve a larger number of creditors, which increases the difficulty of negotiations. The composition of external creditors has also changed over the period, moving from traditional official bilateral creditors ("Paris Club" members) and multilateral creditors to nontraditional official bilateral and commercial creditors (such as Eurobond investors). Other developments have increased the complexity of potential restructurings. Although the lack of data makes it hard to quantify collateralized and syndicated debt, their use has risen in recent years, particularly where risks are high. Collateralization secures the repayment of the debt by giving creditors rights over specific assets or revenue streams if the borrower defaults, providing a de facto "senior" claim to those creditors versus others and reinforcing diverging incentives among creditors. More generally, a lack of transparency in debt data is an obstacle to trust and coordination among creditors during debt restructurings (IMF 2023). In this context, growing attention to debt vulnerabilities in sub-Saharan African countries—and efforts to tackle them—has highlighted possible debt restructuring.

Figure 4. Debt Sustainability Analysis for Countries Eligible for Poverty Reduction and Growth Trust



Source: IMF staff elaborations; as of May 31, 2023.
Note: PRGT = Poverty Reduction and Growth Trust.

Figure 5. Public Debt Composition
(Percent)



Sources: IMF, World Economic Outlook database; World Bank *International Debt Statistics*; and IMF staff calculations.

The debt restructuring process

In a debt restructuring, the terms of sovereign debt contracts are changed to make paying debt service manageable. The process involves the debtor country and its creditors agreeing on new terms that allow the debtor to resume normal economic activity, including new borrowing, while creditors will seek to achieve this at the lowest reasonable loss in the value of their claim. Agreed changes typically involve combinations of lengthening maturities, adding grace periods, reducing the principal amount of the debt, reducing the interest rate, or suspending debt service. Voluntary exchanges or rollover of debt instruments on market terms—liability management operations—are also used to optimize the cost and maturity profile of debt and are not considered as restructuring operations. Creditors will usually agree to debt restructuring when accepting some loss improves the debtor country's economic prospects and enables a resumption of debt service at the new terms thus increasing the overall value of their claim compared with not being paid for a long period, or perhaps at all. Some examples of debt restructuring experiences in sub-Saharan Africa are shown in Box 1.

Box 1. Debt Restructuring in Sub-Saharan Africa: Some Recent Cases

Country	Dates	Perimeter	Process
Chad	Launched January 2021 Agreement reached November 2022	External Debt	Chad's public debt, at 56 percent of GDP in 2021, became unsustainable following the COVID-19 pandemic, volatility in oil prices, heightened insecurity, and a food crisis. Chad was the first country to reach an agreement with its creditors under the G20 Common Framework. • Creditors committed to reconvene and provide a debt treatment, including for 2025-28, if necessary. • A large private creditor agreed to reprofile part of the debt service due in 2024. Official creditors will contribute if this is not sufficient to bring the debt service to revenue ratio below 14 percent in 2024.
Ghana	Launched December 2022, ongoing	Domestic and External Debt	A large fiscal expansion in response to the COVID-19 crisis put Ghana's public debt on an unsustainable trajectory, with the debt-to-GDP ratio reaching almost 90 percent of GDP at the end of 2022 and interest payments representing almost half of government revenue. An IMF program was requested in July 2022 and debt restructuring announced in December. • Domestic debt (48 percent of GDP at the end of 2022) was restructured through voluntary exchange (creditors were offered a menu of new instruments with longer maturities) and was completed by most financial institutions in February 2023. • External debt (40 percent of GDP at the end of 2022): Ghana applied to the Common Framework and official creditors formed a creditor committee in April 2023, providing financing assurances for the IMF to provide fresh financial support in May 2023. Negotiations are ongoing with both official and private external creditors.
Zambia	Launched mid-2020, ongoing	External Debt	Zambia fell into arrears on external debt service after several years of large fiscal and external imbalances, a drop in copper prices in 2015-16, droughts, and the COVID-19 pandemic put public debt on an unstainable path. Total public debt peaked at 150 percent of GDP and external public debt at 96 percent in 2020. The country defaulted on its Eurobonds in November 2020, after losing market access. • Zambia sought a Common Framework treatment in January 2021, and an IMF-supported program was approved by the Board of the IMF in August 2022. • Official creditors agreed on a debt treatment in June 2023 which allowed the second disbursement of the IMF financing. The agreement specifies a baseline treatment, and also a contingent treatment that would be automatically triggered if the assessment of Zambia's economic performance and policies improves, allowing for better terms for creditors. • Discussions with private creditors started in September 2023.

Source: IMF Country Reports.

Pros and Cons of Debt Restructuring

Sovereign debt restructuring is sometimes essential to restoring economic stability but is also disruptive. While uncommon in any one country, restructuring episodes do recur through time and across countries. Debt restructuring disrupts economic activity, creating losses for holders of government debt. Access to external financing, especially market financing, is lost or negatively affected in the short- and medium term, including for corporate borrowers. However, economic shocks or weak economic outcomes can sometimes make debt restructuring unavoidable if debt rises too quickly for repayment to be feasible, or refinancing costs become prohibitive, and the fiscal adjustment required to bring debt back to a sustainable path would not be economically and politically feasible. In such a situation, the benefits associated with restructuring and obtaining some debt relief outweigh the costs.

If restructuring is needed, starting the process earlier leads to better outcomes. When the assessment of capacity to repay suggests that debt is unsustainable, beginning the restructuring process early leads to notably shorter crises and less economic disruption. However, judging when debt is unsustainable can be a difficult exercise, especially if economic uncertainty is high. Additionally, the natural tendency is to wait in the hope that the economic situation will improve, or that creditors will provide sufficient new financing to avoid restructuring ("gambling for resurrection"). This often makes the whole process more difficult to resolve because uncertainty persists, the economic situation worsens, and the required debt relief increases.[1]

Key Steps in Debt Restructuring[2]

The first steps include:

- Gathering comprehensive information on debt obligations, listing all debt contracts that engage the government, including contingent liabilities, such as debts contracted by state-owned enterprises or other extra-budgetary entities that the government might have to cover.
- Hiring experienced, specialist financial and legal advisors who will help the government interact with creditors, organize the negotiation process, and manage the legal aspects of restructuring.

The IMF also plays a well-defined and limited role supporting the debt restructuring process, assessing debt sustainability and the financing needs the country faces over the coming years. This process helps set the key debt reduction objectives of the restructuring process. The IMF does not decide whether to restructure, or on specific restructuring strategies, or enforce intercreditor equity. The debtor country's own efforts to solve its problems are a key part of the restructuring process, usually adopting policies that reduce financing needs and increase capacity to repay through fiscal consolidation, tightening monetary policy, and growth-enhancing reforms. The IMF helps design a policy package that balances ensuring economic recovery with adjustment that reduces financing needs and tackles underlying economic weaknesses. The IMF may also provide financial support to address the country's balance of payments needs and smooth adjustment.

Defining the "perimeter" of debt to be restructured is a key step that country authorities take. The perimeter can be set to include external debt, or domestic debt (or both) of the central and often local governments, and define if any specific projects, state-owned enterprises, or other entities are excluded. If some debts are excluded, the holders of the remaining debt within the perimeter will have to bear a greater burden to reach the debt reduction objectives. The choice of the perimeter depends on factors such as the relative share of each type of debt in total government debt and the terms associated with each debt. Debt to some multilateral institutions is excluded from the restructuring perimeter because these institutions will continue to provide new financing during the crisis. In taking the decision to restructure domestic debt or not, the impact on

1 See IMF (2013), Chapter III. A for a discussion of why debt restructuring tends to be too little and too late.

2 See Buchheit and others (2019) for a more detailed description of the debt restructuring process.

financial stability must be considered, as banks and pension funds will incur losses on their holdings (IMF 2021). Nonetheless, domestic debt can represent too large a burden to be excluded from restructuring—for example in Ghana domestic debt accounted for about half of the total debt stock and prospective debt service before the restructuring at end 2022.

Types of Debt Treatment

Debt restructuring can involve maturity extensions, interest rate reduction, or reductions in the nominal value of debt principal (a nominal haircut). The country's circumstances, the terms of its debt, and the availability of new financing will determine the appropriate debt treatment. Based on the IMF's assessment of the country's macro-economic situation and expected needs for future debt financing, the authorities and their financial advisors will prepare a debt strategy that ensures that debt can be repaid on the new terms and that there is enough financing in the coming years. A flow treatment, which extends maturities and reduces interest rates without a nominal haircut, can be sufficient if the country is facing a temporary liquidity crisis and it is typically less costly for creditors. A restructuring involving a nominal haircut can be necessary when a country is facing a deeper solvency crisis.

Engaging with Different Creditors

Country authorities and their advisors will engage with their creditors once they have determined the magnitude of debt relief and a broad strategy for the restructuring. The type of engagement varies for each type of creditor:

- The engagement with official creditors is typically through an official creditor committee, composed of representatives the creditors choose—for example the Paris Club has been the main forum for official debt restructuring processes in the past and has well-established practices and procedures. Because new official creditors that are not members of the Paris Club have become more important since the mid 2000's, the G20 created the Common Framework in 2020 to integrate non-traditional creditors and ensure that the debt restructuring forum remains representative of all major official creditors (Georgieva and Pazarbasioglu, 2021; IMF 2021). As of October 2023, four countries in sub-Saharan Africa have formally requested a debt treatment under the Common Framework: Chad (now completed), Ethiopia, Ghana, and Zambia.
- External private creditors—often holders of Eurobonds—usually form their own creditor committee that will lead the discussion with the debtor country's financial advisors and government.
- Engagement with domestic creditors can vary depending on the strategy pursued to restructure domestic debt. Because domestic debt is usually contracted under domestic law, there can be scope to obtain debt relief through changing the law to impose changes in the terms of debt contracts. However, this strategy could have significant costs in undermining confidence in national institutions or could face legal challenges and risks. Alternatively, the authorities can offer a voluntary exchange of existing debt for a new typically longer maturity instruments that allow them to manage the debt burden better and avoid a crisis that would prove even more costly for creditors as well as the government (this has been the strategy pursued by Ghana, for example).

  Different types of creditors have a reasonable expectation of being treated equitably. Creditors will not accept a restructuring that leaves them providing more debt relief than other creditors ("comparability of treatment" is a key principle for the Paris Club, for example). Legal challenges are also a potential obstacle—for example, holdout creditors of external debts can sue for full repayment in foreign courts, or domestic debt holders may argue that their property rights are protected under the constitution. These issues can make the design and negotiation phases of debt restructurings lengthy and complicated.

Developing a Communication Strategy

Communication by the debtor country is particularly important during a debt restructuring process. Information about debt restructuring processes is highly market sensitive (investors will trade their holdings based on expectations of losses, which can introduce volatility and exacerbate financing problems). When uncertainty is high at the beginning of the process, information about the debt sustainability assessment, the potential launch of the debt restructuring process or the perimeter of the restructuring can have significant consequences for capital flows, the exchange rate, perception of intercreditor equity, and the availability of new financing. Communications strategies aim to maximize creditor participation, explaining the reasons why debt restructuring is needed and demonstrating that the country's own reform and adjustment efforts are feasible and make a significant contribution to the restructuring effort.

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