5 Sovereign debt via the lens of asset management: Implications for SADC countries

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The COVID-19 pandemic has laid bare the fact that 'hyper-globalisation' has made it impossible to contain crises within national borders. Multilateral international cooperation no longer is a choice but a necessity. This chapter attempts to address debt sustainability issues from two different angles for Southern African Development Community (SADC) countries – a conventional 'debt-to-GDP ratio' approach and a 'public sector balance sheet' approach. In addition, we assess whether and to what extent Chinese debt is a significant source of debt distress for SADC countries, and develop a series of potential policy options for alleviating the debt burden of countries in debt distress.

Part 5.1 below provides an overview of the economic impact of COVID-19 on SADC countries. Part 5.2 reviews the previous literature related to debt sustainability and the Heavily-Indebted Poor Countries (HIPC) initiatives; part 5.3 examines the sovereign debt situation using the traditional debt-to-GDP ratio; part 5.4 introduces an approach focusing on asset and liabilities – the public-sector balance sheet approach. Part 5.5 discusses the overall strategy of debt relief via investment. Part 5.6 proposes patient capital that is important for sustainable development, while part 5.7 presents a few policy options.

5.1 Economic impact of COVID-19

The world economy suffered the biggest shock since World War II due to the COVID-19 pandemic and the 'great closedown'. There was a 'sudden stop' of capital flows and unprecedented capital outflows from emerging market and developing economies (EMDEs) in March and April 2020.[1] The International Monetary Fund (IMF) had estimated in October 2020 that global economic growth would be -4,9 per cent in 2020, worsening by 1,9 percentage points from its April forecast. Such a major contraction

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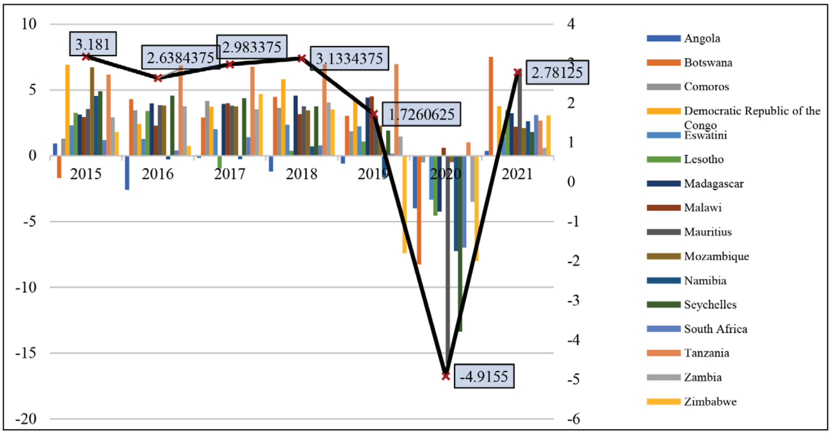
1 IIF *Capital flows report: Sudden stop in emerging markets* (April 2020).

may have repercussions for years to come. In the latest World Economic Outlook in April 2021 the International Monetary Fund (IMF) estimated that the global growth is projected at 6 per cent in 2021, moderating to 4,4 per cent in 2022. The projections for 2021 and 2022 are stronger than in the October 2020 forecast, reflecting the additional fiscal support in a few large economies, the anticipated vaccine-powered recovery, and the continued adaptation of economic activity to subdued mobility. However, the high uncertainty remains.

Before the pandemic the SADC was the home of the largest amount of intraregional trade in Africa.[2] Based on IMF estimates of the impact of the pandemic in the region, the average gross domestic product (GDP) growth rate of SADC countries will have dropped to -4,91 per cent through 2020 (Figure 5.1). The IMF has also provided an overall optimistic projection for the recovery of the SADC group at 2,78 per cent in 2021. However, even before the pandemic, SADC countries' development aspirations were challenged, as massive financing needs had led to rapidly-increasing public debt.

Figure 5.1: Real GDP growth rate, SADC countries and the average, %



Source: IMF WEO data, updated 19 May 2021

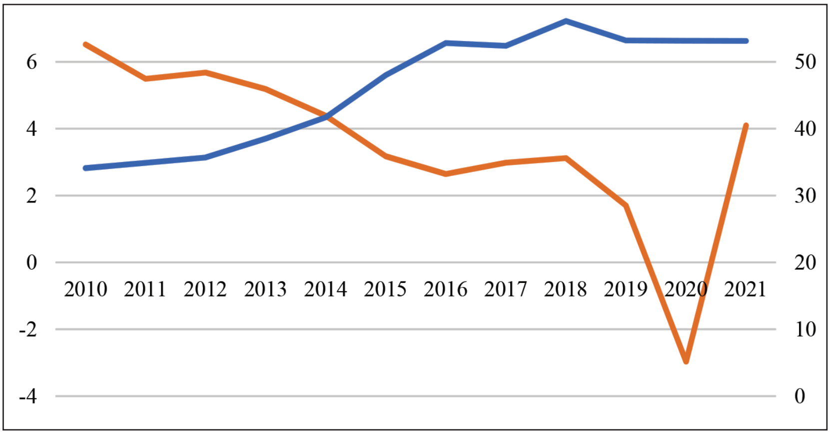
Debt: The current wave of debt accumulation, which began in 2010, has reached record highs and spread worldwide – private sector debt has risen

2 The SADC is comprised of 16 countries, which are Angola, Botswana, Comoros, Democratic Republic of the Congo, Eswatini, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Tanzania, Zambia and Zimbabwe.

rapidly, and public sector debt almost doubled for all economies in the past decade. In the case of the EMDEs debt has risen from 38 per cent of GDP in 2000 to 62 per cent in the past decade. The same trend can be found in low-income countries: Their public debt-to-GDP ratio now is 47 per cent of GDP, up from 29 per cent of GDP in 2010.

To foster macro-economic stability, the SADC has set a target of 60 per cent with respect to the government debt as a percentage of GDP. Based on the African Development Bank (AfDB) data, the group has stayed within its target (Figure 5.2). Nevertheless, the SADC countries have experienced a slow-down in economic growth while the government debt is getting closer and closer to the preset target. Country performance varies dramatically; some have a debt-to-GDP ratio of less than 15 per cent, while others, such as Angola and Mozambique, have a higher than 100 per cent public debt-to-GDP ratio. In addition, Zambia defaulted in October 2020 and entered into restructuring talks with private creditors and China Development Bank (CDB).[3]

Figure 5.2: SADC real GDP rate against government debt as a % of GDP



Source: IMF and AfDB databases. Note: Gov't debt using right axis.

The initial threat in March and April 2020 was of a global liquidity crunch due in part to large capital outflows from EMDEs, leading to the loss of official foreign exchange reserves and local currency depreciation in many

3 A debt deferral agreement has been reached between the government of Zambia and CDB on 28 October 2020, according to the Treasury Secretary of Zambia. (Eric Olander, Oct 28, 2020)

countries. Although capital inflows to some emerging markets resumed in the second half of 2020, the liquidity shortage is far from over.

The pandemic is not the only challenge lying ahead. Global warming and climate change have devastated the living conditions in many countries, rich and poor, small and big, bringing a multi-dimensional effect. New thinking such as 'asset-based refinance' (ABF), the debt-for-climate swaps are now being discussed.

5.2 Indicators of debt sustainability: Definitions, and pros and cons

Although, historically debt has been an instrument of development, over-borrowing and over-lending, in the presence of volatile capital flows in the globalised economy, should be avoided. This part briefly reviews the previous debt waves and the respective international debt frameworks during each period, and we will provide our comments and critiques of the conventional indicators.

5.2.1 Debt sustainability: Pre/post-HIPC

The global economy has experienced three waves of debt crises and restructuring over the past 40 years: the 1980s, 1990s and in 2008. The historic peak of the total debt of emerging market economies reached almost 170 per cent of GDP in 2018. Despite initiatives led by the World Bank and the IMF on global debt sustainability analysis, the existing frameworks are not sufficient, as reflected by the continuous criticism from scholars and civil society.

First, Fischer and Easterly, in their seminal work, explained debt dynamics using the following identity:

$$\text{Change in } d = (\text{primary deficit}/GNP) - (\text{seignorage}/GNP) + (\text{real interest rate} - \text{growth rate}) \times d \tag{1}$$

Where ***d*** denotes the debt ratio, or the ratio of government debt to GNP.

The authors provided a simple and intuitive explanation with the equation that the non-interest deficit has to be financed with new debt to the extent that this deficit exceeds the amount of money created by the central bank. Additionally, nominal interest expenditures have to be financed with new debt. However, many researchers have pointed out the weaknesses in the above formulation.

- Debt dynamics given above are significantly affected by the difference between the growth rate (g) and real interest rate (r), as pointed out by many.[4]
- A major problem is that it completely ignores the public assets a country has, and the saving and investments that could increase public assets. It has blurred the picture of what a government does: to finance consumption or to finance investment in public goods? What is the capital formation rate per dollar of debt borrowed?[5]
- In other words, the framework has a bias against government investment in productive assets including human capital and hard infrastructure, which could later become public sector assets as a cushion for debt sustainability.[6]

5.2.2 Three waves of debt restructuring

The HIPC initiative, originally launched by the World Bank and the IMF in 1996, was designed to address debt problems and poverty reduction. A reduction in the stock of HIPC countries' external debt to sustainable levels occurred on the condition of continued efforts in macro-economic stabilisation, structural adjustment. The initiative sets out the completion point at which HIPCs are required to reduce the net present value (NPV) of external debt to a maximum of 150 per cent of exports, prior to the revision in 2017.

In 2005, with poverty reduction being tied firmly with debt relief, the Multilateral Debt Relief Initiative (MDRI) cancelled 100 per cent of outstanding debts, both bilateral and multilateral, to HIPC countries that reached the completion point. By January 2006, 19 countries were eligible for immediate MDRI relief. Meanwhile, this marks the start of the post-HIPC era, along with a new definition of debt sustainability, as defined below.

In April 2005 the Bretton Woods institutions agreed on a new debt sustainability framework (DSF) for low-income countries, which included post-completion point HIPC countries. The DSF was again revised in 2017. The revised framework associated a country's risk of debt distress with the quality of its policies and institutions as measured by the World

4 For now, we ignore the small difference between GNP and GDP in developing countries. See Sergei Gorbunov and Henning Bohn's studies on Russian Federation and the United States, for example.

5 J Lin & Y Wang *Going beyond aid: Development cooperation for structural transformation* (2017) 66-69.

6 IMF *Fiscal monitor: Managing public wealth* (2018).

Bank's Country Policy and Institutional Assessment (CPIA) scores, on the basis that better-performing countries would be able to bear a higher debt burden (Table 5.1).

Table 5.1: Debt Sustainability Framework (DSF) Country Policy and Institutional Assessment (CPIA)

Debt Sustainability Indicators (%)	**Strong (**		**Medium (**		**Weak (**	
	Old	**2017 Rev.**	**Old**	**2017 Rev.**	**Old**	**2017 Rev.**
PV of debt/GDP	50	55	40	40	30	30
PV of debt/exports	200	240	150	180	100	140
Debt service/ exports	25	21	20	15	15	10
Debt service/ budget revenue	22	23	20	18	18	14

Source: IMF (2017)

However, developing country governments and their economists have had many complaints about the DSF and the mechanism, because countries that violated these benchmarks will be defined as being in 'debt distress', and will lose access to the global capital market.-

- The 2017 version of the IMF DSF was considered 'obsolete' since it only treated the 'total public debt' and missed out the fact that many governments were borrowing at market interest rates, both domestically and externally.[7]
- In our view, this framework has ignored the public-sector assets, including infrastructure assets, and thus has an anti-investment bias.
- The fiscal austerity programme advised by the Troika (the IMF, European Central Bank and European Commission) forced crisis countries such

7 B Pinto 'The 2017 version of the IMF and World Bank's LIC Debt Sustainability Framework: "Significant overhaul" or "obsolete"?' Duke Global Working Paper Series 2019/06 (2019).

as Greece to 'cut public spending to the bone', which 'the IMF later admitted were self-defeating'.[8]

- In addition, the above approach could not deal with the issues of large capital inflows and outflows under 'liberalised capital account'. In this regard, China's experience in avoiding financial crises in the past four decades is worth studying.
- On the other hand, the Washington-based international financial institutions (IFIs) promoted 'capital account liberalisation' before 2012,[9] which had led to a financial crisis in some countries.[10] Therefore, EMDEs must be careful and vigilant against the 'capital flight' as happened in March and April 2020, during which 'temporary capital controls might prove useful'.[11]

5.3 Assessing debt sustainability of SADC countries: All creditors, including China

In this part we first utilise the conventional indicators of debt-to-GDP ratios in our descriptive analysis, and then provide critiques on this measure. An alternative measure of government net worth (as asset minus liability) will be presented in part 5.4.

5.3.1 Sovereign debt databases and SADC data analysis

Using the IMF 2018 Global Debt Database (GDD), we found that four SADC countries have a debt level exceeding the SADC target of 60 per cent. As noted earlier, the debt-to-GDP ratio, of course, is not sufficient as a single indicator to determine debt sustainability (Figure 5.3).

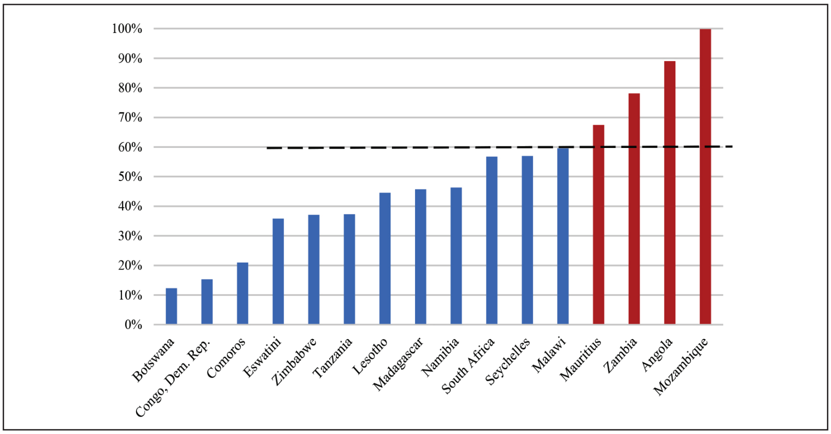
8 M Mazzucato *The value of everything: Making and taking in the global economy* (2018) 234.

9 In 2012 the IMF officially recanted its policy conditionality of opening capital account, as shown by Managing Director Christine Lagarde's speech in Malaysia indicating that temporary capital controls can be used during crises.

10 J Ostry, P Loungani & D Furceri 'Neoliberalism oversold?' (2016) 53 *Finance and Development* 38; KP Gallagher *Ruling capital: Emerging markets and the reregulation of cross-border finance* (2015).

11 Christine Lagarde, speech in Kuala Lumpur, Malaysia (14 November 2012).

Figure 5.3: Government debt-to-GDP Ratio, SADC countries, %, 2018

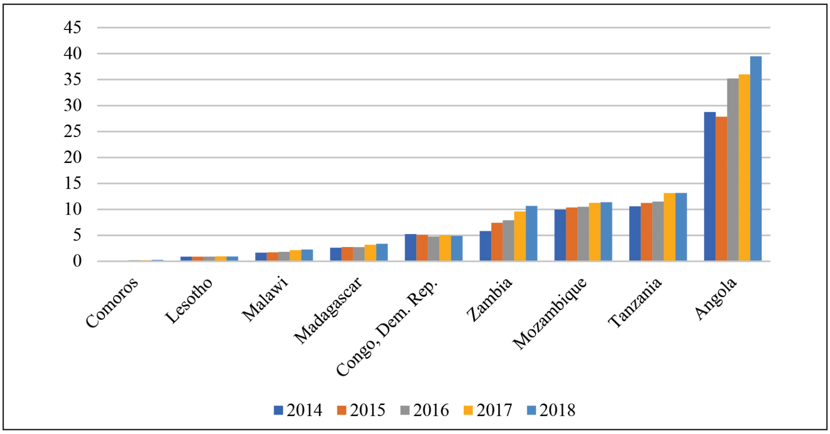


Source: Authors, based on IMF Global Debt Database (GDD). Note: Given the constraint of data availability, we used general government debt (percent of GDP) for the DRC, Mauritius and Tanzania, and central government debt (per cent of GDP) for the rest.

We examine the external debt of nine SADC countries using the international debt database provided by the Debt Service Suspension Initiative (DSSI) and found the following preliminary results for the nine SADC countries with available data.[12] The debt accumulation in the past few years is already a warning for the debtor countries, even without the pandemic. The total debt of the nine countries in 2014 was US $65,54 billion, which had accumulated to over US $86 billion in 2018. In addition, the level of indebtedness varies from country to country. Among the nine SADC countries, Angola is the most indebted country, with a total debt exceeding US $39 billion in 2018. Meanwhile, Zambia, Mozambique and Tanzania for the past few years all have had a total debt of over US $10 billion. Zambia in fact requested a six-month suspension on $42,5 million interest payments from the holders of its $3 billion in Eurobonds in October 2020 – essentially defaulting on those bonds (Figure 5.4).

12 Angola is also eligible under the DSSI for debt suspension, given its high level of indebtedness, despite the fact that it is not a low-income country.

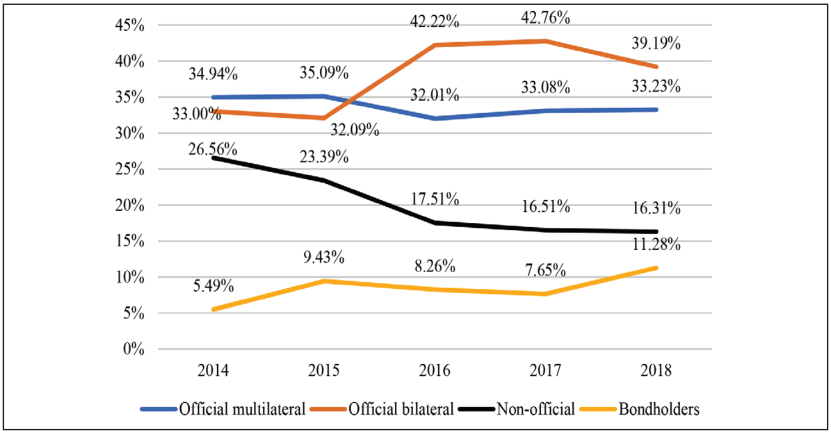
Figure 5.4: Total external debt of nine SADC countries, US$ billion, 2014-2018



Source: World Bank-IMF DSSI database, accessed in October 2020

Major creditor types of these countries vary significantly. In general, the official multilateral and bilateral creditors are the major creditors, to whom these countries owe over 60 per cent of the total external debt. An interesting trend observed is that the amount owed to non-official creditors, such as commercial banks, has been decreasing while the portion owed to bondholders has been rising in recent years (Figure 5.5). However, debt issues are very country-specific. For example, the portion of the external debt of Angola owing to the official bilateral creditors is declining with a growing share owed to the non-official creditors. On the other hand, over 80 per cent of the external debt of low-income countries (LIC) such as Malawi is owed to the official multilateral creditors such as the International Development Association (IDA) of the World Bank, the IMF and the AfDB.

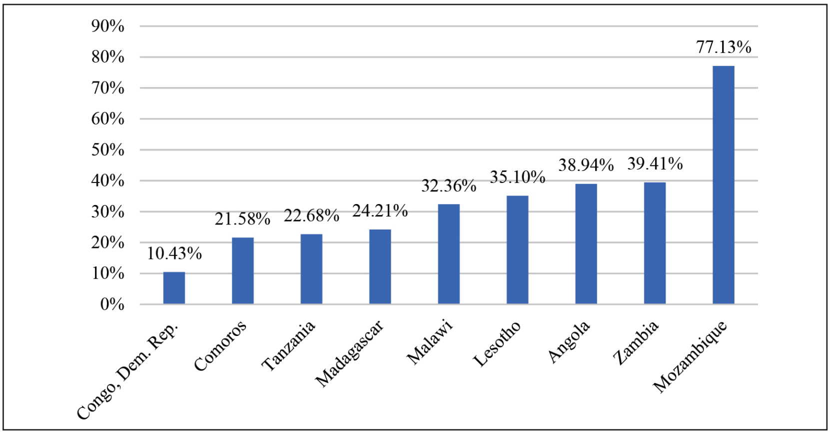
Figure 5.5: External debt of nine SADC countries by creditor type, % of total debt, 2014-2018



Source: World Bank-IMF DSSI database accessed on 17 October 2020

We also calculated the external debt-to-GDP ratio for these nine countries and found that the debt-to-GDP ratio is 31,66 per cent on average. However, there are large differences among countries in terms of the external debt-to-GDP ratio. The external debt is 77 per cent of the GDP for Mozambique, while it is slightly over 10 per cent for the DRC (Figure 5.6). Based on the June 2020 IMF assessment on the risk of external debt distress, Tanzania and Madagascar are among the low-risk group, the DRC, Comoros, Malawi and Lesotho are among the moderate group, while Mozambique (as well as Angola) is regarded as being in debt distress.

Figure 5.6: External debt-to-GDP ratio, nine SADC countries, 2018



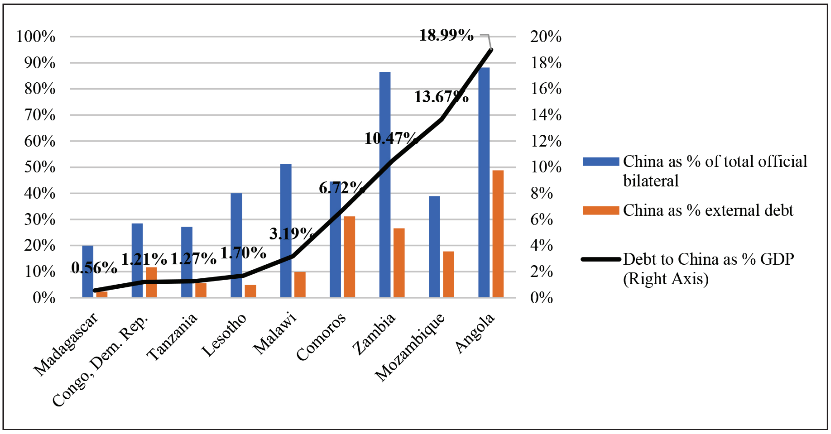
Source: World Bank-IMF DSSI, WDI

5.4.1 China as the creditor: An analysis based on DSSI

China has been portrayed as 'the largest creditor' or, to be more specific, 'the largest official bilateral creditor' in the world. However, in fact, these misperceptions were due to the non-transparency of various Chinese lenders and the lack of data on global sovereign debt, as pointed out by Acker et al.[13] Using the DSSI database, we provide a descriptive analysis on Chinese lending to the nine SADC countries covered by the DSSI initiative (Figure 5.7).

13 K Acker, D Brautigam & Y Huang 'Debt relief with Chinese characteristics' CARI Paper Series (2020).

Figure 5.7: Chinese lending to nine SADC countries, %, 2018



Source: authors, based on DSSI database 2020. Note: Debt owed to China = Official bilateral debt owed to China + non-official bilateral debt owed to China. The left axis is for China as % of total official bilateral debt and China as % of external debt, the right axis is for the debt to China as % of GDP.

On average, China is the creditor of 17,6 per cent of the external debt for SADC countries, including both official and non-official, which is around 6 per cent of the GDP for the nine SADC countries. In the cases of Zambia, Mozambique and Angola, the borrowing from China is over 10 per cent of their GDP. More than 86 per cent of Zambia's official bilateral debt is owed to China, and 88 per cent in the case of Angola. On average, almost half of the official bilateral debt of these nine SADC countries is owed to China. Although the proportions of debt owed to China seemed high in these countries, evidence also shows that the Chinese debt relief for these countries has been going on for many decades.[14]

However, the above analysis using the conventional measure of debt-to-GDP ratio fails to provide a full picture as it ignores the asset side of the public-sector balance sheet, and it neglects the uses of the debt – whether it is for consumption or investment. This bias in measurement has led to a policy bias against investment, especially investment in infrastructure in low-income countries over many decades. We will return to this topic in part 5.5.

14 As above.

5.5 Debt relief through development: Investing in public asset

Investing in public infrastructure is now widely recognised to be beneficial for economic development in developing countries. For example, investment in transportation can greatly reduce the transport cost and facilitate trade. However, building infrastructure is lumpy, risky and takes a long time to complete and, hence, can be very expensive. Here we present another angle of assessing a country's creditworthiness, which encourages investment in public assets. If the public sector asset increases, the cushion for debt distress becomes thicker and stronger.

An alternative measure of debt sustainability: Public sector net worth

Public assets are critical in current debt discussions. The IMF 2018 study on 'Managing public wealth' highlights the importance of using the public sector balance sheet (PSBS), including all government-owned and controlled enterprises, both financial and non-financial assets. In this approach, public sector net worth (= assets minus liabilities) is key to debt sustainability and investor confidence. If the public sector net worth is positive, the country is solvent, but may have a liquidity problem.[15] If the public sector net worth is negative, then the country has a serious issue of insolvency. According to the World Bank on belt and road initiative,[16] investment in transport corridor infrastructure is projected to generate certain trade and growth. In other words, if countries borrow to fill the identified infrastructure bottlenecks, they will see an increase in trade and GDP, from which more public revenue can be derived. For example, China invested massively in infrastructure after the global financial crisis in 2008/2009. As a result, its export competitiveness became stronger and its public sector net financial worth remained positive, at 8 per cent of GDP in 2017, despite also having large amounts of domestic and foreign debt.

Data on public sector net worth is difficult to obtain, especially for non-financial assets such as real estate assets and productive assets, the value of which may fluctuate over time. In fact, good estimates of public assets are currently unavailable for most SADC countries. We only managed to find data for Tanzania and South Africa. The public sector net worth of

15 A caveat is that the value of non-financial assets may fluctuate and be difficult to be liquidated. Hence, financial net worth is more critical in the international credit market.

16 World Bank *Belt and road economics: Opportunities and risks of transport corridors* (2019).

Tanzania was 45,8 per cent of GDP in 2014, and it was 151,5 per cent of GDP for South Africa in 2016 (Tables 5.2 and 5.3).

If all SADC countries can provide a good estimate of their public sector assets, it could help them to boost investor confidence to continue investing in these countries and, thus, facilitate further borrowing. In addition, good management of existing public sector infrastructure can help create jobs, generate revenues for the government, and reduce the need for debt restructuring.

Table 5.2: Tanzania: Public sector balance sheet, 2014, percentage of GDP

	General government	**Non-financial public corps**	**Consolidated public sector**
TOTAL ASSETS	123.7	31.9	101.3
Of which: Non-financial assets	99.7	14.4	73.5
Financial assets	24.0	17.6	27.8
TOTAL LIABILITIES	77.9	31.9	96.2
Of which: Debt securities	6.6	-	4.7
NET FINANCIAL WORTH	-53.9	-14.2	-68.4
NET WORTH	45.8	-	5.2

Table 5.3: South Africa: Public sector balance sheet, 2016, percentage of GDP

	General government	**Non-financial public corps**	**financial public corps**	**Consoli-dated public sector**
TOTAL ASSETS	208.3	49.6	72.3	269.0
Of which: Non-financial assets	156.7	44.6	2.5	203.7
Financial assets	51.6	5.0	69.9	65.3
TOTAL LIABILITIES	56.8	49.6	72.3	117.5
Of which: Debt securities	47.4	7.2	1.8	41.8
NET FINANCIAL WORTH	-5.2	-44.6	-	-52.3
NET WORTH	151.5	-	-2.5	151.5

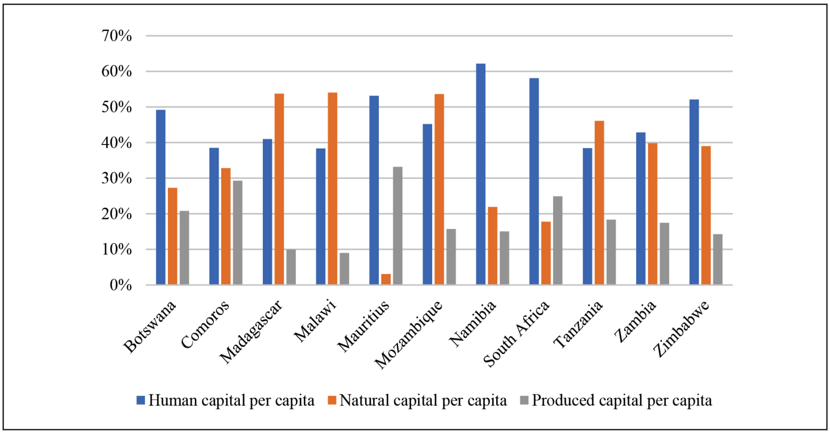
Source: IMF (2018)

What additional assets do SADC countries have?

SADC countries have a good level of produced capital, human capital and natural capital, indicating that the structure of their factor endowment is quite rich and appropriate for balanced growth. Traditional economic growth theory places less emphasis on human than natural capital leading to underinvestment in human capital and over-exploitation of natural capital. The latter, natural capital, includes land, forests, subsoil resources (oil, gas, minerals), water, biodiversity and other natural assets. If the host country continues to invest in all three of these assets, the country's creditworthiness will become stronger.

Building on the foundation of all capitals in various forms, these SADC countries can target their comparative advantages (for example, Mauritius, Namibia and South Africa are human capital-abundant, while Madagascar, Malawi, Mozambique and Tanzania are natural capital-rich) (see Figure 5.8). The human capital-rich countries can develop their human capital-intensive export sectors such as garment, footwear, and other light manufacturing sectors, while natural capital-rich countries can concentrate on agri-business, forestry and mineral export or nature-friendly tourism. For South Africa, it has emerged as the industrial hub of SADC countries.

Figure 5.8: Produced capital, human capital and natural capital of 11 SADC countries, as a percentage of total capital, 2014

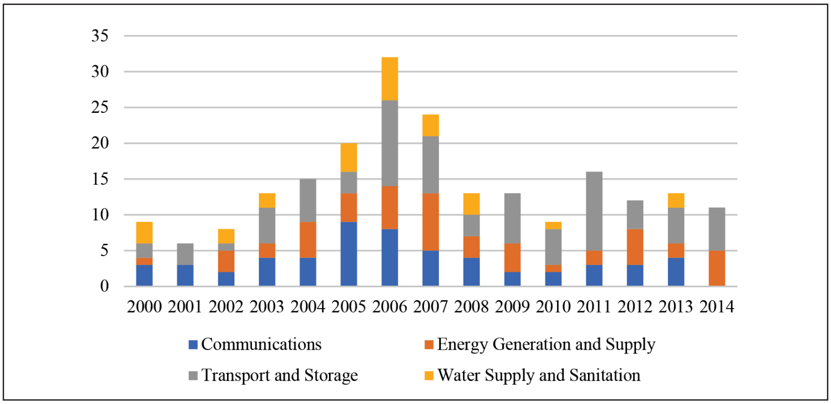


Source: Data based on World Bank, 2018

China has been actively helping African countries to target their respective comparative advantages. It is estimated that approximately 25 per cent of all infrastructure development in Africa in the past 18 years has been funded by the Chinese government, with the African government contributing an estimated 40 per cent.[17]

China-sponsored and completed projects have addressed Africa's bottlenecks in economic transformation, representing public sector assets, not only debt. In recent research, Lin and Yan Wang[18] identified economic bottlenecks for 54 African countries and found that Chinese-financed projects had matched with African countries' bottlenecks in 78 per cent of the 214 hard infrastructure projects that it supported in 2000 to 2014. The 214 hard infrastructure projects that had been completed covered water (26), energy (52), transport (80) and communication (56). These projects were largely public goods (74 per cent),[19] including electricity, water and sanitation, ports, airports, highways and railways, as well as semi-public goods (26 per cent) which is telecommunication (Figure 5.9).[20]

Figure 5.9: Decomposition of the 214 completed hard infrastructure projects financed or co-financed by China, by sector and year



Source: Lin and Wang 2021, based on completed projects in China Aiddata.com

In sum, we strongly support the approach of using the public sector balance sheet (and net worth=asset minus liabilities) as a more comprehensive

17 YM Wang 'China's BRI could help Africa achieve transformation agenda' *Xinhua* (17 October 2019), https://mp.weixin.qq.com/s/HpwQBZyTPtDkC4Z6aoW7ww (accessed 26 October 2020).

18 J Lin & Y Wang 'Economic transformation in Africa and how best China can support' in A Zeufack & S Wang (eds) *China and Africa in the 21st century* (forthcoming 2021).

19 In economics, a public good is a good that is both non-excludable and non-rivalrous.

20 Lin & Wang (n 18).

measure of creditworthiness and debt sustainability, which encourages public investment in assets. The completed infrastructure projects represent public assets that can potentially generate jobs, government revenue, while promoting economic growth. They provide a thick cushion for any debt distress.

5.6 Chinese state actors are patient capital holders

Chinese state actors are holders of patient capital[21] as illustrated by their long history of providing debt relief for African countries. Acker et al[22] provide an insightful analysis on the history of debt relief with 'Chinese characteristics' for developing countries including those in Africa. The authors pointed out that the Western media has provided misinformation on China and debt distress. Most importantly, 'no asset seizure' is found and no evidence is found to support the so-called 'debt-trap diplomacy' accusation.

China has shown considerable forbearance and flexibility in debt negotiations in the 1980s and 1990s. It is noticed that the cost of violating the contract with Chinese lenders was actually 'quite low' for borrowers. The cases of the Republic of the Congo and Mozambique suggest that 'agreements have been easier to reach with Chinese lenders than with private creditors'.[23] China's approach was even more flexible than the members of the Paris Club, during the HIPC initiative. During recent bilateral negotiations, China has used Paris Club terms/conditions for debt relief, illustrating that China is behaving within the international 'rule of the game', despite the fact that China is not a member of the Paris Club, and that does not agree with all the conditions.

Nevertheless, China is unlikely to write off or forgive a large portion of outstanding debt, as the tradition is that China maintains the policy that only its zero-interest loans are eligible for forgiveness. Alternatively, rescheduling and refinancing are more common in recent years' restructuring of debt (Figure 5.10, based on Kratz et al).[24] Chinese state

21 Patient capital is defined as the ultra-long-term capital invested in a relationship, much like venture capitalists investing in innovative ideas, and equity-like investors holding a stake in the development of a country. Its maturity could be longer than ten years, and their capacity for taking risk is stronger. Lin & Wang (n 5); Mazzucato (n 8).

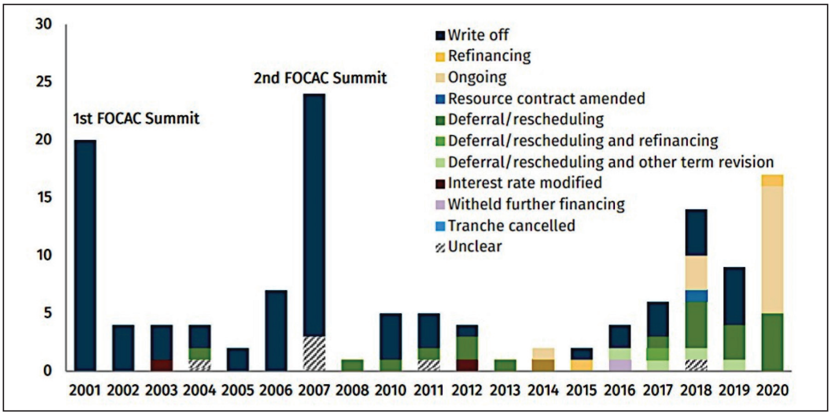
22 Acker et al (n 13).

23 As above.

24 A Kratz, M Mingey & D d'Alelio 'Seeking relief: China's overseas debt after COVID-19' Rhodium Group (8 October 2020), https://rhg.com/research/seeking-relief/ (accessed 19 October 2020).

actors are constrained by the Budget Law, whereas there is no foreign aid law in China.

Figure 5.10: ***Restructurings of Chinese debt by outcome and year***



Source: Kratz et al 2020. Rhodium Group

Note: This does not include recent Chinese claims to have given ten countries debt deferrals through DSSI within the G20 framework.

When considering requests from debt-distressed countries, China's flexibility is based on the fact that China and African countries are partners in climbing the same mountain of structural transformation. Essentially, the Chinese are taking a stake in the development of the host countries in Africa, as reflected in the recent case of Angola.

Recent case of Angola: The country has been hit both by the oil price fall and COVID-19. According to the IMF report released in late September 2020, Angola will receive $6,2 billion in debt relief thanks to agreements lined up with three of its major creditors, among which China is the largest official bilateral creditor. Meanwhile, the country is also busy negotiating with some Chinese banks and government agencies on debt re-profiling deals.[25]

25 For details, see IMF 'Angola: Third review under the extended arrangement under the extended fund facility, requests for augmentation and rephasing of access, waivers of non-observance of performance criterion and applicability of performance criterion, modifications of performance criteria, and completion of financing assurances review' – Press release; staff report; and statement by the executive director for Angola (September 2020) 44-45.

On debt accumulation, China is not the only creditor and is not necessarily the largest bilateral creditor for all the African countries. In fact, other official creditors and the private sector are collectively even more important. Furthermore, 'there are reasons why [developing] countries prefer to borrow from China, given that the private lenders usually provide short-term financing and the traditional Western donors completely forget about the hard infrastructures'.[26] Thus, China's patient capital may be preferred by developing countries, given that they are in great need of real sectoral development.

5.7 What more can be done? Policy options

(1) Support multilateralism and push for the IMF to issue more SDRs, as issuing SDRs is countercyclical and unconditional. In particular, Gallagher et al[27] also suggest putting the funds of the SDRs that are not used by countries, particularly by high-income countries, into trusts of different kinds, which could partly serve the needs of Africa and other developing regions.

(2) Support the IMF, the World Bank Group and regional financial arrangements (RFAs) to issue more emergency liquidity loans and expedite their disbursement. Currently, only about 12 per cent of the IMF and RFAs' resources have been used and only about half of that is disbursed.[28] In addition, the IMF should not resort to its DSF without considering the country's public sector balance sheet and prevent certain countries from borrowing/refinancing. During this pandemic-led global recession, encouraging public investment by allowing continued borrowing and refinancing is critical to maintain economic recovery and to 'build back better'.

(3) Innovative financing and refinancing may be designed, based on already-completed projects that are part of the public assets. Concretely, assume an internationally-financed infrastructure project in country A has been completed and in operation with cash flows,

26 D Dollar 'Seven years into China's Belt and Road' (1 October 2020), https://www.brookings.edu/blog/order-from-chaos/2020/10/01/seven-years-into-chinas-belt-and-road/ (accessed 19 October 2020).

27 KP Gallagher, JA Ocampo & U Volz 'IMF special drawing rights: A key tool for attacking a COVID-19 financial fallout in developing countries' Brookings Blog (26 March 2020), https://www.brookings.edu/blog/future-development/2020/03/26/imf-special-drawing-rights-a-key-tool-for-attacking-a-covid-19-financial-fallout-in-developing-countries/ (accessed 19 October 2020).

28 T Stubbs et al 'Whatever it takes? The global financial safety net, COVID-19, and developing countries' (2020) 137 *World Development* 105171.

and the host country A has repaid a part of the loans, say, 30 per cent, but is now having difficulties in repaying its debts, then if the host country agrees, multilateral or bilateral financial agencies can use the 30 per cent equity share of the cash flows that the government owns as the collateral to issue new finance at a lower interest rate, which may be called 'asset-based refinance'. Again, if the host government agrees, sovereign wealth funds (SWFs) and green funds can participate in the auction of these shares and bid for these unlisted equity shares. In this way, new liquidity will flow into country A without hurting its credit rating.[29]

(4) The pandemic might be the force that catalyses long-overdue innovation in the sovereign debt market to facilitate less protracted and simpler restructurings and help avoid pitfalls in the future. The 'state-contingent debt instruments' have been mentioned again, which link a sovereign's debt service payments to its capacity to pay, thus could maintain debt relief that a country obtained in a restructuring.[30] One such example is 'commodity-linked' bonds (CLBs).[31]

(5) Utilising 'tailored solutions' in the 'debt-distressed' countries. We have suggested, on various occasions, for the Chinese government to enhance transparency and accountability and expedite the process of enacting a foreign aid law, while continuing to coordinate with G20, the IMF, the Paris Club, and follow international rules of the game. It is possible for the Chinese institutions to 'find innovative solutions' for debt restructuring, because they are holders of 'patient capital', and they are essentially in the same boat with these African countries where the projects are located.

- China has been acting, and is likely to continue working, within the common framework agreed by G20 countries.[32] China is so far the biggest

29 A recent example is that the USDFC has made a deal with the Ecuadorian government which will privatise the public assets that China helped to build, and USDFC will help repay the Chinese loans. Essentially the Ecuadorian government is auctioning away the public asset. SWFs can do the same, and new finance will flow to this country. See https://www.ft.com/content/affcc432-03c4-459d-a6b8-922ca8346c14 (accessed 19 October 2020)

30 P Breuer & C Cohen 'Time is ripe for innovation in the world of sovereign debt restructuring' IMF Blogs (20 November 2020), https://blogs.imf.org/2020/11/19/time-is-ripe-for-innovation-in-the-world-of-sovereign-debt-restructuring/?utm_medium=email&utm_source=govdelivery (accessed 22 November 2020).

31 IMF blog on 'The role of state-contingent debt instruments in sovereign debt restructurings' (December 2020).

32 A debt reduction framework will be discussed and agreed in the G20 meeting in November 2020 according to the declaration by G20 finance ministers on 14 October

contributor to the DSSI, suspending at least $1,9 billion in repayment due this year, according to the G20.[33] In addition, Xi Jinping announced additional debt exemption within the framework of the FOCAC.[34] Recently, former Central Bank governor Zhou Xiaochuan also stressed the preference to a 'tailored approach'.[35]

- China's development financing and debt restructuring are driven by requests of host countries. Examples include the TAZARA (Tanzania-Zambia) railways and its maintenance; sugar refineries in Sukala Mali, the Agriculture Technologic Demonstration Stations (which are now commercialised), and the approach used in Angola this year.
- 'Demonstrated willingness to repay' is important for Chinese creditors, as in the cases of Pakistan.[36] However, due to capital flow volatilities of EMDEs, large liquidity injection is not feasible from Chinese creditors, unless capital flight can be stopped through temporary capital controls in these countries. After all, 'liberalising capital account' is not a part of China's experience. Washington-based IFIs need to make good for their own policy conditionalities on liberalising capital accounts and serve as the international lender of last resort.

(6) Debt-for-climate swaps: There is now over 30 years' experience with debt-for-nature swaps whereby countries in debt distress agree to invest a certain percentage of debt relief into natural assets. The most recent case in the SADC region is Seychelles, which had defaulted on its debts in 2008 and had struggled with debt distress thereafter. Seychelles partnered with third parties to buy back US $21,6 million of its sovereign debt at a discount from its creditors. Seychelles now repays these loans into a trust fund called the Seychelles Conservation and Climate Adaptation Trust (SeyCCAT). Then, the trust repays US $15,2 million in loan capital over a ten-year period. Over 20 years, the trust will finance upwards of US $5,6 million of marine conservation

2020.

33 J Wheatley 'African debt to China' Financial Times (26 October 2020), https://www.ft.com/content/bd73a115-1988-43aa-8b2b-40a449da1235 (accessed 30 October 2020).

34 On 17 June 2020 Chinese President Xi Jinping announced that China would exempt the zero-interest loans to 15 African countries under the framework of Forum of China and Africa Cooperation (FOCAC).

35 XC Zhou 'The BRI is not debt trap and China supports G20 proposal to extend debt relief' CF40 (24 October 2020), http://www.xinhuanet.com/english/2019-10/17/c_138480217.htm (accessed 19 October 2020).

36 It is reported that Pakistan received a new loan of $1,3 billion after the country 'made a significantly large foreign debt repayment, resulting in depletion of reserves by $1,71 billion in the week ended on May 26, 2020', https://tribune.com.pk/story/2252732/pakistan-receives-1.3-billion-loan-from-china (accessed 19 October 2020).

> and climate adaptation activities, and transfer US $ 3 million into a long-term endowment that will finance similar activities long into the future.[37]

For SADC countries, and for developing countries in general, it is important to know what the government owns (asset) and owes (liability), to distinguish 'patient capital' from 'footloose' investors, and to separate long-term (structural) and short-term (liquidity) issues. First, to address the immediate health and liquidity crises, African countries need liquidity support from the multilateral financial organisations such as the IMF and the World Bank Group. Debt cancellation will not achieve the goal of liquidity support. The lending of unused SDR and various currency swaps can be used for short-term liquidity purposes. Second, to address the long-term structural issues, African countries need to work with patient capital holders such as multilateral development banks, regional and national development banks. Innovative re-financing arrangements can be explored and designed carefully and worked out, including, but not limited to, 'asset-based refinance', as well as debt-for-climate swaps. The advantage of these approaches is that they provide liquidity without hurting a country's credit rating. In the long term, patient capital is needed to address developing countries' structural issues, such as capacity development for export competitiveness.

37 Economists Group 'Seychelles swaps debt for nature' World Ocean Initiative (8 April 2020), https://www.woi.economist.com/seychelles-swaps-debt-for-nature/ (accessed 19 October 2020).

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