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Debt will be devastating legacy of Covid for Africa

Philip Aldrick 10/4/2021

Storm clouds are gathering over the continent and China is playing its part

Africa has had a good pandemic. At least that's what you might think from a look at the numbers. Recorded Covid deaths on the continent, with its population of 1.3 billion, total 115,000, fewer than Britain with its 66 million residents. Of course, the data isn't awfully reliable because Africa does not have comprehensive testing. A rule of thumb that friends in Kenya use is to multiply the official death toll by ten. But even then, Africa has had half as many deaths relative to the population as the UK.

That's not to say it's a sunny picture. The continent has had its own mutation, the South African variant, and parts are in the midst of another wave. Many countries went into lockdown. More than a dozen are on Britain's travel ban "red list". Coronavirus has claimed one opposition leader and, possibly, a president.

Yet the storm clouds are only starting to gather. Much of Africa is at risk of its own pernicious strain of long Covid; weak growth, unsustainable debt and a spike in poverty.

The plight of low income countries was top of the agenda at this week's World Bank and International Monetary Fund meetings. Stock markets may be soaring and optimism in the west returning, but the global growth upgrades overshadowed a dismal outlook for developing economies. The IMF forecasts were the definition of a K-shaped recovery: a "roaring 20s" for the rich and a great depression for the poor.

The figures were sobering. Another 95 million people joined the ranks of extreme poverty last year. Education losses have been three times higher in low income nations than the advanced. Scarring from the crisis will leave GDP in sub-Saharan countries 5.5 per cent below pre-pandemic forecasts in 2024, compared with 0.7 per cent in the west.

Weaker growth makes debt less affordable. And it is already a problem. The World Bank estimates that 40 of the world's 74 poorest countries are at high risk of debt distress, and that figure will rise. Over the past decade, public debt among low-income countries jumped from 30 to 50 per cent of GDP while debt servicing costs rose by a half — in contrast to the rest of the world where borrowing costs fell as debt piles grew.

The debt is now a noose. As the IMF warned, economic recovery in the west will lead to higher interest rates, whether central banks raise them or not, and as domestic returns improve western investors in Africa will pull their money home. Capital outflows will make the debt more unaffordable. It’s a familiar story that never ends well for the weak.

Efforts are being made to stave off a catastrophe. Through the World Bank and the IMF, the G20 has delayed repayments for poor nations under the “debt service suspension initiative (DSSI)”. So far, $12.5 billion has been rescheduled and as much as $9.9 billion more is eligible after the DSSI was extended last week. The DSSI just buys time, though. Ultimately, debt restructuring will be needed. On that, private creditors, the World Bank and the IMF agree. The world’s biggest creditor, however, is not so sure. And that’s China.

The plight of Africa threatens to be a test like none before. Sovereign debt restructurings tend to be ugly affairs. The conditions attached never go down well with governments, but at least the negotiations are clear. Today debt structures are so complicated that just bringing the creditors to the table threatens to be a marathon slog.

Essentially, there are three buckets of creditors: multinational institutions (like the World Bank and IMF); official bi-lateral lenders (governments); and the private sector. In the past, private sector creditors were banks, who negotiate on their own behalf as they hold the debt on their balance sheet. Now most of the debt is held as bonds by asset managers on behalf of clients, diffusing ownership. Some of those bonds have even been spliced into financial instruments, making ownership impossible to identify.

To complicate matters, asset managers have a fiduciary duty to clients and, just to begin negotiations, often need a trigger, like a default. For those reasons, the private sector has not been involved in the DSSI, much to the World Bank's frustration. But there is another reason: China.

China is technically a bilateral lender but in reality it stands alone. Largely through the belt and road initiative, its lending and building programme in Africa and Asia, it has become the world's biggest creditor, providing $1.5 trillion to 150 countries; more than World Bank, the IMF or the whole Paris Club, a group of 22 rich nations that have signed on to the DSSI. (Incidentally, private sector creditors are today as big as the Paris Club.)

Unlike traditional creditors, though, China's contracts are opaque and discriminatory. Analysis of contracts that have been uncovered revealed that Beijing has carved out preferential terms protected by airtight non-disclosure agreements that hand China strategic assets in the event of a government default, so called "debt trap diplomacy", particularly in Africa.

David Malpass, president of the World Bank, has hinted at other tactics such as clauses that exempt China from debt restructurings and interest rates of 6 or 7 per cent — from a country that last November raised debt with a negative yield. China has contributed a little to the DSSI, but nothing close to an amount that reflects its influence.

If Covid does bring Africa's debt crisis to a head, as seems inevitable, picking a way through the mess of the creditor structure may prove insurmountable. As one asset manager put it, how can they fulfil their fiduciary duty if China is demanding full repayment on a vastly greater sum? A package like that would be as much a rescue for Beijing as the country in question.

The IMF and World Bank have drawn up a “common framework” to navigate a path through these problems, but it will need co-operation. Private sector creditors, many of whom are standard bearers for social impact investing, face the hypocritical prospect of championing diversity while persecuting the poor. China will have to choose if it stands with the world or against it. Either way, some form of reckoning is coming.