JUBILEE DEBT CAMPAIGN

October 2017 (UPDATED)

The new developing world debt crisis

Summary

1. A new debt crisis has begun in impoverished countries, with Mozambique, Chad, Congo and Gambia unable to pay debts

2. Unless dealt with effectively, the crisis could cause increasing poverty and declining public service provision, as happened in the 1980s and 1990s

3. The crisis comes from a boom in lending and borrowing since the global financial crisis, followed by the crash in the price of commodity exports

4. Structural changes are needed to the global economy to prevent the cycle of crises, including better regulation of lenders, tax justice and enabling countries to be less dependent on commodity exports

5. But the UK needs to take responsibility now for the large amount of debt contracted under English law, **and to ensure loans are transparent**

1. A new debt crisis has begun

"Low Income Countries are increasingly exposed to a wider set of vulnerabilities ... The challenging global environment suggests that debt vulnerabilities are likely to increase for many of these countries."[1]
International Monetary Fund, August 2016

Mozambique, Congo, Chad and Gambia have all defaulted on some debts to private lenders. Ghana and Mongolia are dependent on loans from the IMF and World Bank to pay the high interest on loans to private lenders.

These are the first signs of a new developing world debt crisis. Many of these debts to private lenders are under the jurisdiction of the UK, with **over 90% of sub-Saharan African government bonds owed under English law**.[2]

Throughout the 1980s, 1990s and into the 2000s, many developing countries were caught in a debt trap, where unpayable debts held back progress in tackling poverty and inequality. Then, as now, more loans were given by the IMF and World Bank to pay off private lenders, whilst the debt increased. Meanwhile, economies stagnated and poverty increased.

Urgent action is needed now to ensure that history is not repeated, especially to ensure loans are transparent.

1. IMF. (2016). Review of the Debt Sustainability Framework for low income countries. August 2016 http://www.imf.org/external/np/exr/consult/2016/licdsf/pdf/LICDSFreview.pdf
2. Calculated by Jubilee Debt Campaign from cbonds database

2. Lending to impoverished countries increased dramatically from 2008

"Large cross-border financial flows to developing and transition economies have often led to lending booms and busts, currency mispricing and the build-up of foreign liabilities without contributing to an economy's capacity to grow and service such obligations."[3]
United Nations Conference on Trade and Development, 2013

Since the Western world financial crisis of 2008, there has been a boom in lending to the most impoverished countries. Annual lending to low and lower middle income country governments more than quadrupled from $57 billion in 2007 to $260 billion by 2016 (the latest year with figures available).[4]

This increase has been because quantitative easing and low interest rates in the western world mean that lenders have wanted to give more loans to developing countries where they can charge higher interest rates. Furthermore, multilateral institutions and governmental lenders such as China, France, Germany and Japan have increased their annual lending.

Of debts owed by low and lower middle income governments:

• 38% are owed to private lenders. The amount in international bonds issued by sub-Saharan African governments increased from $1 billion in 2011 to $6.2 billion by 2014.[5] There have been similar increases in loans given directly by banks. Over 90% of sub-Saharan African government bonds are owed under English law.[6]

• 36% are owed to multilateral institutions, primarily the World Bank, IMF and regional development banks such as the African Development Bank

• 26% are owed to other governments

Jubilee Debt Campaign research in March 2017showed that debt payments by impoverished countries had increased by 50% in two years, and had reached their highest level since 2005.[7]

3. Recent falls in commodity prices have led to government revenues being far lower than expected

"Depressed commodity prices have slowed growth sharply in commodity-exporting emerging and developing economies, which are home to more than half the global poor."[8]
World Bank President, Jim Yong Kim, June 2016

The debt crisis of the 1980s, 1990s and early 2000s was triggered by a fall in the price of commodities and rise in US interest rates. Since mid-2014 the IMF's commodity price index has fallen by more than 40%,[9] and the US dollar has risen in value by 15%. This has caused rapidly worsening financial conditions for many countries.

Using figures from the IMF and World Bank, Jubilee Debt Campaign has calculated that this has led to a group of 51 low and lower middle income country governments being $61 billion worse off in 2016 than previously expected, due to falls in government revenue and increases in the relative size of debt payments. For comparison, this is $13 billion more than the $48 billion of aid which is claimed by the OECD to be spent in the 51 countries included in the study.[10]

4. A new debt crisis has begun

Of 67 low and middle income countries assessed, 21 are at high risk of not being able to pay their debts, 28 medium risk and only 11 low risk (whilst 7 are already in default).[11]
IMF and World Bank, October 2017

In contrast to individuals and companies, no bankruptcy laws exist for governments. This means that, in the words of the IMF, when debts are too large "debt restructurings have been too little and too late".[12] As has happened recently in Greece, countries get stuck in a debt trap where bailout loans pay profits to private lenders, high debt payments and austerity increase poverty and reduce growth, and without growth the debt continues to increase.

3. UNCTAD. (2013). Trade and development report 2013. http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=636
4. Calculated from World Bank. World Development Indicators database.
5. World Bank. (2015). Sub-Saharan Africa's sovereign bond issuance boom http://blogs.worldbank.org/opendata/sub-saharan-africa-s-sovereign-bond-issuance-boom
6. Calculated by Jubilee Debt Campaign from cbonds database
7. The Guardian. (2017). 'US interest rate rise to deepen debt crisis in developing world'. https://www.theguardian.com/business/2017/mar/13/us-interest-rate-rise-to-worsen-developing-countries-debt-crisis
8. World Bank. (2016). Overiew: Global economic prospects https://www.worldbank.org/en/publication/global-economic-prospects
9. http://www.imf.org/external/np/res/commod/index.aspx
10. See http://jubileedebt.org.uk/press-release/collapse-in-commodity-prices-leads-to-61-billion-funding-gap-for-impoverished-countries and https://www.theguardian.com/business/2016/apr/10/poorer-countries-commodity-slump-stronger-dollar-debt-payments
11. IMF. (2016). List of low income country debt sustainbility assessments for PRGT-eligible countries. As of 1 October 2016. http://www.imf.org/external/pubs/ft/dsa/dsalist.pdf Since this list was produced, the IMF has confirmed that Mozambique has moved from medium risk to in default.

Jubilee Debt Campaign's July 2015 report, *'The new debt trap'*,[13] identified nine countries which are most dependent on foreign lending. Two of these, Ghana and Mozambique, are now back in debt crisis.

One particular problem is the transparency, and thus accountability of lending. In Mozambique, loans given in secret by London-based banks, under UK law, are the route of the crisis. Other countries with claimed hidden loans include Gambia, Gabon, Republic of Congo and Zambia.

Mozambique

In April 2016 it was revealed that the London branches of Credit Suisse and VTB Capital had lent over $1billion to Mozambique state owned companies in 2013. The loans were not approved by the Mozambique parliament, as required under Mozambique law, and not disclosed to the IMF, Mozambique people or financial markets.

The revelations about the hidden debts led to the IMF suspending its loans to Mozambique in April 2016. These had been being used to pay off previous lenders. Mozambique has now begun defaulting on the hidden debts.

All the hidden debts are owed under English law. VTB has said it has sold off the debts it is owed by Mozambique and there is a possibility that these have been bought by vulture funds. Because of the lack of international mechanisms to restructure debt, it could therefore result in vulture funds suing Mozambique in UK courts, seeking large profits on what they originally paid to buy the debt.

Mozambique civil society, including the Budget Monitoring Forum and Mozambique Debt Group have said the loans are illegal because they were not approved by the Mozambique parliament as required in the constitution.

An independent audit into the loans by US company Kroll has found that:

- A condition of Credit Suisse to get the loans signed off by the Bank of Mozambique was dropped in order for the loans to be given
- Credit Suisse and VTB gave or arranged loans to three companies which had no revenue, and without the contracts in place to suggest that they would generate revenue in the future
- There is an unexplained difference of between $683 million and $714 million on what was paid for equipment bought by the loans, and its expected cost[14]

Box. Vulture funds and the UK

Vulture funds are hedge funds which specialise in buying up debt when it cannot be repaid, then sue the government concerned for large profits once other creditors have agreed to cancel some of the debt. Vulture funds buy up debts cheaply so they can make many hundreds or thousands of per cent profit. They take advantage of the fact that there are no rules to enforce agreed debt restructurings on all creditors.

In 2010 the UK parliament passed the Debt Relief (Developing Countries) Act, which prevented companies suing any of the countries in the agreed debt relief scheme for low income countries in UK courts for more than they would have got if they had taken part in the scheme. This immediately helped Liberia which was being sued by a vulture fund at the time. The UK government estimated it saved countries £145 million when they made the law permanent in 2011. However, the law only applies to loans made before 2004, so vulture funds can now once again use UK Courts to make large profits out of impoverished countries debt crises.

Ghana

Since qualifying for debt cancellation in 2005, Ghana's government external debt has grown from $2.3 billion to $19 billion. A large source of loans has been bonds issued under English law paying up to 11% interest, as well as less transparent direct private sector loans. Multilateral institutions and other governments have also lent heavily to Ghana. The World Bank broke its own rules to do so, giving 93% of its finance as loans to a government which should have been receiving a maximum of 50% of its finance as loans.

Furthermore, in October 2015, the World Bank again broke its own rules by guaranteeing $400 million of a high interest private loan to a country it had assessed as at high risk of not being able to pay its debt. The higher interest rate and World Bank guarantee mean if Ghana pays the interest until 2024 but make no other payments, including any of the principal, the lenders will still make a profit. The speculators lent to Ghana knowing it was likely they could not be repaid.

Falls in the price of gold and oil have led to Ghana's revenue dropping dramatically, with GDP in dollar terms falling by 25%. Since April 2015 the IMF has been lending more money to Ghana, which is being used to make the high interest payments to private lenders. The IMF assesses Ghana as at high risk of not being able to pay its debt, and even this is based on very optimistic assumptions such as dollar GDP growing by 8% a year for the next twenty years (the average for the last eight years has been 4%).

12. IMF. (2013). Sovereign Debt Restructuring - Recent developments and implications for the Fund's legal and policy framework. 26 April 2013. https://www.imf.org/external/np/pp/eng/2013/042613.pdf
13 Jubilee Debt Campaign. (2015). The new debt trap: How the response to the last global financial crisis has laid the ground for the next. http://jubileedebt.org.uk/reports-briefings/report/the-new-debt-trap
14. For more on the audit see: http://jubileedebt.org.uk/blog/release-audit-raises-huge-questions-2-billion-loans-mozambique

If and when Ghana does default on its debt, all the bond contracts are owed under English law, and possibly many of the other debts owed to the private sector. There are no regulations which enable any debt restructuring agreed with a majority of creditors to be enforced on the minority, which means Ghana's debt could be bought up by vulture funds, and Ghana sued in courts in the UK.[15]

5. The UK needs to take responsibility for debts contracted under English law

"But the best way to ensure that an economy delivers long term success, and that success is felt by all of its people, is to have it overseen by political institutions in which everyone can share ... That is why the transparency agenda is so important."[16]
Rt Hon David Cameron MP, October 2013 (Speaking as Prime Minister)

"We further acknowledge that successful debt restructurings enhance the ability of countries to achieve sustainable development and the sustainable development goals. We continue to be concerned with non-cooperative creditors who have demonstrated their ability to disrupt timely completion of debt restructurings."[17]
Addis Ababa Action Agenda, agreed by all 193 members of the UN in July 2015

The UK Parliament took welcome action in 2010 passing the Debt Relief (Developing Countries) Act to ensure private creditors complied with internationally agreed debt relief. However, it only applies to loans given before 2004.

A new debt crisis has begun, which could lead to economic stagnation and increasing poverty. Jubilee Debt Campaign's partners in developing countries are trying to hold their governments to account. We need to help them by increasing the transparency of debts issued under English law, and the ability to restructure them when necessary.The UK should:

1) Require all loans to governments or with government guarantees, issued under English law, to be publicly disclosed at the time the loan is given. This would enable media, parliamentarians and civil society in borrowing countries to hold their governments to greater account.

2) Pass new legislation to stop vulture funds preventing debt restructurings under English law. This could include a law preventing vulture funds suing for more than a certain amount more than they paid for a debt (for example double), and/or a law saying that if a certain proportion of creditors agree to a debt restructuring, it becomes binding on the remainder. In 2015, Belgium passed a law saying that vulture funds could not sue for more than they paid for a debt in Belgian courts. A motion is being introduced to the German parliament for a similar law.

These measures have been supported in Early Day Motion 158 (session 2017-19). For more information:

Tim Jones, Policy Officer
tim@jubileedebt.org.uk
020 7324 4725

15. For more on Ghana see Jubilee Debt Campaign et al. (2016). The fall and rise of Ghana's debt: How a new debt trap has been set http://jubileedebt.org.uk/reports-briefings/report/fall-rise-ghanas-debt-new-debt-trap-set
16. PM speech at Open Government Partnership 2013. https://www.gov.uk/government/speeches/pm-speech-at-open-government-partnership-2013
17. Addis Ababa Action Agenda, 13-16 July 2015. http://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf Adopted as UN resolution A/RES/69/313 on 27 July 2015 http://www.un.org/en/ga/69/resolutions.shtml

JUBILEE DEBT CAMPAIGN

Jubilee Debt Campaign is part of a global movement demanding freedom from the slavery of unjust debts and a new financial system that puts people first.

The Grayston Centre
28 Charles Square
London N1 6HT

020 7324 4722
info@jubileedebt.org.uk
www.jubileedebt.org.uk

Jubilee Debt Campaign
@dropthedebt