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Debt Justice Join the movement for a fair economy

FAQs on legislative reform to ease debt restructuring for lower income countries

Summary

Lower income countries are facing a debt crisis, in the wake of the Covid pandemic and rises in inflation and food and fuel prices. This is destabilising countries around the world by preventing them from addressing the needs of their people or responding to the climate emergency. Yet the G20's Common Framework is failing to facilitate fast, fair and transparent debt restructurings.

The UK has a critical role to play in addressing this impasse in the Common Framework. Since 90% of debt of countries eligible for the Common Framework is governed by English law, UK legislation could incentivise private creditors to agree to equal treatment to that offered by government creditors.

Why is the Common Framework failing to enable fast and fair debt restructurings?

The Common Framework for Debt Treatments Beyond the DSSI was announced by the G20 in November 2020 in response to the growing debt crisis triggered by the pandemic. However, in the three years since it was established, only four countries (Chad, Ethiopia, Ghana and Zambia) have applied, and none have yet seen any debt cancelled.

The key reason is the failure of private creditors to provide equal levels of debt cancellation to that agreed by government creditors. Although the Common Framework requires private creditors to take part, it lacks a process to ensure this. G20 governments and the IMF have urged private creditors to cooperate and provide equal treatment, but they have offered lower income countries no new tools to negotiate deals with their creditors.

As a result, private creditors have sought to minimise their concessions and be paid off through the debt relief granted by governments, in effect at the expense of global taxpayers. Under the in principle deal that bondholders obtained from Zambia in October 2023, bondholders would have been repaid a third more than government creditors including China and the UK, even though they lent at higher interest rates initially. The deal was vetoed by government creditors, principally China, on the basis that it failed to provide equal treatment as required by the Common Framework.

As a result, Zambia and Ghana are in limbo, without tools to negotiate a sufficiently generous deal from bondholders that would satisfy government creditors. There is an urgent need for a mechanism that would reassure China that Western private creditors will share an equal burden in debt restructurings.

The role of legislation

The UK has a key role to play in improving the systems for debt relief. 90% of bonds of countries eligible for the Common Framework are governed by English law. Furthermore, the UK has a track record of using legislation to ensure private lenders cooperate with internationally agreed debt relief, in the form of Debt Relief (Developing Countries) Act 2010.

The UK could pass legislation to incentivise private creditors to take part in debt relief. Two possible legislative options, both proposed by Dr Karina Patrício Ferreira Lima from the University of Leeds, and Prof Celine Tan and Dr Stephen Connelly from the University of Warwick[1], are to:

a) Replicate the Debt Relief (Developing Countries) Act by stating that no creditor can sue for more than they would have got if they had taken part in the Common Framework for debt restructuring, or any other internationally agreed debt restructuring the UK government is party to, including all restructurings agreed by the Paris Club.

b) Extend existing UK corporate law on debt restructuring so that governments can restructure their debts in a similar way to companies. Part 26A of the Companies Act 2006 allows companies in financial difficulty to restructure their debts without undertaking insolvency. Similar provisions for sovereign debt could enable the courts to require disruptive private lenders to take part in debt relief if other creditors, such as governments, have agreed to the debt relief deal, or if a certain proportion of creditors have voted in favour.'

How would UK legislation unblock the Common Framework?

The first legislative option would limit the level of repayments that private creditors could sue for to the equivalent of what government creditors will receive after restructuring. Both lower income countries and private creditors would know that debts would be unenforceable in court above this level, so there would be no incentive for private creditors to hold out for more favourable treatment. By providing a clear upper limit on repayment levels, this would much simplify negotiations with private creditors, and rebuild trust with China.

The second legislative option would give lower income countries greater ability to speed up the restructuring process, and overcome opposition from any private creditors holding out on offering equivalent debt relief to governmental or other creditors.

Would legislation lead to higher borrowing costs or lost access to capital markets for lower income countries?

The first legislative option replicates the Debt Relief (Developing Countries) Act 2010, which applied to the HIPC debt relief of the 2000s, updating it to apply to the Common Framework and current debt.

Ahead of the 2010 Act, private sector lobbyists claimed it would lead countries to lose access to lending – yet in fact lending increased dramatically. In the years following the Act, lending by private lenders to the 36 countries covered by the Act increased from $3 billion between 2005 and 2009, to $24 billion between 2010 and 2014, and $41 billion between 2015 and 2019, according to World Bank International Debt Statistics. A 2011 review of the Act by the Conservative-Liberal Democrat coalition government found that "no evidence has been found of unintended or adverse effects".

The second legislative option replicates existing English law for corporate debt restructurings. The existence of this legislation for corporate debt has not undermined or prevented lending to corporations. Clear processes for restructuring debt to sustainable levels are a key part of our financial system - it is an aberration that they only exist for corporate debt and not government debt.

The evidence is that effective debt relief does not lead to lenders being unwilling to lend, but actually enables countries to regain access to lending. Countries in debt crisis currently cannot borrow more from private lenders, because those lenders are unwilling to lend to countries with unsustainable debts. Where lower income countries are able to access loans, they are at extortionate interest rates – above 10% in the case of Kenya's February 2024 bond issuance. But once debts have been reduced, the evidence is that lenders are willing to lend again, at lower interest rates.

According to Scope Ratings, "If an economy's debt sustainability is adequately enhanced via public and private sector debt relief, this could support stronger market access and lower borrowing rates longer term, and with this, potentially a stronger credit rating long term."

The IMF has recognised that "debt restructurings have often been too little and too late, thus failing to re-establish debt sustainability and market access [new loans from private lenders] in a durable way".

Would legislation lead to lenders using other jurisdictions?

English and New York law are used by lenders because of the long case law history – there would be huge risk for lenders to move to a different legal system. Similar legislation has already been proposed in the New York Assembly.

The introduction of the Debt Relief Act in 2010 had no impact on the reliance by lenders on English law. In fact, of bonds issued by countries covered by the Act since 2010, 90% use English law and 10% New York – the same proportion as for lower income countries more generally.

Would legislation put British pensions at risk?

An insignificant amount of British pension fund wealth is invested in lower income country debt. Further, pension funds have already accounted for 'losses' from the fall in the price of lower income country bonds in recent years, losses far greater than any reduction in profit that would come from more effective debt restructuring processes.

Bonds are the sole form of lower income country debt owned by pension funds. The 73 countries eligible for the Common Framework collectively owe $88 billion through bonds, according to the World Bank International Debt Statistics. In contrast, the total assets held by pension funds based in 22 major economies amount to $48,000 billion ($48 trillion) – 550 times as much.

Nowhere near all such bonds will be owned by pension funds. Bond ownership is very untransparent, but a study by Eurodad found that the ownership of only 24% of bonds had been disclosed to regulators. The bonds owned by pension funds are included among those that need to be disclosed to regulators – so this means that a maximum of $21 billion of bonds of the 73 countries are owned by pension funds. This is an overestimate because some of this $21 billion will be owned by other categories of creditors.

$21 billion amounts to 0.04% of global pension assets. In contrast, prices of shares, the main investment for pension funds, change on a daily basis by 0.5%-1%. This means that pension funds lose or gain far more from daily changes in stock exchanges than they would if all the 73 countries' bonds were entirely cancelled – which is far more than what the legislation would do.

Furthermore, pension funds owning such bonds will have bought them as a risky asset. The bonds charged high interest rates of around 6%-10%, at a time when loans to governments like the US and UK were at 0%-1%. Such risky assets would be a tiny proportion of any pension portfolio, alongside many other risky investments (e.g. high yield corporate bonds, equity in start-up companies). Pension managers expect some of the bets on risky assets not to pay off, but they earn a return because enough do.

Where pension funds own bonds they adjust how much the bonds are worth as the price of the bonds changes on financial markets. Many lower income country bonds have fallen significantly in value in recent years. This means that bondholders who bought the debt closer to face value have already written significant amounts off on their books, though still claim they are owed the full amount. And speculators who have bought the debt more recently, since the bonds started falling in price, stand to make huge profits unless there is significant cancellation of the debt. Debt Justice has calculated that bondholders stand to make $30 billion in profit if they are paid in full from five countries seeking debt cancellation, compared to the current market price of the bonds.

References

1. Connelly, S., Patrício Ferreira Lima, K., and Tan, C. (2024). UK parliament responses to deal with sovereign debt crises: Proposals for legislative reform. GLOBE Centre and CBLP Briefing Paper. February 2024.

Does legislation have international support?

"We also are pressing for some of the changes, legal changes that need to happen in New York, in London, to close loopholes for vulture funds and others to prevent debt resolution. We are discussing how we can bring more contingency measures in debt agreements, how to press for more debt transparency

Kristalina Georgieva, Head of the IMF

"Given the depth of the pandemic, I believe we need to move with urgency to provide a meaningful reduction in the stock of debt for countries in debt distress. Under the current system, however, each country, no matter how poor, may have to fight it out with each creditor. Creditors are usually better financed with the highest paid lawyers representing them, often in U.S. and UK courts that make debt restructurings difficult. It is surely possible that these countries—two of the biggest contributors to development—can do more to reconcile their public policies toward the poorest countries and their laws protecting the rights of creditors to demand repayments from these countries

David Malpass, Former Head of the IMF

African Finance Ministers have called for:

"...major sovereign debt issuance jurisdictions to require enhanced collective action clauses and enhanced force majeure clauses in all sovereign debt contracts and to implement comprehensive anti-vulture fund legislation in major creditor countries

About Debt Justice

We are a UK charity working to end poverty caused by unjust debt through education, research and campaigning.

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