07

Developments in Commonwealth Debt Since the Global Financial Crisis

7.1 Introduction

The Commonwealth has long played a key role in supporting its member countries with analysis and policy suggestions regarding debt issues. This began in the 1980s with the Commonwealth Expert Group Report on The Debt Crisis and the World Economy, chaired by Lord Lever of Manchester (Commonwealth Secretariat, 1984), which was highly influential in provoking policy measures on debt reduction cancellation for developing countries during the 1980s and thereafter. Since then, the Commonwealth has produced multiple analytical reports on debt issues, mostly for its Finance Ministers' Meetings, and most recently focusing on small island developing states (SIDS). Between 1999 and 2010, this assistance peaked with the establishment of a Heavily Indebted Poor Countries (HIPC) Ministerial Forum (changed into a Ministerial Debt Sustainability Forum from 2008). This met during the Commonwealth Finance Ministers' Meetings and provided a forum for detailed discussions and policy suggestions on the progress of the HIPC and Multilateral Debt Relief Initiatives (MDRIs), which since 1995 have cancelled close to US$100 billion of lower-income country debt. The forum, chaired by HIPC ministers but attended by all member countries, reported annually to the broader plenary of finance ministers and was a valuable source of feedback and advocacy for faster progress on providing relief. The forum was ended when almost all Commonwealth HIPCs had received their HIPC and MDRI debt relief.

Partly as a result of HIPC debt relief, which relieved debt burdens for many of the most indebted countries, sovereign debt issues have not been at the forefront of the international community's agenda for the past decade. Nevertheless, as this special report discusses in more detail, debt burdens have been on an upward trajectory since the global financial crisis of 2008, for most groups of Commonwealth member countries. More recently, the International Monetary Fund (IMF, 2018a) and the World Bank (2019) have begun to speak of a new debt 'crisis' or 'vulnerabilities' for considerable numbers of developing countries, including those in the Commonwealth, and to suggest new policy measures are needed to resolve this crisis.

In this context, the objective of this special report is to provide Commonwealth member countries with an independent assessment of the current state of debt in Commonwealth countries. It provides an analysis of the trajectory of Commonwealth debt since the global financial crisis (Section 2), analyses the factors and policy measures that have contributed to this trajectory (Section 3) and identifies the key emerging debt policy problems that require solutions and makes suggestions for the policy measures which could resolve these problems (Section 4).

7.2 Developments in Commonwealth debt since the global financial crisis

7.2.1 Analytical methodology

This section analyses trends in the debt of Commonwealth member countries over the past decade – since the global financial crisis of 2008. Many indicators could be used to assess these trends. However, the focus here is on two key indicators:[1]

- **Debt stock compared with gross domestic product (GDP)**. This is a key indicator of the 'overhang' burden of debt on economic growth and development, above all its potential discouraging effects for investment. It is therefore widely used by international organisations such as the IMF, World Bank, Organisation for Economic Co-operation and Development (OECD) and UN to compare country debt burdens, as well as by rating agencies and other private sector analysts.
- **Debt service compared with budget revenue**. This is a key indicator of the 'liquidity' burden of debt on the national budget, and is especially important for its potential impact in terms of

crowding out the high government spending on other sectors needed to reach Agenda 2030 and the Sustainable Development Goals (SDGs). It is also widely used by international organisations and independent analysts to assess debt burdens, especially for developing countries.

In interpreting the following analysis, it is important to be aware that assessments of the weight of debt burdens should vary with the income level of the economy. Wealthier countries can generally support a much higher level of debt to GDP, as well as more easily borrow in international capital markets to refinance and repay debt service. They should also vary with the vulnerability of the economy to exogenous shocks (as the IMF is now introducing for climate shocks in its Debt Sustainability Analyses (DSAs)). Nevertheless, criteria used by governments to judge sustainable levels of debt are often similar. For example, the EU and Eastern Caribbean Currency Union use debt stock to GDP of 60 per cent; the Economic and Monetary Community of Central Africa and the West African Economic and Monetary Union use stock to GDP of 70 per cent; the East African Community uses 50 per cent present value of debt to GDP; and the IMF/World Bank Low-Income Country (LIC) DSA framework uses a range of 35–70 per cent present value to GDP (varying based on the strength of country debt management capacity).

For both indicators, this report focuses on **total public sector debt** rather than total national debt – that is, excluding private sector debt. Private sector (especially household) debt is also an issue of growing concern in Commonwealth countries, and will be the subject of a separate paper to be presented to Finance Ministers by the Secretariat in October 2019.

Total public sector debt includes both external and domestic debt (i.e. debts held by residents and non-residents). This distinction is not usually important in higher-income countries where debts are issued on international capital markets to residents and non-residents alike, but in many developing countries debts are issued separately on international and domestic capital markets and therefore called 'external' and 'domestic'. This is even though many of the latter are bought by non-residents, exposing countries to additional risks of capital flight in times of economic volatility.

To conduct the analysis, this report relies on two main data sources:

- For data on debt stock compared with GDP, it uses the IMF World Economic Outlook database, from which data are available for all countries except Tonga.[2]
- For data on debt service compared with budget revenue, it uses DSAs prepared by the IMF and World Bank for 27 LICs and lower-middle-income countries (LMICs), supplemented by data from individual countries' budget and other economic publications for 14 other developing countries, and World Bank external debt data for four others.[3]

In order to assess which groups of countries have the most vulnerable debt situations, we have grouped them according to income level, special UN status (SIDS and landlocked countries) and region.

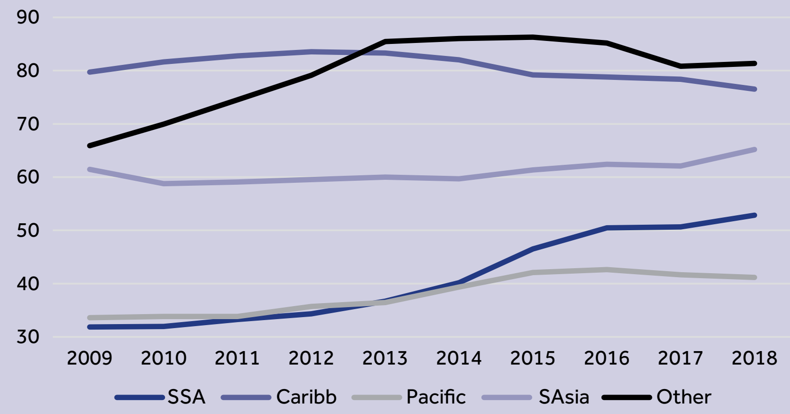
7.2.2 Trends in debt stock

Figures 7.1–7.3 show trends in debt stock to GDP ratios for different country groupings since the global financial crisis. They show that debt problems are concentrated in Sub-Saharan Africa and the Caribbean, and in SIDS, ex-HIPCs and LICs, especially as these are also the groups of countries with the lowest incomes, least access to capital markets or highest vulnerability to shocks.

Analysed by region, Figure 7.1 shows that the developing region with the highest debt burdens has consistently been the Caribbean. Though debt stocks have fallen by about 7 per cent of GDP since they peaked in 2012, they remain at 77 per cent on average, well above levels considered

Figure 7.1

Trends in debt to GDP by region (%)



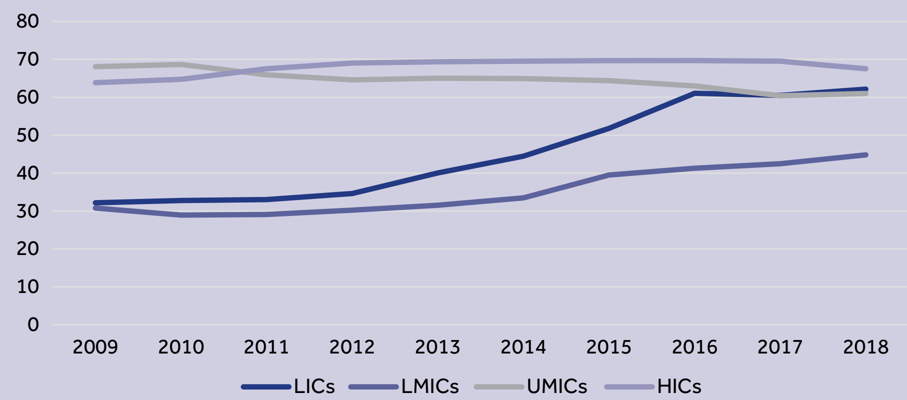
Note: 'Other' grouping includes Canada, Cyprus, Malta and the UK

Source: IMF World Economic Outlook database and national sources

sustainable by the international institutions. The 'other' grouping also has high levels of debt stock and has seen a sharp rise in Canada, Cyprus and the UK since the global financial crisis (with small declines in recent years), but their higher income levels and greater access to capital markets make their debts far more sustainable. South Asian debt has been relatively stable at around 60 per cent of GDP, though it has been rising recently. East Asian and Pacific countries (excluding Nauru) have seen the second largest rise, of 8 per cent of GDP, though average debts remain sustainable at 41 per cent. Sub-Saharan Africa has seen the sharpest rise, of 19–51.8 per cent, average debt levels which are becoming unsustainable.

Figure 7.2

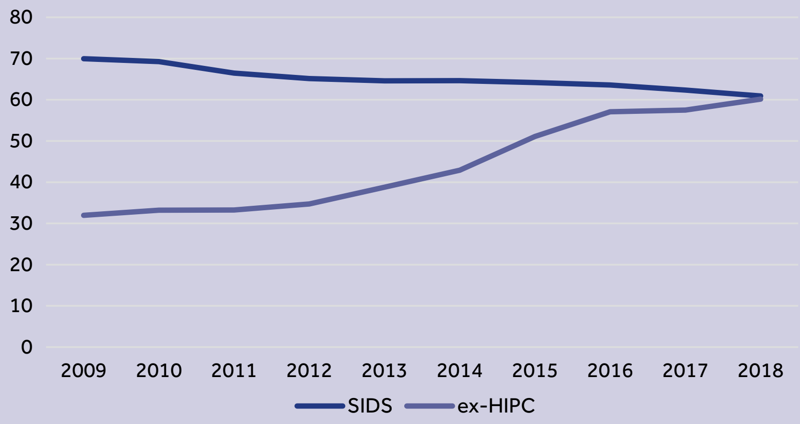
Trends in debt to GDP by income group (%)



Source: IMF World Economic Outlook database and national sources

Figure 7.3

Trends in debt to GDP of SIDS and ex-HIPCs (%)



Source: IMF World Economic Outlook database and national sources

Looking at different income groups, Figure 7.2 shows that high-income countries (HICs) and upper-middle income countries (UMICs) had much higher debt to GDP levels coming out of the global financial crisis, at around 70 per cent and, while UMIC debt has fallen by 10 per cent of GDP over the past decade, HIC debt has risen by 4 per cent. However, LIC and LMIC debt levels have risen much more rapidly since 2009, by 14 per cent and 30 per cent of GDP respectively, so LIC debt levels are now averaging 62 per cent of GDP and looking very unsustainable, whereas LMICs are at only 45 per cent.

It is also vital to take account of groups of countries in special development situations. This report focuses on two that have historically been of particular interest to the Commonwealth: SIDS and former HIPCs. Figure 7.3 shows that, just after the financial crisis, SIDS had average debt levels more than twice as high as those of ex-HIPCs (not surprisingly as ex-HIPCs had recently received their debt relief under the HIPC initiative and MDRIs). By 2018, SIDS had reduced their debt levels by around 10 per cent of GDP to 60.1 per cent, but the debt levels of ex-HIPCs had risen by 28 per cent to the same proportion of GDP as SIDS.

7.2.3 The liquidity burden: Debt service to budget revenue

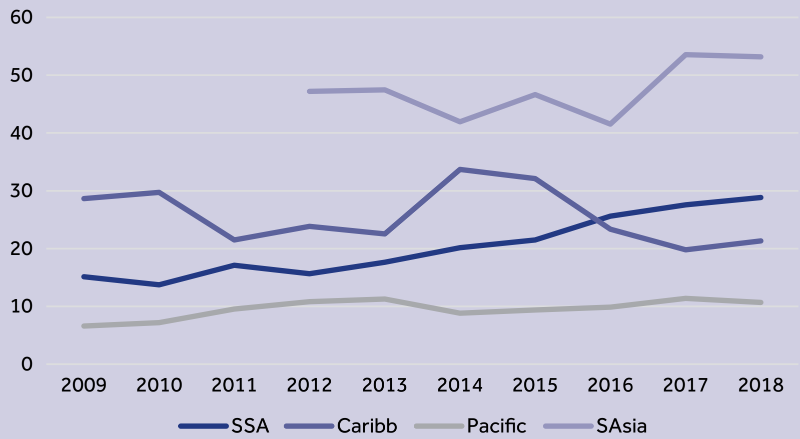
How does the picture look in terms of the debt liquidity burden – debt service payments compared with budget revenue? Figures-6 show the same analysis of trends for different groups.

Figure 7.4 shows that, by region, South Asia (53 per cent) has by far the highest debt service burdens, with Sub-Saharan Africa (29 per cent) and the Caribbean (21 per cent) at high levels, and the Pacific considerably lower at only 11 per cent. The sharpest rises in debt service burdens since the global financial crisis have been in Sub-Saharan Africa (14 per cent) and South Asia, while Pacific debt service has risen slightly (4 per cent) and Caribbean debt service has come down in recent years by around 10 per cent of revenue.

Figure 7.5 shows that, analysed by income group, LICs have by far the highest debt service burdens, up by 22 per cent of revenue from 13 per cent in 2009 to 35 per cent in 2018. Debt service for two other groups has also risen considerably, by 14 per cent for HICs (mostly SIDS, given the lack of data for other countries) and 13 per cent for LMICs; for UMICs it has come down slightly.

Figure 7.4

Trends in debt service to revenue by region (%)



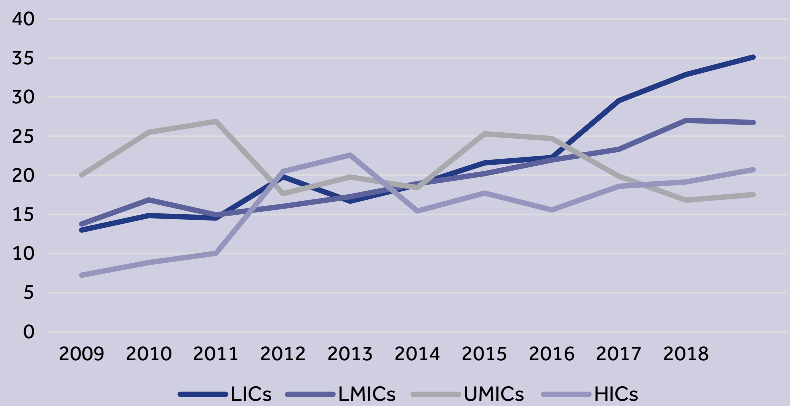
Note: No data available for countries in 'other' group. No data for Sri Lanka before 2012 so South Asia average begins 2012.

Source: IMF/World Bank DSAs and national documents

Finally, in terms of countries in special situations, Figure 7.6 shows that the debt service burdens of HIPCs have risen dramatically in the past decade, from 16 per cent to 36 per cent of budget revenue. Those of SIDS rose at the same speed as HIPCs until 2014 (by 7 per cent of revenue) but have since fallen back to 21 per cent in 2018 as a result of substantial debt relief. Nevertheless, both groups have levels of debt service that would commonly be regarded as unsustainable and diverting large sums from the SDGs.

Figure 7.5

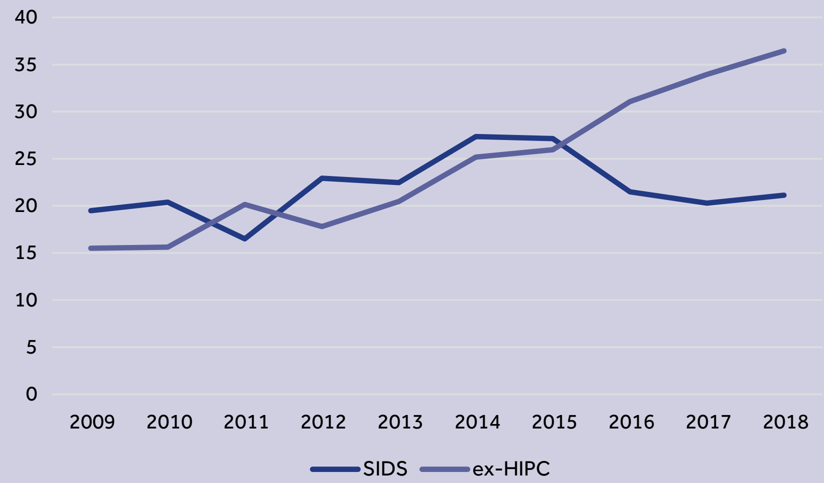
Trends in debt service to revenue by income group (%)



Source: IMF/World Bank DSAs and national documents

Figure 7.6

Trends in debt service to revenue of SIDS and ex-HIPCS (%)



Source: IMF/World Bank DSAs and national documents

7.3 Identifying key countries in debt distress

Averages of country groups are of limited use in identifying the countries with debt problems. This section of the report therefore identifies countries that currently have high debt burdens, using two methods: 1) the IMF/World Bank assessment of a country's level of debt distress risk (limited to the 27 countries for which such assessments are made); and 2) countries with the highest levels of debt to GDP and debt service to revenue based on data collected from a broader range of sources.

Table 7.1 shows the classifications of Commonwealth countries according to the latest IMF and World Bank DSAs. It is important to remember in interpreting these assessments that they 1) use present value of debt instead of stock; 2) place a heavy weight on overhang/stock as opposed to liquidity/service indicators; and 3) focus above all on external debt.

The table shows that Commonwealth countries are reasonably evenly distributed in terms of debt distress risk, with marginally more at high risk or in debt distress than are at low or moderate risk. However, this marks a significant deterioration compared with five years ago, when more than two thirds of the countries were at low or moderate risk. The table also shows that ex-HIPC countries are relatively evenly distributed, with six out of 11 at high risk or in debt distress; SIDS are at slightly higher risk (seven out of 12 at high risk or in debt distress). All the countries at high risk or in debt distress are either SIDS or ex-HIPCs.

The final line of the table as well as Figure 7.7 indicates the proportion of Commonwealth countries in each category compared with the total for all countries. It shows that Commonwealth countries are at somewhat higher risk than others – with 52 per cent of Commonwealth countries at high risk or in debt distress, compared with 41 per cent of non-Commonwealth countries.

It is important to note one recent welcome development in the LIC-DSAs. In line with the methodology used in the 2016 IMF Board Paper, 'Small States' Resilience to Natural Disasters and Climate Change', for countries vulnerable to natural disaster and

Table 7.1 Risk of debt distress: LIC-DSA classifications

Low risk	Moderate risk	High risk	In debt distress
Bangladesh	Guyana (H) (S)	Cameroon (H)	The Gambia (H)
Rwanda (H)	Kenya	Dominica (S)	Grenada (S)
Tanzania (H)	Lesotho	Ghana (H)	Mozambique (H)
Uganda (H)	Malawi (H)	Kiribati (S)	
	Papua New Guinea (S)	Samoa (S)	
	Saint Lucia (S)	Sierra Leone (H)	
	Solomon Islands (S)	St Vincent and the Grenadines (S)	
	Vanuatu (S)	Tonga (S)	
		Tuvalu (S)	
		Zambia (H)	
4 of total 14	**8 of total 26**	**10 of total 25**	**3 of total 7**

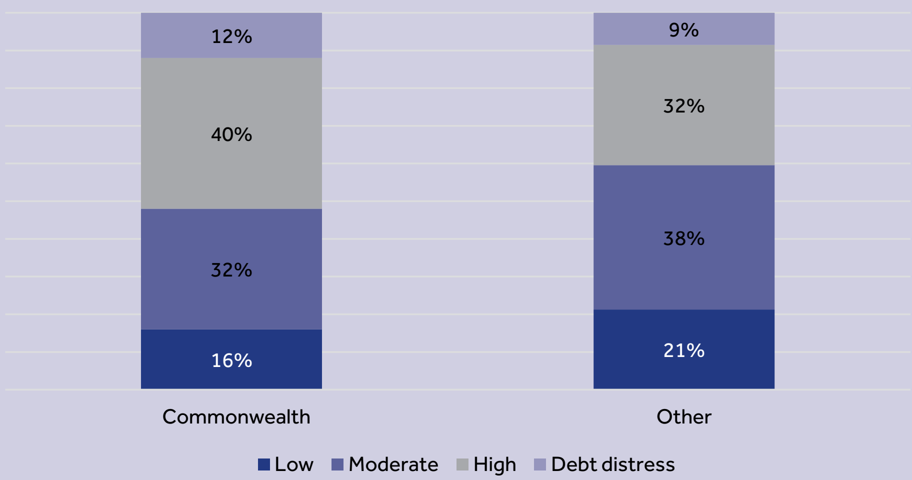
Source: https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf, as at 5 July 2019

climate shocks the DSAs now include tailored baseline or alternative scenarios based on the past impact of natural disasters (e.g. Samoa, Solomon Islands, St Vincent and the Grenadines, Tonga, Tuvalu, Vanuatu) or the likely long-term impact of climate change (Kiribati, Tuvalu) – and these correctly make major contributions to the assessment of countries as having higher risks of debt distress than before. However, the policy conclusions generally drawn are about more prudent fiscal policy and borrowing, and do not resolve the problem of how to finance infrastructure or growth.

In order to take a broader view of total public debt levels, as well as to analyse other countries not covered by the LIC-DSA, Figure 7.8 shows the debt to GDP and debt service to budget revenue ratios for

Figure 7.7

LIC-DSA debt classifications (Commonwealth and other) (%)



Source: https://www.imf.org/external/Pubs/ft/dsa/DSAlist.pdf, as at 5 July 2019 all Commonwealth countries at the end of 2018.[4] Because it includes domestic debt, looks at debt stock rather than present value and gives equal weight to stock and service ratios, it gives a somewhat different picture of debt burdens from the LIC-DSAs.

Figure 7.8 shows that a considerable number of Commonwealth countries have debt levels that are commonly considered unsustainable (not just by the LIC-DSAs but also by regional economic convergence criteria in the EU and other regions as cited above). In particular:

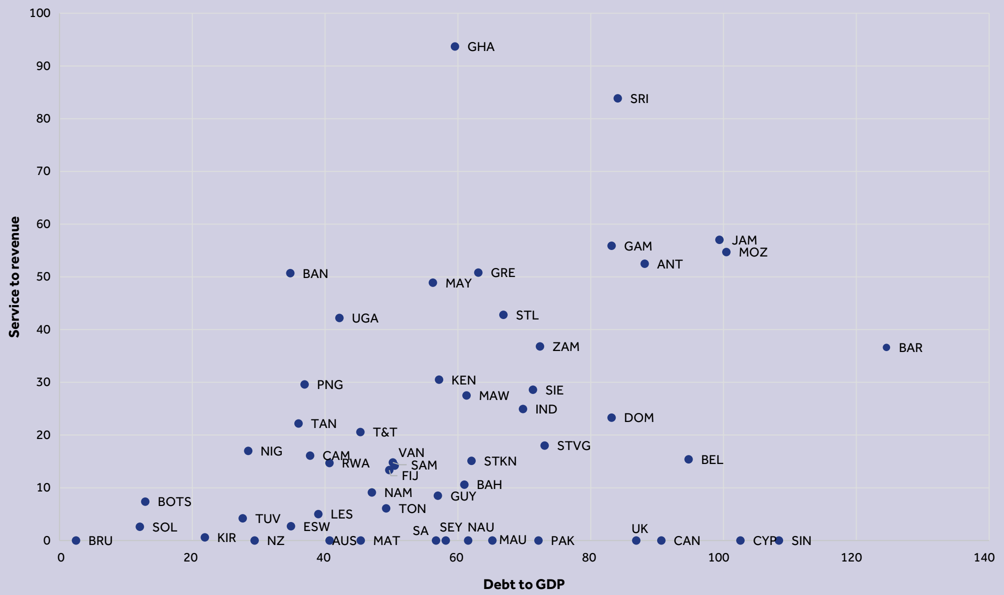
- Twenty-five countries have debt stock levels at above 60 per cent of GDP. Of these countries, 14 are SIDS, six are ex-HIPCs and six are from other categories
- Twenty-one countries have debt service to revenue ratios above 20 per cent. Of these eight are SIDS, eight are ex-HIPCs and five are from other categories.

Once again, as with the previous assessments of debt indicators and debt distress classifications, heavy debt burdens appear to be concentrated in the SIDS and ex-HIPC group. However, when looking beyond averages to individual countries, the situation appears more concerning in SIDS than in ex-HIPCs in terms of debt overhang, with almost two thirds of SIDS affected, compared with only half of HIPCs. However, the reverse is true in terms of debt service costs, with almost two thirds of ex-HIPCs having high debt service burdens compared with only a third of SIDS. As the following section explains, this results from the 'high-service' composition of new ex-HIPC debt.

It is also important to note that there are several non-SIDS or HIPCs, such as Cyprus, Pakistan and Sri Lanka, that have very high debt levels, notably crowding out large amounts of budget expenditure on other priorities; and even several HICs might be facing high debt service burdens (given their high debt stocks) if it were not for the historically low current costs of borrowing in international markets for such countries. In other words, as the IMF has also pointed out, the existence of high debt burdens is by no means confined to SIDS and ex-HIPCs.

Figure 7.8

Debt burdens 2018 (%)



7.4 Underpinning factors and policy actions

What are the underlying factors and policy actions that explain the recent rise in debt burdens? They fall into four categories: 1) increases in debt financing needs; 2) changes in financing sources and instruments; 3) exogenous shocks; and 4) other policy factors. This section examines each of these factors in turn in order to identify which have been the most important for different groups and individual countries.

7.4.1 Increases in debt financing needs

Across the globe, in the context of Agenda 2030 and the SDGs (and for some HICs where the SDGs are less central to their economic plans, as a result of other promises to voters), government spending needs have been rising. Most important, Agenda 2030 and the SDGs acknowledge new global challenges on which government action is expected – notably on environmental issues such as climate change, biodiversity and life below water; on social issues such as inequality, decent work and social protection; and on new economic concepts such as sustainable production and consumption; and on governance. They also imply very high levels of expenditure on particular infrastructure sectors and individual projects (notably energy, transport and telecoms), which will mean making large upfront spending commitments over relatively short-term periods during the SDG period.

Estimates of SDG-related public spending needs show that government spending will need to rise by between 100 per cent and 200 per cent to fulfil most of the SDGs. Two of the most comprehensive analyses of these needs are by the IMF (see Gaspar et al., 2019), which suggest that spending will need to rise by US$2.6 trillion a year by 2030, which represents on average 4 per cent of GDP in emerging market economies and 15 per cent in LICs; and by the Sustainable Development Solutions Network (Schmidt-Traub et al., 2015) which estimates additional spending needs at $1.4 trillion a year.

7.4.2 Changes in debt financing sources and costs

The second key factor pushing up debt and especially debt service levels since the financial crisis has been a change in the key debt financing sources available to countries, and in their financial conditions and debt service costs. Based on analysis made in recent IMF/World Bank LIC DSAs and other country-specific IMF Board Papers, the most important of these sources have been as follows.

External bonds Since 2008, in spite of increased volatility in financial markets, a growing number of Commonwealth countries have been accessing global bond markets for financing; those already accessing such markets have been increasing the amounts they are borrowing. New Eurobond borrowers have included Ghana, Kenya, Nigeria, Rwanda, Seychelles, Tanzania and Zambia. Many of these countries are LICs or LMICs with significant past debt problems that have not had major access to international capital markets since the 1980s. Kenya and Seychelles were attempting to diversify their financing sources by tapping Eurobond markets. Countries that have increased their borrowing have included Bangladesh, India, Jamaica, Malaysia, Pakistan, Singapore, South Africa and Trinidad and Tobago. The borrowing costs for these bonds have varied but they have often been 3–5 per cent above standard Eurobond borrowing costs for OECD creditor countries.

Other external commercial creditors Various other external creditors (banks, suppliers and commodity traders) have offered countries commercial loans – for example to Cameroon, Ghana, Kenya and Mozambique. These loans have generally not been for specific projects, and their costs have typically been 1–2 per cent higher than those of external bonds.

Domestic debt Virtually every country has made efforts to develop its domestic capital markets by issuing shorter-term bills and longer-term bonds in domestic currency. In some cases, where either there is a stable currency and a well-organised reasonable market (as in Central Africa for Cameroon or in the Eastern Caribbean) or governments have issued fixed-price bonds (as in Rwanda), such debt has not been excessively expensive. However, in other countries, depending on the prevailing inflation rate and the balance between government financing needs and private sector willingness to buy government paper, interest rates have peaked at 25–30 per cent (with volatility sometimes exacerbated by non-residents buying 'domestic debt' and then selling it following signs of currency weakness or accelerating inflation). These issues have affected The Gambia, Kenya, Malawi, Mozambique, Sierra Leone, Tanzania, Uganda and Zambia.

South-South lending There has been a large amount of media focus on the impact of China in pushing up debt burdens in other developing countries. This has certainly been true for a few Commonwealth countries (including Cameroon, Sri Lanka and Tonga), especially where they have borrowed at near commercial rates from the less concessional windows of Chinese state-owned banks or directly from enterprises. However, in most other countries, Chinese lending has not been a major cause of increased debt because China has in general respected country borrowing policies as defined in national debt management strategies or IMF programmes; and has a wide range of more concessional windows available for financing most sectors from its different lending banks. Most other South-South lending has not been large enough to have a significant impact on debt burdens, though Indian and Turkish export credits have been growing.

OECD government aid and export credit lending Since the end of the HIPC debt crisis, various OECD governments have decided to switch from loans to grants for certain projects (e.g. France, Germany and Japan) or to resume export credit cover for low-income and other vulnerable post-debt relief countries (notably Italy). Typically, both the aid loans and the export credit loans have been relatively cheap, given current global financing conditions, and there are no countries where these have been the main types of credit increasing debt levels.

Graduation from concessional funds Several countries (Cameroon, Ghana, Guyana, Kenya, Lesotho, Nigeria, Zambia) have graduated from LIC to LMIC status and seen a gradual reduction of their access to aid funds (grants or concessional loans) from both bilateral and multilateral sources. At the same time, various multilateral organisations have been making efforts to leverage their funding to provide larger amounts to LICs and LMICs, by providing them with access to less concessional funds for high-return projects (African Development Bank), or pooling funds and offering more variable graduated terms depending on the project and country debt situation (Asian Development Bank, World Bank). Other regional organisations such as the Inter-American Development Bank and Caribbean Development Bank have so few 'low-income' members that they have no longer been replenishing concessional windows.

Public-private partnerships Many countries decided in their post-Addis Ababa national development strategies that they would try to fund a much higher share through 'public-private partnerships' (PPPs) and 'private financing initiatives', especially for large infrastructure projects. Large-scale financing of this type has mostly been confined to high-income Commonwealth and larger middle-income countries such as India, Malaysia and South Africa. More recently, smaller and lower-income countries have been moving into PPPs, but so far without major financing implications, because most projects have been small (partly because private financiers are wary of perceived high risks and uncertain returns in such countries). The lessons of these projects are generally that they are two to three times as expensive in financing costs as even the most expensive external bonds or commercial loans, which are paid for by an automatic loss of the revenue generated by the project to repay the financiers (sometimes supplemented by government budget subsidies if such revenue is insufficient). They also carry large potential risks of non-performance by the private implementing partner, or underestimates of costs and overestimates of revenue streams, which can lead the project to fail financially and all the costs to fall back on the government budget. Countries with long histories of PPPs (including the UK) have lived this experience: however, the scale of the additional liabilities so far for lower-income and smaller developing countries is only just being quantified by current IMF missions under the new LIC-DSA framework, and no consistent data are available to analyse countries.

Overall, it is important to ask why countries have been turning to these new, more expensive, sources of financing. One very strong reason is that there have been factors in the international community that have pushed them towards these sources. First, on the negative side, a clear message was transmitted by OECD governments and received by developing countries at the Addis Ababa Financing for Development Summit in 2015 (but even before that, in 2010) that, after a decade of significant increases, aid was likely to stagnate, and therefore countries should look to private sector and commercial financing (as well as domestic revenue mobilisation) to fund their development. Second, there were massive 'sales campaigns' by international bond advisory organisations and investment banks, together with encouragements and offers of financing to acquire credit ratings as a precursor to bond market access; and other potential commercial creditors such as banks and commodity traders or suppliers were just behind them in the queue to offer new finance. Third, there was considerable technical assistance and political support provided behind the development of domestic capital markets and issuance of increased treasury bills and bonds, as well as liberalisation to allow non-residents to purchase such 'domestic' debt. Fourth, China and other South-South creditors, owing to high growth and commodity prices, found themselves flush with money and in a position to offer much higher loans; as well as wanting to promote their own political and economic links with smaller developing countries. Fifth, multilateral organisations wanted to maximise their own financial leverage and be able to offer more funds to countries for funding the SDGs.

7.4.3 Exogenous shocks

Another important factor influencing the rise in country debt levels since the financial crisis has been exogenous shocks. The most prominent of these in recent years have been:

- The global financial crisis itself – which pushed up borrowing levels in Commonwealth OECD countries during 2009/10, as well as in Caribbean countries, which most felt the immediate spill-over effects from slower US growth.
- Repeated – as well as more frequent and damaging – natural disasters in the form of hurricanes, cyclones and typhoons, notably for SIDS. Most of the Commonwealth SIDS in the Caribbean, and many in the Pacific, have been hit by such disasters since 2008, resulting in debt increases ranging from 5 per cent to 30 per cent of GDP in the years following the disasters, as the countries need to fund reconstruction and absorb lower growth. Other countries, such as Malawi and Mozambique, have had to absorb shocks of droughts or flooding, also on a relatively regular basis, depressing GDP but not provoking so much new borrowing for immediate reconstruction, owing to greater concessional funding.
- Commodity price and other growth shocks – for example to iron production in Sierra Leone, copper prices and

production in Zambia and more broadly to many commodities for a wide range of countries in 2015/16 as Chinese and broader global demand reduced.

- The Ebola crisis, which sharply pushed up Sierra Leone's borrowing in 2011–2013.

It is of course doubtful whether many of these events should be called 'shocks'. Those from natural disasters and commodity volatility have been so common for many decades that they could have been planned into forecasts of country ability to repay their debts. Overall, earlier studies have found that 80–90 per cent of 'shocks' are so predictable that they can be factored into economic policies and insured or protected against in various ways (Matthews, 2018). But, because such measures have only recently begun to be taken, following most of the existing Commonwealth country shocks, debt burdens increased significantly.

7.4.4 Borrowing country policy factors

The final set of factors had to do with policies in borrowing countries, notably:

The **higher spending needs** discussed in Section 3.1 above – often for 'higher-return' infrastructure projects felt to be able to repay less expensive loans.

A wish to diversify funding away from existing sources, in a new 'Age of Choice' (Prizzon et al., 2016). Existing funders were seen as having negative characteristics such as OECD bilateral or multilateral donor conditionality, or slow implementation of projects. On the other hand, commercial funders offered immediate disbursement and no conditionality; and South-South funders were seen to have faster implementation and less conditionality. However, to some degree, this Age of Choice turned out to be illusory, since the choice was sometimes to go for more expensive funding with new types of conditions and pitfalls, or not to have the funding needed for key national development projects.

Lack of sufficient knowledge of the new financing sources on offer. Many of the countries using the new financing sources had had little or no prior experience of them (especially of international bonds, Chinese export credit lending or PPPs) – and contracts such as those for PPPs and infrastructure projects were often extremely complex and hard to negotiate. There was also often no immediately available source of independent advice on negotiating the financing and contracts – or sometimes advisors did not do the best-quality job in protecting the borrowing country interests. So some countries suffered from overpriced (as often indicated by very oversubscribed) bonds, borrowed too expensively from the Chinese or other lenders, or saw major costs and risks materialise from PPPs, owing to poor negotiation.

Poor investment project design and implementation. Particularly in the context of the SDGs, many poorer and smaller countries have been trying to plan and implement major investments in sectors where they have relatively little experience (airports, ports, dams, railways, etc.). Their public investment management systems have been assessed as weak by the IMF and World Bank.[5] Many countries have therefore seen significant problems in designing and implementing large infrastructure projects, with major delays and cost overruns. Others have dramatically overestimated the returns or revenues projects would produce, and therefore borrowed much more expensively than the project could justify. Many did not have in place any system for 'matching' a realistic rate of return for a project with an appropriate cost or source of financing. Others even borrowed very expensive funds without allocating them to any specific projects. At all stages of the public expenditure and financing cycle, insufficient capacity or faulty procedures undermined the likelihood that the project would generate returns to repay more expensive debt.[6]

Corruption and non-transparency. Corruption and non-transparency are often a problem in (especially large) projects in countries in all regions and at all income levels.

However, in a few country cases, very large-scale corruption has been seen to be a major cause of increased debt. Two of the most public cases are the defence and fishing loans by state-owned enterprises of a Southern African Commonwealth country exceeding US$2 billion in 2013–2016;[7] and the massive borrowing followed by embezzlement of the proceeds by the former president of a West African Commonwealth country in the build-up to his flight from the country in 2017. This has led to renewed focus on the systems in place in countries for approving and using loans, and especially the unique role finance ministers should play in loan signature, and Parliament in approving debt limits or even individual loans, to ensure full transparency in borrowing. Additional similar problems have been caused in various countries by more widespread non-transparency in loans contracted by public enterprises and other decentralised agencies, in guarantees of private sector loans and in PPPs. It is naturally vital to point out that there has been a similar lack of transparency and evidence of corruption among the providers of these funds.

7.4.5 Inadequate debt relief

One additional factor increasing (or failing to reduce sufficiently) debt burdens in Commonwealth countries has been the inadequacy of debt relief provided to non-HIPC countries (and post-HIPC countries). Since the financial crisis, at least nine Commonwealth countries (Antigua and Barbuda, Belize, Cameroon, Grenada, Jamaica, Mozambique, Seychelles, St Kitts and Nevis and St and the Grenadines) have received debt relief, and debt relief discussions are currently underway for The Gambia. Other countries have reduced their debt service by refinancing Eurobonds or domestic debts at lower interest rates (in Ghana's case with a World Bank guarantee).

In particular, debt relief for countries has:

- Largely failed to take account of countries' needs to restore long-term **debt sustainability**. A 2015 review of debt relief for Commonwealth small countries (Robinson, 2015) concluded that restructuring of middle-income countries' debt had continued to treat the problem as 'one of short-term liquidity rather than solvency' and to ignore the persistent vulnerability of such countries to exogenous climate and economic shocks. It had therefore involved almost entirely liquidity relief (medium-term postponement of debt service) rather than comprehensive debt reduction.
- Not been sufficiently comprehensive in **coverage of creditors**. Countries that have received Paris Club debt relief have often had major problems negotiating with non-Paris Club bilateral creditors (e.g. The Gambia, Grenada, Mozambique under HIPC). More recently, some post-HIPC countries, like Cameroon, Mozambique and St Vincent and the Grenadines, have owed little to Paris Club creditors so have instead been trying to negotiate bilaterally with non-Paris Club creditors (e.g. Brazil, China, India and Venezuela). Even the recent discussions of debt relief for The Gambia have focused on Arab creditors, South-South multilateral institutions (the Arab Bank for Economic Development in Africa, Islamic Development Bank, the Organization of the Petroleum-Exporting Countries Fund for International Development) and India, rather than multilateral creditors, which account for one third of external debt (though the authorities have been requesting that it cover all debt service). Relief of domestic debt has focused on measures to reduce inflation (and therefore in theory domestic interest rates), to reduce net borrowings, and to extend maturities, rather than on comprehensive restructuring of domestic debt.
- Been **delayed or limited in their scope** by concerns about preserving county access to financial markets (external or domestic). This has long been an

important issue delaying or limiting the scope of debt relief for countries, even though many studies and surveys of creditors and ratings agencies have indicated that they would prefer an immediate hit from debt reduction followed by sustainable economic recovery, to the longer-term, more corrosive, damage to growth and financial market access caused by accumulation of arrears, repeated short-term rescheduling and unsuccessful fiscal austerity. In the case of middle-income countries with very little access to aid, this has been exacerbated by a concern about the lack of other potential non-market sources of flexible financing. An additional worry for some countries has been potential damage to domestic financial institutions (such as commercial banks), which have become heavily dependent on government debt interest payments for their own financial sustainability.

One positive aspect of recent restructurings has been the 'hurricane contingency clause' negotiated by Grenada in 2015 with bondholders, Taiwan and the Paris Club, bringing a service moratorium of up to one year and potentially saving EC$45 million (around one third of external debt service). Such clauses could be more systematically built into all restructurings with countries vulnerable to weather-related shocks, with considerably longer deferrals of service given that the IMF and others have estimated that the after-effects of such disasters can last anything up to five years (IMF, 2016; Mitchell et al., 2017).

7.4.6 Overall relative importance of the factors

Overall, it is not possible to identify precisely the relative weight of these factors in increasing debt burdens in Commonwealth countries. However, it is possible to identify the more widespread and clear factors for different groups, notably higher debt funding needs for virtually all, the widespread availability of new financing sources, exogenous shocks especially for SIDS and Sierra Leone, poorer investment management and debt negotiation capacity in lower-income countries. Table 7.2 also shows the key factors that have affected debt sustainability for the countries identified as being in or at high risk of debt distress in Table 1 above. It underlines that the predominant factors have been exogenous shocks, Eurobond and domestic borrowing, large infrastructure projects and contingent liabilities. The next section of this paper explores the policy implications of these contributing factors.

7.5 Key emerging issues and policy implications

7.5.1 Key emerging issues

The key issue emerging from this report is that debt should once more and for the next few years be at the forefront of Commonwealth finance ministers' discussions. Section 2 shows that:

- Debt stock to GDP and debt service to budget revenue ratios have been rising consistently for most analytical groups (regions, income levels, HIPCs and SIDS) since the global financial crisis.
- As judged by the IMF and World Bank LIC-DSAs, 52 per cent (and rising) of Commonwealth LICs and LMICs are at high risk of debt distress or in debt distress, higher than the overall global total of 42 per cent.
- As judged by a broader picture of total public debt burdens, 25 countries have high debt stock levels, and 21 have high debt service to revenue ratios, and could require concentrated and continuing action to reduce their debt burdens and avoid debt crises over the next decade.

Section 3 identifies the key factors and policy actions underlying the recent rise in debt burdens among many Commonwealth countries as being:

- Dramatically increased debt financing needs, owing to a combination of much more ambitious SDG-related development plans, stagnating or

Table 7.2 Factors causing high risk or debt distress

Country	Exogenous shocks	Non-concessional borrowing	Other factors
Cameroon	Oil/commodity 2014	Eurobond, domestic	Infrastructure, state-owned enterprise contingent liabilities
Dominica	Hurricane (2017), tourism		No debt relief
The Gambia	Aid	Domestic	Political instability, embezzlement
Ghana	Falling aid flows	Eurobonds, domestic	Infrastructure, pre-election fiscal laxity
Grenada	Hurricane (2017), tourism	Domestic, non-Paris Club	Inadequate debt relief
Kiribati	climate change and lower aid flows*		
Mozambique	Cyclone 2019, commodities and exchange rate	Commercial loans	Poor state-owned enterprise transparency ad high contingent liabilities, inadequate debt relief
Samoa	Cyclone shock;* falling grants	China	Infrastructure
Sierra Leone	Ebola, iron prices		Infrastructure, state-owned enterprise contingent liabilities
St Vincent and the Grenadines	Storms/floods 4% GDP, tourism		PPP contingent liabilities
Tonga	Cyclone 2014		
Tuvalu	Cyclone 2015	Commercial fishing loans	
Zambia	Copper exports	Eurobonds, domestic	Infrastructure

Note: * As explained earlier, the high risk classifications of these countries owe to inclusion of future scenarios for climate change or disaster shocks.
Source: IMF Article IV and programme documents

slowly rising tax revenues and growing budget deficits and falling aid grants and concessional loans;

- Changes in debt financing sources and costs, notably newfound access to international bond markets for lower-income countries, and increased access by existing users; the return of other external commercial creditors to those countries; rapidly growing use of domestic debt markets; increased South-South lending including by China; renewed lending by OECD (non-Commonwealth) governments; graduation from bilateral and multilateral concessional funds; and growing use of PPP financing agreements. All of these have been strongly promoted as financing alternatives to concessional flows, regardless of their much higher costs and risks;
- Exogenous shocks, including the global financial crisis itself; more frequent natural disasters owing to climate change; commodity price and other

growth shocks; and health pandemics such as Ebola. Most of these were relatively predictable but were not protected against;

- Policies in borrowing countries, including a wish for greater choice on funding sources; lack of knowledge of new instruments leading to poor negotiating results; poor investment project design and implementation; and (in a minority of cases) corruption and lack of transparency.

Overall, the most important of these factors have been higher debt funding needs, greater access to diversified funding sources, exogenous shocks for some countries and poor investment management and debt negotiation capacity.

7.5.2 Policy implications

Given the multiple causes of the problem, potential policy solutions need to be equally comprehensive.

Across a wide range of countries, there is need to pay **closer attention to the levels of debt stock and service** and the degree to which these may be crowding out private investment or public spending to achieve Agenda 2030 and national development plans. For countries eligible for LIC-DSAs, annual assessments already provide the key data needed to analyse debt sustainability. However, the higher the income level of the country, often the more difficult it is to locate easily clear and comparable debt stock and service figures for all levels and agencies of government. One key step forward here could be to make sure IMF Market Access Country DSAs (for which the system is currently being reviewed) present such numbers and ratios as clearly as the LIC-DSAs.

Slowing the rise in debt. To cope with the factors underlying increases in debt levels:

- Countries will need to prioritise their development plan spending needs even more clearly, and ensure any financing mobilised is compatible with debt sustainability.
- Countries (and the international community in terms of changing the global tax system and providing technical support to lower-income countries) will need to accelerate dramatically their efforts to increase tax revenues.
    - The international community (notably major OECD economies) needs to sharply reinforce its efforts to increase concessional aid flows, not just to lower-income countries but also to vulnerable groups such as SIDS, or they will not be able to reach the development goals or the SDGs without falling into debt crisis.
    - There is a need for action to monitor (and where necessary regulate) the behaviour of creditors to ensure they are lending responsibly, including:
        - More specific guidelines and recommendations for pricing and maturity of international bonds, including where necessary staggered repayments to avoid bunching of bullet maturities; and greater use of bond guarantees by the multilateral development banks in return for sharply reduced interest costs;
        - More caution in use of domestic debt markets, based on in-depth analysis of trends in maturities and costs as well as liquidity among potential purchasers, and promotion of greater competition in the markets or use of ‘fixed price’ securities to reduce debt costs;
        - Further encouragement of South-South lenders to follow responsible lending principles, including any debt limits contained in country debt strategies or IMF programmes;

  - Potential rethinking by OECD government agencies of their recent decisions to move from loans to grants for lower-income countries, and to restore export credit loan cover;
  - Redesigning and delaying 'graduation' from concessional funding for countries that have not yet achieved the SDGs, and greater use of concessional funds for lower-return projects in LMICs and 'vulnerable' (e.g. SIDS) UMICs.
  - Much greater caution in use of PPPs, which should be subject to the same rules on debt sustainability and transparency as other types of borrowing.
- There is a need to step up the multiplicity of solutions currently being provided against exogenous shocks, but above all through highly concessional low-conditionality rapidly disbursed funding to affected countries from official sources, including higher IMF quotas.
- It is critical to dramatically increase capacity-building, negotiating and legal support to countries in identifying funding sources, understanding new instruments and designing and implementing projects and contract
- Current measures to fight corruption and increase transparency already being promoted by the G20 need to be accelerated, but with an equal focus on transparency of creditors through a mandatory public register of loans; and on transparency to citizens and parliaments of borrowing countries.

Enhancing debt relief. For countries already in debt distress, and indeed for those beyond the LIC-DSA group with high public debt and debt service burdens, there should be scope for greater and genuine debt relief, either through rescheduling for countries with only a liquidity problem or through outright cancellation for countries with a severe overhang/stock problem. There is also an urgent need to reintroduce HIPC principles for such actions, to ensure they are based on country debt sustainability and not creditor preferences, and cover all creditors comprehensively and on comparable terms – but preferably also learning the lessons of HIPC so relief is provided faster and with fewer conditions.

One objection frequently raised to such comprehensive debt restructurings in the context of new creditors and instruments is that it will be much more difficult to convince the new types of creditors to participate, or to include the new instruments, because of their different characteristics. This is not a credible argument because all of these 'new types of debt' have existed for any decades in other countries and frequently been restructured. To take a few examples:

- China and many other South-South creditors have been providing debt relief for many decades, most recently in a HIPC context, albeit not via the Paris Club Forum. There will of course be a need to design relief to fit with the financial procedures and regulations of new creditor agencies (such as ExIm banks and development banks), but efforts are already under way to work with China and other South-South creditors on such procedures.
- Bonds have been restructured by sovereign debtors multiple times over the past few centuries. Ensuring they are again is more a question of political will, technical solutions like collective action clauses and, where necessary, laws to enforce creditor participation, as were necessary against vulture funds during the HIPC process.
- Domestic debts have also been restructured in many countries over the past few decades. While this requires

great care so as not to destabilise or undermine the domestic financial system, it has been done with success most recently in countries such as Cameroon and Cape Verde.

7.5.3 Specific priority actions for the Commonwealth

Within this list of potential policy actions, there are two the Commonwealth may be particularly well placed to pursue:

1. To enhance its support to countries on ***transparency*** in debt recording, reporting and monitoring, already being undertaken by the Debt Management team in the Economic, Youth and Sustainable Development Directorate, as part of the rollout of the new Meridian debt management system. This would require even more intensive training and capacity-building support to countries to ensure they can deliver on all the different data transparency needs discussed above – both to the international and creditor community and to their own citizens and parliaments. It would also require support to countries in designing laws, regulations and reporting formats that reflect the priorities of their creditors and citizens. However, for this to be feasible, the Meridian trust fund will require enhanced resources, as current resources are barely sufficient for systems development, installation and initial training for users.

2. To revive a separate two-hour ***Commonwealth Debt Sustainability Forum*** just before the Commonwealth Finance Ministers' Meeting, along the lines of the former Commonwealth Ministerial Debt Sustainability Forum. This could have a particular focus on exchanging best practices among the groups of countries that currently have the highest debt levels (notably LICs, ex-HIPCs and SIDS), in preventing debt crises and reducing debt burdens, discussing the various solutions proposed above and taking forward specific initiatives in each of the areas depending on Commonwealth member country priorities. It could be chaired by a country from among these groups, but of course would be open to participation by all Commonwealth countries, as well as inviting BWI and other independent experts to present analyses and potential initiatives, as was the case with the HIPC Forum. The Organisation Internationale de la Francophonie (with which the Commonwealth already has a strong partnership) is also focusing the work of its Finance Ministers' Forum on Financing for Development on debt issues for the years 2019–2021, and therefore it may also be possible if desired to broaden the discussion and organise joint events and consultations.

Notes

1 These are not the only indicators that can be used to assess debt sustainability and burdens (others include debt to exports, present value of debt to gross domestic product (GDP), etc.). They are used here because they are the only indicators for which it is possible to find a consistent series of data for all Commonwealth countries.

2 For Tonga, data are taken from IMF/World Bank DSAs undertaken since 2012. Data for Nauru start in 2009.

3 Unfortunately, for countries that do not undertake LIC-DSAs, there is no adequate global data source for total public debt liquidity ratios. For this reason, we this report uses individual country budget and debt management office data for 14 countries and only external debt data for five countries (Mauritius, Pakistan, Seychelles, South Africa); and omits eight high-income countries (Australia, Brunei, Canada, Cyprus, Malta, New Zealand, Singapore and the UK). There are no data available for Nauru except estimates in the most recent IMF Article IV document, which

put service at 2 per cent of revenue. This is one crucial issue that current efforts to enhance debt transparency could tackle, by including these in data collected and analysed by the IMF and World Bank.

4 Countries for which debt service ratio data are not available appear on the y axis of the graph.

5 For a summary of the IMF's views see IMF (2018b).

6 For a comprehensive analysis of the problems in public investment management and how they have contributed to renewed rises in debt, see DFI's study for DFID, ***Productive Expenditure for Debt Sustainability***, October 2016, based on case studies of Ghana and Rwanda, available at www.development-finance.org

7 For a frank civil society analysis of what happened in Mozambique, see https://jubileedebt.org.uk/countries-in-crisis/mozambique-secret-loans-unjust-debts

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