DECEMBER 2020

DEVELOPMENT REIMAGINED

OCIC


# COVID-19
# CHINA'S DEBT RELIEF

How significant are Chinese debt relief efforts for supporting the response to Covid-19 in poorer countries?

Consultancy project by Oxford China Africa Consultancy on behalf of Development Reimagined

## Introduction

In the wake of Covid-19, governments around the world have scrambled to fund health care and welfare efforts, and as a result fiscal expenditures have increased globally. Consequently, many countries - including in Africa - have looked to postpone their debt payments, so as to create fiscal space. In recent years, China has become one of the biggest global bilateral lenders, particularly to African countries. Therefore, postponement negotiations have had to involve China.

This report explores China's potential impact on debt suspension efforts and therefore on Covid-19 recovery, particularly among low- and middle-income countries and African countries, and provides context by analysing the scale of fiscal and debt service pressure, as well as the role of other lenders at the multilateral and bilateral level.

# DECEMBER 2020

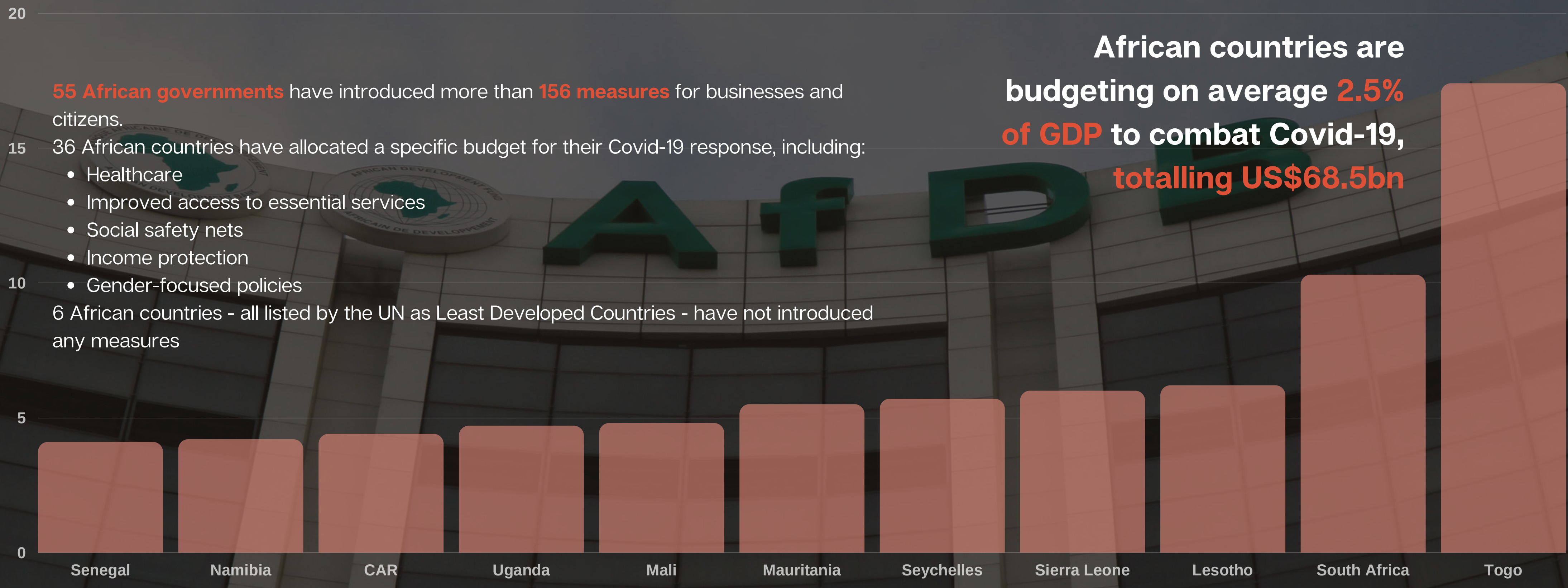
## 1. African governments have had to increase spending on health and economic measures in order to counteract Covid-19's effects

**55 African governments** have introduced more than **156 measures** for businesses and citizens.
36 African countries have allocated a specific budget for their Covid-19 response, including:

- Healthcare
- Improved access to essential services
- Social safety nets
- Income protection
- Gender-focused policies

6 African countries - all listed by the UN as Least Developed Countries - have not introduced any measures

**African countries are budgeting on average 2.5% of GDP to combat Covid-19, totalling US$68.5bn**



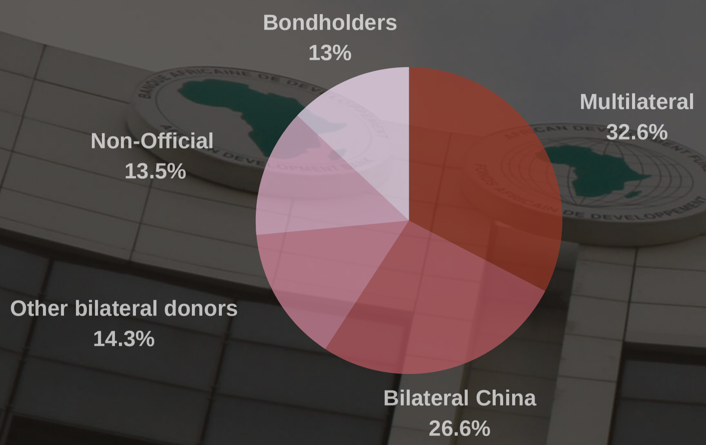

**Highest budgets for Covid-19 response as a % of GDP**

SOURCE: Development Reimagined

DECEMBER 2020

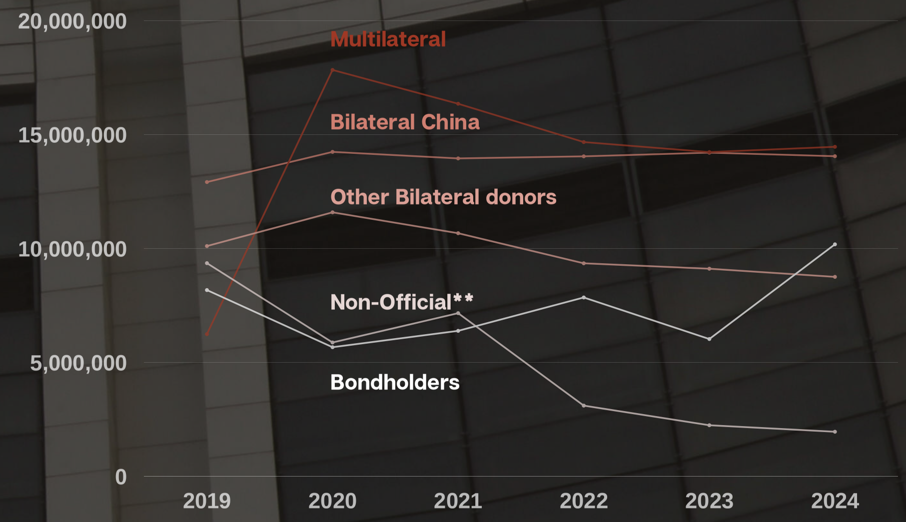
## 2. Most low- and middle-income countries* around the world have - in the past - borrowed money from a wide range of lenders, to whom they have to pay "debt service" costs.

**Total Debt Service 2020: Low and Middle Income Countries**




Total debt service for low and middle income countries in 2020 totalled **USD 437bn.**

**Total Debt Service Trends 2019-2024 for Low and Middle Countries (USDth)**



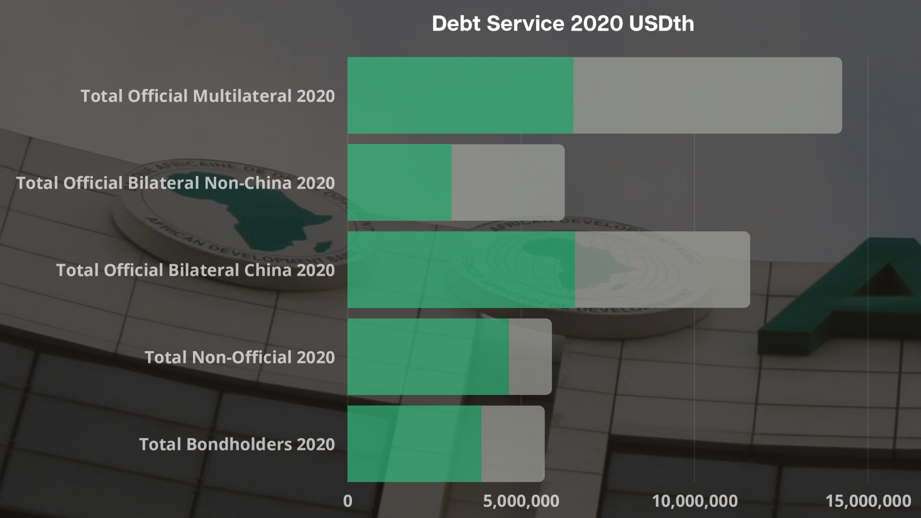

Debt service costs have to be included in budgets for many low and middle income countries. Overall, **bilateral** debt service costs to **China** currently make up **27%** of total debt service costs. However, multilateral debt service costs are and are projected to remain higher over the next 5 years, unless postponed or written-off.

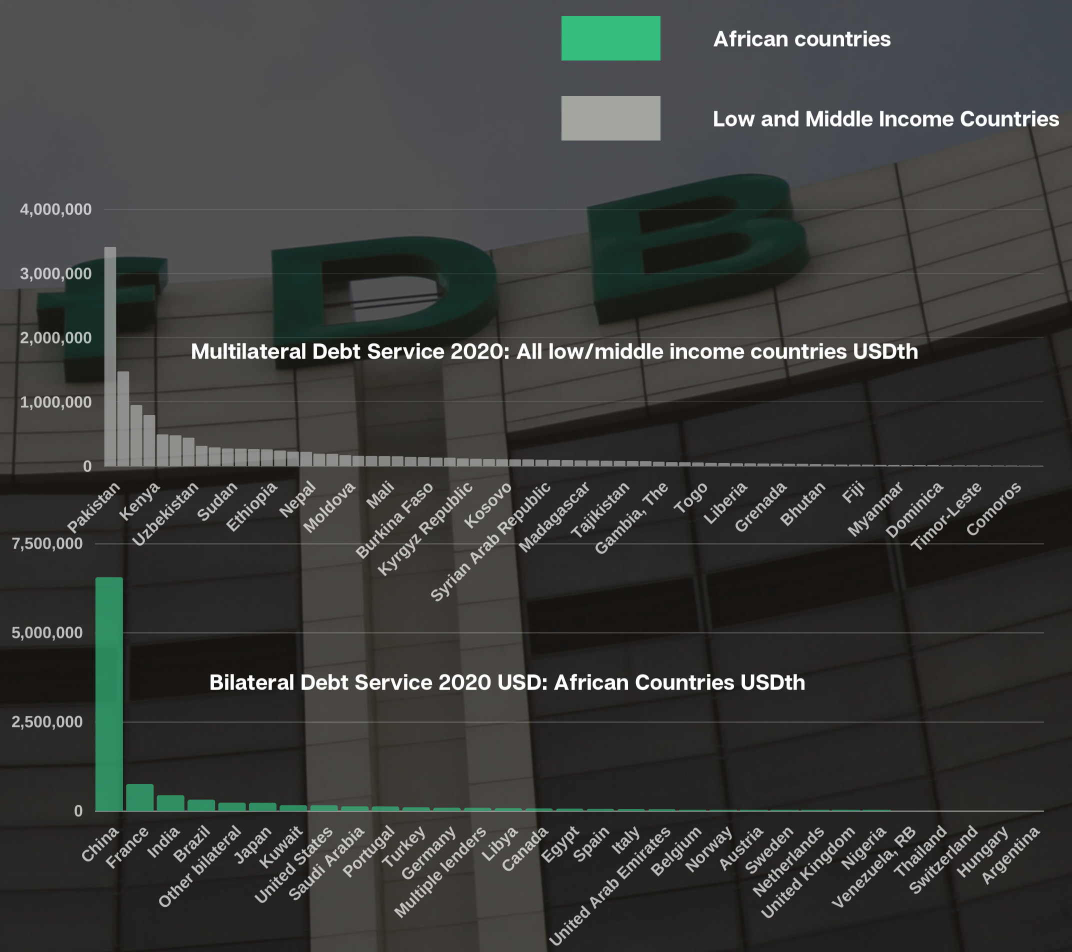
***Low-income countries defined as those that access World Bank IDA funds; middle-income countries defined as those that can access World Bank IBRD funds**

**** Non-official includes some debt issued by Chinese commercial creditors**

SOURCE: World Bank Data/David Mihalyi

## 3. Within the group of low and middle-income countries, African countries are particularly significant borrowers, reflecting their significant needs for finance to achieve poverty reduction and sustainable development.




The majority of debt service costs among low and middle income countries need to be made by **African countries as a whole.** The majority of bilateral debt service owed by Africa as a whole is to **China.**

SOURCE: World Bank Data/David Mihalyi

DEVELOPMENT REIMAGINED

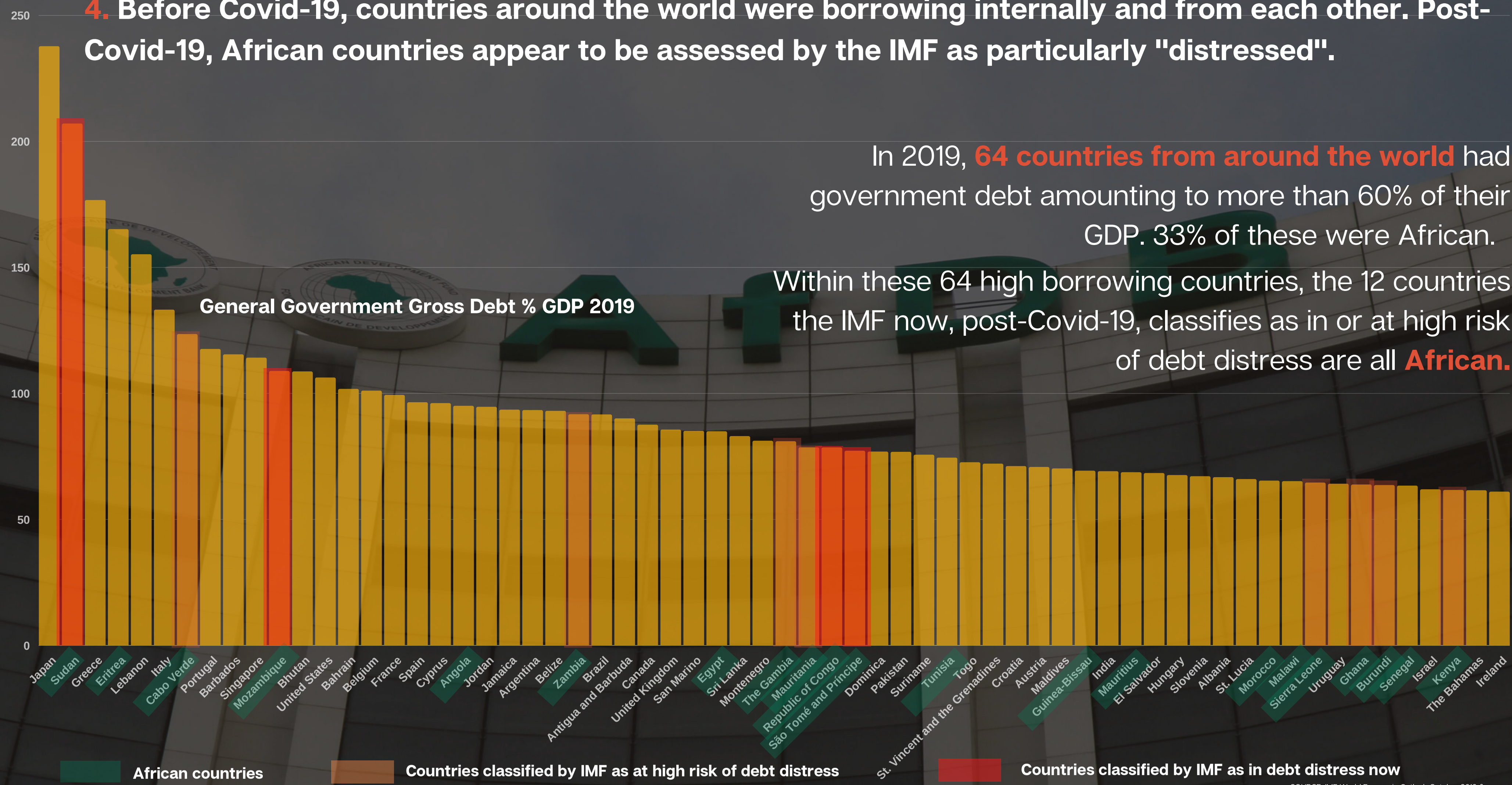
OCIC

DECEMBER 2020

## 4. Before Covid-19, countries around the world were borrowing internally and from each other. Post-Covid-19, African countries appear to be assessed by the IMF as particularly "distressed".

In 2019, **64 countries from around the world** had government debt amounting to more than 60% of their GDP. 33% of these were African.

Within these 64 high borrowing countries, the 12 countries the IMF now, post-Covid-19, classifies as in or at high risk of debt distress are all **African.**




SOURCE: IMF World Economic Outlook October 2019 & List of LIC DSAs for PRGT-Eligible Countries As of November 25, 2020

## 5. African countries also appear to have been the focus for credit ratings' agencies assessments of poor debt sustainability post-Covid-19.

From January to end-November 2020, S&P, Moody's and Fitch **downgraded 15 African countries'** credit ratings.
6 countries now have ratings indicating 'substantial risks' while Zambia's rating indicates it is in default.


25 other countries globally were downgraded by Moody's and Fitch.

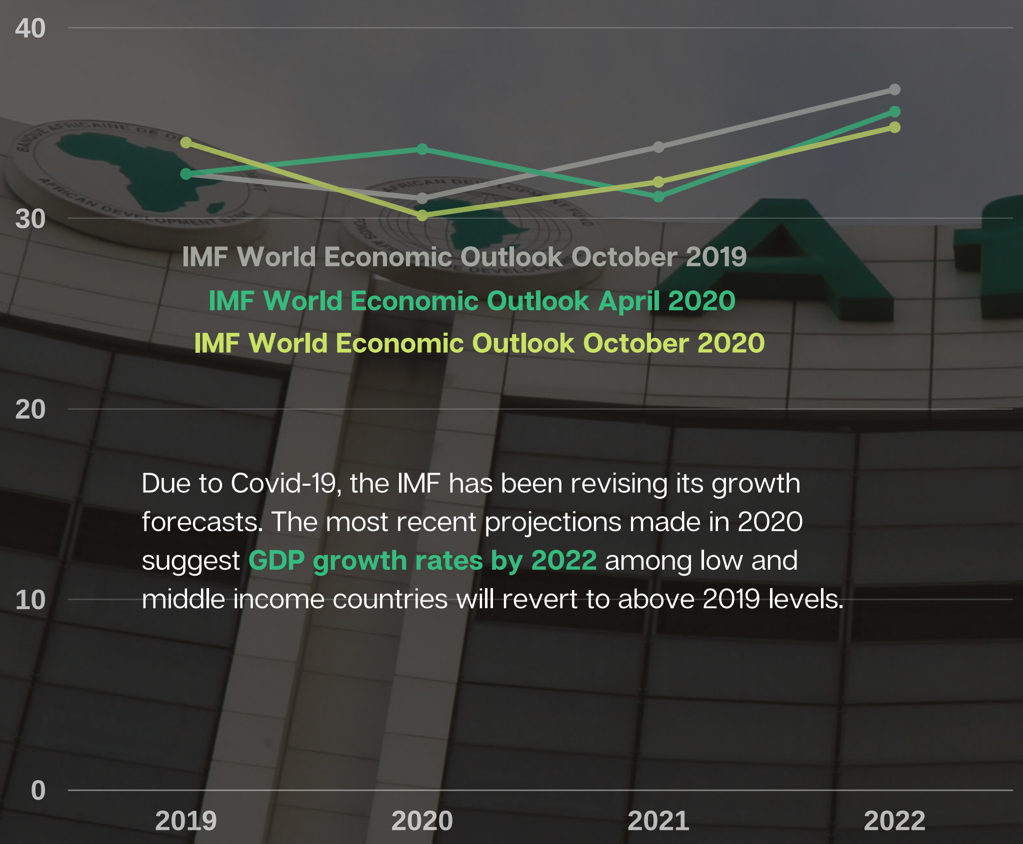
| | | |
|---|---|---|
| Canada | Costa Rica | Belize |
| Hong Kong | San Marino | Sri Lanka |
| Slovakia | Aruba | Maldives |
| Mexico | Maldives | Angola |
| Colombia | Oman | Argentina |
| United Kingdom | Bahamas | Lebanon |
| India | Bolivia | Ecuador |
| | Nicaragua | Suriname |
| | Armenia | |
| | Bahrain | |

| | S&P | | Moody's | | Fitch | |
|---|---|---|---|---|---|---|
| Algeria | | | | | | |
| Angola | CCC+ | 26 March 2020 | Caa1 | 8 September 2020 | CCC | 4 September 2020 |
| Benin | B+ | | B2 | | B | |
| Botswana | BBB+ | 27 March 2020 | A2 | | | |
| Burkina Faso | B | | | | | |
| Burundi | | | | | | |
| Cabo Verde | B | | | | B- | 17 April 2020 |
| Cameroon | B- | 10 April 2020 | B2 | | B | |
| Central African Republic | | | | | | |
| Chad | | | | | | |
| Comoros | | | | | | |
| Congo, Dem. Rep. | CCC+ | | Caa1 | | | |
| Congo, Rep. | B- | | Caa2 | | CCC | |
| Cote d'Ivoire | | | Ba3 | | B+ | |
| Djibouti | | | | | | |
| Egypt | B | | B2 | | B+ | |
| Equatorial Guinea | | | | | | |
| Eritrea | | | | | | |
| Eswatini | | | B3 | 20 July 2020 | | |
| Ethiopia | B | | B2 | 7 May 2020 | | |
| Gabon | | | Caa1 | | B | |
| Gambia | | | | | CCC | 3 April 2020 |
| Ghana | B- | 14 September 2020 | B3 | | | |
| Guinea | | | | | B | |
| Guinea-Bissau | | | | | | |
| Kenya | B+ | | B2 | | | |
| Lesotho | | | | | B+ | |
| Liberia | | | | | B | |
| Libya | | | | | | |
| Madagascar | | | | | | |
| Malawi | | | | | | |
| Mali | | | Caa1 | 8 September 2020 | | |
| Mauritania | | | | | | |
| Mauritius | | | Baa1 | | | |
| Morocco | BBB- | | Ba1 | | | |
| Mozambique | CCC+ | | Caa2 | | BB+ | 23 October 2020 |
| Namibia | | | Ba2 | | CCC | |
| Niger | | | B3 | | BB | |
| Nigeria | B- | | B2 | | | |
| Rwanda | B+ | | B2 | | B | 6 April 2020 |
| Sao Tome and Principe | | | | | B+ | |
| Senegal | B+ | | Ba3 | | | |
| Seychelles | | | | | B+ | |
| Sierra Leone | | | | | | |
| Somalia | | | | | | |
| South Africa | BB- | 29 April 2020 | Ba2 | 20 November 2020 | BB- | 20 November 2020 |
| South Sudan | | | | | | |
| Sudan | | | | | | |
| Tanzania | | | B2 | 20 November 2020 | | |
| Togo | B | | B3 | | | |
| Tunisia | | | B2 | | B | 12 May 2020 |
| Uganda | B | | B2 | | B+ | |
| Zambia | SD | 22 October 2020 | Ca | 3 April 2020 | RD | 18 November 2020 |
| Zimbabwe | | | | | | |

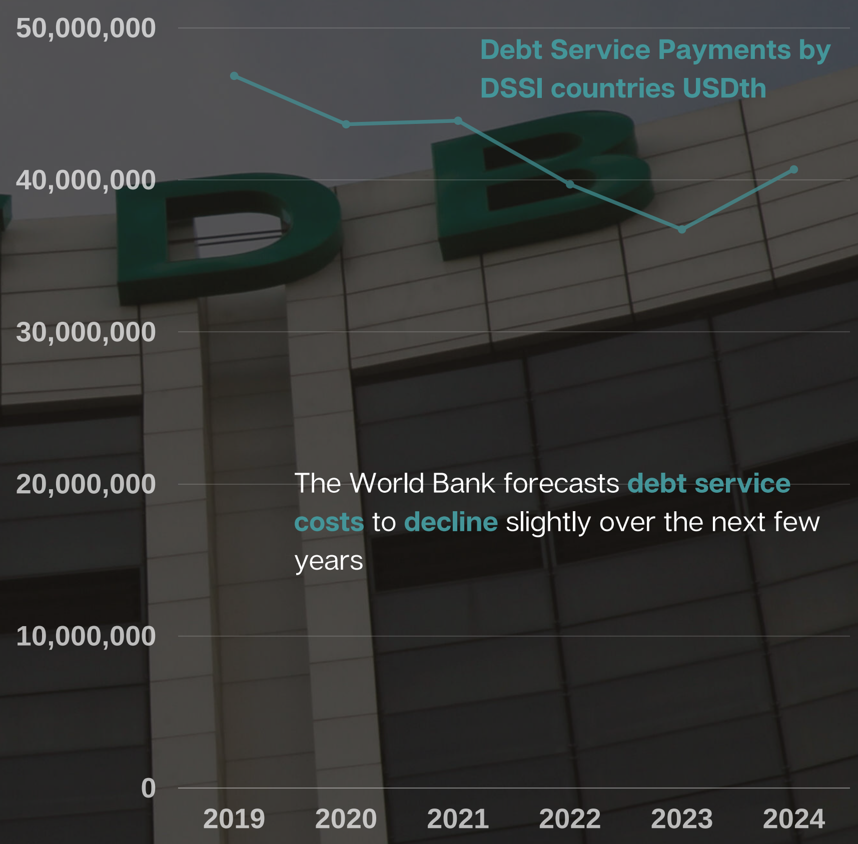
Sub-Investment Grade
Substantial Risks
In Default

SOURCE: S&P, Moody's, Fitch

**6. The focus on Africa does not seem to be because of forecasts. Debt service costs in low and middle income countries are projected to decline slightly over 2019-2024, while growth rates in low and middle income countries are still projected to rise after 2020, despite Covid-19.**




Due to Covid-19, the IMF has been revising its growth forecasts. The most recent projections made in 2020 suggest **GDP growth rates by 2022** among low and middle income countries will revert to above 2019 levels.




The World Bank forecasts **debt service costs** to **decline** slightly over the next few years

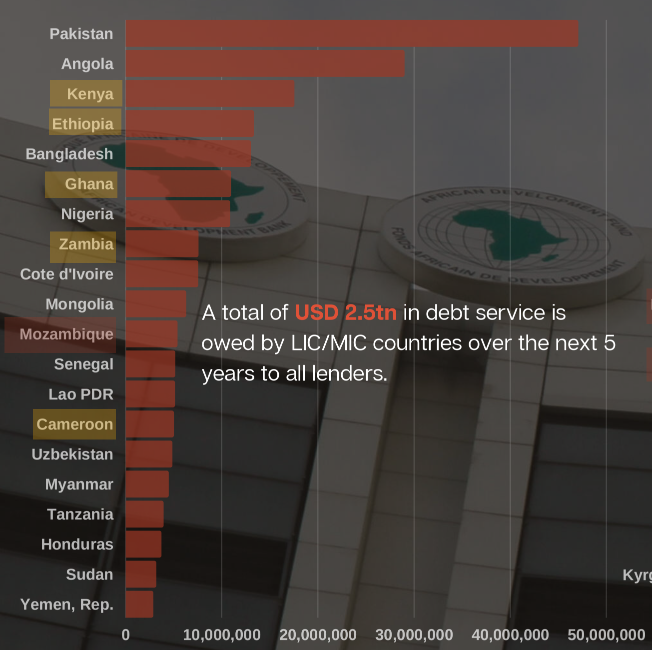
SOURCE: World Bank Data/David Mihalyi/IMF World Economic Outlook April 2019, October 2019, April 2020

DEVELOPMENT REIMAGINED | OCIC

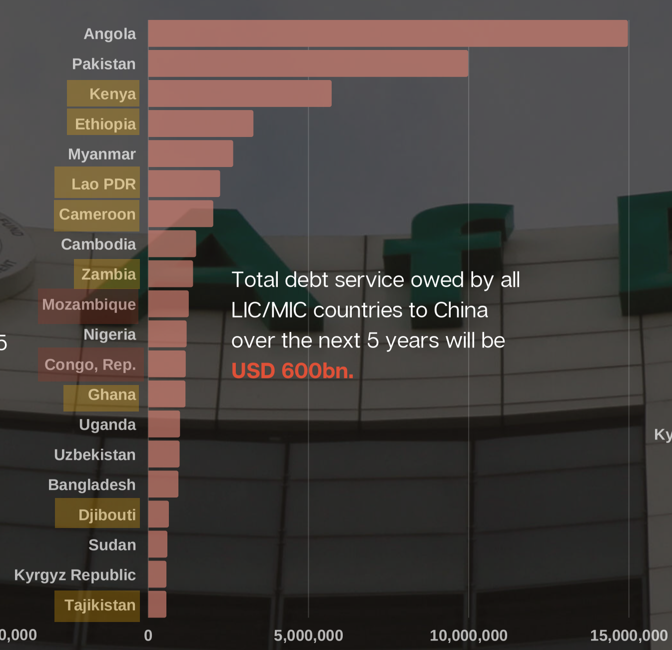
# DECEMBER 2020

## 7. The focus on Africa also does not appear to be a result of China's presence as a creditor. Debts and debt payments to China vary significantly within Africa and beyond.

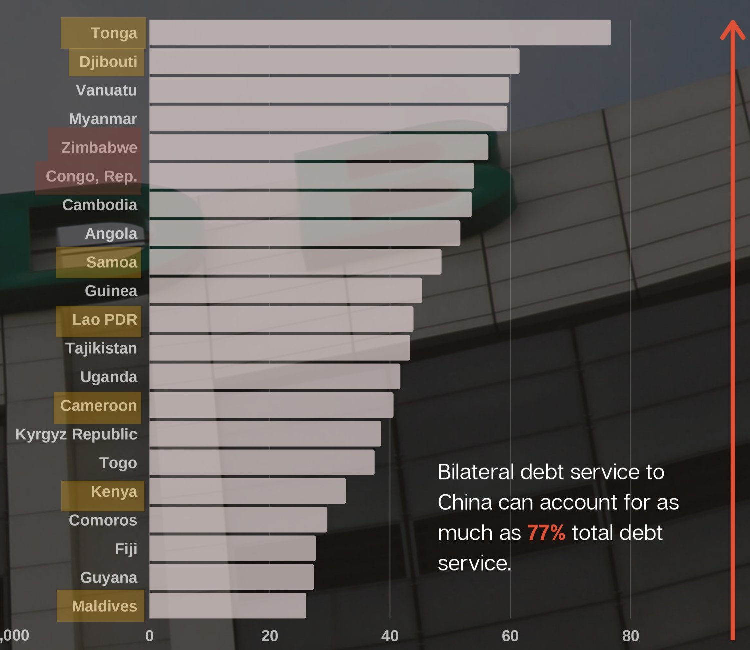
**Total Debt Service USDth**




**Bilateral Debt Owed to China USDth**




**LIC/MIC Bilateral Debt to China (% of total debt)**




**Pakistan,** a country that is **not** classified as in or at high risk of "debt distress" by the IMF, owes the most in total debt service, and around **20%** of this is owed **bilaterally to China. Angola,** also **not** in or at high risk of "debt distress" according to the IMF, has the second highest debt service pressure overall, with around **50%** of this owed to China.
However, some African and Asian countries owe the highest proportion of their debt service to China, reaching almost **80%.** Those with the highest proportion owed to China are **smaller economies,** who often are overlooked by other creditors for various reasons.

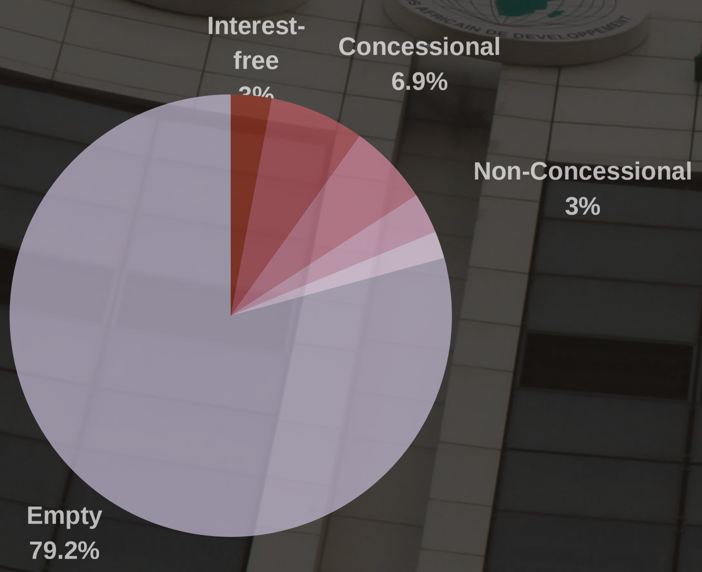
**Countries classified by IMF as at high risk of debt distress (Nov 2020)**

**Countries classified by IMF as in debt distress now (Nov 2020)**

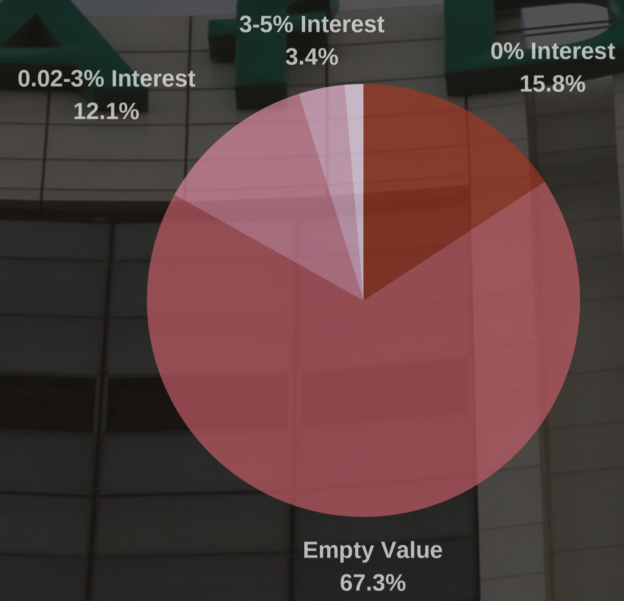
SOURCE: World Bank Data/David Mihalyi

## 8. In addition, it is difficult to calculate what proportion of debts owed to China have different interest rates, and therefore how "sustainable" they are.

**Centre for Global Development:**
**Concessional and Industrial Breakdown of Chinese loans in 157 countries 2000-2014**




**Johns Hopkins**
**China Africa Research Initiative:**
**China Loans by Interest Rate to Africa 2000-2019**

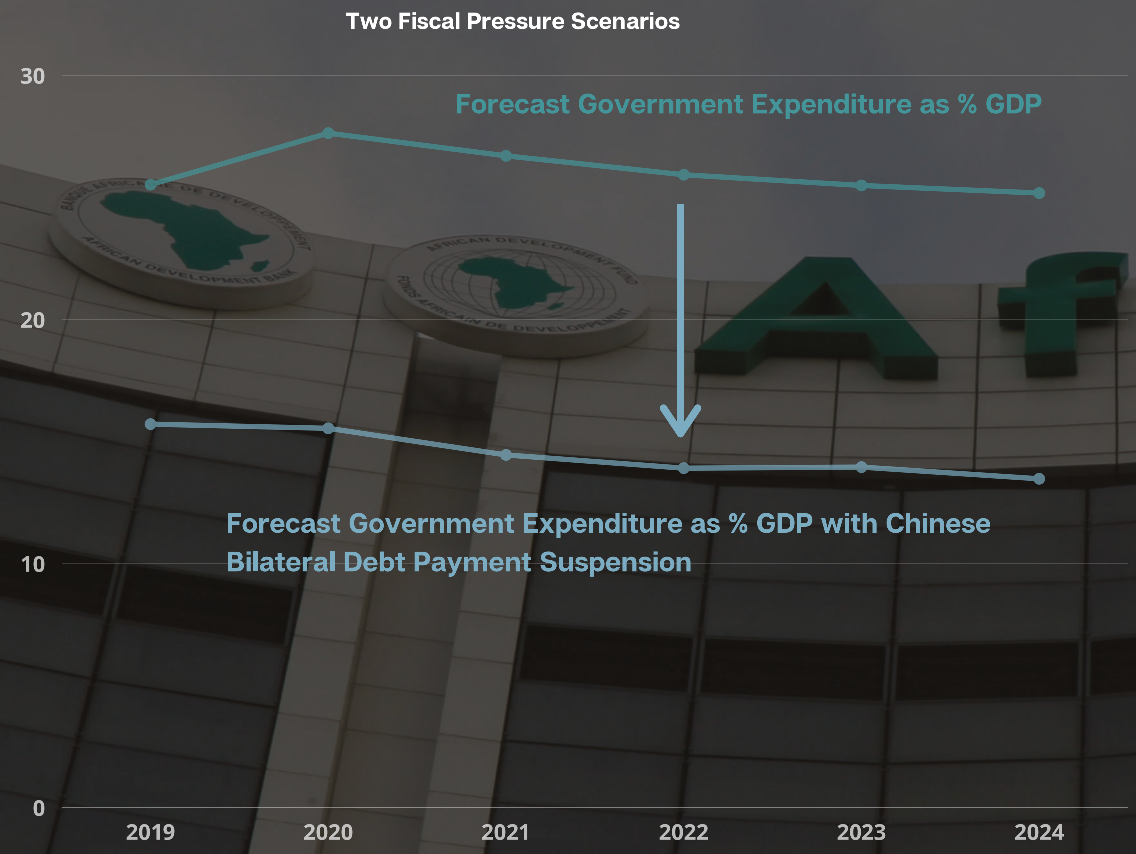



Some organisations (e.g. **CGD**) suggest that interest free loans from China account for **3%** of total loans from China to 157 countries, but other organisations (e.g. Johns Hopkins **CARI**) suggest they account for **16%** of China's loans to African countries. In addition, both datasets show a lot of empty values i.e. no recorded data on the interest rate of the loans.

This highlights an unreliability in data coverage of China's loan composition, making the impact of China's debt on African countries difficult to calculate.

SOURCE: CGD 2020; CARI 2019

## 9. But we estimate that China can still have an impact by suspending or cancelling debt for low and middle income countries.




**Chinese bilateral debt service suspension** for 2020 could cut overall government expenditure for low and middle income countries by around 9% compared to no suspension.

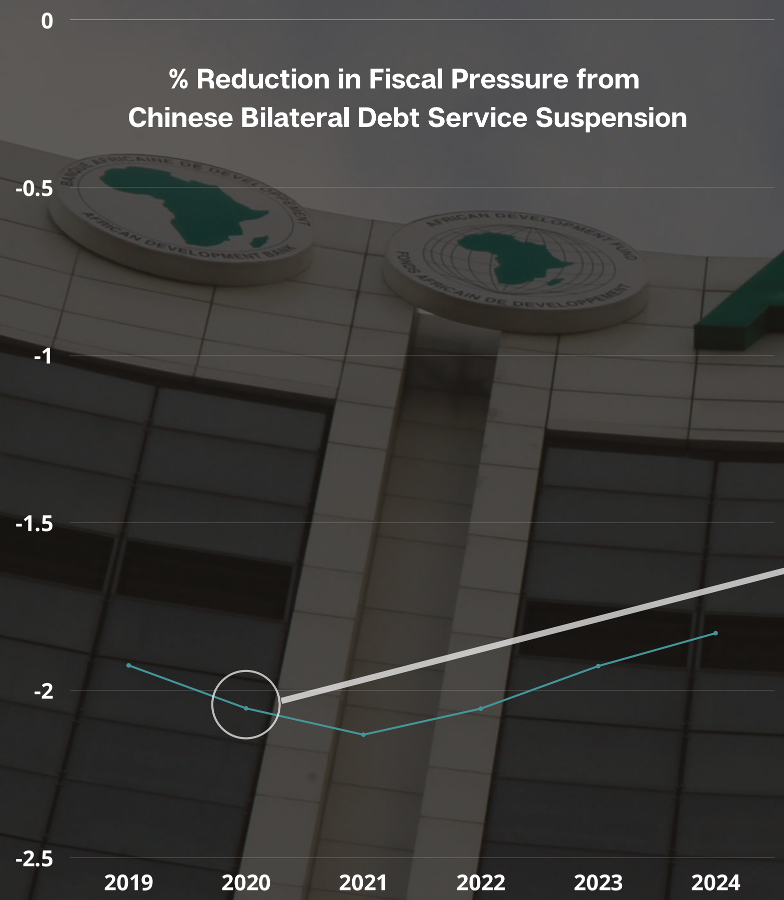
Continued suspension would create **significant budgetary space** for low and middle income countries to deal with the long-term effects of the pandemic.

**NB: "Fiscal pressure"** can come about as a combination of both higher debt payments AND lower growth, meaning lower income to governments (e.g. from taxes).

NB Averages are non-weighted

SOURCE: World Bank/David Mihalyi; World Bank

# 10. However, the individual impact of China's bilateral debt suspension would vary considerably for different low and middle income countries




NB Averages are non-weighted

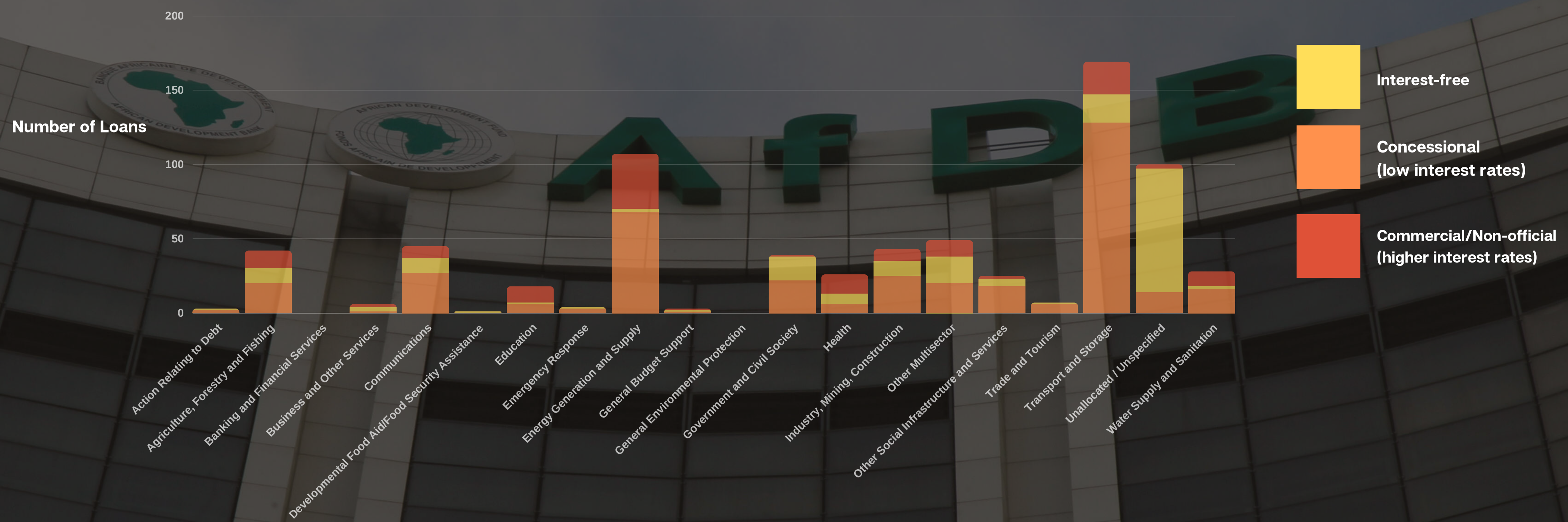

On average, China's bilateral debt suspension could lead to around a **2% reduction in fiscal pressure** across all low and middle income countries. But the impact of this varies significantly across countries, **reaching over 20%** for Angola.

SOURCE: World Bank/David Mihalyi; World Bank

DEVELOPMENT REIMAGINED | OCIC

## DECEMBER 2020

# 11. The effect of debt suspension from China would also vary considerably by sector, because debt for different types of loans comes at a different cost, and different projects have different impacts on the economy.

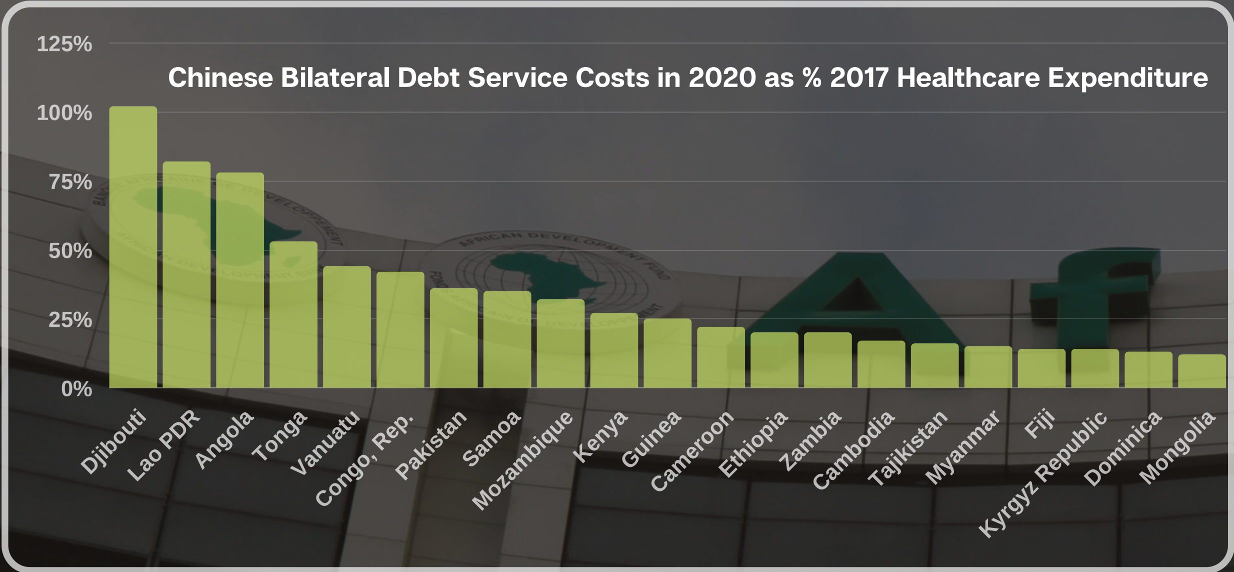



The largest number of interest-free loans that China has provided appear to be for **Transportation and Storage**, and for government and civil society. The most commercial loans (at more expensive rates) appear to be for **Energy Generation and Supply**. Therefore, the impact of debt service suspension in each country depends on how what sort of activities or sectors countries have taken the loans for.

SOURCE: Centre for Global Development; Gardner et al 2020

DECEMBER 2020

## 12. Suspending debt payments to China could also save lives, by enabling countries to spend more on health now and in the coming years than they otherwise would.





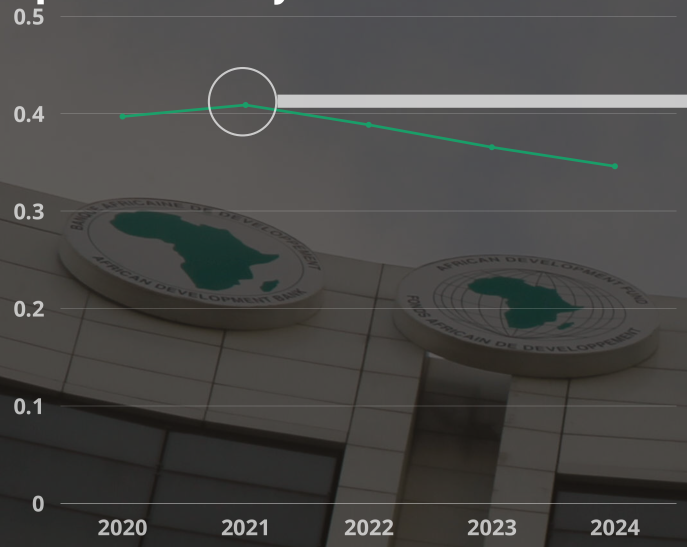
Servicing debt carries opportunity costs - while well-spent debt generates growth, it temporarily diverts funds from elsewhere. Examining the cost of Chinese debt service as a proportion of government health expenditure is one way to analyse this opportunity cost, especially during Covid-19.

Chinese debt service costs amount to an average of 14% of 2017 health costs in low and middle income countries. In one country, Djibouti, Chinese debt service costs in 2020 amount to more than the country's entire 2017 health budget.

NB Averages are non-weighted

SOURCE: World Bank/David Mihalyi; World Bank; Development Reimagined

## 13. Suspending debt payments to China from African countries specifically would enable more to be spent directly on Covid-19 recovery packages for many countries.





Overall for African low and middle income countries, debt service costs to China are equivalent to 40% of total estimated Covid-19 expenditures in 2020, gradually declining over time. Chinese debt service suspension would therefore significantly help deliver required Covid-19 spending, including in 2021.

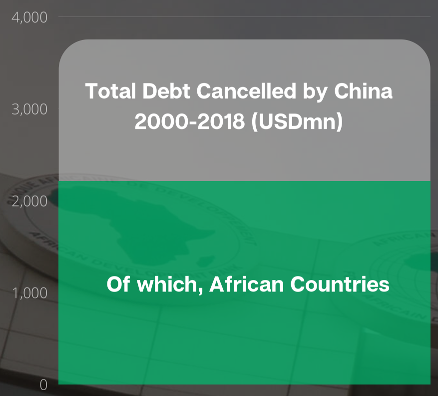
However, the effect varies hugely across countries - partly because some countries have spent more than others on Covid-19. For example, Angola's debt service costs to China for 2020 amount to almost 40x the value of its Covid-19 expenditures. Mozambique's debt service costs to China are 4x its Covid-19 expenditures, while debt service also outweighs Covid-19 expenditures in Djibouti, Zambia and, Cameroon. China could have a significant effect in these countries. But for many other low and middle income African countries, the effect is marginal.

NB Averages are non-weighted

SOURCE: World Bank/David Mihalyi; World Bank; Development Reimagined

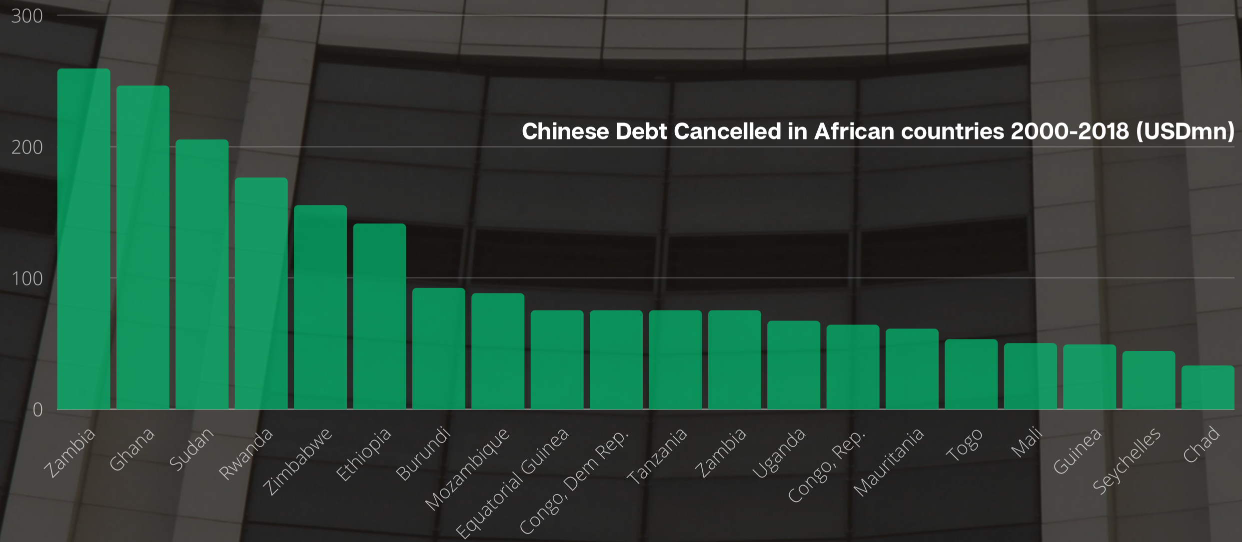
DECEMBER 2020

## 14. There is precedent for this kind of action. China has cancelled and restructured debt before, including in African countries.




The majority of debt cancellations by China in Africa have been:

- for interest-free foreign aid loans; less than 5% of Chinese lending
- for values <USD100m
- for debt which has already expired/is unserviceable
- made around big events - e.g. FOCAC summits.


SOURCE: Development Reimagined/Oxford China Africa Consultancy; Sun 2020; Acker et al 2020; SAIS-CARI

## 15. Can the same be done now? China has made some pledges - from new grants to temporary debt suspension and restructured debt... But more would be welcomed.

*'China will provide **USD2bn over two years** to help with Covid-19 response and with the economic and social development in affected countries, especially developing countries'*

***President Xi Jinping at 73rd World Health Assembly, 18 May 2020***

### Multilateral

USD50m to WHO

### Bilateral

The Chinese foreign ministry has suspended bilateral principal and interest payments from 1 May until the end of 2020 for low-income countries, equivalent to approx. **USD1.9bn**

This is part of the G20 commitment for all IDA-eligible countries and Angola

This is the first time China has been part of a coordinated debt relief commitment

### Private/Commercial

Chinese financial institutions such as the Export-Import Bank of China (Exim) and the China Development Bank (CDB) have been urged by the government 'to conduct consultations on **commercial** sovereign loan arrangements'. Zambia has been the first country to announce, in October and November 2020 respectively, deferred payments to CDB (undisclosed amount) and Exim Bank of USD110m.

SOURCE: Brookings (2020), Wheatley and Cotterill (2020), Ministry of Foreign Affairs China (2020)

## 16. But will all low-income and middle-income countries that need it ask for debt payment suspension from China or others? There are three reasons why they may not...

### 1 Violating conditions on certain private sector loans

Certain loans terms and conditions and contract terms - especially for "Eurobonds" - prohibit countries from seeking a suspension of debt payments under multilateral initiatives; if they do this they automatically are seen as defaulting and must pay the entire value of the outstanding Eurobonds immediately. Similarly, for certain Chinese loans, contracts can link a default on one loan to defaults on others taken by the country, which will then make it harder/riskier to get future loans.

### 2 Receiving a (further) sovereign credit downgrade by some ratings agencies

This would make their debt more expensive as they'd have to pay higher interest rates, will hinder ability to finance budget deficits in the medium term. For instance, Moody's treats an appeal for bilateral debt relief as a 'credit event' necessarily leading to appeals for private debt relief. Fitch and S&P only classify explicit appeals for private debt relief as a 'credit event'.

### 3 Restricting future policy direction

Countries under the G20 debt relief programme are restricted from taking new loans from other creditors and are limited to spending savings to address pandemic shocks. Additionally, frontier economies tend to rely more on external rather than domestic debt markets to finance deficits, further limiting their ability to make policy in the face of receiving debt relief.

SOURCE: Mutize 2020; Smith 2020; Renaud Basso 2020

# Conclusion

Currently, African countries are spending around 2.5% of GDP to combat Covid-19's impacts.

While this is significantly below spending by countries in other regions, China's debt relief efforts - from suspension to cancellation and restructuring - in the context of Covid-19 could be significant, helping African countries (and other low and middle income countries) direct more resources to Covid-19 recovery and health more broadly.

While a lack of transparency from China and borrowing countries make estimates difficult, this report suggests that overall, 40% of finance spent on Covid-19 so far by African countries could be covered by suspending debt payments to China, and populations in some of the countries with highest debt levels to China - such as Angola, Djibouti and Zambia - could benefit the most. Moreover, further debt service cancellation in and beyond 2021 would help to continue protecting governments from the impacts of the prolonged pandemic.

There is precedent for China cancelling debt, and this report therefore offers hope in this regard.

However, this report also sounds a note of caution. While China is a significant lender to low and middle income countries, one of the most significant challenges is one of "classification". Many countries that arguably have the highest financial needs for infrastructure and poverty reduction, especially in Africa, are classified by the IMF as debt distressed, as well as seen as "risky" by private credit ratings agencies. This makes them hesitant to even ask for debt suspensions, let alone cancellation or restructuring, and it limits their potential to take new loans to provide for future generations.

Thus, while China can help, multilateral lenders, other countries and their private sectors must also find ways to do their part - both by providing debt relief themselves but also by shifting how they see "debt risks" going forwards.