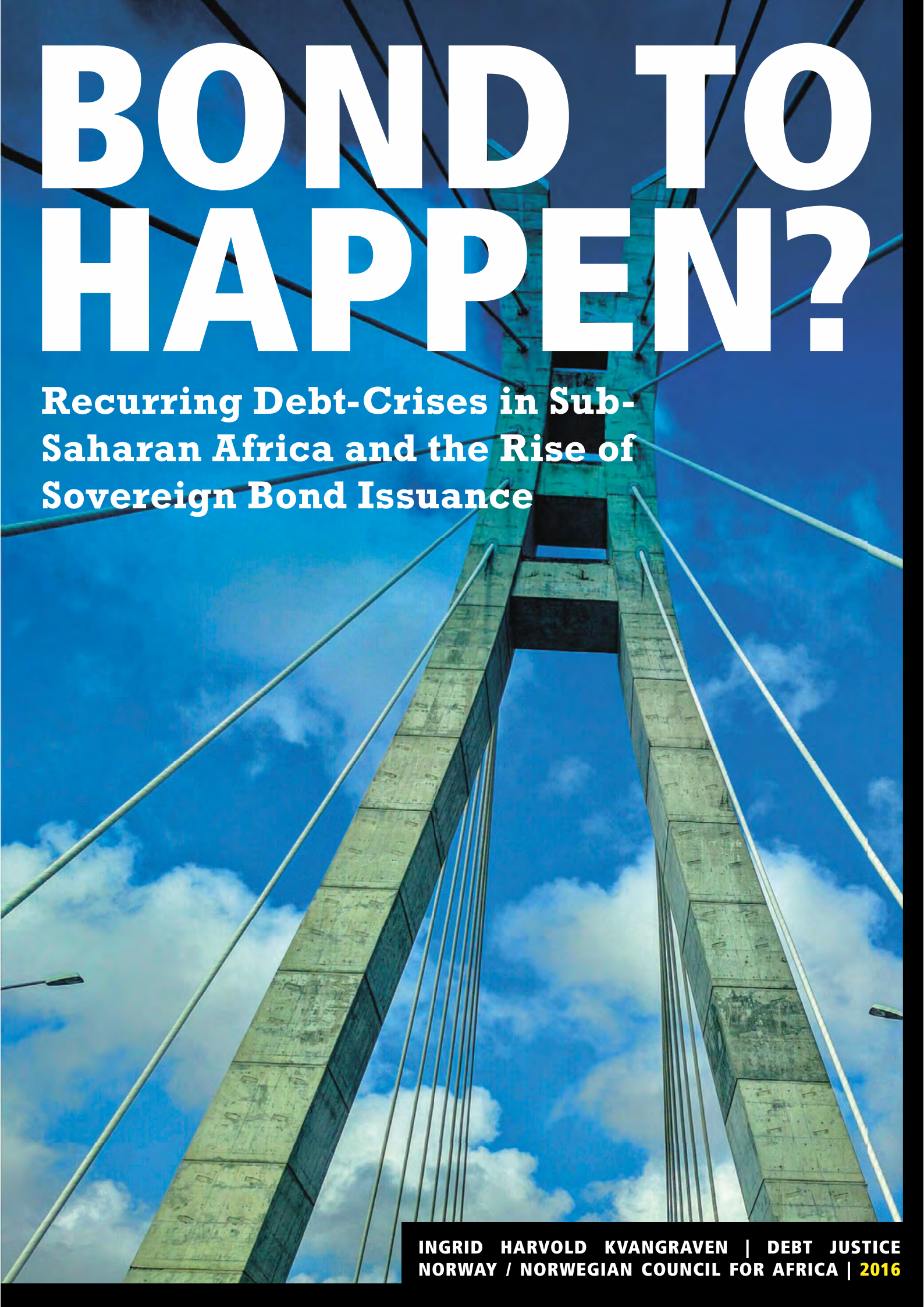


BOND TO HAPPEN?

Recurring Debt-Crises in Sub-Saharan Africa and the Rise of Sovereign Bond Issuance

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SLUG is an umbrella organization with more than 40 affiliated organizations. Our work consists of raising awareness, campaigning and political lobbying on debt cancellation and responsible lending. Read more about our work, our demands and our principles at www.slettgjelda.no

SLUG Debt Justice Norway

The Norwegian Council for Africa is a solidarity and human rights organisation which sees dissemination of information as its most important tool in its contribution towards justice and development in and for Africa. Read more at www.afrika.no/fellesradet

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Key Terms

Asset – Any resource of economic value that can be invested in with the expectation that it will provide future benefits. This can be anything from financial assets such as stocks and bonds to non-financial assets such as real estate.

Asset manager – A manager of assets, usually in the form of a fund. For example, the Norges Bank Investment Management is an asset manager because it manages the asset investment of the Norwegian sovereign wealth fund.

Collective Action Clause (CACs) – A contract clause designed to mitigate collective action problems in debt restructurings. Including CACs in a bond contract helps prevent creditors from refusing to cooperate in restructuring processes.

Domestic Debt – The part of the total government debt in a country that is owed to lenders within the country.

Environmental, social and governance (ESG) criteria – A set of standards that socially conscious investors use to screen investments.

Equity (investment) – An equity investment is the buying and holding of shares of stock on a stock market in anticipation of income from dividends and capital gains. Most of the Norwegian sovereign wealth fund is invested in equity.

Eurobond – A bond denominated in a currency other than the home currency of the country or market in which it is issued.

External Debt – The part of a country's total government debt that is owed to lenders outside of the country.

Fixed Income (investment) – A type of investment for which real return rates or periodic income is received at regular intervals and at predictable levels. The most common form of such investment is bonds.

Interest rate – the amount charged by a lender to a borrower for the use of assets (for example a bond), expressed as a percentage of the principal amount.

Maturity – At maturity of a bond, the borrower is required to repay the full amount of the outstanding principal plus any applicable interest to the lender.

Portfolio investments – Hands-off investments in the form of a portfolio of assets, including investments in equity securities and debt securities such as bonds, made with the expectation of earning a return.

Socially Responsible Investing (SRI) – An investment strategy that seeks to consider both financial return and social good to bring about a social change.

Sovereign bonds – Debt security issued by sovereign governments.

Terms of trade – The value of the exports of a country, relative to the value of its imports. When a country's terms of trade improve, it indicates that for every unit of export that a country sells, it is able to purchase more units of goods that are imported.

To Issue – Issuing bonds is one way to raise money. By doing this the issuer increases the financial resources available for the government to spend today (but the resources will have to be paid back in the future).

Yield – the income return on an investment, such as the interest or dividends received from holding a particular security.

Abbreviations

CAC – Collective Action Clause

CRA – Credit Rating Agency

DSA – Debt Sustainability Analysis

DSF – Debt Sustainability Framework

ESG – Environmental, Social and Governance criteria

FDI – Foreign Direct Investment

FRA – Fiscal Responsibility Act

HIPC – Heavily Indebted Poor Country Initiative

IDA – International Development Association

IFI – International Financial Institution

IMF – International Monetary Fund

LICs – Low Income Countries

MDRI – Multilateral Debt Relief Initiative
MICs – Middle Income Countries

ODA – Overseas Development Assistance

S&P – Standard and Poor's

SSA – Sub-Saharan Africa

PRI – Principles for Responsible Investment

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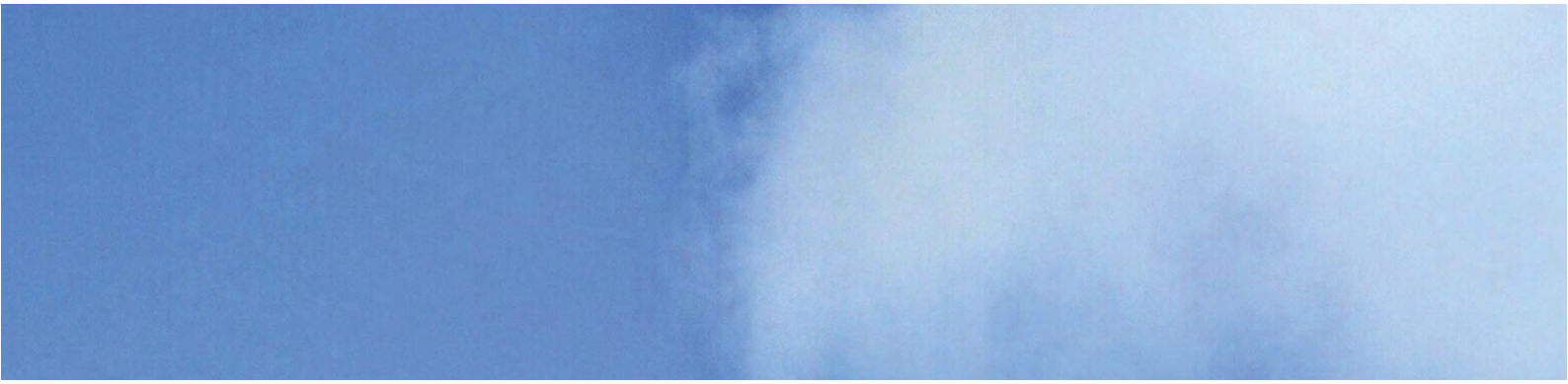
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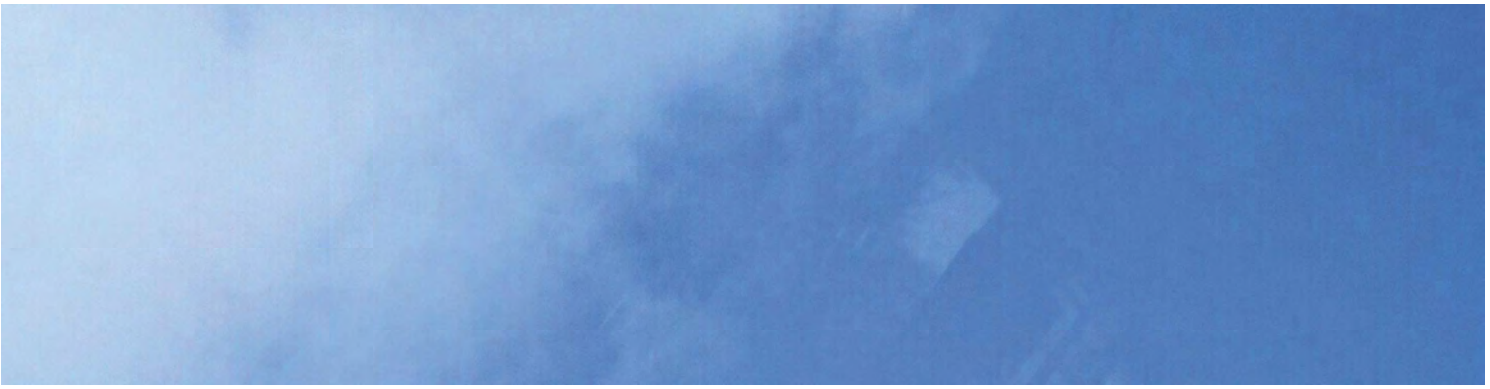
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Executive summary

Many sub-Saharan African countries have undergone substantial transformations with respect to the type of finance they have been attracting over the past decade. Private flows are becoming more important while the importance of public flows is diminishing, particularly for the middle-income countries in the region. A crucial characteristic of the changing flows to the region is the growing importance of sovereign bonds issued in foreign currency, so-called Eurobonds. Although this form of financing is a form of debt issuance, investors rarely apply principles for responsible lending when making such investments.

Since 2006, sixteen sub-Saharan countries have issued Eurobonds and many have issued more than one. Such bonds are considered to be a much-needed source of financing for development expenditures as well as a convenient way to plug budget deficits. These issuances have amounted to over USD 25 billion in total, which represents about 20% of foreign aid to the region. In 2014, the IMF cautioned African countries that they could be endangering their debt sustainability by issuing sovereign bonds.

In light of these developments, this report discusses the risks and opportunities this form of financing entails. As financing for development is central to attaining the Sustainable Development Goals (SDGs), the question of whether the existing frameworks for and practices of contracting debt are likely to be pro-development is of concern.

Furthermore, Eurobonds should be of particular interest to the Norwegian public, since approximately 20% of the Norwegian sovereign wealth fund is invested in sovereign bonds, which amounts to approximately NOK 1500 billion. While the fund cannot invest in countries where UN sanctions –supported by Norway – are in place, there are currently no further ethical guidelines governing this form of investment. In June 2016, however, the Norwegian Parliament requested that Norges Bank Investment Management (NBIM)i evaluate the possibility of subjecting the Norwegian sovereign wealth fund's investments in sovereign bonds to ethical guidelines.

There has been growing awareness of the ethical behaviour of investors in sovereign bonds internationally over the past decade. Not only have individual asset managers sought to establish ethical guidelines for their sovereign bond investments, but the UN also published their own Principles for Responsible Investment (PRI) in 2006. Meanwhile, the Norwegian government has been a progressive player internationally when it comes to responsible lending, by admitting co-responsibility as a creditor for the debts resulting from the Ship Export Campaign, funding work within the UN on establishing principles for responsible lending and borrowing, and carrying out a creditor's debt audit.

This report finds that there are opportunities for developmental investments associated with Eurobonds. It is a form of financing that is relatively cheap compared to domestic debt issuance, countries can access relatively large amounts of financing through such bonds and, technically, there are no conditionalities attached. However, the report also identifies several substantial risks.

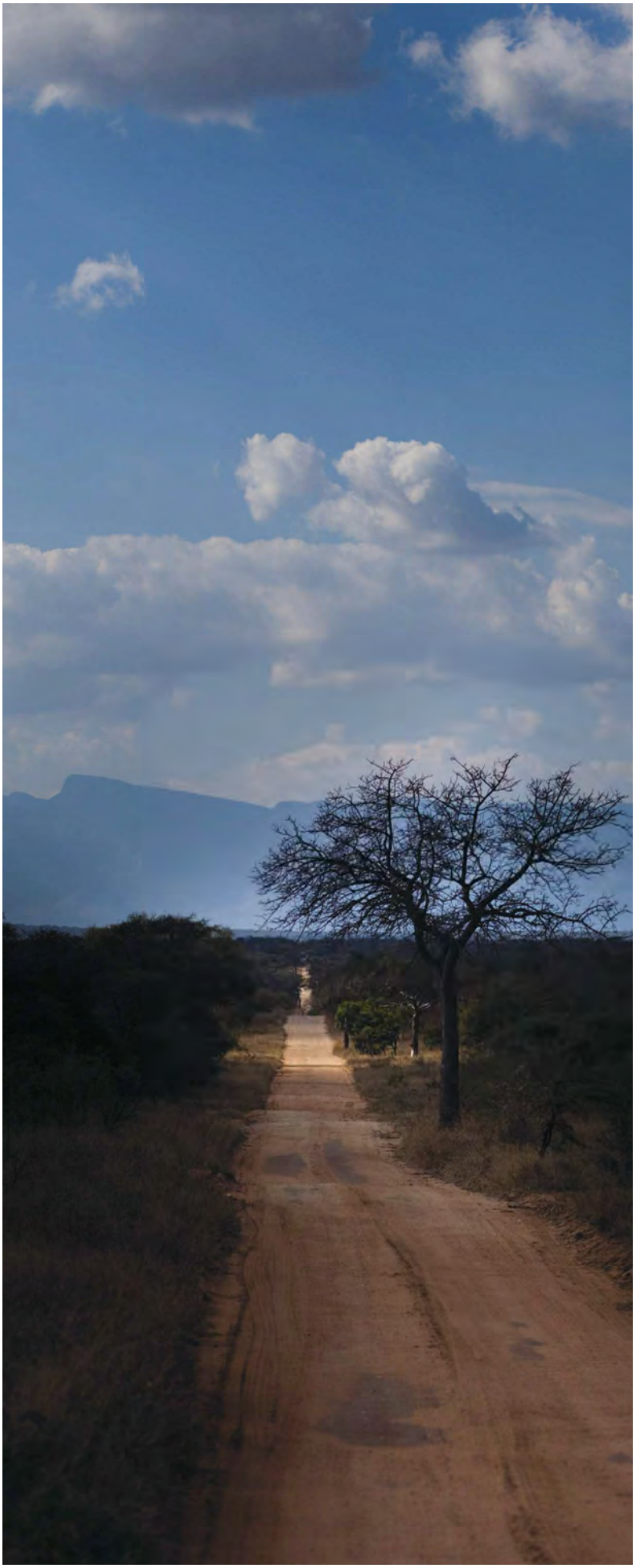
First of all, there is an exchange rate risk involved in any borrowing carried out in a foreign currency. This is of particular relevance to sub-Saharan African countries, as many of them are highly dependent on a narrow selection of primary commodities in order to earn foreign exchange. Thus, in the wake of falling commodity prices over the past decade and the related depreciation of many sub-Saharan African currencies, servicing the foreign debt accumulated through Eurobond issuances has become a challenge.

Furthermore, the case studies of a small selection of sub-Saharan African countries examined in this report expose a lack of accountability when it comes borrowing

processes. In fact, the process of bond issuance is often plagued by lack of transparency and ultimately legitimacy, from the perspective of the citizens of the issuing country. In some cases, civil society and parliamentarians have little information about the loan contracts and what the funds are being used for. Additionally, civil society groups are demanding to be a part of the decision-making process and for there to be public debates about the use of the borrowed funds and the terms of the loans.

As this is playing out in the context of a defective framework for sovereign lending and borrowing and a flawed system for debt restructuring, issuing Eurobonds entails many serious risks. These risks are amplified by the fact that many of the Eurobonds do not contain collective action clauses.

Based on these findings, this report therefore recommends a comprehensive framework for responsible lending practices applied to investments in sovereign bonds, in order to ensure: that the borrower is complying with the due process of law, that contractual instruments such as collective action clauses are included in the bond contracts, that the bond issuance is transparent and open to public debate, and that the debt is likely to be sustainable. The report also makes several recommendations to the Norwegian government, the most specific being that the government should implement ethical guidelines for investments in government bonds. These guidelines should be universal, predictable and guarantee equal treatment; basing the guidelines on the UNCTAD Principles for Promoting Responsible Lending would be advisable. A minimum requirement for ethical guidelines would be to involve criteria for transparency in the debt contracting process in the issuing country. In addition, the report makes several suggestions as to the issues the Norwegian government should promote internationally, in order to contribute to a more predictable, transparent and fair international framework for debt management.



Sammendrag (norsk)

I løpet av det siste tiåret har man sett store endringer i hvilken type finansiering afrikanske land sør for Sahara har klart å tiltrekke seg. Private finansstrømmer spiller nå en større rolle enn før, mens betydningen av offentlige strømmer har avtatt, særlig for mellominntektsland i regionen. Den økende betydningen av statsobligasjoner utstedt i utenlandsk valuta er en viktig del av denne trenden. Selv om denne formen for finansiering er en form for låneopptak, anvender investorer sjelden prinsipper for ansvarlig utlån når de gjør slike investeringer.

Om man ikke teller med Sør-Afrika, har totalt seksten land i Afrika sør for Sahara utstedt slike statsobligasjoner siden 2006. Til sammen har de utstedt statsobligasjoner til en verdi av over 25 milliarder dollar, noe som tilsvarer rundt 20% av bistand til regionen. Slike obligasjoner anses både for å være en sårt tiltrengt kilde til utviklingsfinansiering og en relativt enkel måte å tette budsjettunderskudd på. I 2014 advarte Det internasjonale pengefondet (IMF) om at statsobligasjoner kan være en trussel for gjeldsbærekraften i regionen.

I lys av denne utviklingen drøfter rapporten muligheter og risikofaktorer knyttet til denne formen for finansiering. Ettersom utviklingsfinansiering er sentralt for å nå FNs bærekraftsmål blir spørsmålet om hvorvidt de eksisterende rammeverkene for utlån og låneopptak er utviklingsfremmende sentralt for denne rapporten.

Problematikken bør være av særlig interesse for den norske befolkningen, ettersom rundt 20% av oljefondet, eller rundt 1500 milliarder norske kroner, er investert i statsobligasjoner. Mens norske myndigheter har vært en pådriver for ansvarlig utlån internasjonalt, ved for eksempel å ta medansvar som kreditor for skipseksportgjelda og ved å finansiere arbeid innen FN for å etablere prinsipper for ansvarlig utlån og låneopptak, har regjeringen ennå ikke vedtatt noe etisk rammeverk for utlån gjennom oljefondet, annet enn at fondet ikke kan investere i land med norsk-støttede internasjonale sanksjoner mot seg.

I juni 2016 bad Stortinget om at Norges Bank Investment Management (NBIM) skulle vurdere muligheten for å utvikle retningslinjer for oljefondets investeringer i statsobligasjoner. Det har også vært en økende bevissthet rundt etiske investeringer i statsobligasjoner internasjonalt det siste tiåret. Ikke bare har enkelte forvaltere etablert etiske retningslinjer for sine statsobligasjonsinvesteringer, men FN lanserte også prinsipper for ansvarlige investeringer (PRI) i 2006.



Denne rapporten viser til at det er en rekke muligheter for utviklingsfinansiering knyttet til statsobligasjoner. Dette er en form for låneopptak som er relativt billig i forhold til innenlandsgjeld, land får tilgang til relative store summer gjennom slike obligasjoner, og det er lån som er frie for politiske kondisjonaliteter. I rapporten identifiseres imidlertid også flere alvorlige risikofaktorer knyttet til denne formen for finansiering.

For det første er det risiko knyttet til låneopptak som foretas i utenlandsk valuta. Dette er spesielt relevant for land i Afrika sør for Sahara, ettersom mange av dem er svært avhengige av råvareeksport for å tjene inn utenlandsk valuta. I kjølvannet av fallende råvarepriser de siste årene og den relaterte svekkelsen av valutaen til mange afrikanske land, har det for mange blitt dyrt å betjene statsobligasjonene utstedt i amerikanske dollar.

Videre eksponerer case-studiene i denne rapporten en mangelfull gjeldsutstedelsesprosess. Prosessen er ofte preget av mangel på åpenhet og legitimitet, sett fra et sivilsamfunnsperspektiv. Sivilsamfunn og parlamentarikere har generelt lite informasjon om lånekontraktene og hva midlene blir brukt til. I tillegg kjemper sivilsamfunnsgrupper for å få være en del av beslutningsprosessen og for offentlige debatter om bruk av lånte midler og vilkårene for lånene.

Ettersom alt dette foregår i en kontekst med et mangelfullt internasjonalt regelverk for utlån, låneopptak og gjeldshåndtering, blir utstedelsen av statsobligasjoner ekstra risikabel. Risikoen forsterkes for de landene som ikke har inkludert Collective Action Clauses (CACs) i statsobligasjonene sine, som kunne gjort gjeldshåndtering enklere om gjelden skulle bli ubetalbar.

Basert på disse funnene anbefaler rapporten et omfattende rammeverk for ansvarlige utlånspraksis for investeringer i statsobligasjoner, for å sikre at lånopptak er i samsvar med rettssikkerhet, at kontraktsmessige virkemidler som CACs er inkludert i obligasjonskontraktene, at obligasjonsutstedelsen er åpen for offentlig debatt, og at gjelden er bærekraftig.

Rapporten gir også flere anbefalinger til norske myndighetenes investering i statsobligasjoner gjennom Statens Pensjonsfond Utland, for eksempel om at regjeringen må etablere etiske retningslinjer for investeringer i statsobligasjoner. Disse retningslinjene bør være universelle, forutsigbare, og sikre likebehandling og et godt utgangspunkt er UNCTADs prinsipper for ansvarlig utlån. Et minstekrav for etiske retningslinjer vil være å sette kriterier for åpenhet i gjeldsutstedelsesprosessen. I tillegg peker rapporten på hvilke saker den norske regjeringen bør fremme internasjonalt for å bidra til et mer forutsigbart, åpent og rettferdig internasjonalt rammeverk for gjeldshåndtering.







1 Introduction

1 Introduction

The type of finance flowing to sub-Saharan Africa has changed substantially over the past decade. As financing for development is central to the attainment of the Sustainable Development Goals (SDGs), the question of whether these new forms of finance are likely to be pro-development is of particular concern. There has been a notable increase in private flows to the region, in particular to middle-income countries. The issuance of sovereign bonds issued in foreign currency, so-called Eurobonds, is a part of this trend. Such issuances amounted to over USD 25 billion in total between 2006 and 2016, which represents about 20% of foreign aid to the region.[2] This new form of borrowing has led the IMF to caution African countries against the risk of endangering their debt sustainability by issuing sovereign bonds.[3]

This report starts by laying out the general financial and macroeconomic trends in sub-Saharan Africa, particularly over the past decade (chapter 2), in order to better understand the specific context in which the change in financial flows is taking place. In chapter 3, the report delves deeper into the issue of sovereign bond issuance on the continent and the specific risks and opportunities this entails. The report uses Nigeria as a case study to investigate the role Eurobonds have played in the economy and, in particular, to gain insight into the perspectives of civil society representatives, scholars, and parliamentarians on this new development (chapter 4). Ghana and Zambia are used as secondary case studies.

Furthermore, in order to understand the global environment, chapter 5 discusses the current international framework for lending and borrowing, debt restructuring, and the various voluntary processes and guidelines that exist, with a particular focus on lending through an investment in sovereign bonds. Finally, recommendations are made based on the findings of the report, both for sovereign bond investment in general, and for the Norwegian government in particular (chapter 6).


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2 Macroeconomic Overview

Foreign perceptions of development in sub-Saharan Africa tend to be polarized – it's either the "dark continent" or "Africa Rising".[4] Although The Economist Intelligence Unit dubbed development in the region an economic "miracle"[5] in 2012, it is now more widely recognized that many sub-Saharan African countries are facing difficult economic times as the commodity boom has ended, interest rates are rising in the US, China's growth is slowing, and debt levels are rising in the region.

There appears to have been a gap in the mainstream media and business perceptions of Africa and the perceptions of ordinary Africans.[6] Survey data shows that Africans themselves perceive their economy and living standards as deteriorating, and between 2010 and 2013 the number of major public protests quintupled. This suggests that Africa's high economic growth over the past decade should not be conflated with "development". This chapter aims to give a sober analysis of the recent trends in the region, with a focus on macroeconomic structure and financial flows. Of particular significance is the new trend of Eurobond issuance among sub-Saharan African countries, which will be dealt with in the next chapter (see chapter 3).

According to IMF data, growth in the region fell to 3.5% in 2015 (its lowest level for over a decade) and is set to fall even further.[7] While oil exporters face difficult economic conditions due to falling oil prices, non-energy commodity exporters, such as Ghana, South Africa and Zambia, also face harsh conditions. Nonetheless, several oil-importers, such as Kenya, Côte d'Ivoire, and Senegal, are faring better than average, with growth rates over 5%. It is thus important to keep in mind that there are substantial differences within the region.

This chapter finds that trends in financial flows to sub-Saharan Africa since the 2008 financial crisis involve both a drastic increase in private capital and a recent decline in aid and non-concessional lending. In addition, the nature of capital flows to the region is changing in terms of the types of capital attracted, the origin of the capital, and which countries are able to attract international finance. In order to evaluate the sustainability of debt, it is also necessary to consider the general macroeconomic structures and trends in the region, current account balances, export diversification, domestic debt issuance and foreign reserve accumulation. Furthermore, the chapter analyses the global environment within which these developments are taking place and the potential risks it entails. Needless to say, there are vast issues with data quality that must be kept in mind when studying African countries.[8]

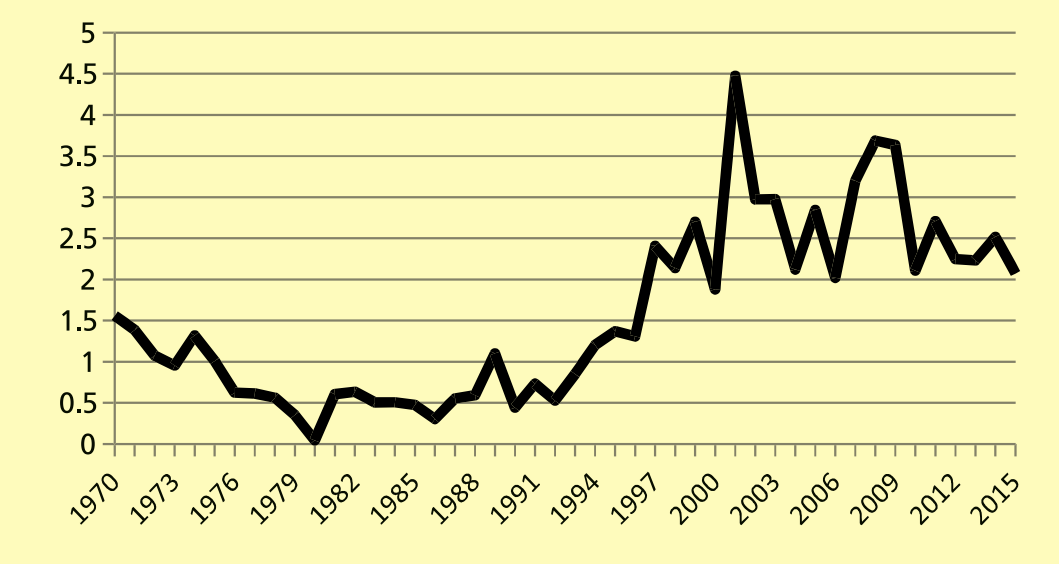


Figure 2.1 Foreign Direct Investment in Sub-Saharan Africa, Net Inflows (% of GDP) Source: World Bank, World Development Indicators

2.1 The Changing Character of Financial Flows

The continent is undergoing historic transformations with respect to financial flows. First of all, private capital flows are becoming more important in the region and the importance of public flows is diminishing. Moreover, the trends differ according to the country groups. For example, while capital flows beyond foreign direct investment (FDI) tend to be important for the middle-income countries in the region, fragile states are likely to continue to rely on official development assistance.

Around the 2000s, sub-Saharan Africa started becoming a popular destination for FDI, as evidenced by figure 2.2. Furthermore, FDI in the region has increased sharply since 1990, peaking at 4.5% of GDP in 2001. FDI inflows fell in the wake of the dot-com bubble of 2001 and after the financial crisis of 2008.

As figures 2.1 and 2.2 illustrate, there was a fall in FDI from 2014 to 2015.[9] According to the 2016 UN World Economic Situation and Prospects report, the decrease from 2014 to 2015 is largely due to portfolio investments[10] as well as "other" investments, such as interbank loans and trade credits.[11] These types of investment flows are relatively new to the region and can be welcome sources of investment, but they also tend to be the most volatile.[12]

What's more, the rise of such financial flows is closely linked to the widespread liberalization of international capital flows and greater openness to foreign financial institutions that is taking place globally.[13] This internationalization of finance has led to an increase in foreign presence in bond, equity and credit markets in sub-Saharan Africa. Furthermore, as private capital flows play an increasingly important role in the region, the volumes and volatility of private capital flows also becomes important for these countries' economic development. In fact, portfolio flows, including those related to bonds, have repeatedly been associated with financial instability in developing countries.[14] For example, portfolio flows were a key channel for transmission of the global financial crisis from advanced to developing countries.[15] As these flows are increasing and the financial linkages between sub-Saharan Africa and the rest of the global economy are being strengthened, the economies in the region are becoming more vulnerable to global financial shocks.[16]

The gains in FDI have been highly concentrated both geographically and by sector. Approximately three fourths of the investments go to resource rich countries and extractive industries and it is unclear whether this investment provides benefits to local firms and employment markets.[17] Generally, the middle-income countries

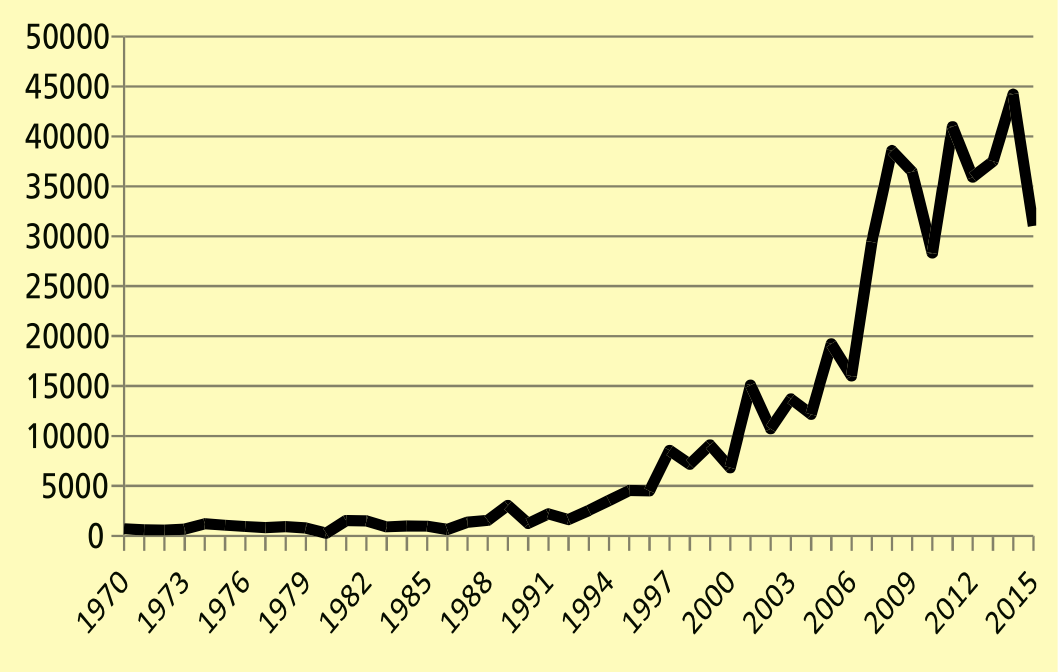


Figure 2.2 Foreign Direct Investment in Sub-Saharan Africa, Net Inflows (current US$). Source: World Bank, World Development Indicators

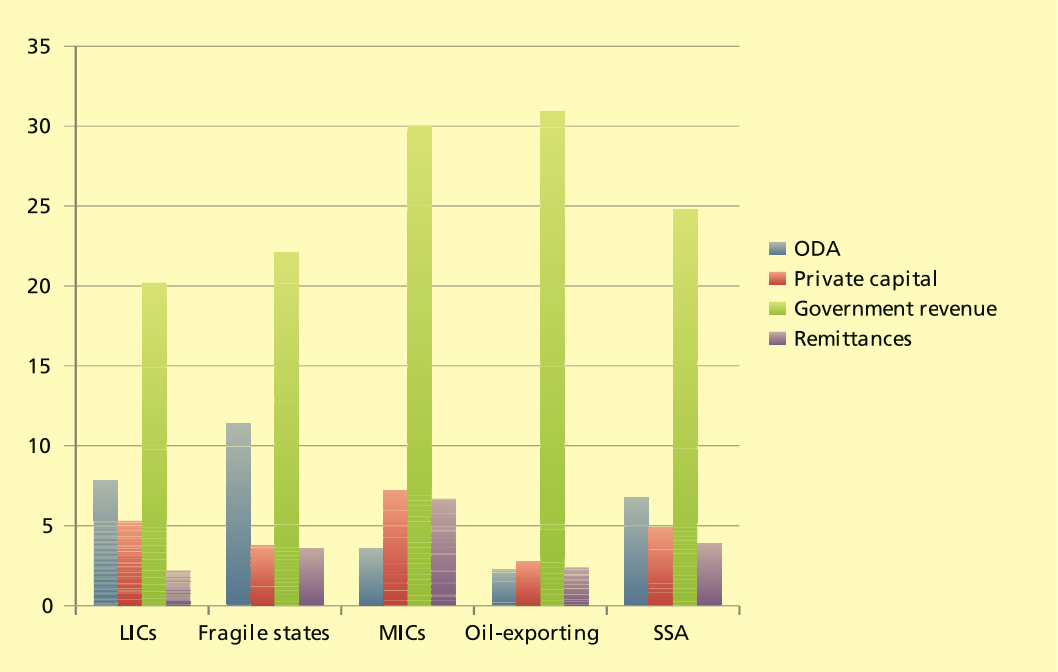


Figure 2.3 Financial Flows to Sub-Saharan Africa Broken Down by Country Groups (Average 1990-2012). Source: Sy and Rakotondrazaka (2015)

have benefited the most from FDI, especially South Africa and Nigeria, which receive about half of all FDI to the region.[18]

What's more, the origins of the investments have been changing over time, as the BRICS countries have made inroads into the region. In 2010, 25% of FDI inflow to sub-Saharan Africa originated from the BRICS, while Europe accounted for 41% of the FDI.[19] Nonetheless, only about 4% of BRICS FDI goes to Africa, making BRICS more important to Africa than Africa is to the BRICS. The Chinese FDI flow to Africa has grown particularly quickly since the mid-2000s and is considered an important factor driving growth in the region over the past decade.[20] South Africa's FDI in the rest of Africa also increased by 57% between 2007 and 2015.[21] While the diversification of trading and investment partners could be beneficial and stabilizing, many African countries are simply diversifying their "dependence", as is evident when studying the economic structure of these economies.[22]

As the specificities of capital flows depend largely on the characteristics of the individual country in question, it is useful to break the data down into country groupings. Figure 2.3 shows financial flows to four mutually exclusive groups, namely oil-exporting, middle-income (MICs), low-income (LICs) and fragile countries, as defined by the IMF Regional Economic Outlook for Sub-Saharan Africa. Interestingly, figure 2.3 shows that although there has been a notable decline in official development assistance (ODA) since the crisis (see figure 2.4), ODA still has an important role to play for LICs and fragile states. MICs have experienced the sharpest decline in ODA as a share of total external flows. Note that government revenue is the most substantial source of financing for all groups.

Remittances, which are transfers made by migrants to their home country, have increased in importance in sub-Saharan Africa. Although the remittance flows to sub-Saharan Africa are lower than those to many other regions in absolute and per capita terms, many African countries are among the largest recipients of remittances relative to their GDP.[23] In addition, remittances account for a substantial portion of the foreign exchange of many sub-Saharan countries. Although remittances are generally less volatile than other private capital flows, there has been a decline in remittances to the continent since 2008.

In addition to assessing the quantity of financial flows, it is also necessary to consider the quality of finance.[24] Generally, "better" finance is associated with lower risk. Ways of mitigating risk include moving from short-term, volatile, external capital flows to prioritizing more stable, long-term finance from sovereign wealth funds or development finance institu-

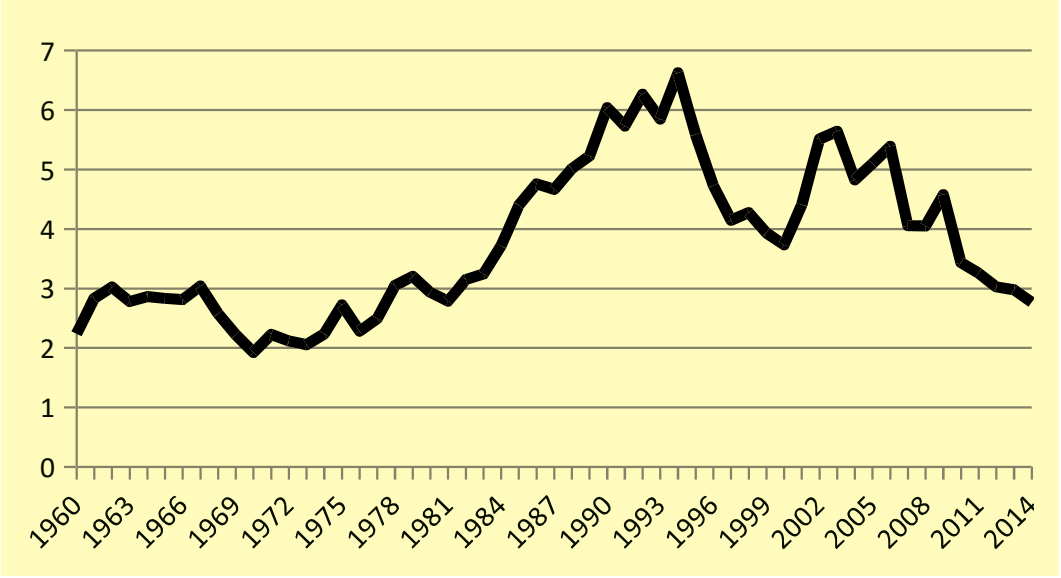


Figure 2.4 Sub-Saharan Africa: Net ODA Received (% of GNI). Source: World Bank, World Development Indicators

tions, for example.[25] Moreover, regardless of the quality of finance, how the money is spent is also important. For growth to be pro-poor and developmental, substantial parts of the investment generally need to be targeted to employment-generating sectors.[26] Unfortunately, the lion's share of FDI goes to extractive industries, with few linkages and opportunities for job creation.[27]

Finally, another serious issue that cannot go unmentioned is illicit capital flight from the region. Capital flight is often defined as the unrecorded and (mostly) untaxed illicit leakage of capital and resources out of a country.[28] Several scholars have identified a revolving door phenomenon in sub-Saharan countries; where up to 80% of public loans are channelled out of the country as private assets through capital flight.[29] It is therefore imperative to keep in mind when analysing capital flows to sub-Saharan Africa that there is always the very real risk of capital flowing back out again through illicit channels. In fact, UNCTAD finds that the continent as a whole lost about $854 billion in illicit flows from 1970 to 2008, which is approximately equivalent to all ODA received during that period.[30] In 2015 alone, Sub-Saharan Africa lost 6.1% of GDP to illicit financial flows.[31] The African Development Bank and Global Financial Integrity estimate that illicit flows are the main driver of the net drain of resources from Africa.[32]

2.2 Debt Levels and Sustainability

Many African countries encountered grave debt problems in the 1980s and 1990s, largely triggered by commodity dependence and falling commodity prices at the beginning of the 1980s.[33] As foreign earnings fell, servicing foreign debt became increasingly difficult. After years of global campaigning for debt cancellation, the IMF and the World Bank set up two debt relief schemes, namely the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). Thirty African countries were granted substantial debt reduction through HIPC and MDRI in the mid-2000s. A decade later, many of the same countries are again facing debt distress and the composition of debt has changed substantially.

Lending to sub-Saharan African countries has increased significantly since the mid-2000s, although mostly to middle-income countries.[34] Resource-rich countries in particular, such as Nigeria and Angola, have seen a striking increase in lending: cross-border lending tripled to Angola and sextupled to Nigeria between 2000 and 2012. The African Development Bank recently warned its members of the dangers of rising sovereign debt.[35] The IMF too has called for an urgent need to reset the region's growth policies.[36] And UNCTAD warns that there is a risk of a recurrence

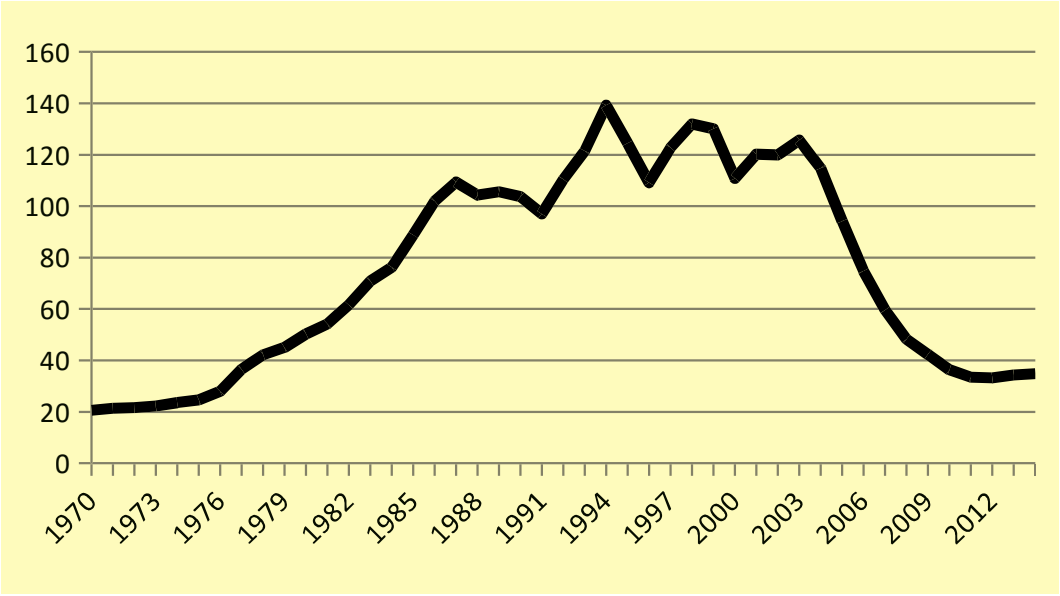


Figure 2.5 External Debt, Average for Sub-Saharan Africa (% of GNI). Source: World Bank World Development Indicators[38]

of the African debt crisis of the late 1980s and 1990s.[37]

As is evident from figure 2.5, external debt as a percentage of GNI is now at low levels compared to the mid-1990s. As pointed out by UNCTAD, however, although debt-to-GNI levels are relatively low, external debt stocks grew by about 10.2% a year in 2011-2013 compared to 7.8% in 2006-2009.[39] Furthermore, as evidenced by figure 2.6, general government net debt as a percentage of GDP started rising in the mid-2000s for several African countries, despite this also being the time of Africa's "rising", with high commodity prices and high growth rates in the region. According to IMF estimates, several African countries will have debt-to-GDP ratios over 50% by 2020.

Debt-to-GDP levels are not always very useful indicators to determine whether a debt level is sustainable however, as much depends on the macroeconomic and financial characteristics of the country in question.[40] Furthermore, data on African GDP is not always reliable. Nigeria and Ghana recently revised their GDP statistics by 40% and 60%, after reviewing national economic data. In fact, national statistics on economic production throughout Africa might be off by as much as 50%.[41] In addition to considering the debt-to-GDP ratio, it is equally, if not more, important to consider debt servicing-to-revenue ratio, in order to understand how debt is impacting government spending.

According to the IMF, 27 sub-Saharan countries[42] were at moderate or high risk of debt distress at the end of 2015, two countries[43] were already in debt distress, while ten countries[44] were at low risk of debt distress.[45] Data was missing for 15 countries. However, there are a number of problems with the Debt Sustainability Framework (DSF) used by the IMF to assess whether a country's debt is sustainable or not, as we will see in chapter 5.

Moreover, although debt sustainability ratios may be reasonable, they depend on continued strong GDP growth.[46] With decelerating growth since 2014, larger fiscal deficits have led to a further rise in public debt.[47] In fact, the median public-debt-to-GDP ratio rose by 5.25 percentage points between 2014 and 2015 to 43%.

As resource mobilization through taxation has remained low in the region,[48] many African countries are borrowing in order to raise the necessary funds for de-

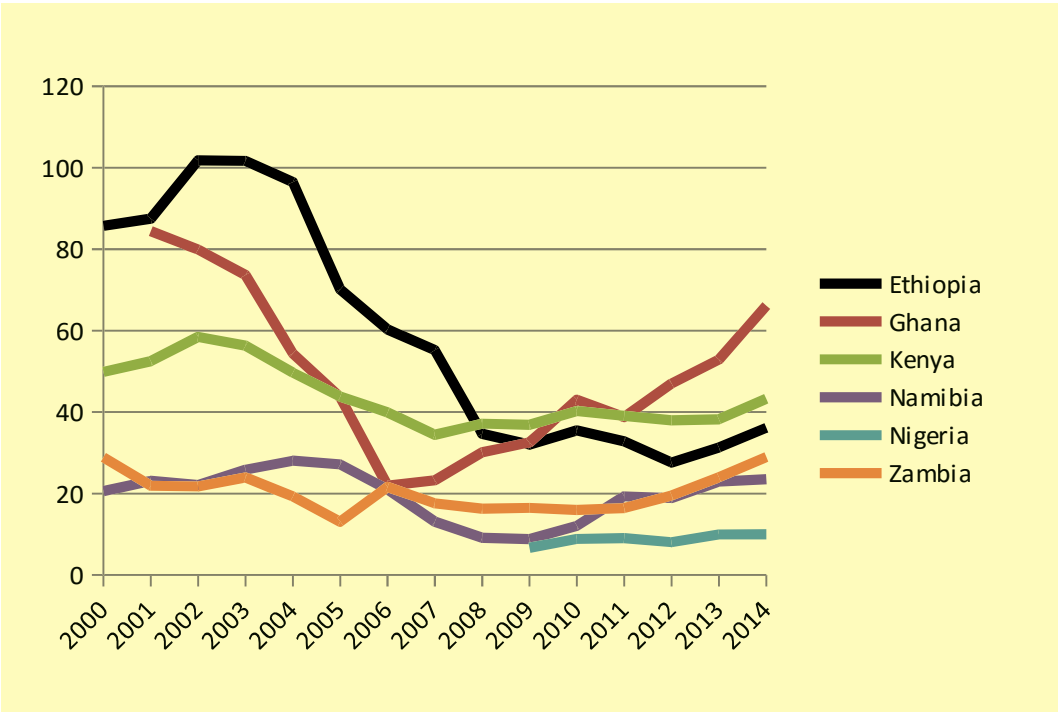


Figure 2.6 General Government Net Debt (% of GDP). Source: International Monetary Fund, World Economic Outlook Database, April 2016. Net debt-to-GDP for the bond-issuing sub-Saharan African countries for which data was available.



velopmental purposes.[49] Needless to say, although borrowing can be a source of much needed financing for many developing countries, there is no clear link between sovereign borrowing and poverty reduction.[50] What's more, high levels of debt can divert scarce resources from development investments[51] and from human rights obligations.[52]

While the norm a decade ago was for sub-Saharan African countries to borrow bilaterally and multilaterally on concessional terms, that has rapidly been changing for many countries in the region. Since 2005 there has been a steady decline in the concessionality and maturity of new external debt commitments for HIPC-countries.[53] For two thirds of HIPC-countries, the share of concessional financing declined from 2005-2007 to 2011-2013. While concessional loans typically have an average interest rate of 1.6% and a maturity of 28.7 years, the sovereign bonds issued by African countries today have, on average, an interest rate of 6.2% with an 11.2-year maturity.[54]

According to the World Bank International Debt Statistics, interest payments on external debt grew from approximately 5 to 8 billion USD between 2009 and 2013. External borrowing costs have increased further since 2014, triggered by the fall in commodity prices, oil price volatility, and heightened risk perception on the part of international investors.[55] Furthermore, private external debt has increased significantly, as a part of a general trend of private sector flows becoming more prominent than public flows.[56]

The spread of public-private partnerships (PPPs) also warrants attention from a debt-management perspective. The partnerships tend to be complex and risky, as they are generally treated as off-budget transactions (contingent liabilities) although they can become a fiscal burden in the future.[57] Such estimates are not included in the IMF's Debt Sustainability Framework. PPPs are responsible for 15-20% of infrastructure investment in developing countries[58] and they are heavily promoted by donors through aid, loans, and debt relief agreements.[59] In general, the private sector agrees to make the investment and the government guarantees the payments and/or commits to bailing out the private company if the investment fails. Strikingly, research shows that PPPs are the most expensive way for governments to invest in infrastructure and generally end up costing more than double what it would have cost had the government financed the investment itself through bank loans or bond issuances.[60]

While many sub-Saharan African countries are in need of external funds for investment purposes, countries have become painfully aware of the risks that external borrowing entails. Thus, many countries are now taking measures to borrow do-

mestically in order to insure themselves against external shocks.[61] Generally, domestic debt has been considered a safer source of finance than external debt, due to the currency mismatches involved with external debt.[62] However, although domestic debt may be safer in theory, there are a few troubling aspects of such debt. The interest rate is of particular concern, as domestic debt is generally more expensive than external debt.[63] For example, while Ghana's 10-year Eurobond issued in 2013 carried an interest rate of 7.9%, a 5-year local bond yielded more than 20%. Furthermore, domestic interest rates vary widely depending on the country. Nonetheless, on average market depth has increased, maturities have lengthened, and the investor base has broadened, making domestic borrowing generally much cheaper for sub-Saharan African countries than it used to be.[64]

Furthermore, international investors have now entered the local bond markets of sub-Saharan Africa in search of higher yields.[65] This has for example been the case in both Zambia and Ghana, particularly for short-term treasury bills. This foreign presence makes the host economies more susceptible to market volatility, since having fewer domestic creditors means more exposure to sudden reversals of capital flows in the face of global volatility.[66] Naturally, domestic debt has contributed to the increase in public debt that the region has experienced recently.[67] In fact, African local debt as a whole rose from USD 150 to USD 400 billion from 2004 to 2014, thus dwarfing the $25 billion raised through sovereign bonds between 2006 and 2016.[68] According to Standard & Poor's, in 2014, 80% of commercial borrowing, by the 17 sub-Saharan African countries it rates, was raised domestically, rather than externally.

Another way sub-Saharan African countries – as other developing countries – are protecting themselves from external shocks is by drastically increasing their foreign reserves. These reserves serve as a way of preventing or mitigating external shocks and boosting investor confidence.

As Figure 2.7 illustrates, there was a sharp increase in reserves as a proportion of external debt in the 2000s, from 18% of total external debt in 2000 to 71% in 2008. However, since the 2008-crisis the reserves have dropped.

2.3. Macroeconomic fundamentals

While high average growth over the past two decades has led many commentators to dub the sub-continent an economic miracle, inequality in the region is also arguably the highest in the world[69] and exports are highly concentrated.[70] In fact, export dependency and export concentration is rising faster in sub-Saharan Africa than in other regions of developing countries, with a 73% increase between 1995 and 2008.[71]

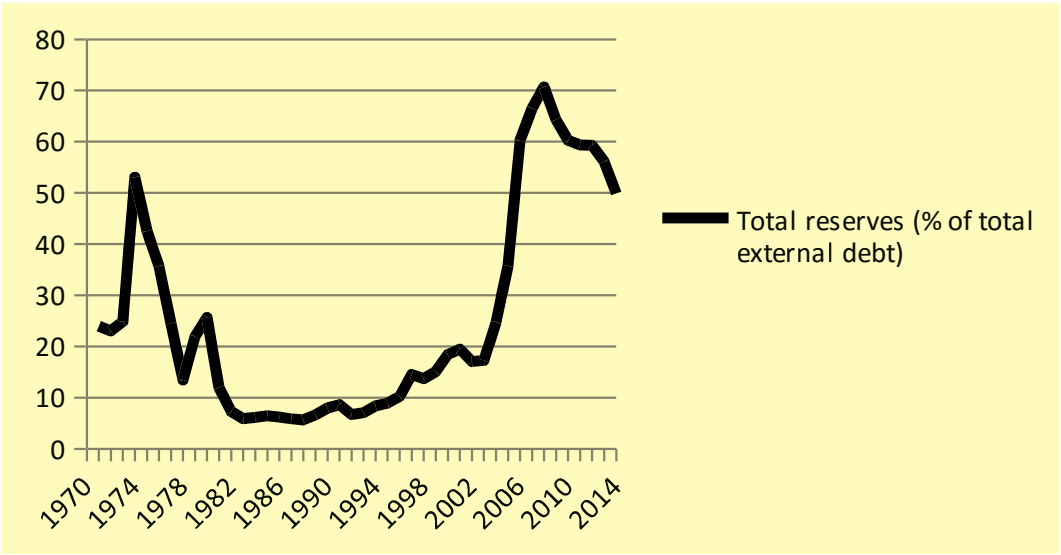


Figure 2.7 Sub-Saharan Africa: Total Reserves (% of External Debt). Source: World Bank, World Development Indicators

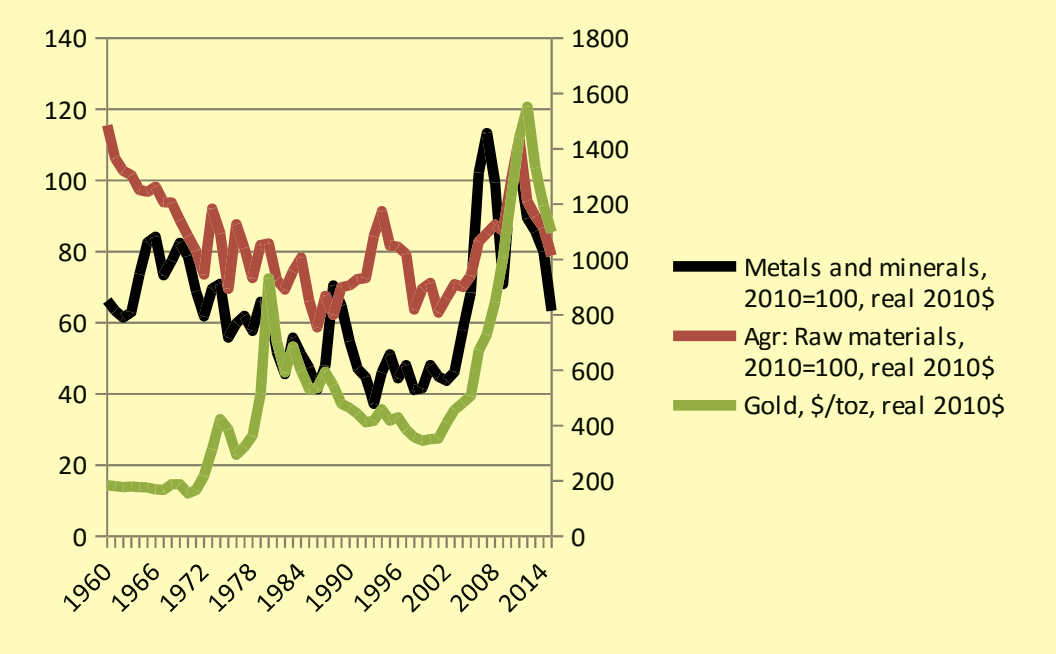


Figure 2.8 Global Commodity Prices' Rise and Crash. Source: Global Economic Monitor (GEM) Commodities, World Bank Data

As the continent holds one tenth of the world's oil, one third of its mineral reserves, two thirds of the world's diamonds, and approximately 60% of the world's uncultivated arable land, the continent's growth has been closely linked to global commodity cycles.[72] Thus it is no wonder that sub-Saharan economies have been faltering, as commodity prices have been falling since 2011 and oil prices have slumped since 2014.[73]

As Prebisch (1950) was the first to observe, and as has been empirically illustrated by Erten and Ocampo (2012), terms of trade are likely to deteriorate for primary commodity exporters.[74] This means primary commodity exporters will be likely to run persistent trade deficits and have to borrow to cover the difference. Furthermore, over-dependence on primary commodity exports is a destabilizing factor exacerbating already fragile macroeconomic conditions in developing countries.[75]

The IMF characterizes the current situation as a "shock of historic magnitude" facing the SSA primary exporter countries in the current declining phase of the commodity super-cycle.[76] Metal exporters have also experienced losses since 2011. The DRC, Sierra Leone and Zambia, for example, have seen their commodity terms of trade drop by about 5-10% of GDP since 2011, due to a fall in iron and copper prices. Botswana and Namibia are exceptions in the region, as the price of their commodi-



ty export – diamonds – increased between 2009 and 2014.

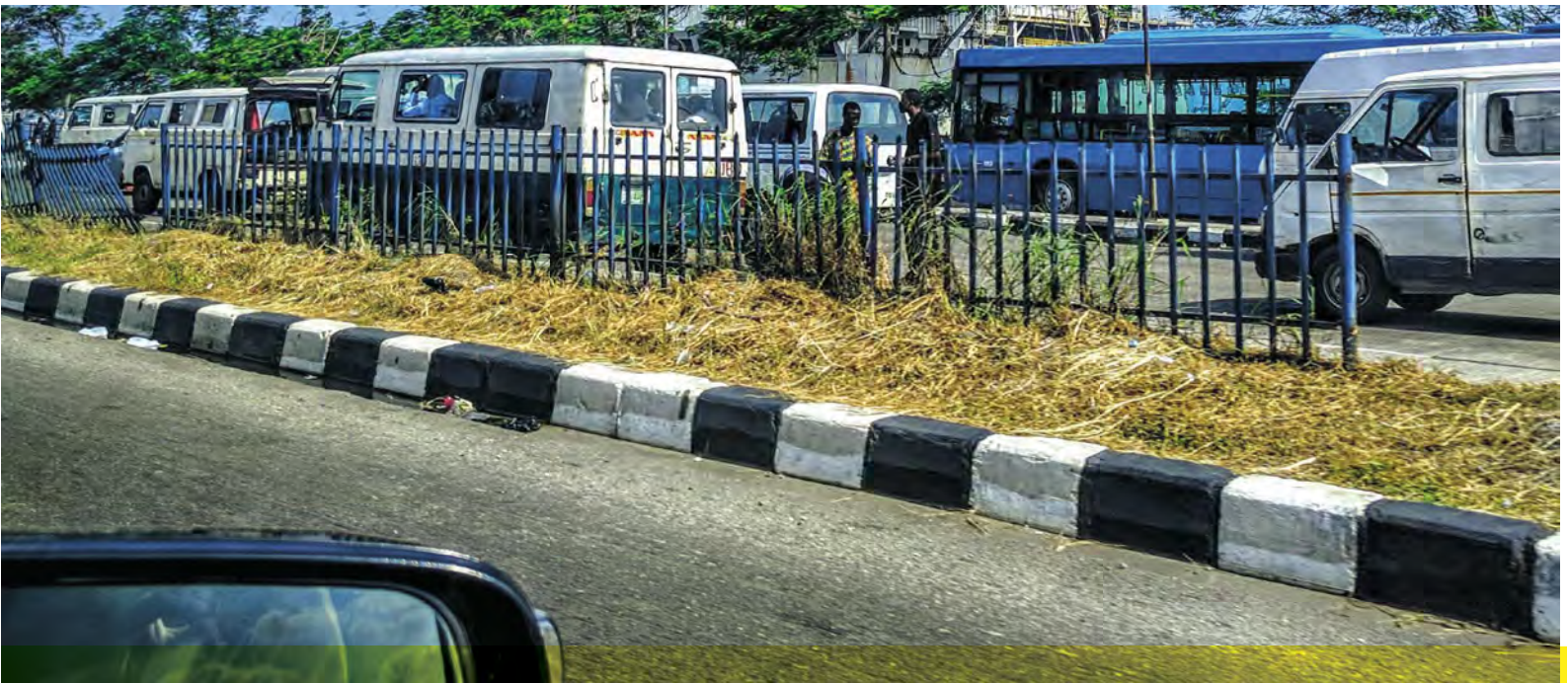
Furthermore, trade has become more important for sub-Saharan African countries over the past decade, with trade in general accounting for more than 60% of the region's GDP and exports accounting for more than 30%. As is evident from figure 2.9, there was a fall in the export share to GDP in sub-Saharan Africa from 2008 to 2009, due to falling oil prices as well as weakened demand in the wake of the 2008 financial crisis.[77] According to the UNDP, this was the biggest fall among developing regions.[78]

Sub-Saharan African countries' reliance on a narrow range of commodities in addition to a narrow range of markets makes them especially vulnerable to volatility in these markets.[79] Furthermore, less diversified economies may face a higher risk of default as foreign exchange revenues needed to cover interest payments depend on the export prices of just a few commodities.

The importance of extractive commodity exports has increased since the 1990s in sub-Saharan Africa.[80] In contrast to Latin America and Asia, net commodity exports actually rose for the region, from 2% of GDP in the 1980s to 6% between 2010-2014, reflecting the expansion of extractive industries. Commodity exports now represent about half of the region's exports, up from less than one fourth in the 1980s. Growth over the past decade has in large part been due to an intensification in resource extraction, creating deepening dependency and increased inequality.[81] As SSA countries have diversified the origin of their financial flows, so too have they diversified their trading partners. But again, as with financial flows, this seems to be a case of diversified dependence, as sub-Saharan African countries still tend to export primary commodities and import manufactured goods.[82] For example, 70% of Chinese exports to Africa are made up machinery and manufactured goods, while 85% of its imports from Africa are in the form of oil and raw materials.[83]

Consequently, one answer to the sub-Saharan African countries' repeated debt crises may be found in their insufficiently diversified economic structures and their lack of real competitiveness on the international market. As many African countries run current account deficits year after year, they are forced to rely on external funding to make up for this (see figure 2.10). In fact, UNCTAD explicitly identifies widening current account deficits and slower economic growth as the sources of growing debt stock.[84]

To conclude, the recent developments in sub-Saharan Africa do suggest there is cause for concern. Although there are benefits and opportunities associated With the diversification of the types and origins of finance and trading partners, there are also risks associated with dependence on primary commodities and on risky and expensive forms of finance.



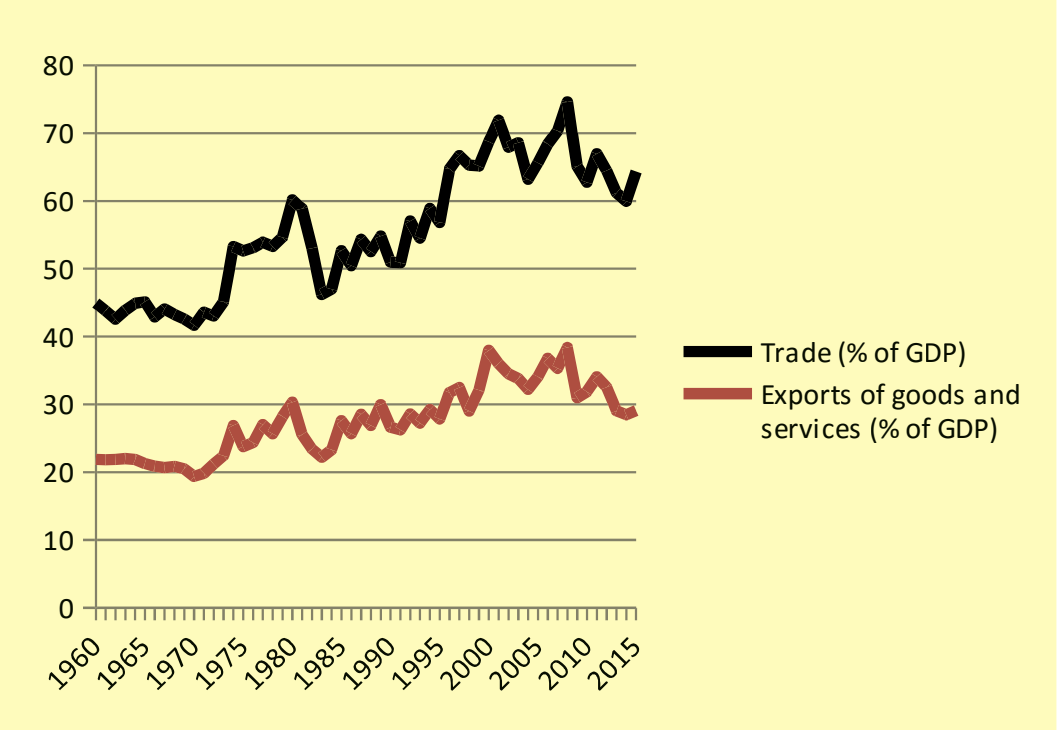


Figure 2.9 Trade Volumes in Sub-Saharan Africa (% of GDP). Source: World Bank, World Development Indicators

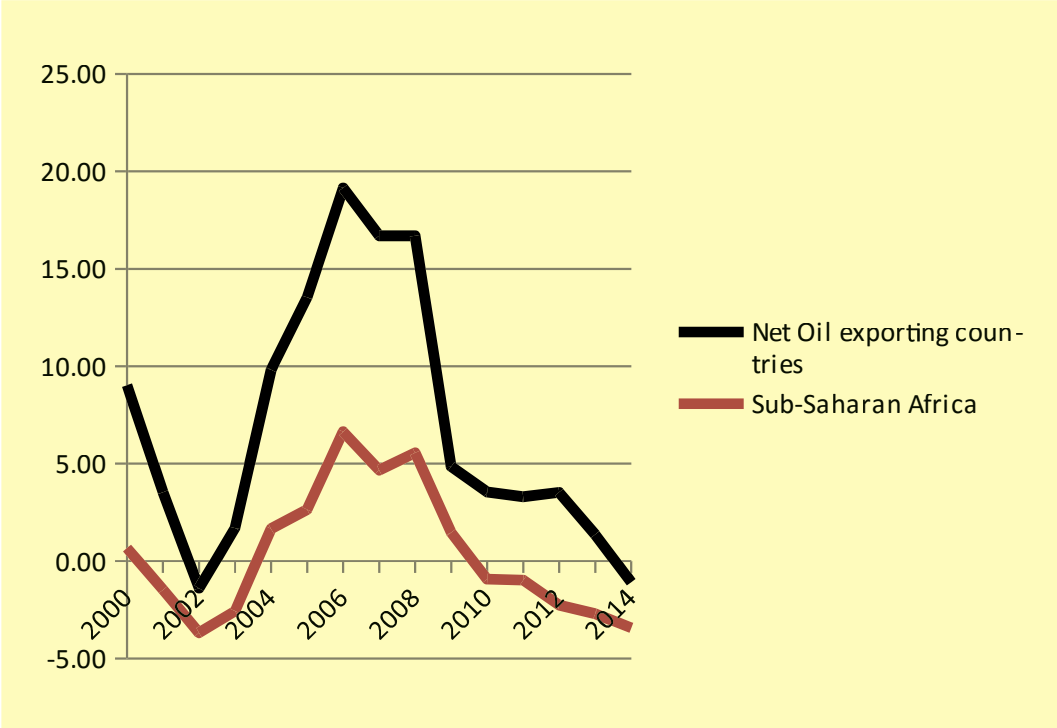


Figure 2.10 Average Current Account Balance in Sub-Saharan Africa (% of GDP.)Source: AfDB Socio Economic Database





3 Eurobonds: Risks and Opportunities

As outlined in chapter 2, the nature of financial flows to sub-Saharan Africa has changed considerably over the past decade. A part of this development is the increased use of sovereign bond issuances on the international market as a way to finance development and plug budget deficits. This chapter considers the opportunities as well as the risks that this new form of financing entails.

3.1 Bond Basics

A sovereign bond is a debt security issued by a national or sub-national government entity. Foreign-currency denominated sovereign bonds are commonly known as Eurobonds, although they are often denominated in US dollars.

The average size of a Eurobond is much larger than any other external funds African governments have access to.[85] What's more, international bond investors impose no conditions on how funds are spent by sovereign borrowers, unlike multilateral and bilateral lenders.

3.1.1 What Are the Benefits?

No strings attached

The fact that the bond investors do not impose conditions on how the funds are spent by the sovereign borrower provides a lot of policy breathing space for the issuing government. A bond prospectus may state that the proceeds will be allocated to infrastructure development or debt rescheduling, but this is not always the case – and indeed any mention of how the funds will be allocated is non-binding.[86] Once the bond is issued, the country may use the funds as they wish. However, while fungibility may not concern investors or government officials, as the case studies show, it does concern legislators and citizens.

A benchmark for the private sector

A Eurobond issuance usually provides a benchmark for corporations and sub-national entities wishing to issue bonds on the international market.[87] This means that once the sovereign has issued a bond on the international capital market, it will be easier for sub-national entities and national corporations to access credit on the international market too.

It's relatively cheap (but also relatively expensive)

While this form of borrowing is more expensive than concessional loans,[88] it is usually significantly cheaper than what is available to African sovereigns on the domestic market.[89]

There is demand for finance

Sub-Saharan African countries are facing major challenges in meeting their development finance needs through public budgetary resources and issuing sovereign bonds is a way for them to at least partially meet this need.[90] Moreover, such bonds allow governments to borrow relatively large sums.

3.1.2 What Are the Risks?

The exchange rate risk

Borrowing in a foreign currency does involve some exchange rate risks and the extent to which debt is foreign currency denominated is often considered to be a key determinant of stability in output, capital flows, and exchange rate.[91] While Eurobonds are a cheaper form of financing than domestic debt, there is always the very real currency risk involved with issuing bonds in a foreign currency. For example, after their Eurobond issuances were made in US dollars, Tanzania, Zambia and Kenya all experienced a depreciation of their currency against the dollar because of the strengthened dollar on the global currency market.[92] The Ghanaian cedi and Nigerian naira both depreciated by more than 20% in 2014 with a peak depreciation of over 60%.[93] The local currency depreciation in relation to the dollar made servicing dollar-denominated debt significantly more expensive. This risk is further exacerbated if the issuer is earning its foreign exchange through commodities with volatile global prices, as is the case for most sub-Saharan African countries (see chapter 2).

"There is a system for private-sector debt default – bankruptcy. But there is no system for sovereign default – sovereigns aren't supposed to default."
– Amir Shaikh, AfDB's African Legal Support Facility

The interest rate risk

In addition to exchange rate risks for bonds denominated in foreign currency, there is also the possibility of interest rate risk if bonds are issued with a floating interest rate, as this entails an increase in payments when the interest rate increases.

A recent study shows that yields on African sovereign bonds are closely correlated with the global capital markets' volatility, changes in the price of the borrower's main commodity export and the interest rate on US T-bills, which is considered a benchmark for access to global liquidity.[94] All three factors are outside of the developing countries' control and in turn are highly influenced by investors' perceptions of yet another set of core factors: health of the global economy, prospects of monetary tightening in developed nations, and actual ability of the SSA borrowers to sustain interest payments as primary export commodity prices decline.

However, 96% of bonds issued in sub-Saharan Africa are issued with a fixed coupon, which means the interest rate is fixed and thus payments are constant and predictable.[95] As a consequence, the yield volatility will not affect current borrowing costs so much as it affects the borrowing cost of new bond issuances. Thus, although sub-Saharan Africa has a limited role in the global bonds market, the region's sensitivity to global shocks could be serious.

The legal risk

The issuance of international sovereign bonds to commercial investors does expose the borrower to specific legal risks in case of default.[96] For example, vulture funds have been known to buy up cheap bonds on the secondary market and then sue the borrower for repayment. The Argentinian case that was handled in a New York court in September 2014 is a clear example of how much damage such vulture funds can have on a debtor.[97]

The International Capital Markets Association, the IMF and the African Development Bank are currently studying ways to mitigate this risk for African issuers. The main instrument advocated is

the inclusion of Collective Action Clauses (CACs) in the bonds.

Amir Shaikh of the AfDB's African Legal Support Facility put it this way: "There is a system for private-sector debt default – bankruptcy. But there is no system for sovereign default – sovereigns aren't supposed to default."[98]

The risk of excessive debt accumulation

As with any debt instrument, there is a risk of over-borrowing. Among the bond issuers in the region, the risks are moderate as the level of capital flows from Eurobonds is low relative to GDP.[99] Nonetheless, vulnerabilities are increasing, as explained in chapter 2.[100]

Fungibility

Since this type of borrowing comes in the form of general budget support without strings attached (a benefit), the downside is that it can be harder for legislators and civil society to track exactly what the money is being used for.

3.2 Sovereign Bonds in Sub-Saharan Africa

Sovereign bonds are increasingly becoming a part of the African debt experience. When the Seychelles issued its bond in 2006, it was the first sub-Saharan country, other than South Africa, to issue foreign currency denominated bonds in 30 years. Since then, the DR Congo, Gabon, Ghana, Côte d'Ivoire, Senegal, Angola, Cameroon, Nigeria, Tanzania, Mozambique, Namibia, Rwanda, Kenya, Ethiopia and Zambia have all followed suit. By 2014, the IMF cautioned African countries about endangering their debt sustainability by issuing sovereign bonds.[101] Over the past decade, sub-Saharan African countries have accumulated over $25 billion worth of Eurobonds (see table 3.1). The bonds to the region in 2013 ($5.1 billion) represented approximately 20% of foreign aid and 12% of FDI.[102]

In 2013, bonds had increased to make up 73% of debt from private creditors for non-HIPC countries, up from 44% in 2005.[103] Excluding South Africa, the



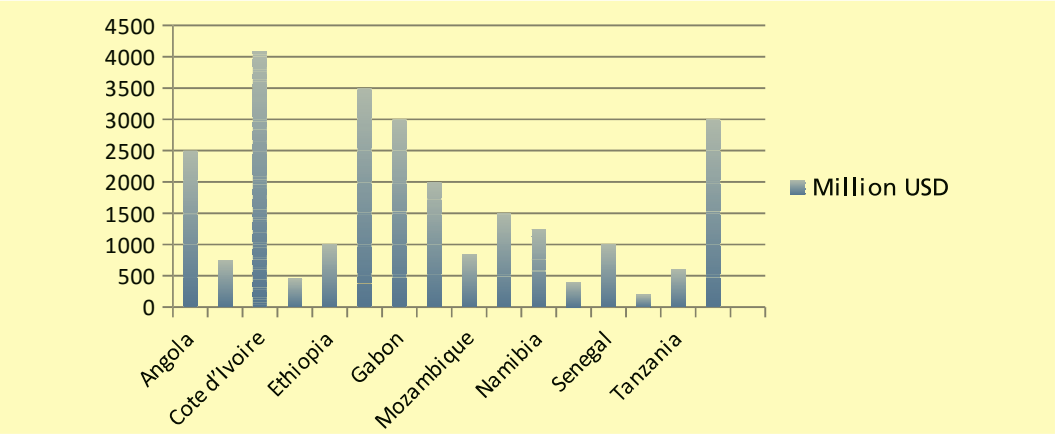


Figure 3.1 Sub-Saharan African Eurobonds by Country for 2006-2015 (million USD). Source: Compiled by author based on data from Bloomberg, the Financial Times, and the Debt Management Office of Nigeria

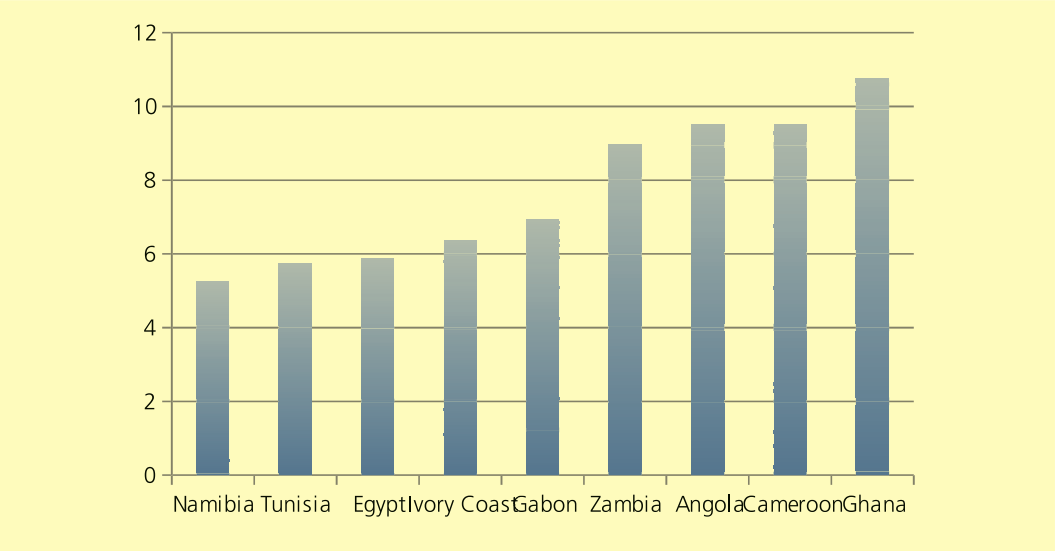


Figure 3.2 Interest Rate on Eurobonds Issued by African Sovereigns in 2015 (%). Source: Debt Management Office of Nigeria

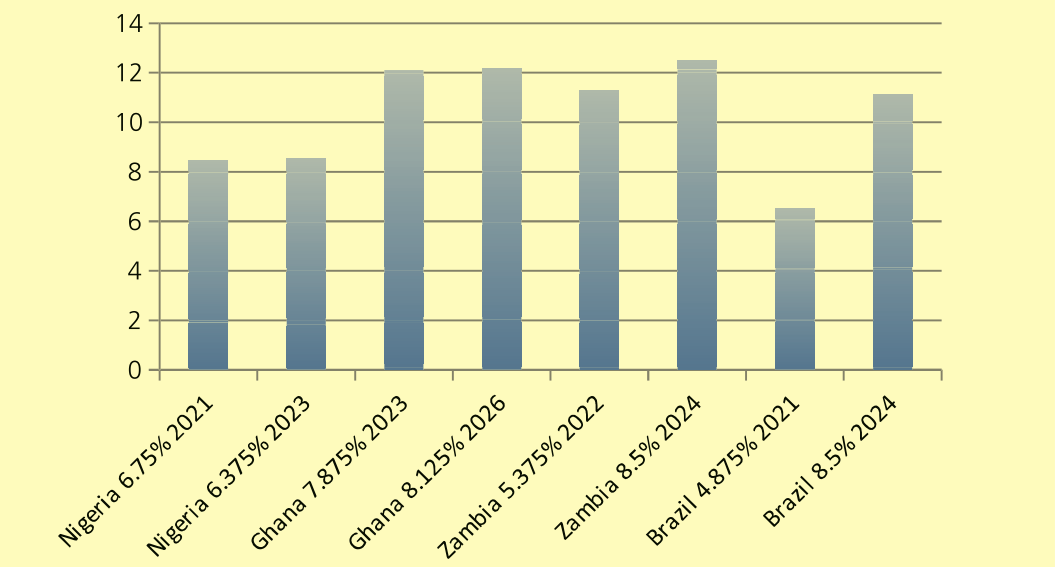


Figure 3.3 Yields on Secondary Market, end of 2015. Source: Debt Management Office of Nigeria

Table 3.1 Eurobond Issuances in Sub-Saharan Africa (million USD)

Country	2006	2007	2010	2011	2012	2013	2014	2015	TOTAL
Angola					1,000			1,500	2,500
Cameroon								750	750
Cote d'Ivoire			2,330				750	1000	4,080
DRC		454							454
Ethiopia							1,000		1,000
Ghana		750				750	1,000	1,000	3,500
Gabon		1,000				1,500		500	3,000
Kenya							2,000		2,000
Mozambique						850			850
Nigeria				500		1,000			1,500
Namibia				500				750	1250
Rwanda						400			400
Senegal				500			500		1,000
Seychelles	30		168						198
Tanzania						600			600
Zambia					750		1,000	1,250	3,000
TOTAL	**30**	**2204**	**2498**	**1500**	**1750**	**5100**	**6250**	**6,750**	25,332

Source: Author's calculations based on data from Bloomberg, the Financial Times, and the Debt Management Office of Nigeria

bond share of private creditor debt rose from 30% to 48%. In countries that benefited from debt relief through the HIPC-Initiative, the share of bonds in private credit increased from 24% to 42% between 2005 and 2007 and fell to 16% in 2011 before recovering to 25% in 2013.

3.3 How to Issue a Bond

The process of issuing a sovereign bond is closed and obscure, and usually governments hire underwriters to do most of this work for them. For example, Deutsche Bank, Barclays and Citibank have managed many of the issuances. In this case, the underwriters act as intermediaries between the bond issuers and the bond buyers. When investment bankers underwrite the bonds, they assume the risk of buying the newly issued bonds from the government, before they resell the bonds on the secondary market. The underwriters are the ones that recommend the interest rate on the bond, aiming at a rate that will attract enough investors to ensure full subscription. If bonds go unsold the underwriter is obliged to buy them at the issuing interest rate.[104]

In 2013 and 2014 most African issues were heavily oversubscribed, suggesting that the underwriters had recommended excessively high interest rates on the bonds, stimulating huge demand. For example, Kenya's 2014 bond was oversubscribed by 300% and Senegal's 2014 bond was oversubscribed by 700%.[105] Namibia, Nigeria, Senegal and Kenya all saw their bond yields immediately drop on the secondary market, also suggesting that the issuing interest rates were set too high. Since the interest rates on the bonds are fixed, however, these countries must continue paying the interest rate set above the market rate. Civil society groups and parliamentarians in sub-Saharan Africa have little access to information about how the size, interest rates, and conditions of the loans are determined.[106]

The IMF advises developing countries to pursue the following process when looking to issue a sovereign bond:[107]

1. Select legal and financial advisers and managers with an established presence in the targeted markets



2. Ensure that the process of receiving a sovereign rating is completed in order to guide the financial markets in pricing the bond

3. Conduct road shows in key markets to build a wide investor base

Furthermore, the IMF recommends that the borrower conduct debt sustainability analyses and an evaluation of the currency risk in order to determine the appropriate size of the bond.[108] The IMF also emphasizes the need to set up the "legal framework and institutional capacity needed to support, monitor, and service international bonds".[109]

Usually, the minimum threshold for inclusion in global bond indices is $500 million, which most African countries have met or exceeded.[110] Furthermore, the maturities are typically around 10 years, but there have been some exceptions. The issuer must also decide on the legal terms of the bond. The most important legal aspect is selecting which law will govern the bond and the market in which it will be issued.[111] Other elements, such as the currency denomination, will largely depend on the target investor group. For example, the issuer could choose to issue a bond under New York law, under English law, or an Islamic Sukuk bond. Other legal terms to decide on during the debt issuance process are the inclusion of collective action clauses (CACs) and whether to include a modified pari passu clause.

3.3.3 The Use of CACs and Pari Passu in Sub-Saharan African Bonds

What's the problem with pari passu?

A pari passu clause is standard in both corporate and government bond agreements. The inclusion of this clause means that the debtor has to ensure equal treatment of its creditors. In ordinary bankruptcy proceedings for a corporation, the clause ensures that, in the case of liquidation, all unsecured creditors will have the same priority to the debtor's unsecured debt. In other words, all unsecured creditors will be repaid at the same time and the same fractional amount as other creditors. As there is no liquidation procedure for states, the pari passu clause has not been interpreted in the same way when it

comes to sovereign bonds. Applying the same pro rata payment interpretation to sovereign bonds would enable holdout creditors to sue and get paid a disproportionally greater amount than the creditors who have accepted a restructuring. The pro rata interpretation of the pari passu clause also means that the debtor cannot repay its other creditors without also repaying the holdout creditors in full. In some cases, for example in the Argentina case, the clause has been interpreted in this way. A system where holdout creditors can gain a disproportionate amount compared to the other creditors will tend to make restructuring more expensive for the debtor and disincentivize debt restructurings, as few creditors would want to take large haircuts on their bonds, while other creditors are paid in full.

As a consequence of the Argentina case the IMF recommends a modified pari passu clause that explicitly excludes the obligation to effect rateable payments, in order to avoid such situations.[112] In the modified pari passu, equal treatment does not mean equal payment.

Collective Action Clauses

Collective Action Clauses (CACs) are contract clauses designed to address collective action problems in debt restructuring. In a debt restructuring, creditors agree to exchange their original bonds for new bonds on less advantageous terms. In such restructurings, collective action problems will occur for a number of reasons. A common example is a case where an offer to restructure may be beneficial to the group of bondholders as a whole, but where an individual bondholder would still benefit from demanding a disproportionately greater payment than the amount received by the rest of the bondholders in the restructuring. In such situations, some bondholders (holdout creditors) refuse to participate in the restructuring and instead sue (or threaten to sue) the debtor in order to receive payment in line with the value of the original bond.

CACs address this problem by mandating a supermajority of bondholders to agree to a debt restructuring that is legally binding on all holders of the bond, including those who vote against the restructuring.

Table 3.2 Legal Status of Selected Sub-Saharan African Sovereign Bonds

Country	Date	Size and maturity	Governing law	Includes CACs	Includes modified *pari passu*
Cote d'Ivoire	2015	US$ 1bn 13Y	English	Yes	Yes
Ethiopia	2014	US$ 1bn 10Y	English	Yes (enhanced)	Yes
Gabon	2015	US$ 0.5bn 10Y	English	Yes (enhanced)	Yes
Ghana	2013	US$0.75bn 10Y	English	No	No
Ghana	2015	US$1bn 15Y	English	Yes (enhanced)	Yes
Nigeria	2011	US$ 0.5bn, 10Y	English	No	No
Nigeria	2013	US$ 0.5bn, 10Y and US$ 0.5bn, 5Y	English	No	No
Zambia	2015	US$ 1.25bn 12Y	English	Yes (enhanced)	Yes

Source: IMF 2015[115]

Table 3.3 The Meaning of a Credit Rating Agencies' Grade

Category		Moody's	Standard & Poor's	Fitch
Investment grade	Highest grade	Aaa	AAA	AAA
	Very high grade	Aa1, Aa2, Aa3	AA+, AA, AA-	AA+, AA, AA-
	High grade	A1, A2, A3	A+, A, A-	A+, A, A-
	Good credit grade	Baa1, Baa2, Baa3, Baa4	BBB+, BBB, BBB-	BBB+, BBB, BBB-
Speculative ("junk") grade	Speculative grade	Ba1, Ba2, Ba3	BB+, BB, BB-	BB+, BB, BB-
	Very speculative credit	B1, B2, B3	B+, B, B-	B+, B, B-
	Substantial risk/In default	Caa1, Caa2, Caa3, Ca	CCC+, CCC, CCC-, CC, C, D	CCC, CC, C, RD, D

Source: Moody's, Standard and Poor's, Fitch

Table 3.4 Sub-Saharan African Countries' Ratings by Broad Rating Categories, 2015

Rating Grade	Rating Grade Description	Country Rating Based on Highest Rating in 2015
Investment Grade	Highest grade	---
	Very high grade	---
	High grade	Botswana
	Good credit grade	Mauritius, South Africa, Namibia
Speculative grade	Speculative grade	Angola, Gabon, Lesotho, Nigeria, DR Congo
	Very speculative credit	Côte d'Ivoire, Kenya, Mozambique, Rwanda, Senegal, Seychelles, Uganda, Zambia, Cape Verde, Congo, Ghana, Burkina Faso
	Substantial risk/In default	---

Source: Nalishebo and Halwampa 2015



Following the Argentina case, CACs have become more common.

The IMF has been involved in the promotion of CACs in new international sovereign bond issuances. Apparently, the uptake of CACs has been slightly greater for new issuances under New York law than under English law.[113] The standard CACs are only applicable to the specific bond referred to in the relevant contract; they do not necessarily allow for coordinated and timely restructuring. However, the IMF has done important work in promoting modified CACs, which would apply across bond issuances.[114]

The new modified CACs state that creditors who want to holdout against a restructuring deal will need at least 25% of the investors to holdout before suing the sovereign debtor. This may also solve the possible problem caused by a pro rata interpretation of the pari passu clause.

As table 3.2 illustrates, some sub-Saharan African countries have included CACs in their bonds and a modified pari passu, while others have not. Those that have included these clauses are likely to have an easier time restructuring their debt should it become necessary. This can also help prevent the worsening of debt crises.

3.3.4 The Role of the Credit Rating Agencies

The process of receiving a credit rating is an important step in the debt issuance process. A credit rating can be assigned to any institution that seeks to borrow money, from an individual, a corporation, a state-entity or a sovereign government. In this chapter we are concerned with the ratings of the sovereign government. The credit rating of a sovereign is considered to be an evaluation of its ability and willingness to meet its financial obligations in full and on time.[116]

The top three credit rating agencies (CRA) are Moody's Investors Service, Standard & Poor's (S&P) and Fitch Ratings. These agencies act as watchdogs and they adjust the credit grades depending on how they perceive the credit-worthiness of a country.

While being downgraded by any of these CRAs can have serious effects on a sovereign's ability to borrow on the private market, the precise methods of these agencies are generally unknown to the public. Many CRAs fail to disclose their rating methodologies or fail to follow policies for timely downgrading of securities, according to a report from the US Securities and Exchange Commission.[117] In fact, the UN has raised concerns over CRAs' strong influence on international private financial flows and has pledged to seek ways to "enhance and improve the level and objectivity of information regarding a country's economic situation and outlook".[118] Furthermore, as pointed out in the Debt Justice Norway report "Ethical Deficit" (2012), CRAs do not take the sovereign's degree of transparency into account, nor any measure of ethics.[119]

As illustrated in this chapter, there are both risks and benefits to contracting debt in the form of Eurobonds for sub-Saharan African countries. Much will depend on the process of the Eurobond issuance and how the funds are spent. In order to understand the specificities of how bonds are issued and perceived, this report examines a few case studies (chapter 4).





4 Debt Beyond the Numbers

To study the changing landscape of debt in sub-Saharan African countries, this chapter looks at three countries that are in somewhat different situations, but have all issued sovereign bonds. Nigeria has among the lowest debt-to-GDP levels in the region but high domestic debt levels, Zambia has a worryingly high debt stock, while Ghana has already had to be bailed out by the IMF in order to repay its other creditors. According to the IMF Debt Sustainability Analysis, Nigeria is at a low risk of debt-distress, Zambia at medium risk and Ghana at high risk.

This chapter goes beyond the numbers to look more closely at the process of debt accumulation, the legal framework concerning debt, as well as how people in the countries in question experience the debt issue. The chapter therefore relies heavily on interviews with civil society and policy-makers. The report takes a comprehensive view of Nigeria, while focusing more specifically on the issuing of Eurobonds in Zambia and Ghana. The Nigerian case study draws heavily on fieldwork carried out there by the author in July 2016.

4.1 Nigeria

While Nigeria's debt is relatively low compared to GDP, it is an interesting case to consider because of the rapid pace at which the government has been accumulating debt, the high domestic debt payments, as well as the democratic process of contracting debt. In 2011–2013, the external debt stock grew almost 24% a year in Nigeria, which is among the most rapid-growing on the continent.[120] It is now the highest it has been since 2007.[121] In total, Nigeria's external debt increased by about 240% between 2007 and 2015.[122] Although the debt stock to GDP ratio is relatively low, the government allocates more than 40% of its revenue to servicing debt.[123]

4.1.1 Nigerian Debt in Numbers

Overview of debt situation and strategy

Nigeria's external debt rose to USD 11 billion earlier in 2016 and domestic debt stands at N11 trillion (approximately USD 35 billion).[124] These figures include the debts of the federal and all the state governments. Nonetheless, according to the Debt Management Office (DMO) of Nigeria's debt sustainability analysis, Nigeria's external debt portfolio is at a 'very low level of risk and distress'.[125]

A large part of the government's debt is in the form of high-interest loans from domestic banks.[126] Furthermore, because of the fiscal federalism in the country, the government's liabilities could balloon quickly if Nigeria's 36 states default on their debts. The government therefore announced an explicit debt management strategy that involved borrowing externally in order to pay off expensive domestic debt in 2013.[127] The explicit goal is to achieve a 60:40 ratio of domestic to external debt, in order to lower borrowing costs. In 2015, the ratio of domestic to external debt was 80:20. The DMO thus considers the exchange rate risk of the economy to be very low. Although the debt-to-GDP level is low at 11.7% (in 2015), the debt-to-revenue level is at 316.5% and the debt service-to-revenue level is at 46.4%.[128]

Most of Nigeria's loans over the past decade were obtained under President Goodluck Jonathan with former World Bank executive Ngozi Okonjo-Iweala as his Minister of Finance. The Nigerian NGO Social Action has called this period of borrowing a "coordinated borrowing frenzy".[129]

Nigeria's external debt

As table 4.1 illustrates, the external debt stock increased significantly between 2006 and 2013, although it is still low in relation to the country's GDP. Furthermore, as figures 4.1 and 4.2 illustrate, although commercial debt (Eurobonds, in the case of Nigeria) is a relatively small part of the total debt stock (14%), the high interest rates on commercial debt mean it makes up almost one third of the total debt service. Conversely, while multilateral debt makes up over 70% of the total debt stock, it represents only 41% of total debt service on external debt.

The Eurobond issuances

Eurobond issues are a new form of commercial debt for the Nigerian government, with its first bond being issued in 2011. All Eurobonds are issued under English

Table 4.1 Overview of Nigeria's External Debt

Gross national income (millions of dollars)		Total external debt stocks (millions of current dollars)		External debt stocks (average annual growth rate, %)		External debt stocks (% of gross national income)		External debt stocks (% of exports of goods, services and primary income)	
2006-2009	**2011-2013**	**2006-2009**	**2011-2013**	**2006-2009**	**2011-2013**	**2006-2009**	**2011-2013**	**2006-2009**	**2011-2013**
160 805	440 006	4 630	10 938	18.3	24.0	2.9	2.5	6.9	11.0

Source: Debt Management Office of Nigeria

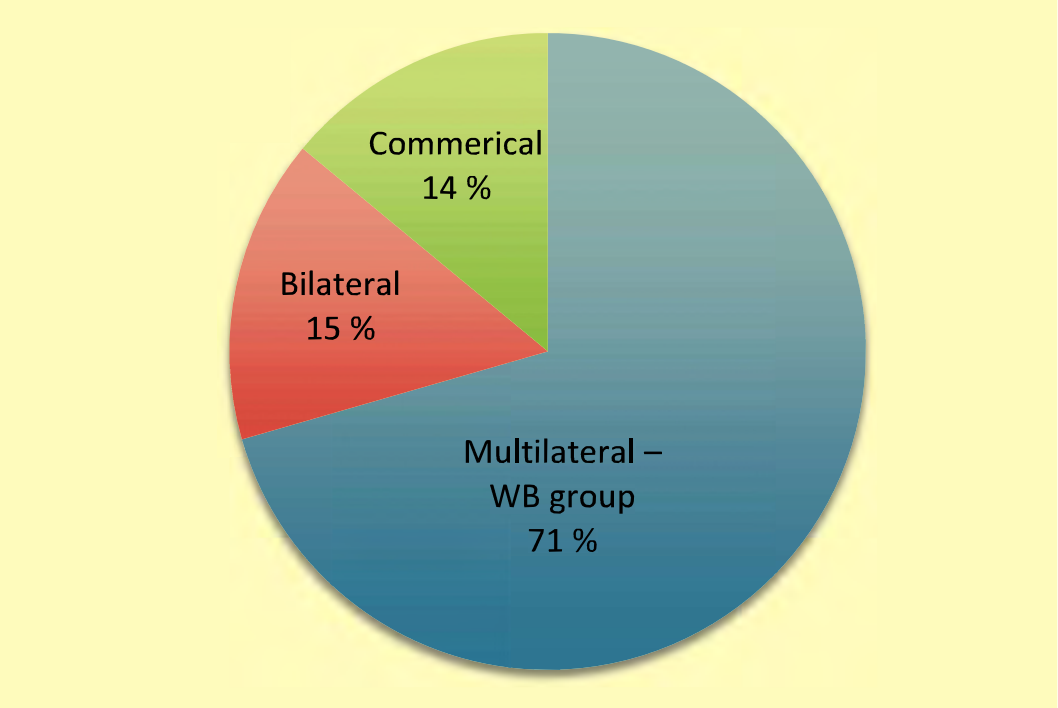


Figure 4.1 External Debt Stock by Source, end of 2015. Source: Debt Management Office Nigeria. 2015. 2015 Annual Report and Statement of Accounts.

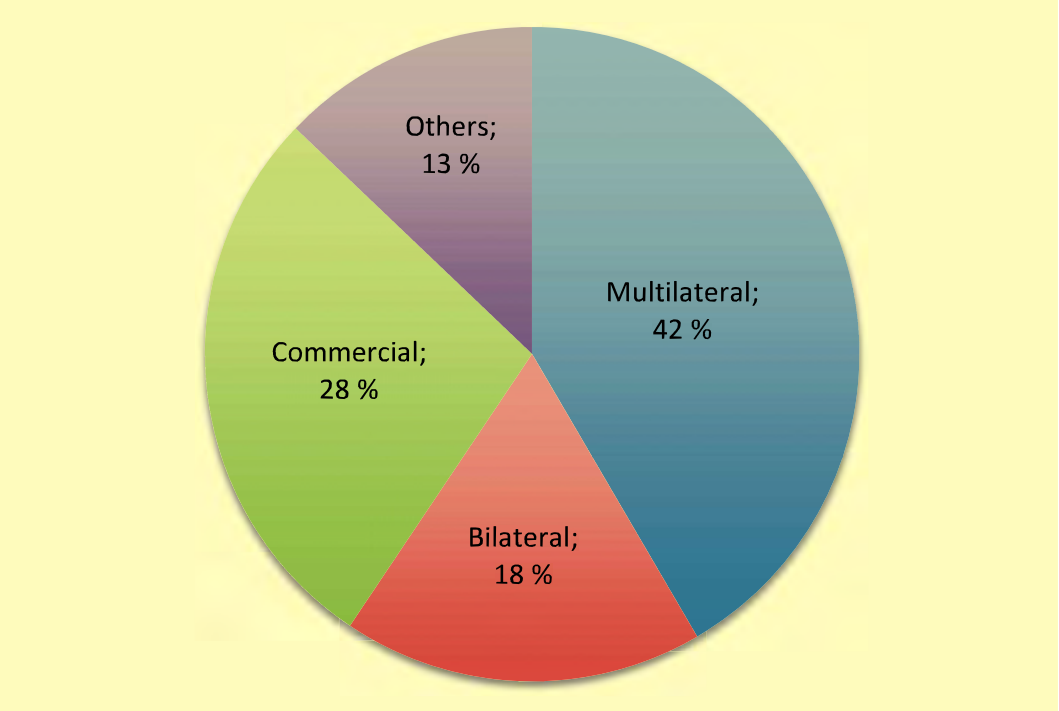


Figure 4.2 External Debt Service by Source, end of 2015. Source: Debt Management Office Nigeria. 2015. 2015 Annual Report and Statement of Accounts.

Table 4.2 Eurobonds Issued in Nigeria

Year	Amount Issued	Interest Rate	Maturity	Rating
2011	500 million	6.75%	10Y	BB- / B+ [131]
2013	500 million	5.125%	5Y	BB- / BB- / Ba3 [132]
2013	500 million	6.375%	10Y	BB- / BB- / Ba3 [133]

law and are listed on the London Stock Exchange.[130] None of them have collective action clauses.

According to the Director-General of the DMO, Dr. Abraham Nwankwo, the floating of the first Eurobond positively changed the profiles of Nigerian corporate organizations and their ability to raise long-term funds from the international capital market. According to the DMO, the Eurobonds were issued in order to fund the power sector, with the focus on transmission projects, meeting the liquidity funding requirements of the Nigerian Bulk Electricity Trading PLC and gas-to-power projects.[134] This was meant to boost electricity generation and distribution throughout the country and thereby have a positive impact on the small and medium scale enterprises and enhance industrial capacity.

Despite being upgraded by Fitch in 2013 because of improved financial stability and optimism over reforms to the banking and electricity sectors,[135] in April 2016, Moody's downgraded Nigeria from Ba3 to B1.[136] This could make it more difficult for Nigeria to borrow on decent terms on the international capital market. In fact, in 2015, the spread of these three Eurobonds widened considerably due to the weak global economy, the slowdown in China, volatility in commodity prices, structural decline in crude oil prices, and the increases in the rates of US Treasuries.[137] Although interest rates of between 5% and 7% are high compared to concessional loans from multilateral institutions, they are relatively low compared to the cost of domestic debt.

Note that the underlying structure of the Nigerian economy has remained largely the same over the past five years. Thus, the Credit Rating Agencies adjust their ratings due to global factors affecting Nigeria's development, such as the fall in the oil prices, thereby adding an additional source of instability for the country.

Sub-national debt

In May 2015, 23 out of Nigeria's 36 states became insolvent and could no longer meet their basic financial obligations. They therefore filed for bailouts from the government.[138] In response, the Central Bank set up a special intervention fund that would provide soft loans in order to enable the states to pay the backlog of salaries.[139] By mid-2016, the Nigerian government had bailed out 27 states to the value of $2.1 billion.[140]

Domestic debt

From 1981 to 2003, Nigeria's domestic debt was heavily concentrated in maturities of less than one year, mostly 3-month treasury bills. In 2003, the government imposed a range of reforms and brought back a sovereign bond issuance program that had been discontinued in 1986. This meant that the government started issuing debt with much longer maturity, such as 3, 5, 7 and 10 years. The three-month treasury bills accounted for over 60% of total domestic debt in 2003, but by 2014 this had fallen to 36%. Notably, non-residents are also investing in Nigeria's domestic debt, as international investors have shown renewed interest in emerging markets because of the high yields.[141]

As mentioned, the government's medium-term debt strategy is to reorient towards external debt and away from domestic debt because the interest rates on domestic debt are relatively high. In fact, since 2010 the interest rate on domestic debt has been above 20%.[142] [143]

In 2014, 20.3% of the Nigerian budget was earmarked for domestic debt servicing, which subverts funds that could go towards more development-friendly projects. If the Nigerian debt service cost

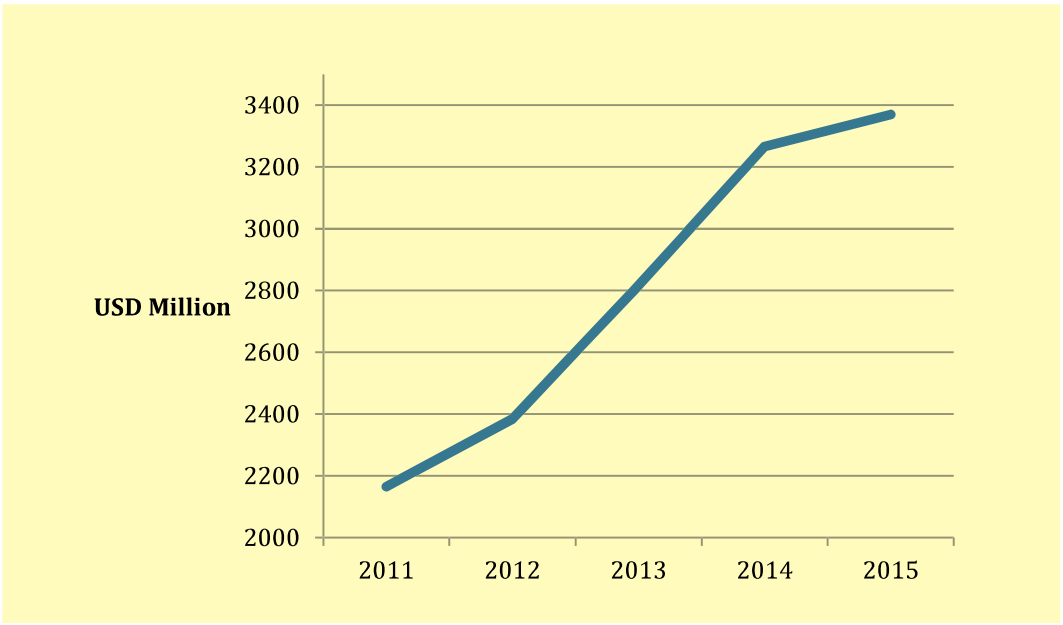


Figure 4.3 States and the Federal Capital Territory's External Debt Stock, 2011-2015. Source: Debt Management Office of Nigeria 2015

continues to rise at the same rate, over N1.8 trillion will be required for domestic debt servicing by 2019 (40% of the 2014 budget).[144] Domestic debt increased by 11.30% from 2014 to 2015.[145] According to the Nigerian DMO, this increase was due to new borrowings to fund the 2015 appropriated budget deficit and the refinancing of matured debt obligations.

The International Finance Corporation (IFC) of the World Bank has also begun issuing naira-denominated bonds in order to improve liquidity in local capital markets. In 2012, Nigerian domestic debt was admitted to JP Morgan's Government Bond Index-Emerging Markets (GBI-EM). Furthermore, Nigeria set up an over-the-counter trading platform in 2013 to facilitate a secondary market in local debt. However, despite all these efforts, the local currency bond market remains underdeveloped, representing only 7% of GDP, compared to more than 50% of GDP in South Africa.

In 2015, JP Morgan GBI-EM phased out Nigerian bonds, following the placement

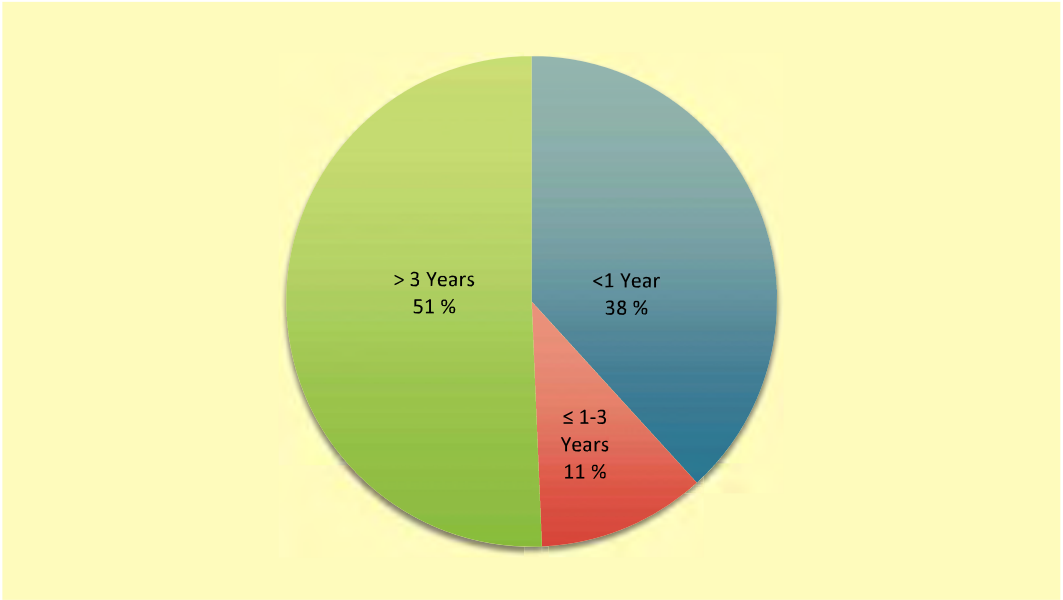


Figure 4.4 Maturity Structure of Domestic Debt, end of 2015. Source: Debt Management Office Nigeria. 2015. 2015 Annual Report and Statement of Accounts.

of Nigeria on the JP Morgan Negative Watchlist in January 2015.[146] Furthermore, Nigeria has been notified that Barclay intends to remove Nigeria from the Barclay Capital Emerging Markets – Local Currency Government Bond Index by 2016.

4.1.2 Nigerian debt relief in 2005

Nigeria entered a debt buy-back deal with the Paris Club in 2005, in which Nigeria paid $12.4 billion out of about $30 billion owed to the Paris Club creditors at the time.[147] Following this unprecedented payment, the Paris Club cancelled the remainder of the debt. Therefore, the debt buy-back deal is usually referred to as debt relief.

Most of Nigeria's external debt load accrued through accumulated penalties and compound interest rates on loans, mostly under military dictatorships, as Nigeria did not transit from military to civilian rule before 1999.[148] Between 1985 and 2004 Nigeria's external debt to Paris Club creditors rose by $23 billion from interest, arrears and penalties alone, rather than through new borrowing. Notably, although Nigeria had paid over $35 billion in annual debt service payments, at the beginning of 2005 the country still owed 36 billion. At this time there was a debt cancellation movement in Nigeria, also supported by the civilian government of Olusegun Obasanjo and international NGOs.

According to Social Action, most of the debt that was cancelled in 2005 could be classified as odious as most of it was contracted by the military government. In 2005, the House of Representatives adopted a motion demanding that the government stop further payment on foreign loans owed to the Paris and London Clubs, instead suggesting that payments should be focused on development of the country.[149]

> "What Nigeria paid was more than double of what it had actually borrowed. There was interest, compounded interest, penalties for late payments… we were ripped off."
> – Vivian Bellonwu-Okafor, Head of Social Action

While actual debt cancellation or repudiation was never achieved, the engagement with the creditors and outcry from the international community led to the 2005 debt buy-back deal. Nigerians question the logic of calling it 'debt relief', as Nigeria had already repaid more than what it had actually borrowed. In addition, a controversial $1 billion was paid in consulting fees to 33 unnamed persons who supposedly facilitated the deal. Furthermore, the National Assembly was excluded from the deal, as the deal was unilaterally decided on by the then president Olusegun Obasanjo and his Minister of Finance, Ngozi Okonjo-Iweala. [150]

4.1.3 The Legal Process of Contracting Debt

Nigeria established a budget office, a debt management office and a domestic debt-rating agency in 2005. The National Assembly also passed the Fiscal Responsibility Act (FRA)[151] in 2007, after much lobbying from civil society.[152]

The Aim of the Fiscal Responsibility Act was to:

"…provide for prudent management of the Nation's resources, ensure long-term macro-economic stability of the national economy, secure greater accountability and transparency in fiscal operations within the medium term fiscal policy framework, and the establishment if the Fiscal Responsibility commission to ensure the promotion and enforcement of the Nation's economic objectives; and for related matters."[153]

More specifically, the Fiscal Responsibility Act:

- States that "government at all tiers shall only borrow for capital expenditure and human development, provided that, such borrowing shall be on concessional terms with low interest rate and with a reasonable long amortization period" (section 41.1.a)
- States that "any Government in the Federation or its agencies and corporations desirous of borrowing shall, specify the purpose for which the borrowing is intended and present a cost-benefit analysis, detailing the economic and social benefits of the purpose to

which the intended borrowing is to be applied" (section 44.1).

- Recommends that the government hold public consultations regarding its Medium-term expenditure framework (section 13), requires that it seek input from the National Assembly (section 13b) and that it be finally approved by the National Assembly (section 14.2).
- States that a Fiscal Responsibility Commission should be established, including members of the organized private sector, civil society, and organized labor (section 5b).
- States that "the President shall…with advise from the Minister of Finance subject to approval of National Assembly, set overall limits for the amounts of consolidated debt of the federal and State Governments" (section 42.1).

Evidently, Nigerian law allows a central role for both Parliament and civil society in debating and approving the debt strategy of the government. As illustrated in the accompanying interviews, however, the government largely ignores the FRA. Civil society groups are not included in any stage of the borrowing process and the parliament struggles to acquire the information they required to make informed judgements about loan decisions. As the Chairman of the House of Representatives Committee on Aids, Loans and Debt Management, Adeyinka Ajayi, explains in the interview in section 4.4.3, "the Fiscal Responsibility Act is being observed in the negative in Nigeria."

4.1.4 Nigeria and the World

Nigeria is mainly tied to the world economy through its dependence on oil exports. In fact, Nigeria is the largest oil exporter in sub-Saharan Africa. Although Nigeria was among the fastest growing economies in the world between 2004 and 2014, with an average of 6.8% real GDP growth over the period, it has experienced highly volatile terms of trade.[154] Moreover, oil and gas accounted for 70% of total government revenue in 2011-2013.[155] Because of its dependence on oil, Nigeria's economy fluctuates along with global economic activity. Naturally, the fall in oil price has caused a significant decline in fiscal and external buffers in Nigeria. What's more, Nigeria is connected to the global economy through financial channels, such as external borrowing. However, compared to other African countries, Nigeria has a relatively strong domestic debt market, so it has limited its external borrowing.

4.1.5 Perspectives from Nigeria

Nigerian Academics

Economist Dr. Oshikoya

Name: Temitope Oshikoya

Position: Economist and Consultant for Nextnomics. Formerly worked with the World Bank, African Development Bank, Central Bank. Author of *The Nigerian Economy* (1990), *Monetary and Financial Integration in West Africa* (2010), *Pathways to Shared Prosperity in Nigeria* (2016), and *The Art of Central Banking in Nigeria* (2016).

Temitope Oshikoya explains that debt is becoming particularly problematic for Nigeria now because of the fall in oil prices. Even the interest rates on Eurobonds are high now, because of global uncertainty such as Brexit. Investors are simply not that keen on investing in emerging markets right now.

Furthermore, Oshikoya is worried about Nigerian private banks. They are also borrowing significant amounts in US dollars – almost 40% of their loans. Meanwhile, most of their liabilities are in naira. After 2008, banks issued a lot of Eurobonds, following the sovereign issuance, which served as a benchmark. Most of the loans went to oil and gas companies, who are now having trouble servicing their loans. The Central Bank recently changed the management of one of the Nigerian banks because it was overexposed.

There are global factors that are important for Nigerian development, such as the oil price and capital flows, Oshikoya adds. Due to global uncertainty, capital flows have stayed abroad. Remittances are also quite important.

Political Scientist Dr. Akhaine on "Fiscal Rascality"



Name: Sylvester Odion Akhaine

Position: Senior Lecturer, Political Science Dept, Lagos State University, author of Patrons of Poverty

There were basically two factors that drove unsustainable debt accumulation in Nigeria before 2005, Akhaine begins. First, there was the structure of the economy, which is largely based on oil exports. The second issue was the political crisis in the Niger Delta. Although Nigeria did not qualify for HIPC, Nigeria did receive some form of debt reduction in 2005. Shortly after that, Nigeria started accumulating new debt.

The problem is that Nigeria has not diversified its economy since then. Even as we speak it is still at the level of rhetoric. What we have now is sheer fiscal irresponsibility, or what I call rascality, says Akhaine. Available resources are often misappropriated and misapplied. There is an absence of prioritization of needs. Akhaine adds that loans that were taken were invested in artefacts of development, such as hotels, and not so much in infrastructure. The states also took loans. A lot of loans were invested in projects that did not take off. They were enmeshed in so much politics.

Therefore, many of us are worried that Nigeria is going back to that situation pre-debt relief, says Akhaine. The worry is heightened by the fact that we have an undisciplined state elite. In fact, I think a debt crisis is inevitable unless we see an increase in self-discipline. Fiscal rascality is what led to the debt crisis spanning the 1980s up to 2005, when the country got some relief from the Paris Club. That fiscal rascality is still very much around.

In order to avoid another debt crisis, Nigeria must look inward to tackle its economic problems and diversify its economy, says Akhaine. – My greatest concern is that there seems to be a lack of political will to go through with serious economic and political reforms that are needed.

Economist Jimoh Saka

Name: Dr. Jimoh Saka

Position: Lecturer I in Economics, Lagos State University

Saka argues that it is safer for Nigeria to issue debt in its own currency, as this makes it possible for the government to repay the debt through raising taxes or reducing spending. In addition, it shields the economy from exchange rate fluctuations. After devaluation, external debt can become very expensive. Meanwhile, domestic debt has been rising for a while in Nigeria and the federal and state governments both participate in this market. In the summer of 2016, N4 trillion had been issued in local government bonds.

To Saka, one way out of the mess is increased transparency and engagement from the international community. He suggests that international organizations could engage with the government, and carry out stage-by-stage monitoring.

Economist Ayoola Odubunmi

Name: Dr. Ayoola Sunkanmi Odubunmi

Position: Professor of Economics, Lagos State University, with a specialization in Quantitative and Health Economics

Dr. Odubunmi says he fears that Nigeria is heading back towards a debt crisis and that this time it will be more critical. 27 out of 36 states cannot pay salaries to their workers right now. The bailout money from the government has also been mis-

managed and was not utilized in the way it should have been. What's more, advanced countries are encouraging corruption, as they fail to take action to track capital flight from politicians and multinationals.

China is a solid alternative lender to go to, or a 'good bride to marry', says Odubunmi. More dependency on the renminbi would entail a diversification of currencies in Nigeria's debt portfolio. However, the main issue is that Nigeria is a monolithic economy; it depends almost entirely on oil. It will need to diversify its economy, but the problem is that the political will is not there.

Nigerian Civil Society: The Constitution is not Being Respected – Head of Africa Network for Environment and Economic Justice, David Ugolor



Name: David Ugolor

Position: Executive Director of the Africa Network for Environment and Economic Justice (ANEEJ). Ugolor was the head of the Jubilee movement in the 2000s and Chairman of Publish What You Pay Nigeria from 2004-2008.

David Ugolor explains that there are a range of governance challenges in Nigeria, which include the lack of effective implementation of the procurement and fiscal responsibility laws in the country. He argues that Nigeria needs solid institutions to act as a safeguard, such as public finance management policies that are implemented in accordance with the law. An example of such a law is the Fiscal Responsibility Act. Unfortunately, the government is not acting in accordance with this act, he says.

In contrast to what is stated in the FRA, there is no civil society involved at any stage of a loan agreement, there is no oversight, and there is no transparency, Ugolor says. As government officials dip their hands in private treasuries, you can imagine how borrowed funds are put to use, he explains. An example of misappropriation of funds is the stashing of money in Switzerland by former dictator, Abacha.[156]

Another important aspect people often forget about is human development, Ugolor explains. If we consider human development, the debt we currently have is not sustainable. In the IMF's debt sustainability analysis, the human development perspective is completely lacking. Ugolor therefore considers Nigeria to be in a silent debt crisis. By this he means that the international financial institutions cannot see the current crisis because all they see is that the debt is small relative to GDP.

Responsible Lending and Borrowing

On a question about what an investor considering buying government bonds from Nigeria should consider in order to ensure that this is a responsible form of lending, Ugolor raises the following issues:

- The borrower must publish how they plan to use the money that they are borrowing in an accessible way
- The borrower must provide space for non-state actors to intervene
- Measures should be put in place for monitoring the borrowed funds
- The embassies of the lending country should also have a role in providing feedback on how the country is acting as a responsible borrower. If there is no embassy in the country, then there should be a commissioner. It will not be easy to assess the degree of transparency, civil society participation, and democratic decision-making, without being present in the country.
- The issues of equity and fairness should be central in any cost-benefit analysis before lending.

Head of Social Action, Vivian Bellonwu-Okafor



Name: Vivian Bellonwu-Okafor

Position: Head of Social Action, an Abuja-based NGO.

Of particular concern to Bellonwu-Okafor are the legal provisions for loan acquisitions. She points out that the Fiscal Responsibility Act (FRA), which outlines the democratic steps that should accompany any loan, is not being respected. In other words, she believes that the problem is not the constitution itself; it is the circumvention of the constitution.

Bellonwu-Okafor points out that debate in the National Assembly about Nigeria's debt is carried out at a very superficial level with no room for proper inquiry. Furthermore, the FRA states that the purpose of the loan should be clear before the loan is agreed to, but this is often ignored. The FRA states that loan acquisition should be tied to specific projects and that cost-benefit analyses should be carried out, but this is not always the case. The FRA states that there should be no loans for recurrent processes, only capital projects, but Nigeria has taken many loans to pay salaries, organize meetings, etc. The FRA states that there should be a debt ceiling, set by the government in cooperation with the DMO, but they have not set a debt ceiling as of today. Finally, Bellonwu-Okafor adds, the FRA recommends that loans be subject to public hearings and debates, but this is never done.

Furthermore, the terms of the loans are often secretive, despite the fact that they can be damaging to the economy. Terms such as "all manpower will be provided by the lending country" or "consultants will come from the lending country" are not very beneficial to Nigeria. If there were public hearings, Bellonwu-Okafor imagines that the terms of loans would come to light and this would provoke greater discussion and debate among stakeholders.

Responsible Lending and Borrowing

When it comes to Eurobonds, Bellonwu-Okafor points out that the level of transparency is very, very low. We don't really know much at all about what's going on there'. When asked her thoughts on guidelines for lenders considering investing in Nigerian sovereign bonds, she identifies the following conditions:

- The loan acquisition process of the constitution must be followed
- There must be legislative oversight of the loans
- There must be government accountability

Based on these points, she argues that Nigeria does not qualify as a responsible borrower, because Nigerian debt management is neither responsible nor transparent since it does not abide by the FRA. Besides, she adds, the solution to the Nigerian government's economic challenges should not be to borrow more.

Head of Centre for Social Justice, Eze Onyekpere



Name: Eze Onyekpere

Position: Executive Lead Director of the Centre for Social Justice (CSJ), based in Abuja, Nigeria.

"The money we owe today is already more than what we got in debt relief.

The oil price is declining. Forget about the debt-to-GDP story, yes I foresee a new debt crisis."

Onyekpere does not consider it relevant or applicable for all countries to use debt-to-GDP ratios as a measure of sustainability, and specifically not Nigeria. He explains:

"Oil and gas contributes approximately 15% of Nigeria's GDP as of today. On the other side of the coin, it contributes about 90% of foreign exchange. And brings in about 70-80% of the government budget. Therefore, one needs to look at the active component of the GDP, the one that is bringing in government revenue and foreign exchange, in order to determine the sustainability of government debt. If it was really just debt-to-GDP that mattered for all countries, both the US and Japan would be in trouble."

Furthermore, Onyekpere explains that the law is very clear. It says that debt should only be used for capital expenditure and that Nigeria should only borrow on concessional terms. However, a good chunk of money has double-digit interest rates. He adds that the Fiscal Responsibility Act requires the government to set a debt limit, and based on this limit, the fiscal responsibility commission is supposed to monitor borrowing levels. But there's currently nothing to monitor, because no limit has been set.

"Civil society was active in pushing for and developing the Fiscal Responsibility Act. It was enacted in 2007, but the federal government probably regretted it right after it was passed. "

What's more, Onyekpere argues that the National Assembly does not have a good handle on the debt situation, as they take the government's proposal to borrow to be a fait accompli. He argues that they do not check whether laws have been obeyed, and that they don't strictly interrogate the loans.

When asked what kind of principles an investor who is considering buying a government bond should follow, Onyekpere identifies the following ethical principles:

- The borrower must follow the due process of law. This must involve public stakeholder participation in a democratic decision to take up a loan. In addition, all information related to the loan must be made public.
- The lender must delve deep into the issue to assess whether countries are following due process; it is simply not enough to consider the law.
- Other ethical issues such as children's rights, slavery, the environment, climate change, must also be considered.

The Nigerian National Assembly: The Fiscal Responsibility Act is Being Observed in the Negative: Interview with Adeyinka Ajayi



Name: Adeyinka Ajayi

Position: Ajayi is a Member of the House of Representatives, representing the All Progressives Congress in Ife Federal Constituency. He is also the Chairman of the House of Representatives Committee on Aid, Loans and Debt Management.

Adeyinka Ajayi explains that parliamentarians tend to be the last to know about funding that is coming through to the government. He calls it an 'absolute knowledge gap' between donors and the parliament, as donors tend to go straight to the government. They might make courtesy calls to the parliament, but the details of the deals are decided within the executive branch.

Furthermore, Ajayi points out that the National Assembly does not get the chance to change the focus of a loan when it comes to parliament for approval as a part of the budget discussion. Instead, they are simply asked to vote to pass it. Thus, only the executive branch has a global picture of fundraising activities, and the terms which apply to aid and loans.

However, Ajayi says there is a pressure group of parliamentarians now forming to get the executive branch to provide more information to the National Assembly. Although the global borrowing plan does come to the National Assembly, it is incredibly vague. Ajayi explains that: for example, we will be told that China is lending a certain amount to Nigeria, but we will have to struggle to get information about the terms.

When asked about the Fiscal Responsibility Act, Ajayi says: "The Fiscal Responsibility Act is being observed in the negative in Nigeria".

The International Financial Institutions: IMF-representative Gene Leon



Name: Gene Leon

Position: Senior Resident Representative and Mission Chief, IMF Nigeria

Leon points out that there is an expenditure deficit in Nigeria because of infrastructural as well as social needs. By this, Leon means that there is a gap between the desired level of expenditure and the actual expenditure possible based on the country's revenues. Therefore, there is potential for debt accumulation in order to meet the sustainable development goals.

> But in the context of the global market with the potential of rising interest rates in the US, uncertainty in the wake of Brexit, and China's slower growth, the global financial space is not as benign as it was just a few years ago.
> – Gene Leon

Furthermore, Leon sees some cause for concern in the 2016 budget. First of all, the budget assumes a growth rate of 4.2%, high oil prices, and a strong exchange rate. However, the oil price is low, oil production is low due to civil bombing in the Niger Delta, and revenues from oil will be lower than expected. Growth so far this year has been negative, he adds.

If the deficit were to widen, debt would likely have to come from external, as well as domestic sources, Leon says. But in the context of the global market with the potential of rising interest rates in the US, uncertainty in the wake of Brexit, and China's slower growth, the global financial space is not as benign as it was just a few years ago. In addition, markets are well aware that as an oil-exporter, Nigeria's economy is not as strong as it once was.

Increasing capital expenditure is crucial for the country, as it affects economic activity, which in turn affects growth, which affects poverty reduction and social tension. So Leon does not see cutting expenditure as a great option. He asks, "do you forego the development gaps in order to keep the debt level reasonable?"

World Bank economist, Khwima Nthara



Name: Khwima Nthara

Position: Program Leader & Lead Economist, Equitable Growth, Finance and Institutions of the Nigeria World Bank Country Office

Debt servicing has a significant impact on the fiscal space that the Nigerian government has to allocate resources to developmental projects, Nthara explains. He points out that Nigeria already has relatively low public sector spending, and he does hope that the government will do something about this. He foresees that Nigeria will have to start making some tough decisions that it has been postponing for a while, because of the fall in the price of oil. For example, it will have to increase revenue by increasing taxes and possibly revise its exemptions and waivers.

What's more, Nthara is confident that Nigeria is a responsible borrower. Perhaps too cautious, he adds, because it's rather fiscally conservative. When it comes to World Bank lending to Nigeria, the Bank expects the government to consult its stakeholders, but they can do this however they see fit. Nthara points out that it is great if the government has public hearings, but it is up to the government to choose how to consult its stakeholders. The World Bank documents stakeholder consultation and presents this information to its Board when the loan is to be approved. In some cases, the World Bank might also recommend consultations outside of parliament. The Bank generally wants broad ownership, so it encourages broad consultation. At the same time, we do not want to be prescriptive, Nthara adds.

4.2 Zambia

Zambia benefited from the HIPC and MDRI initiatives in 2006. It has achieved high growth since then, along with macroeconomic stability. The high real GDP growth of around 4.5% a year on average stood in stark contract to the two decades preceding debt relief, which were marked by stagnation and falling per capita income. However, Zambia ran large fiscal deficits in 2011-2014, largely due to falling copper prices. According to the IMF DSA, Zambia was at a moderate risk of debt distress at the end of 2015.[157]

The exchange rate risks involved with external borrowing are real in Zambia. For example, when Zambia issued the $1 billion Eurobond in 2014, the kwacha was trading at about K Sh6.2 per US dollar, but by the end of 2015 the kwacha had depreciated to K11 per dollar – meaning an increase of more than 70% (in local currency terms) in the cost of servicing the Eurobond.[158]

In fact, Zambia shows many of the developments that are part of a more general trend in the region (as presented in Chapter 2): there has been a shift from concessional towards non-concessional borrowing, the country has issued several Eurobonds, and there is a lack of accountability and transparency regarding the borrowing process.[159]

4.2.1 Zambian Debt in Numbers

As table 4.3 illustrates, external debt has increased by approximately 70% in Zambia between 2006 and today; this is not visible in the debt-to-GDP ratio. Zambia started issuing government bonds in 2012 (see table 4.4). All the Zambian bonds are issued under English law and are listed on the London Stock Exchange. The 2015 bond issue includes collective action clauses.[160] The first Eurobond was issued to finance infrastructure projects in energy, transport, rehabilitation of hospitals and access to finance to sustain growth. The second bond was meant to increase the funding to these selected projects.[161] However, the third Eurobond was explicitly issued to plug a budget deficit that had grown to more than double the government's target for 2015.[162]

4.2.2 The Legal Process of Contracting Debt

The Loans and Guarantees (Authorisation) Act[166] is the main legislation governing debt management in Zambia. It outlines who has the authority to borrow and sets limits to borrowing. Whereas previously the Minister of Finance had the right to raise loans on behalf of the government for a period of up to one year, in 2014 a new procedure was introduced that required Cabinet approval for all loans contracted.[167] In addition, the Minister needs approval from the National Assembly for all loans exceeding one year.

The constitution also mandates a debt limit. The maximum amount that can be borrowed within Zambia for a period not exceeding one year is K13 billion while the maximum amount for the period excee-

Table 4.3 Overview of Debt in Zambia

Gross national income (millions of dollars)		Total external debt stocks (millions of current dollars)		External debt stocks (average annual growth rate, %)		External debt stocks (% of gross national income)		External debt stocks (% of exports of goods, services and primary income)	
2006-2009	**2011-2013**	**2006-2009**	**2011-2013**	**2006-2009**	**2011-2013**	**2006-2009**	**2011-2013**	**2006-2009**	**2011-2013**
13 881	24 283	3 022	5 308	15.8	6.41	26.8	26.6	64.2	53.1

Source: Debt Management Office of Nigeria

ding one year is K20 billion. The ceiling for external borrowing is K35 billion.[168]

Note that the Loans and Guarantees (Authorisation) Act doesn't explicitly mandate an oversight role for Parliament in the debt management process, except for approving the debt ceiling. Instead, the Parliament's role is to pass the annual budget and scrutinize the Auditor General's reports. Nalishebo and Halwampa (2015) raise the concern that the reports that go to Parliament are mostly general and not disaggregated,[169] thus parliamentary approval is not based on a comprehensive overview of the loans being contracted and their terms.

"The legal framework does not provide for the involvement of the general public and civil society in terms of access to public debt information in order to enhance transparency and accountability, save for the gazette notices issued periodically by Government on various issues for the information of the general public."

– Shebo Nalishebo and Albert Halwampa, 2015. Zambia Institute for Policy Analysis and Research[170]

4.2.3 Perspective from Zambia

Geoffrey Chongo



Name: Geoffrey Chongo

Position: Head of Programs at the Jesuit Center for Theological Reflection (JCTR), based in Lusaka, Zambia.

Chongo says Zambian civil society organizations have no insight into the debt issuing processes of the Zambian government and he observes that the government fails to seek approval from parliament even when the constitution mandates such approval.

Table 4.4 Eurobonds Issued in Zambia

Year	Amount Issued	Interest Rate	Maturity	Rating
2012	750 million USD	5.375%	10Y	Rated B+ 163
2014	1000 million USD	8.5%.	10Y	B+/B/B1 164
2015	1250 million USD	8.97%	11Y	B [165]

Source: Compiled by author based on data from bond prospects, Bloomberg, and Nalishebo and Halwampa (2015)

When asked how the national and international processes can be improved in order to avoid debt problems in Zambia, Chongo points to the following issues:

- The need for transparency in both lending and borrowing processes. More specifically, civil society would like to obtain information regarding loan contracts and the debt stock,
- Improved mechanisms for organizing debt restructuring for countries with problems repaying debt, and
- Improved debt sustainability analysis. Chongo considers the current focus on debt-to-GDP ratios as misguided, as a country's debt servicing must be assessed in the light of a country's capacity to pay taxes.

The Zambian GDP, for example, is produced largely by multinational companies who do not pay adequate taxes, Chongo points out. Therefore, the GDP gives a false indicator of the country's ability to service its debt. Chongo adds that Zambia is not a responsible borrower because of its limited transparency regarding what it borrows and how the borrowed funds are spent.

4.2.4 Zambia and the World

As 80% of Zambia's foreign exchange earnings come from copper, the price of copper determined on the international market is of utmost importance for the Zambian economy. What's more, the strength of the dollar has an impact on Zambian imports and exports, as an appreciation of the dollar makes imports to Zambia expensive. Finally, weakened growth in China reduces the demand for copper, which has had a severe impact on Zambian export earnings. China also plays a more direct role in the Zambian economy, as it provides a market for Zambian natural resources, along with development aid and loans to Zambia.

4.3 Ghana

Ghana has been hailed as Africa's rising star by major media outlets over the past decade.[171] [172] The country is one of the world's largest cocoa exporters, and also exports gold and oil. Although Ghana has been one of the fastest growing economies in the world over the past decade, youth unemployment remains high, and the country still has a long way to go in improving social development indicators such as maternal mortality rates and sanitation coverage.[173]

4.3.1 Ghanaian Debt in Numbers

Between 2007 and February 2015, the IMF and World Bank assessed Ghana to be at a moderate risk of debt distress. In March 2015, they changed this to high risk.

As table 4.5 illustrates, Ghana's external debt has more than doubled over the past decade. Ghana was the third country in sub-Saharan Africa to turn to international capital markets in order to fund its deficit through Eurobonds this past decade. The bonds are issued under English law and sold on the London Stock Exchange. Notably, the 2015 issue contains collective action clauses, although the three others do not.[174] The 2015 issue also has a modified version of pari passu.

The Eurobonds are significantly different from the way Ghana has traditionally funded its deficit, namely through concessional external borrowing at lower inter-

Table 4.5 Overview of Debt in Ghana

Gross national income (millions of dollars)		Total external debt stocks (millions of current dollars)		External debt stocks (average annual growth rate, %)		External debt stocks (% of gross national income)		External debt stocks (% of exports of goods, services and primary income)	
2006-2009	2011-2013	2006-2009	2011-2013	2006-2009	2011-2013	2006-2009	2011-2013	2006-2009	2011-2013
24 799	41 792	5 410	13 227	23.6	18.5	21.6	31.7	81.7	82.4

Source: Debt Management Office of Nigeria



Table 4.6 Eurobonds issued in Ghana

Year	Amount Issued	Interest Rate	Maturity	Rating
2007	750 million USD	8.5%	10Y	B+ [175]
2013	750 million USD	8.0%	10Y	B+/B/B1 [176]
2014	1000 million USD	8.125%	11Y	B/B/B2 [177]
2015	1000 million USD	10.75%	15Y	BB- / B1 [178]

Source: Compiled by authors based on data from bond prospects, UNCTAD, Financial Times, and Bloomberg.

est rates.[179] Illustratively, while the 2007 Eurobond accounted for 14.7% of Ghana's total external debt in 2007, its 8.5% interest payment on the bond accounted for 39.1% of Ghana's total interest payments on external debt in 2008.

4.3.2 From Debt Relief to Crisis

As the dependence on commodities triggered the debt crisis in the 1990s, this same dependence triggered a new debt crisis in 2013.[180] Ghana received debt cancellation through the HIPC and MDRI initiatives, which saw its external debt fall from $6.6 billion in 2003 to $2.3 billion in 2006. In the wake of debt relief, Ghana was again in a position to borrow internationally. International institutions willingly lent to Ghana, which had come to be seen as the poster child[181] of African development because of its high growth rates. Between 2004 and 2015 Ghana borrowed $20 billion externally. However, over the same period, Ghana paid $9.8 billion in interest, leaving only $10.2 billion to be spent on domestic investment. [182] Unfortunately, there is little transparency regarding what Ghana's loans were used for.

When the price of gold starting falling in 2013 and then the price of oil too in 2014, Ghana ran into trouble. In 2013, the value of the cedi had fallen by 50% against the dollar, causing the dollar-denominated size of the economy to fall from $41.9 billion in 2012 to $36 billion in 2015. Furthermore, this increased the relative size of dollar-denominated debt and debt payments. In fact, Ghana's external debt increased from 30% of GDP in 2013 to 56% in 2016.[183]

As discussed in chapter 2, one of the main dangers of borrowing externally is the exchange rate risk. Ghana ran into this problem, as its currency has depreciated significantly since the country started issuing Eurobonds. In fact, while the cedi was approximately at parity with the dollar in 2007, by 2015 one cedi had fallen to $0.26. This means that the $750 million



bond issued in 2007 was equivalent to 750 million cedi at the time, but had jumped to around 3 billion cedi by 2015. Due to the depreciation of the cedi, the Jubilee Debt Campaign UK has calculated that the effective interest rate paid by Ghana on loans from the World Bank between 2004 and 2013 was actually 9%.[184]

In April 2015, the IMF gave Ghana a loan to enable the country to meet its ballooning debt payments – effectively bailing out previous lenders. The IMF estimates that Ghana's external debt payments will amount to 29% of revenue in 2016[185]. Even based on optimistic projections and expected cuts in budget spending, the payments are likely to stay well above 20% of revenue until 2035.

4.3.3 The Legal Process of Contracting Debt

The legislative process of debt issuance in Ghana is guided by the following documents:

- the Constitution of the Republic of Ghana (1992),
- the Loans Act (1970),
- the Bank of Ghana Act (2002),
- the Financial Administration Act (2003),
- the Financial Administration Regulations (2004); and
- the Loans and Fiscal Agency Agreement (2004)[186]

Formally, the Parliament plays a legislative, financial, oversight, representational and deliberative role in the management of public debt. According to the above legal documents, loans should only be used to cover the expenditures set out in the Constitution, otherwise they require the Parliament's authorization. Notably, the entire legal framework on loan contracting and debt management ignores civil society, thus they have no legal basis on the basis of which to demand they be included as participants in the loan process.[187]

4.3.4 Ghana and the world

Ghana is closely tied to the global economy. Production within the economy still takes place on the lower end of the technology scale and the country's exports are still dominated by primary products.[188] Therefore, the IMF finds that the concentration of exports in three commodities – gold, cocoa and oil – makes the economy vulnerable to terms-of-trade shocks.[189]

As developing countries across the world, Ghana benefited from high commodity prices in the 2000s, heavily influenced by Chinese demand.[190] Ghana also discovered oil in 2011, which fuelled additional growth. However, as commodity prices dropped, Ghana faced repayment difficulties.

Because of the country's dependency on primary exports and its lack of competitiveness on the global market, Ghana has

also been dependent on foreign credit to cover its consistent current account deficit.[191] This has led to recurring debt crises, as explained above.

4.4 Summary

These studies of Nigeria, Ghana and Zambia serve to highlight the different implications of changing trends in borrowing in the region, particularly with respect to the role of Eurobonds. Strikingly, the case studies reveal a wide set of risks associated with the new composition and characteristics of debt and a few opportunities.

4.4.1. Opportunities

Private borrowing: The case of Nigeria illustrates the positive impact the floating of Eurobonds may have on private companies' ability to borrow on the international capital market, thus increasing their chances of obtaining long-term financing at relatively cheap rates.

Relatively cheap financing: Although Eurobonds are more expensive than borrowing on concessional terms from multilateral institutions; the interest rates are low compared to domestic debt in all the three countries studied. In Nigeria, for example, this is an important opportunity for the country to reorient itself from expensive domestic debt to relatively cheap external debt.

Meeting the demand for finance: There is clearly demand for additional financing in all three countries studied. Eurobonds contribute to meeting that demand.

Improved debt-restructuring options: As Zambia and Ghana have both introduced CACs into their most recent bonds, they are partly securing themselves against difficult debt restructurings.

4.4.2 Risks

Exchange rate risk: The exchange rate risk is applicable to all three countries, but has had particularly grave effects in Zambia and Ghana, as they both have significantly higher external debt-to-GDP ratios. For example, the depreciation of the kwacha against the dollar meant an increase of 70% in local currency terms of the cost of servicing Zambia's Eurobond and the value in local currency terms of Ghana's 2007 Eurobond quadrupled between 2007 and 2015.

Over-borrowing: The role of Eurobonds in over-borrowing is particularly evident in Zambia and Ghana, where Eurobonds have contributed to a situation of increasingly unsustainable debt. Both countries used Eurobonds to plug budget deficits, rather than for targeted investment.

Lack of democracy and transparency in debt contracting process: All three countries studied have flawed democratic proces-



ses for contracting debt. While Nigeria has the strongest constitutional position on contracting debt, interviews with civil society organizations and parliamentarians illustrate that the constitution is being consistently breached. Civil society groups are not included at any stage in the borrowing process and parliament struggles to acquire the information they need to make informed judgments about loan decisions.

High borrowing costs: For Ghana, the 2015 Eurobond was a particularly expensive form of borrowing, despite the fact that the World Bank guaranteed $400 million of the $1 billion bond. With this issuance, the World Bank broke its own rule against providing such guarantees to governments assessed as at high risk of debt distress.[192] Although Eurobonds can be a relatively cheap form of finance for some countries, those without a stable macroeconomic outlook often face high borrowing costs on the international capital market.

Fluctuating borrowing costs: Although the interest rates on the issued bonds are fixed for these three countries, the interest rates on new bonds will depend on global factors, rather than the countries' fundamental economic structures. Interestingly, the bond yields of Nigeria, Ghana, and Zambia follow a very similar pattern and dynamic, as the yields respond to global factors rather than country-specific factors.[193]

Misleading debt sustainability analysis (DSA): Lack of relevance of the IMF's DSAs is particularly evident in Nigeria, which is at a very low level of risk and distress according to the IMF DSA. This, however, does not take into account contingent liabilities, the fact that Nigeria's revenue sources are highly concentrated in oil and that the debt contracting process is flawed, undemocratic and lacking in transparency. Although debt servicing is included as a part of the DSA, it is not given more prominence than the debt stock. In Nigeria this is misleading, as the government is spending more than 40% of its revenue on debt servicing.

Role of credit rating agencies: While all three countries have had speculative ("junk") credit ratings when issuing Eurobonds, Zambia and Nigeria were both downgraded more recently, as commodity prices have fallen and affected their macroeconomic outlook. This makes their economies even more vulnerable to swings in international commodity prices: not only are countries directly affected through their export earnings, but swings in prices also indirectly affect their borrowing costs due to the resulting credit rating downgrade. In other words, credit ratings appear to have pro-cyclical effects on these countries.







5 Global Debt Management

Sub-Saharan Africa has undergone substantial changes regarding the composition of its debt over the past decade. A valid question therefore is whether the existing national and international guidelines and processes for lending, borrowing and handling crises are sufficient to deal with the risks involved in the contracting these new forms of debt. While the previous chapter dealt with the national processes of debt management, this chapter deals with the relevant international processes, particularly concerning the issuance of sovereign bonds.

This chapter first considers the existing guidelines, processes and practices for responsible lending and borrowing, and thereafter more briefly the existing practices and mechanisms for debt restructuring should a crisis unfold. Shortcomings in the existing rules and practices are discussed throughout the chapter, and recommendations are presented in the next chapter (chapter 6).

5.1. Existing Guidelines on Responsible Lending and Borrowing

There is currently no set of internationally agreed upon rules for lending and borrowing, and the few global processes and guidelines that exist are voluntary. As with other forms of lending, there are no established international rules governing borrowing/lending through sovereign bond issuance/investment. Sovereign bonds will generally be issued under a specific jurisdiction, for example the UK or New York, and the relevant laws in those jurisdictions will apply. Furthermore, the IMF and the World Bank have their own framework for lending.

5.1.1 The UNCTAD Principles

The UNCTAD Principles on Promoting Sovereign Lending and Borrowing[194] were launched in 2012 and they aim to promote responsible behaviour and provide economic benefits to both sovereign lenders and borrowers. The Principles identified are already upheld by some sovereign borrowers and lenders. Thus, the normative contribution lies not in the creation of new rights and obligations in international law, but rather in identifying and systemizing 'best practice' in sovereign lending and borrowing.

In the case of sovereign bonds, the UNCTAD Principles for lenders could be

applied to the institutional investor (e.g. the Norwegian sovereign wealth fund) and the Principles for borrowers could be applied to the issuing governments. Accordingly, they can be considered best practices for bond investors and issuers.

Key principles that apply to lenders (bond investors) are principles of agency, due authorization, responsible credit decisions and international cooperation. According to the principle of agency, lenders should recognize that government officials involved in sovereign lending and borrowing transactions are responsible for protecting public interest. According to the principle of due authorization, lenders have a responsibility to determine, to the best of their ability, whether the financing has been appropriately authorized and whether the resulting credit agreements are valid and enforceable under the relevant jurisdiction(s). According to the principle of responsible credit decisions, a lender is responsible for making a realistic assessment of the sovereign borrower's capacity to service a loan based on the best available information and following objective and agreed technical rules on due diligence and national accounts. According to the principle of international cooperation, all lenders have a duty to comply with United Nations sanctions imposed on a governmental regime and, according to the debt restructuring principle, in circumstances where a sovereign is manifestly unable to service its debts, all lenders have a duty to behave in good faith and cooperative spirit to reach a consensual re-arrangement of those obligations.

On the other hand, the key principles that apply to sovereign borrowers (bond issuers) are agency, transparency, disclosure and publication, adequate management and monitoring, avoiding incidences of over-borrowing, and restructuring. According to the principle of agency, governments are agents of the State and, as such, when they contract debt obligations, they have a responsibility to protect the interests of their citizens. According to the principle of transparency, the process for obtaining financing and assuming sovereign debt obligations and liabilities should be transparent. Governments have a responsibility to put in place and implement a comprehensive legal framework that clearly defines procedures, responsibilities and accountabilities.

According to the principle of disclosure and publication, relevant terms and conditions of a financing agreement should be disclosed by the sovereign borrower, be universally available and be freely accessible in a timely manner through online means to all stakeholders, including citizens. According to the principle of adequate management and monitoring, debtors should design and implement a debt sustainability and management strategy to ensure that their debt management is adequate. An audit institution should conduct independent, objective, professional and timely audits of their debt, and the findings of such audits should be publicized to ensure transparency



and accountability in debt management. According to the principle of avoiding incidences of over-borrowing, governments have a responsibility to weigh costs and benefits when examining sovereign loans. They should only contract a loan if it would permit additional public or private investment, with a prospective social return at least equal to the likely interest rate. Finally, the principle of restructuring states that if restructuring of sovereign debt obligations becomes unavoidable, it should be undertaken promptly, efficiently and fairly.

In light of the case studies studied in the previous chapter, there are clearly improvements to be made both by the bond-issuing countries and by the international lenders, in order to comply more closely with the UNCTAD Principles and thereby become more responsible borrowers and lenders. For example, according to civil society groups in Zambia and Nigeria, the information about loans is not made publicly available, thus inhibiting their ability to partake in the democratic process. Improving this would be necessary for the borrowing governments to meet their obligation to protect the interests of their citizens.

What's more, the sovereign lending principle of responsible credit decisions may be breached when the World Bank/IMF Debt Sustainability Analyses (DSAs) do not adequately capture the debt situation in a country and/or when the DSAs are breached (as was the case when the World Bank provided new loans to Ghana in a time of debt distress).

However, although the UNCTAD Principles provide useful guidelines for lenders and borrower, they remain voluntary. Thus no borrower or lender is actually obliged to comply with these principles.

5.1.1 IMF and the World Bank: Debt Sustainability Framework

The lending rules of the IMF and the World Bank partially mirror the UNCTAD Principles. While, for example, they always make sure that the loan contracts have been authorized by the government and are valid and enforceable under the relevant jurisdictions (the principle of due authorization), they do not always comply with the principle of disclosure and publication (as chapter 4 illustrates, there is lack of disclosure of debt information to citizens in countries receiving IMF and World Bank loans). Furthermore, the principle of responsible credit decisions is perhaps of most relevance to the IMF and the World Bank as lenders.

The IMF and the World Bank apply their joint Debt Sustainability Framework (DSF) in order to avoid unsustainable lending/borrowing to developing countries and ultimately to avoid new debt crises. The official purpose of the DSF is "to guide the borrowing decisions of LICs in a way that matches their financing needs with their current and prospective repayment ability, taking into account each country's circumstances".[195] This is determined based on a country's capacity, which is based on its exports, GDP and revenue compared with its debt stock and service (see Table 5.1). If a country is determined to be in debt distress, it is considered irresponsible and risky to lend to it.

The debt sustainability analyses (DSAs) are conducted for all countries borrowing from either the IMF's concessional lending fund (the Poverty Reduction Growth Trust – the PRGT) or the World Bank's concessional fund (the International Development Association – IDA). This is all low-income countries and some middle-income countries.

Table 5.1 Debt Burden Thresholds under the DSF

	Debt (Present Value) as a percentage of			Debt Service as a percentage of	
	Exports	GDP	Revenue	Export	Revenue
Weak Policy	100	30	200	15	18
Medium Policy	150	40	250	20	20
Strong Policy	200	50	300	25	22

Source: The Joint World Bank-IMF Debt Sustainability Framework for Low-Income Countries



The DSAs have a history of underestimating countries' level of debt distress. For example, although the framework was applied to all lending to HIPC-countries after they received debt relief, many of those countries are again facing a risk of debt distress. IMF has reformed the framework several times in order to improve it, but the fundamental elements have remained the same.

According to the DSF, the World Bank is meant to give loans to low-risk countries, a mix of loans and grants to moderate risk countries, and just grants to countries in high risk of debt distress and countries in debt distress. However, these rules are not always followed.[196] Notably, the World Bank's Country Policy and Institutional Assessment (CPIA) index is used in order to assess the quality of countries' institutions, and it is assumed that LICs with a lower CPIA-score will have more difficulties with repayment than countries with 'better' institutions. However, the CPIA has been criticized for including criteria irrelevant to debt sustainability, such as the degree of trade liberalization.[197]

As the case studies in the previous chapter illustrate, the DSA provides a very narrow picture of the debt situation in a country. For example, while the DSAs for Nigeria show no cause for concern regarding debt, this does not capture the vulnerability associated with the fact that the country relies heavily on one commodity (oil) for foreign exchange earnings. Nor does the IMF's definition of good policies (using the CPIA) capture elements such as the lack of public and parliamentary engagement with debt issues due to a lack of transparency.

Civil society organizations wrote a letter to the World Bank and the IMF this summer to suggest some changes to the framework. Their recommendations included making the assessments independent, basing them on sustainable development goals, encouraging productive investment, excluding irrelevant criteria (e.g. the CPIA), considering debt-service-to-government-revenue as the most important criterion and including currently hidden liabilities.[198] Without going too much into these issues in this chapter, we can certainly say that the DSF leaves much to be desired.

5.2 Guidelines for Responsible Lending through Government Bond Investment

There are currently a range of asset managers that subject their sovereign bond investments to ethical guidelines, for example Ethix. There have been a lot of developments in this regard over the past decade, but all guidelines remain voluntary.

Note that there is a conceptual difference between an investor who buys a government bond on the primary market and one who buys it on the secondary market.[199] The investor buying the bond on the primary market has primary responsibility for considering who the loan will be given to and the societal consequences such a loan might have, i.e. what the money will

be used for. Although there is no direct connection between lender and borrower when the government bonds are purchased on the secondary market, the investor still has a responsibility.[200] Buying government bonds on the secondary market may contribute to maintaining the terms of interest for the issuing country and thereby ease access to credit for the issuing government. Consequently, the Danish Council for Corporate Responsibility recommends that investors carry out similar assessments of the issuing country whether they invest on the primary or secondary market.

There are several examples of asset managers that have incorporated ethical guidelines in their practice of investing in government bonds. For example, the US investment manager Neuberger Berman uses an analytical framework that incorporates environmental, social and governance (ESG) factors alongside economic indicators. 40% of the sovereign debt score relies on ESG and 60% on traditional financial metrics.[201] An example of a country with good economic fundamentals but a deteriorating ESG score would be Turkey.

What's more, several asset managers consider transparency and corruption to be key indicators of sovereign credit strength because of the relationship between fraud, tax avoidance, financial mismanagement and an issuer's ability to repay its debt obligations. For example, the investment manager Danske Capital screens its government bonds based on the World Bank's Worldwide Governance Indicators (WGI). It excludes the countries with low scores except when it is believed that bond financing will help to improve the scores.[202]

The Danish Financial Supervisory Authority (Danish FSA) has said the following about applying ethical standards to investments in government bonds:

"As it is not possible to determine in advance which investment strategy will be the most advantageous, then life-assurance companies and multiemployer occupational pension funds can, within this framework […] legally choose several investment strategies – including strategies that contain requirements for "ethical investments". This does not, however, affect the obligation to achieve the best possible return in the long term".[203]

In other words, the Danish FSA considers it to be both legal and possible to meet the need for the best possible return in the long-term and include requirements to take social factors into consideration.

The UN Principles for Responsible Investment

The UN Principles for Responsible Investment (PRI)[204] came out of an initiative launched by the United Nations in 2006 after former UN Secretary-General Kofi Annan brought together a group of the world's largest institutional investors, academics and other advisors to draft a set of sustainable investment principles.

Although the UN supports the initiative, it is not a part of the UN. According to its website, it "works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions". It promotes six key principles for responsible investments, which are voluntary and aspirational. Generally, the Principles advocate active ownership and the incorporation of ESG issues into investment analysis and decision-making processes.[205]

As pointed out by the Danish Council for Corporate Responsibility's (DCCR) Guidelines for Responsible Investment in Government Bonds, not all of these principles apply equally to investment in government bonds.[206] For example, although the principle of 'active ownership' is central to the PRI, this is not inherently the case with a government bond, which is basically a financial service in the form of a loan. Naturally, a purchase of a government bond does not provide an investor with joint ownership or influence over the country.

Nonetheless, the DCCR does consider the PRI to be applicable and relevant for investments in government bonds. For example, the fundamental principle that investors should exercise due diligence

Table 5.2 UN PRI Recommendations for Areas to Consider in Responsible Bond Investments

Environmental	Social	Governance
Carbon intensity	Demographics	Institutional strength
Energy resources and management	Education and human capital	Corruption
Natural disasters	Political and press freedom	Regime stability
Biocapacity and ecosystem quality	Human rights	Financial reporting
Pollution	Labour standards	Regulatory effectiveness
Biodiversity	Social exclusion	Adherence to conventions
Agriculture	Income inequality	International relations

Source: UN PRI's Fixed Income Investor Guide (2014)

to ensure that their investments do not have adverse societal impacts, including contributing to human rights violations. A dilemma with ESG criteria is that they are retrospective, whereas an investor considering investing in a country's government bonds will typically be interested in future developments in the country. The Guidelines therefore recommend assessing the trend in the country's ESG data and ensuring that the data is as up-to-date as possible.

The DCCR Guidelines conclude that it could be necessary to exclude certain government bonds from the portfolio due to responsible lending concerns. The Guidelines consider it particularly important that the country concerned is developing in a positive direction and that the investments contribute to this positive development. However, if there are no significant improvements and gross violations of human rights are taking place, then investments could be problematic.[207] According to the DCCR, the main principles to consider in order to invest ethically in government bonds are: 1) the extent to which the issuing country is subject to international sanctions; and 2) international and recognized principles for social responsibility. In addition, the DCCR Guidelines recommend considering the following guidelines for responsible investment:

- The UN Guiding Principles on Business and Human Rights (UNGPs)
- The OECD Guidelines for Multinational Enterprises
- The UN Global Compact (UNGC)

While the UNGPs[208] promote ways of protecting and respecting human rights, the OECD Guidelines[209] are somewhat broader as they also incorporate issues such as corruption and the environment. As with the UNGPs and the PRI, the OECD guidelines are based on the principle of due diligence. Finally, the UNGC is amongst the most comprehensive and internationally recognized corpus of principles for CSR.[210] The principles highlight enterprises' responsibility to observe internationally recognized conventions entered into between states on human rights, labour rights, the environment and anti-corruption. The DCCR outlines three examples of models for screening government bonds ethically, namely Denmark's Pension Fund Association, Danish Unipension and Danish Nykredit.

Although none of these guidelines are binding in any sense, they do illustrate that it is possible to implement principles of responsible lending in investments in government bonds. It also illustrates a growing demand for more ethical investments in sovereign bonds and the recognition of sovereign bond investors as lenders. Moreover, as the interviews with civil society in chapter 4 illustrate, civil society in selected sub-Saharan African countries is more concerned with transparency, openness and participation in the borrowing decisions, than all of the ESG factors listed above. Developing guidelines that would satisfy citizens in developing countries may thus be easier than following

Norwegian Investment in Government Bonds: Apolitical and Unethical?

Norway's sovereign wealth fund, the Government Pension Fund – Global (GPFG), also known as the Oil Fund, is managed by Norges Bank Investment Management (NBIM), which is a branch of the Norwegian Central Bank, on behalf of the Norwegian Ministry of Finance. The fund's government bond holdings accounted for approximately 20% of its total investments in 2015 or 1500 billion NOK.[211] The only African government bonds the sovereign wealth fund currently holds are from South Africa and Tunisia.[212]

As Figure 5.1 shows, only a tiny part of NBIM's investments (0,18% to be exact) are in government bonds rated lower than BBB (recall from chapter 3 that BBB is the lowest credit rating that is still considered 'investment grade'). Thus, if the Norwegian sovereign wealth fund were to invest in any of the case countries reviewed by this report, it would be only a small amount.

There is currently no ethical oversight applied to the NBIM's investments in sovereign bonds. This stands in stark contrast to the ethical regulation of equity and corporate bond investments and the Norwegian government's commitment to responsible lending. In a report to the Norwegian Storting in 2010 it was said that: "Exclusion of government bonds issued by certain countries should only be decided where comprehensive UN sanctions have been adopted, or where Norway has supported other large-scale international initiatives aimed at a specific country".[213] In 2015-2016, this applied to securities issued by North Korea and Syria.[214] Thereby, the only UNCTAD principle for sovereign lending that is complied with is the principle on 'international cooperation' which states that "all lenders have a duty to comply with United Nations sanctions imposed against a governmental regime". However, the rest of the principles for responsible lending are ignored.

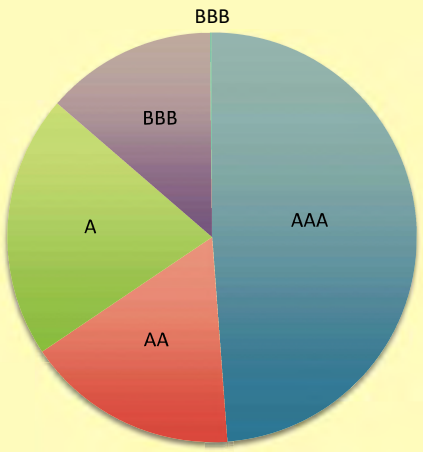


Figure 5.1 Credit Ratings of the Sovereign Bond Holdings, end of 2015. Source: Author's calculations based on Annual NBIM report 2015.

Table 5.3 The Government Pension Fund – Global's Largest Sovereign Bond Holdings, end of 2015 (million NOK)

Issuer	Holding
United States of America	532,806
Japanese government	203,895
Federal Republic of Germany	163,019
UK government	84,952
Mexican government	56,678
South Korean government	50,318
Spanish government	45,175
French republic	41,870
Italian republic	41,018
Indian government	32,888
Turkish government	26,484
Government of the Netherlands	25,941
Polish government	24,252
Australian government	23,995
Brazilian government	22,922
Chinese government	21,544

Source: Annual NBIM report 2015

some of the guidelines that the Danish pension funds apply to their investments.

5.3. Existing Guidelines for Sovereign Debt Restructuring

Although this report is about lending and borrowing practices, rather than crisis management, these issues are clearly linked. If it is indeed the case that some of the lending and borrowing taking place in sub-Saharan Africa is reckless, this could lead to new debt crises. How these crises will be managed depends on the international framework for debt restructuring.

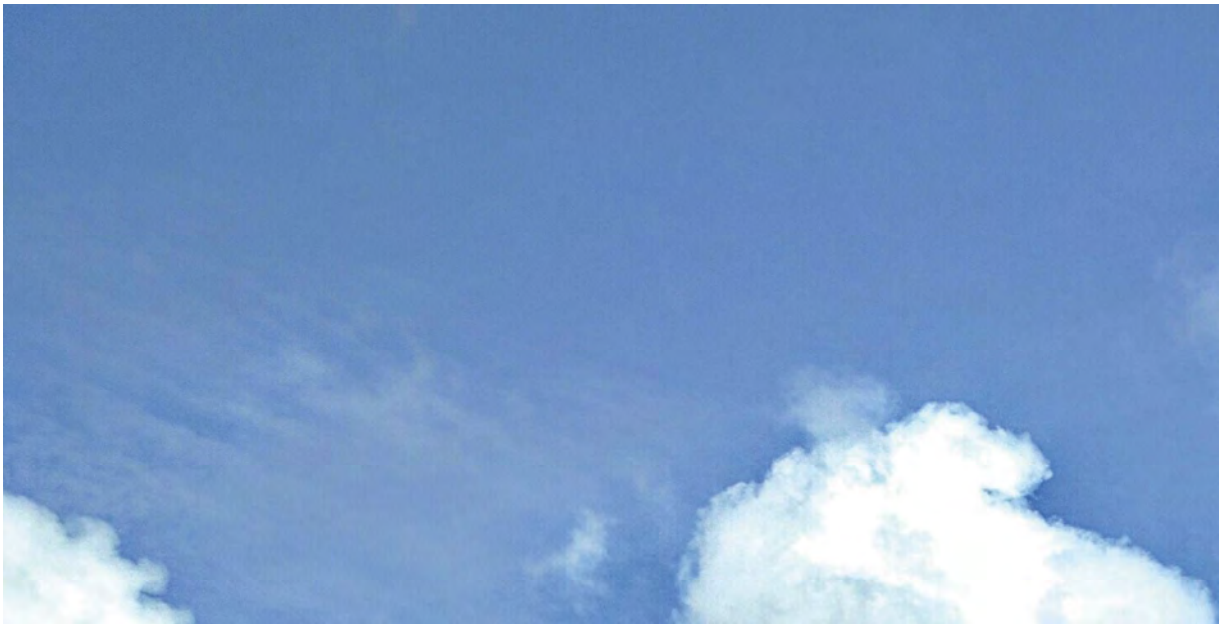
The current global system for debt restructuring is based on ad hoc, voluntary renegotiations of debt contracts. This is particularly difficult when it comes to sovereign bonds, as there are very many holders (lenders) that need to be coordinated. There are a couple of contractual instruments, such as collective action clauses (CACs) prohibiting holdout creditors, which could contribute to making debt restructuring a little less difficult. As found in chapter 3, many African countries are issuing bonds without enhanced CACs and modified pari passu, which is particularly risky and likely to make any restructuring difficult.

UNCTAD summarizes the flaws of the current system for debt restructuring in the following way:

- Fragmentation and lack of coordination: There is no international forum that deals with the resolution of sovereign debt problems. This has led to decisions being made across a wide range of institutional settings at the local level and at the expense of global coherence.
- Fairness: Current practice does not guarantee a fair workout for debtors and creditors. It is still possible for some creditors to purchase distressed sovereign debt at a steep discount in order to hold out and litigate until they extract the nominal value of their assets.
- Efficiency deficit ("Too little too late"): Restructurings are often carried out too late. Debtors often delay the decision to restructure for a variety of reasons, such as uncertainty, lack of information, electoral cycles, fear of contagion, and others. In addition, deficits in creditor coordination or creditors' fear of moral hazard or unwillingness to accept losses might lead to delays. Finally, restructurings are often insufficient as a result of uncertainty, over-optimistic growth expectations or the fear of moral hazard.[215]

In order to deal with some of these flaws in the current system, the General Assembly has passed three resolutions on sovereign debt restructuring since 2014:

- A/68/304 — "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes" (September 2014)
- A/69/247 — "Modalities for the implementation of resolution 68/304,



entitled "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes"" (December 2014)

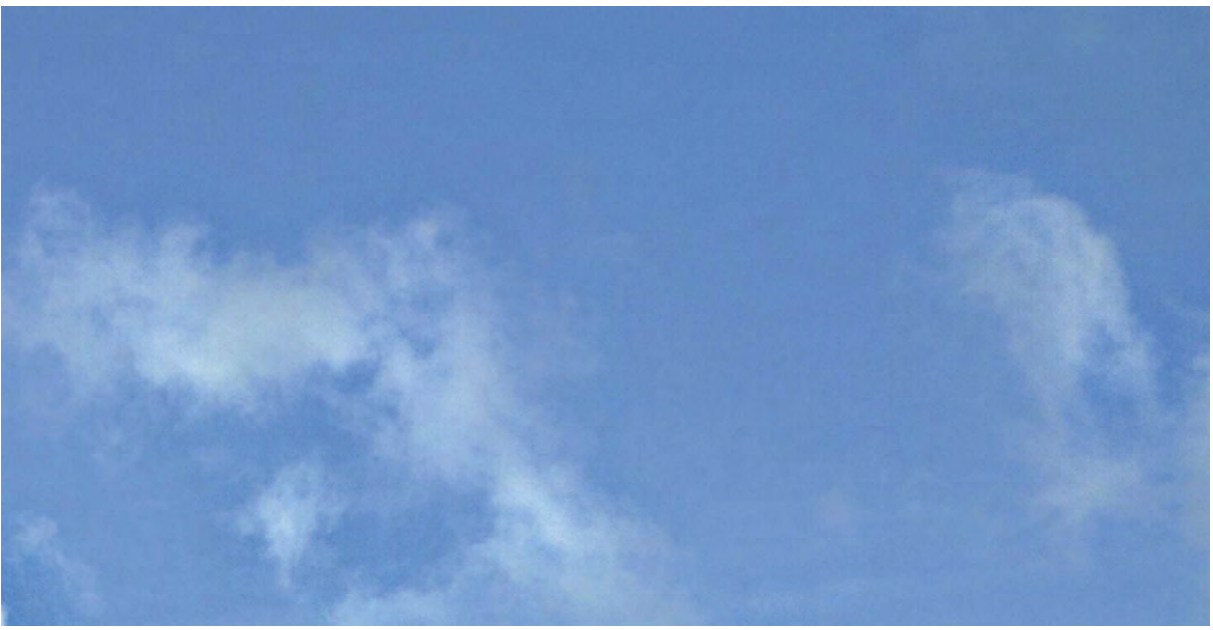
- A/69/L.84 — "Basic Principles on Sovereign Debt Restructuring Processes" (September 2015)

The most recent resolution of the UN (A/69/L.84) sets out nine principles, relating to such matters as the right of sovereigns to design their macroeconomic policies free of abusive measures, good faith and transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, inclusiveness, observance of the rule of law, sustainability, timely and efficient restructuring, human rights and majority restructuring.

Furthermore, UNCTAD has been particularly active in work on sovereign debt, particularly in establishing the Sovereign Debt Workouts: Going Forward Roadmap and Guide (2015), which outlines five principles for sovereign debt workouts.[216] The Roadmap and Guide states that improved debt workout practices are necessary and that they can only result from adherence to a set of commonly shared principles. The principles include legitimacy, impartiality, transparency, good faith, and sustainability. According to the Sovereign Bankruptcy Group of the International Law Association it is not clear at this point if these principles will have any effect on sovereign debt generally and future restructurings, or if they will have any practical implications. The group argues that "further work and expertise would be needed to develop the principles into specific proposals".[217]

Nonetheless, many of UNCTAD's recommendations can be implemented by making progress on contractual terms, such as enhanced CACs and modified pari passu.[218] That said, while improved contractual instruments could facilitate creditor coordination, sophisticated creditors can still circumvent their operation by acquiring debt that does not contain them on the secondary market. Furthermore, these instruments do not address the challenges of debtor procrastination and insufficient debt relief.

While the introduction of revised pari passu clauses and enhanced CACs can be helpful in resolving future debt crises, as discussed in chapter 3, they are not widely used by sub-Saharan African countries to date. Thus, considering the current flawed system for debt restructuring, in the case of debt crises in sub-Saharan Africa, the debt restructuring process is likely to be plagued by fragmentation, lack of coordination, lack of fairness and 'too little, too late'.







6 Summary and Recommendations

This report illustrates the changing landscape of borrowing and lending in sub-Saharan Africa, which presents both opportunities and risks. By studying the process of issuing Eurobonds in particular and selecting Nigeria, Zambia, and Ghana as case studies, several causes for concern are brought to light.

This chapter summarizes the main causes for concern and recommends a number of policies to make loans to sub-Saharan African governments more secure and responsible. As discussed in chapter 2, 'better' finance is associated with reducing risk, thus in order for the opportunities associated with Eurobonds to be realized, there must be some reform of lending, borrowing, and debt restructuring practices to reduce the vulnerabilities and risks caused by borrowing through Eurobonds. This report argues that one way of mitigating risk is to increase transparency and public debate regarding borrowing decisions.

After summarizing the main issues, this chapter recommends specific reforms to lending in the form of investments in sovereign bonds before making some recommendations more particularly aimed at the Norwegian government.



6.1 Summary of Risks Associated with Sovereign Bond Issuance in Sub-Saharan Africa

As discussed throughout this report, there are a range of risks and opportunities involved with sovereign bond issuances. While the bonds clearly hold a lot of opportunity, as they allow countries to access relatively large amounts of finance on the international capital market, with no 'strings attached', there are some risks associated with bond issuances.

First of all, there is the inevitable exchange rate risk involved in any borrowing done in a foreign currency. Secondly, there is the interest rate risk. Although the interest rates on sub-Saharan African bonds are usually fixed, the fluctuation of global demand for emerging market debt makes the possibility of accessing debt on the international capital market uncertain. In particular, it makes it more difficult for developing countries to access such debt at a low price when they need it the most (i.e. in a recession).

Furthermore, there is the risk attached to excessive debt accumulation associated with any form of borrowing and the risk of an ensuing debt crisis. A related concern is that issuing sovereign bonds without collective action clauses and modified pari passu is risky because of the difficulties this could cause for the sovereign in the case of default.

As the case studies show, there is also a lack of accountability in a selection of sub-Saharan African countries, when it comes to debt. In some cases, civil society and parliamentarians have little information about the loan contracts and what the funds are being used for. Additionally, civil society groups are demanding that they be included in the decision process and for there to be public debates about the use of the borrowed funds and the terms of the loan.

When asked what kind of conditions lenders should require of issuing governments before investing in their bonds, civil society groups brought up a range of conditions. For example, David Ugolor of the Africa Network for Environment and Economic Justice suggested that the government should publish how it is planning to spend the money in an accessible way and it should provide space for non-state actors to intervene. Similarly, Vivian Bellonwu-Okafor of Social Action Nigeria emphasized the need for improved government accountability, as parts of the Nigerian constitution that cover public participation in financial decisions are currently not being upheld. Furthermore, Eze Onyekpere of the Centre for Social Justice argues that the lender (bond investor) cannot simply assume that a country is following the due process of law, as governments often circumvent the constitution.

What's more, the global system for evaluating debt sustainability and macroeconomic outlook, which in turn affects the interest rate on bonds, is flawed and non-transparent. Credit rating agencies are given a lot of power to set the level of



interest countries will pay on their loans, as their credit rating tends to signal the strength of their economy. However, there is little openness about how these ratings are determined and they tend to focus on short-term issues such as a change in terms of trade, rather than more structural issues such as the type of investments a government is making. (Thus a country experiencing an oil boom will be considered a good borrower in times of high oil prices and a worse borrower in times of low oil prices). Furthermore, the investment banks consulting with SSA countries on their bond issuances tend to recommend exaggerated interest rates. Thus, the SSA countries end up paying higher borrowing costs than what might have been possible on the international market.

Finally, the way debt sustainability is measured is flawed for many reasons. Some missing elements are contingent liabilities, a focus on productive investments and criteria such as public participation in borrowing decisions. Although the World Bank/IMF debt sustainability analyses (DSAs) consider both debt-to-GDP and debt service-to-revenue, civil society groups argue that more focus should be on the latter.

6.2 A Proposal for Responsible Investment in Sovereign Bonds

As this report has shown, the process of government bond issuance is often plagued by a lack of transparency, and ultimately legitimacy, from the perspective of the citizens of the issuing country. In order to be a responsible lender, it is therefore recommended that the following issues be taken into consideration before making the decision to invest in a government bond:

- Agency: Is there a comprehensive legal framework in place that clearly defines procedures, responsibilities and accountability? Is the issuer acting in its citizens' best interests?
- Disclosure and publication: Have the relevant terms and conditions of the financing agreement been disclosed by the sovereign borrower? This information should be universally available and freely accessible in a timely manner through online means to all stakeholders, including citizens.
- Contractual instruments to facilitate a possible restructuring: Does the government bond include enhanced collective action clauses and modified pari passu?
- Due process of law: Is the debt contracting process in line with the government's own constitution? Input from a wide variety of stakeholders is recommended in order to evaluate this question.
- Responsible credit decision: Is the debt sustainable? In order to answer this question, particular weight should be given to the debt service-to-revenue ratio. The macroeconomic structure of the country should also be evaluated, but preferably not by using credit ra-

tings, as these are vulnerable to procyclical, short-term evaluations.

- Reasonable cost: Is the cost of the loan reasonable? Although a higher cost means a higher return for the lender, it also means higher costs for the borrower and may not be sustainable.
- Exchange rate risk: How vulnerable is the country to exchange rate risks? Would the government be able to handle the vulnerability associated with a Eurobond if its own currency were to depreciate?
- Interest rate risk: Is the interest rate fixed? If not, does the government have the capacity to cope with fluctuations in the interest rate?
- International cooperation: All lenders have a duty to comply with United Nations sanctions imposed against a governmental regime.

Depending on the answers to these questions, the institutional investor must decide whether investing in a particular government bond is responsible. Although the answer may not be a clear yes to all questions, investment may still be desirable and ethical if there is reason to believe that a sovereign bond may help the country make improvements in the right direction.

6.3 Specific Recommendations to the Norwegian Government

The Norwegian government has become well known as a promoter of responsible lending internationally, through admitting co-responsibility as a creditor for the debts resulting from the Ship Export Campaign,[219] funding work within the UN on establishing principles for responsible lending and borrowing, and carrying out a creditor's debt audit.[220] In addition, the government has pioneered the use of ethical guidelines through its sovereign wealth fund's investments in equity and corporate bonds.

Despite this, the only ethical guideline that the Norwegian sovereign wealth fund respects in its investments in government bonds is compliance with United Nations sanctions imposed against a government. In summer 2016, the Norwegian parliament requested that the government evaluate the possibility of introducing ethical guidelines for the Norwegian wealth fund's investments in government bonds. In line with this and in order to avoid irresponsible lending, this report recommends that the government:

- Implement ethical guidelines for the investment in sovereign bonds. These guidelines should be universal, predictable and guarantee equal treatment. Basing the guidelines on the UNCTAD Principles for Promoting Responsible Lending would be advisable. A minimum requirement for ethical guidelines would be to include criteria for transparency in the debt contracting process in the issuing country.[221]
- Promote the application of the UNCTAD principles internationally and particularly in relation to lending through sovereign bond investment.
- Promote an independent debt-workout mechanism internationally. The discussion and establishment of such an institution should ideally be carried out within the UN system.
- Work to enhance and improve the level and objectivity of information regarding a country's economic situation and outlook. This can be done both within the UN system and within the IMF and the World Bank.

End notes

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9 FDI is here understood as the net inflows of equity capital, reinvestment of earnings, and other long-term and short-term capital.

10 Portfolio investments are investments in the form of a portfolio of assets, including transactions in equity securities and debt securities such as bonds. Sometimes portfolio investments are considered to be a component of FDI, other times not. For example, while the UN World Economic Situation and Prospects tends to consider portfolio investments as a part of FDI, the United Nations Conference on Trade and Development tends not to.

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