

AN ANALYSIS OF SOVEREIGN DEBT AND ECONOMIC RISKS FROM COVID-19 IN GAVI-SUPPORTED COUNTRIES

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1. Key takeaways

- *Trends in the level and composition of sovereign debt across 73 countries supported by the Gavi Alliance prior to the onset of COVID-19 highlight the increased risks of debt crises and challenges to the effectiveness of traditional approaches to providing debt relief.¹*
- *External sovereign debt levels grew by 47% in Gavi-73 countries over the period 2011–2018, and this increase has been particularly acute among middle-income countries (MIC).*
- *Servicing debt obligations consumed a median of 6.7% of government revenues in 2018 in Gavi-73 countries, a 123% increase over the same period.*
- *As of the end of 2019, 8 Gavi-supported countries were already in debt distress and 16 other Gavi-supported countries had accumulated debt levels that placed them at high risk of debt distress according to the IMF and World Bank.*
- *There is a stark difference in the composition of the main creditors of external sovereign debt in Gavi-73 low- and middle-income countries (LMICs):*
 - *In low-income countries, the largest credit group is composed of multilateral (e.g. World Bank) and bilateral lenders.*
 - *In middle-income countries, the majority (52%) of debt is held by private lenders (either in the form of bondholders or directly through banks).*
 - *China has become a major – and potentially the largest – lender in lower-income countries (LICs) and LMICs.*
 - *The composition of creditor groups matters as private and non-OECD bilateral lending may be significantly more complex to coordinate and agree to debt relief given the multiplicity of lending terms, debt holders and interests.*
- *Debt transparency has been highlighted as a major bottleneck in relation to understanding actual levels of sovereign debt and effective approaches for providing debt relief. It is estimated that only 50% of debt owed to China is captured by public statistics.*
- *Supporting countries navigate this period of acute stress brought about by the impact of COVID-19 will be critical in ensuring the continued delivery of immunisation and other priority health services.*
- *Key components of the global community’s response are not only grants, such as those provided by Gavi and the Global Fund, but also measures – spearheaded by the World Bank, the IMF and other multilateral development partners – to strengthen national social safety nets and jumpstart economic growth, as well as initiatives to improve debt transparency. Without these, efforts to identify and resolve debt crises in a timely manner will be significantly hampered.*

2. Overview of recent sovereign debt dynamics²

Sovereign debt is an important tool for economic policy-makers but can become a barrier to economic stability and development if not well managed or used excessively. If well invested, domestic and external borrowing can be a useful tool to allow countries to absorb temporary shocks (e.g. sudden liquidity constraints) and can help expand a country’s physical and human capital, thus ultimately increasing its domestic wealth and repayment capacity. However, as a country’s debt levels increase, so do the risks associated with it: government investments in public services may be diverted to the repayment of an ever-growing interest bill; available foreign exchange may be prioritised to service debt to the detriment of other key imports; or governments may try to meet their liabilities by direct money creation, leading to higher inflation, and in certain cases, hyper-inflation (e.g. Zimbabwe). Therefore, high levels of public and publicly guaranteed

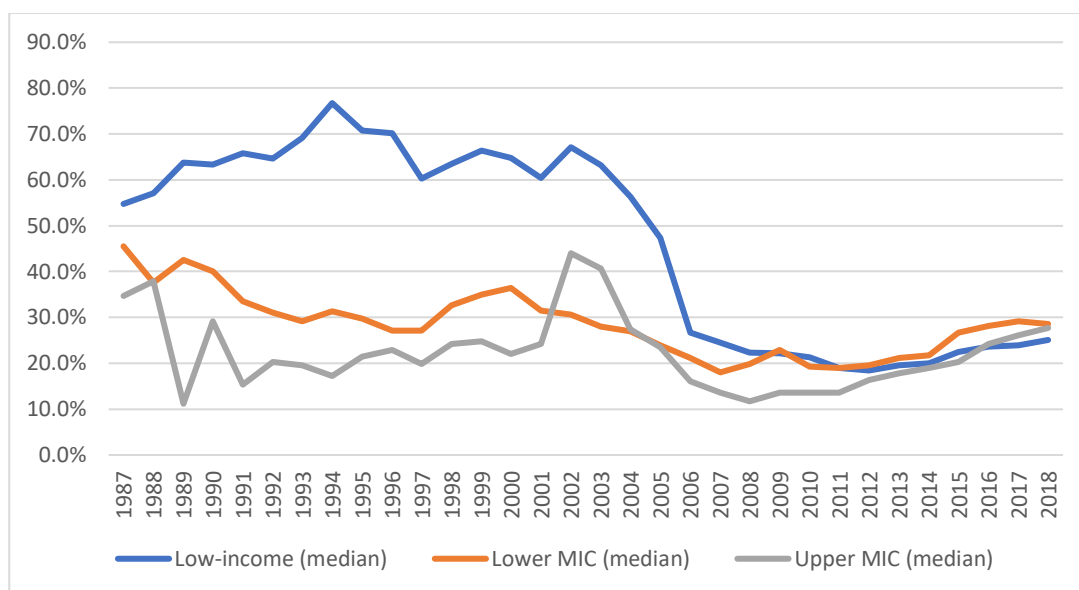
¹ The 73 Gavi-supported countries (hereby referred to as Gavi-73 countries) include 57 Gavi-eligible countries, which are those that are eligible to apply for vaccine support, and 16 former Gavi-eligible countries that Gavi continues to engage with to mitigate risks to successful transition from Gavi support.

² For this analysis, “sovereign debt” refers to external public or publicly-guaranteed debt.

debt can become not only unsustainable but also (as in the past) major barriers to economic growth and prosperity.

While on average overall debt levels in Gavi-supported countries remain far from their historical highs, they have been increasing at a fast pace over the past 10 years. For the median Gavi-73 country, external sovereign debt as a share of GDP stood at 27% in 2018. While this level is still significantly below the medians observed in the 1980s and 1990s prior to the launch of the HIPC (Heavily Indebted Poor Countries) Initiative,³ it has been rising rapidly, increasing by 47% since 2011. However, most of this increase has been seen in middle-income countries, which mostly did not benefit from HIPC debt relief and have since then overtaken low-income countries as the group with the highest debt-to-GDP ratios (see Figure 1). These numbers are expected to increase substantially as a result of the COVID-19 pandemic.

Figure 1: Externally sourced public and publicly guaranteed debt (% of GDP)



This increase in sovereign debt levels has been particularly acute in selected regions and countries. As reported by the World Bank, external debt among sub-Saharan African countries grew faster than in other regions: over half of the countries in the region have seen their external debt stocks double since 2008.⁴ The increase in external debt stock over the same period has been more pronounced for some countries: 885% for Ethiopia; 521% for Zambia; 437% for Uganda; and 395% for Ghana.

Debt servicing – the total annual payments for interest and principal repayment – accounted for a median of 6.7% of government revenues across Gavi-73 countries in 2018, a 123% increase since 2011. As a comparison, the median level of domestic government health expenditure as a share of government revenue across Gavi-73 countries was also around 7% (in 2017, the latest available data), and the change observed over the same period was much smaller at less than 10% (see Figure 2).

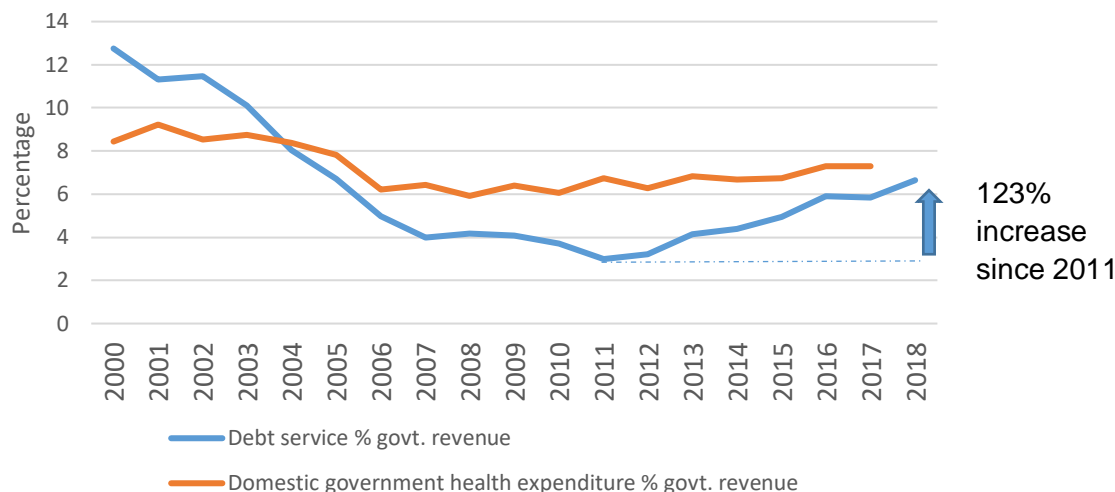
³ The HIPC Initiative was spearheaded by the IMF and the World Bank and provided debt relief in return for boosting social spending and improved debt management.

⁴ International Debt Statistics 2020: <https://openknowledge.worldbank.org/bitstream/handle/10986/32382/9781464814617.pdf?sequence=7&isAllowed=y>.

The increase in debt servicing as a share of government revenue from 2011 to 2018 was 979% in Azerbaijan, 961% in Mongolia, 778% in Zambia, 713% in Nigeria and 677% in Tanzania; this increase was more than 200% for a further 15 Gavi-73 countries over the same period.

As a result, almost a third of Gavi-supported countries are at high risk of being (or already are) unable to meet their debt obligations. According to the IMF and World Bank's Debt Sustainability Framework,⁵ as of the end of 2019, 8 Gavi-supported countries were in debt distress⁶ and 15 other Gavi-supported countries had accumulated debt levels that placed them at high risk of debt distress.⁷

Figure 2: Median cost of debt servicing as a % of government revenue, and domestic government health expenditure as % of government revenue, Gavi-73 countries



3. How much to whom?

Important differences can be observed between low-income and middle-income countries not only in their overall indebtedness levels but also in the composition of their main lenders (see Table 1), and how these have changed over time.

Between 2011 and 2018, Gavi low-income countries increased their total borrowing only marginally, and multilateral institutions and the World Bank continued to be responsible for the largest share of total borrowing, with a combined share of 55% in 2018. The share of bilateral lenders remained broadly stable, at 34%, with a slight increase in borrowing from private creditors.

However, in Gavi-supported middle-income countries, total debt more than doubled in the period, from US\$ 424 billion to US\$ 874 billion, and lending has become much more reliant on private creditors, particularly via issuance of bonds in capital markets which was responsible for 35% of all lending in 2018 (compared to 14% in 2011).

⁵ The Debt Sustainability Framework sets a threshold for external debt-to-GDP share at 30%, 40% and 50% for countries with weak, medium and strong debt-carrying capacity, respectively. Debt-carrying capacity is informed by CPIA scores for the quality of institutions and policy, and macroeconomic indicators.

⁶ The Republic of Congo, Gambia, Mozambique, Sao Tome and Principe, Somalia, South Sudan, Sudan and Zimbabwe.

⁷ Djibouti, Ghana, Lao PDR, Mauritania, Ethiopia, Zambia, Chad, Cameroon, Tajikistan, Sierra Leone, Burundi, Central African Republic, Kiribati, Haiti and Afghanistan.

Table 1: Level and composition of externally sourced public and publicly guaranteed debt in Gavi-73 countries⁸

	Gavi-73 low-income				Gavi-73 middle-income			
	US\$ billion		Share		US\$ billion		Share	
	2011	2018	2011	2018	2011	2018	2011	2018
Multilaterals (excl. WB)	29.3	23.9	27%	21%	63.9	116.0	15%	13%
World Bank	37.7	39.0	34%	34%	96.7	147.7	23%	17%
Bilaterals	37.6	37.9	34%	33%	159.8	234.3	38%	27%
Private: Bondholders	0.0	2.6	0%	2%	60.2	303.1	14%	35%
Private: Commercial banks & other	4.7	11.1	4%	10%	43.5	74.8	10%	9%
Total	109.4	114.5	100%	100%	424.1	874.9	100%	100%
Total, median	2.1	2.9			3.4	8.4		

This trend towards increasing total debt and a growing reliance on private creditors can also be observed in non-Gavi-supported middle-income countries. While the total debt stock between 2011 and 2018 increased by less when compared to Gavi middle-income countries (59% vs. 106%), its absolute value reached almost US\$ 2 trillion in 2018. Private lenders were responsible for about 74% of the total, an increase from the 65% observed in 2011 (see Annex 1).

The composition of creditor groups is an important issue because it can significantly affect the complexity and likelihood of any possible debt relief negotiations. According to the World Bank, lending arrangements with non-OECD bilaterals and commercial creditors are not often public and are complex and varied.⁹ Increased exposure to non-OECD and commercial creditors may pose coordination challenges for debt resolutions in the future, making the consequences of debt distress even more disruptive, especially if debt is guaranteed by government-owned assets or funding streams (e.g. expected oil sales).¹⁰

4. The emergence of China as a lender to low- and middle-income countries

A major development in the world economy over the past two decades has been the emergence of China as a major lender to low- and middle-income countries. Analysis by economists at Harvard and Kiel has estimated that China has *“lent about \$1.5 trillion in direct loans and trade credits to more than 150 countries around the globe. This has turned China into the*

⁸ Data from the WB [International Debt Statistics](https://openknowledge.worldbank.org/bitstream/handle/10986/32382/9781464814617.pdf?sequence=7&isAllowed=y):

<https://openknowledge.worldbank.org/bitstream/handle/10986/32382/9781464814617.pdf?sequence=7&isAllowed=y>.

⁹ <http://documents.worldbank.org/curated/en/378031553539256399/pdf/Debt-in-Low-Income-Countries-Evolution-Implications-and-Remedies.pdf>.

¹⁰ For example, with private bonds, these limits depend on the existence of collective action clauses to bind all bondholders to a change in payment terms and for a qualified majority of bondholders to agree to provide debt relief.

world's largest official creditor — surpassing traditional, official lenders such as the World Bank, the IMF, or all OECD creditor governments combined."^{11 12}

However, “*despite the large size of China’s overseas lending boom, **no official data exists on the resulting debt flows and stocks.** China does not report on its international lending, and Chinese loans literally fall through the cracks of traditional data-gathering institutions.*” The authors estimate that 50% of China’s loans to developing countries go unreported.

They also add that “*for the 50 main developing country recipients, we estimate that the average stock of debt owed to China has increased from less than 1% of debtor country GDP in 2005 to more than 15% in 2017. A dozen of these countries owe debt of at least 20% of their nominal GDP to China (Djibouti, Tonga, Maldives, the Republic of the Congo, Kyrgyzstan, Cambodia, Niger, Laos, Zambia, Samoa, Vanuatu, and Mongolia).*”

Against the backdrop of substantial Chinese lending to developing countries in recent years, **China itself is a large holder of external debt**, equivalent to 14% of its GNI and one quarter of the combined external debt of all low- and middle-income countries.¹³ **The amount of debt held by China may limit its ability to provide debt relief to the developing countries that it lends to.**

5. Challenges in providing debt relief

With the economic downturn brought about by COVID-19 as well as the very significant drop in commodity prices observed over the past two months, **a combination of lower government revenues, rising interest rates and challenges to roll on current obligations means that in many countries, servicing current debt stocks has become untenable** and could jeopardise the delivery of public services and the functioning of the state.

A debt standstill arrangement (temporary suspension of debt payments) is one approach to offer time for countries to “grow” out of the problem. For example, 25 Gavi-supported countries have so far accessed this type of debt servicing relief on IMF loans, totalling US\$ 227 million. **However, this approach may simply postpone the problem without dealing with the underlying issue.** A protracted debt crisis would instead require more structural approaches to debt restructuring such as lowering of interest rates or outright debt cancellation in light of a lower likelihood of repayment.

Dealing with the challenge of creditor coordination will be important to providing effective debt relief. The G20, which includes China, has announced that its members will suspend bilateral debt servicing payments for the poorest countries that request support. However, private creditors have been requested to participate only on a voluntary basis.

However, there can be a free-rider problem if major lenders, including Chinese state-owned enterprises (such as banks), do not participate in debt restructuring. A low level of participation among creditors may undermine the benefits of debt relief. For example, debt relief provided by a relatively small proportion of creditors may result in freed-up funds being used to meet debt

¹¹ <https://hbr.org/2020/02/how-much-money-does-the-world-owe-china>.

¹² <https://www.ifw-kiel.de/publications/kiel-working-papers/chinas-overseas-lending-12820/>.

¹³

International Debt Statistics 2020:

<https://openknowledge.worldbank.org/bitstream/handle/10986/32382/9781464814617.pdf?sequence=7&isAllowed=y>

servicing payments to non-participating creditors rather than being used to strengthen the economy and the government's overall financial position.

6. Conclusion and next steps

It is important to continue to closely monitor these trends over the coming months, particularly considering the large negative economic shock that low- and middle-income countries are likely to face because of COVID-19. The available evidence indicates that the pandemic is expected not only to affect access to capital markets, but also to significantly dampen economic growth, putting downward pressure on government revenues and decreasing countries' ability to finance their obligations.

Supporting countries to navigate this period of acute stress will be critical in mitigating the impact of COVID-19 and ensuring the continued delivery of immunisation and other priority health services. Grants, such as those provided by Gavi and the Global Fund, will be a key component of the global community's response. Equally important will be measures – spearheaded by the World Bank, the IMF and other multilateral development partners – to strengthen national social safety nets and jumpstart economic growth, as well as initiatives to improve debt transparency. Without these, efforts to identify and resolve debt crises in a timely manner will be significantly hampered.

Annex 1: Creditor composition in non-Gavi-supported middle-income countries, 2011–2018

Non-Gavi-supported middle-income countries				
	US\$ billion		Share	
	2011	2018	2011	2018
Multilaterals (excl. WB)	167	200	14%	10%
World Bank	111	139	9%	7%
Bilaterals	157	164	13%	8%
Private: Bondholders	519	1085	43%	56%
Private: Commercial banks & other	263	353	22%	18%
Total	1217	1941	100%	100%
Total, median	4.8	10.5		