A DEBT CRISIS ENDANGERS DEMOCRACY WORLDWIDE

Hakainde Hichilema

THE developing world is facing a looming debt crisis precipitated by the pandemic and the war in Ukraine. My country, Zambia, was the first nation to default since COVID-19 spread across the planet. Efforts to restructure our debt, at first bearing promising progress, have now calcified. The past debts, run up by the previous administration, are preventing a more hopeful future. But Zambia is merely a guinea pig, a test case for how the world will deal with the forthcoming tide of defaults.

Not only are developing countries looking down at a lost decade where development gains will be reversed, the debt issue could set off a cascade of instability. Even before the pandemic, populations across the developing world were growing restive on the back of high cost-of-living prices. Defaulting makes everything worse, leaving countries in limbo with no foreign reserves, strained currencies, and cost-of-living crises.

The reverberations will be felt across the developed world, not least in Europe, still reeling from a migration crisis. If economic hope is quashed by debt distress, migrant numbers can only surge.

Expensive EU aid programs have sought to improve the economic and security situation in many African countries in a bid to dampen the exodus. But these will not be sufficient, nor, crucially, provide nations the tools to build their own resilience. Unlocking private sector investment is the only clear solution, but only possible if rampant debt distress is properly addressed. This is where the West should focus its efforts.

The cause of the current crisis reaches far back. But the pandemic and the war in Ukraine have lit the fuse on unsustainable debt burdens. High energy and food prices have drained reserves of many countries. COVID-19 was ruinous for economies, dowsing the tourism sector and crashing commodity prices—an important source of foreign exchange for developing countries. Few of us have been able to bounce back as our wealthier, more developed counterparts have, lacking their ability to prop up their economies in the downturn. The result has been deep scarring.

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As inflation has taken hold, interest rates have shot up from the world's central banks, precipitating capital flight from developing nations. The costs of servicing dollar-denominated debt, a majority of financing, have risen precipitously as the greenback has strengthened due to its role as a safe haven. Consequently, in 2022, debt interest payments soared by 35 percent. Precisely at the time when developing nations need the resources to recover from three years of global crises, they are being asked to pay more.

The convergence of such factors leaves developing nations few options. With lenders unwilling to extend further credit in the current climate, or at prohibitive costs, debt

must be restructured to stem the crisis. Given the number of countries facing this reckoning, the situation is urgent.

Zambia, Sri Lanka, Suriname, and Ghana have all defaulted since the pandemic began. But the World Bank predicts that about a dozen countries could face default in 2023. The IMF has stated that 60 percent of low-income developing countries are in debt distress or at high risk of it. According to the United Nations, 52 countries—home to more than half of the world's poorest population—are suffering from severe debt problems.

With the world in a state of permacrisis, developed nations have been slow to recognize the impending crisis. However, a mechanism has been put in place. The G20—a group of the world's largest economies—has established the Common Framework: a forum in which external creditors could come together to reach an agreement on restructuring.

It grew out of a COVID-era debt suspension for the world's 73 poorest countries. As the global economy nosedived, the risk of defaults became acute. Service payments were suspended for bilateral loans for those countries, allowing them to re-channel funds to deal with the economic and healthcare impact of the pandemic. The initiative ended in December 2021.

In theory, the Common Framework would take over debt treatments today for those same countries that were previously eligible for the debt suspension. However, it has so far proved insufficient to meeting the task ahead. Time is running out before the tipping point is reached. As one of the first to enter the initiative, Zambia's story should be instructive.

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Under my predecessor, Zambia, a nation of 20 million people, defaulted on its debt in November 2020. One of the world's leading copper producers, when commodity prices collapsed during the pandemic, the president's economic mismanagement of the country was laid bare.

As his popularity plummeted, he recklessly ran up debt to shore up support. With the election nearing, the pile stacked higher as pork barrel politics became his core election strategy. But because of dire economic mismanagement, lenders would only offer exorbitant rates—10, 11, 12 percent—weighing down the millstone already around the country's neck. With the corruption he instilled in our governance, only a fraction of the credit actually reached the infrastructure projects the president touted.

He was punished at the ballot box. Despite last-ditch desperate efforts to rig the vote, the electorate turned out in numbers above and beyond the simple majority threshold to choose a new path.

Aside from reinstating civil liberties and tackling corruption, the restructuring of Zambia's debt has been the priority since day one. Zambia requested to join the Common Framework in February 2021. At the end of August, the change in government took place. The process showed initial promising signs. Preliminary approval for a $1.3 billion support package from the International Monetary Fund was granted in December 2021 and finalized in September 2022. In May 2022, the creditor's panel to renegotiate the debt was established, to be chaired by France and China. But progress has since faltered. A debt restructuring has yet to be agreed despite protracted talks.

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The impasse is holding up the release of the second tranche of funding from the IMF. When the deal was agreed in September, it allowed Zambia access to $188.7 million. But the next release is contingent on agreeing a debt restructuring with all external creditors.

Part of the problem lies in the changing nature of debt. In the latter half of the twentieth century, multilateral institutions held the majority owed by developing countries. To solve the last debt crisis required like-minded countries coming together to settle the issue—though it still took some time.

A debt crisis was set off in the early 1980s, when the U.S. Federal Reserve hiked interest rates over 20 percent. As today, the dollar strengthened and with it the variable interest repayments of many low-income countries shot up. For over two decades, poor nations were devastated. The late Tanzanian President Julius Nyerere would ask: "Must we starve our children to pay our debts?"

An international campaign grew to cancel the unsustainable debt, which was diverting developing countries' budgets away from healthcare, education, and poverty reduction programs. At Gleneagles in 2005, the then G8 agreed to cancel $130 billion of debt for dozens of poor countries answering the moral quandary posed by Nyerere back in the 1980s. Private investors surged into frontier markets and bond

markets were buoyed. Abebe Selassie, the director of the IMF's African department, recently stated: "We need another Gleneagles moment."

But today's situation is a more complicated matter. Though the debt propositions are more modest—simply restructuring debt rather than a wholesale write off—the much larger number of stakeholders places strain on the process. China and other rising economies are now major lenders across the developing world. Gleneagles took significant cooperation and political will. Amongst the superpower rivalry that has accelerated in recent years, that necessary cooperation has become more difficult. Creditors are concerned whether restructuring their share of the burden would hand advantage to others in the struggle for global influence. Developing debtor countries are now little more than the grass to be trampled when elephants fight.

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The private sector and bondholders are now also major players—accounting for 23 percent of the debt held by the 73 developing countries eligible to enter the Common Framework. Yet they are not obliged to come to the negotiating table in the Common Framework—another major hurdle to a comprehensive debt-restructuring deal being reached, which is required by the IMF to release the next tranche of funding.

And so a deal between this complicated mélange of parties is not forthcoming, despite Zambia passing all the IMF reforms to ensure future fiscal resilience. Key amongst them have been the removal of fuel subsidies, despite the dramatic prices we see in international markets, and an increase in electricity tariffs. Given the cost-of-living pressures that Zambian citizens face, these reforms have come at significant political cost. But they shall be worth it to mend the economy and put the country on a stable footing. Yet Zambia now occupies an uncomfortable gap between the painful work undertaken and the yet to be released IMF funds and FDI that should now be flowing.

The problems are evident in my country. The local currency, the Kwacha, has plummeted in value. With confidence in the government, it had been the best performing currency against the U.S. dollar for most of 2022. We reduced the inflation rate from 24.4 percent in August 2021 to 9.7 percent in June 2022. But the protracted talks are taking their toll. The currency has lost a third of its value since September, pushing up the price of food and other essentials (not to mention the cost of servicing debt). Ordinary Zambians are struggling once more. International investment still remains largely blocked.

The glacial pace to unlock the restructuring via the bureaucratic Common Framework is now discouraging others from entering the initiative. So far, only Chad, Ethiopia, Ghana, and Zambia have applied to it. How others will seek to manage their debt distress is an open-ended question.

Across the world, the high cost of servicing debt is straining low-and middle-income nations' budgets to breaking point. Funds are being diverted from healthcare, education, and poverty reduction to feed the debt machine. Decades of development gains in poverty, hunger, and malnutrition risk are being wiped out. For the first time since the Human Development Index has been measured, declines have been registered for two consecutive years. Globally, we are back to 2016 levels.

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It also poses risks to the global economy. From the perspective of developed economies, unsustainable debt causes complications when exporting to those nations. Stifling the development of emerging economies will also slow global growth and prevent the widening of markets.

Something has got to give. The G20 Common Framework is ad hoc and sluggish, creating a vacuum for geopolitical rivalries to crowd out the imperative of restructuring. What debt distressed countries need is a systematic process that would leave no ambiguity as to what debtor nations need to do to make their debt affordable and sustainable, whilst reassuring them that once those steps are taken, relief will shortly follow. Such a process would also ensure an equitable sharing of financial burdens between all actors, private and public, rather than allowing political jockeying to dictate it, which often only leads to irresolution.

Some form of payment debt suspension or drawing rights should follow the joining of the Common Framework to ensure countries are not unfairly racking up further debt whilst enrolled in the process to those same creditors. Private investors should be obliged to come to the table, to ensure debt relief isn't used to bail out other creditors. This should all happen at the same time, rather than first resolving

bilateral debt and only then addressing private sector creditors, which slows down restructuring.

It is also clear that the debt issue is bigger than the poorest nations on the planet. Sri Lanka's default has cast the country into significant difficulty. But as a middle-income country, it is not eligible under the framework's conditions. However, more countries of this status look set to default, and need to be considered when thinking about ways to avert a looming debt disaster.

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Beyond the current crisis, it speaks to a need to overhaul the entire sovereign debt relief provision framework. The architecture that governs relief is rooted in political blocs such as the G7 and outdated in today's multipolar world. Reforms have not kept pace with developments over the last two decades. This will require genuine discussion at truly global forums such as the United Nations if we are to prevent another debt crisis from rearing its head without the tools to combat it.

These may sound like tall orders. But the international community has shown it can act with speed when it needs to—such as during the pandemic or the recent mini-banking crisis. If it doesn't, the developing world faces ruin. The developed world would feel the impact most acutely.

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