Hogan Lovells

Business Restructuring and Insolvency Alert

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Sovereign Debt Restructuring in Africa

Overview of sovereign restructurings

Sovereign debt restructurings are complex processes that involve negotiations with a sovereign's creditors to alter the terms of existing debt, aiming to restore fiscal sustainability and ensure long-term economic stability. Factors such as escalating debt service and borrowing costs, liquidity pressures originating from foreign exchange shortages and revenue shortfalls, limited revenue base resulting from recessions or stagnation from structural weaknesses such as declining competitiveness or having a narrow export base, or more subjective factors such as internal or external political pressure to ensure social stability at any given moment, often prompt considerations of debt restructuring.

The nature of a restructuring depends on many things, including the types of creditors, which can be, among others: (a) *official creditors*, typically other sovereign states (or agencies thereof) or multilateral financial institutions (these latter generally having a "preferred" status over all other sovereign creditors) providing loans under official development assistance programs or other multilateral agreements, often driven by geopolitical considerations and international cooperation mandates, (b) *external private creditors* such as commercial banks, bondholders, and other private financial entities, or (c) *domestic private creditors*, typically domestic entities such as local banks, non banking financial institutions, and the domestic bond market.

The forum of the restructuring is also a crucial consideration and varies mainly depending on the types of creditors involved. Unlike corporate bankruptcies, there is no formal, centralized system for sovereign restructuring (despite notable proposals over the years such as the IMF's unmaterialized Sovereign Debt Restructuring Mechanism). Debt restructuring forums include (a) the *Paris Club*, a group of official creditors formed in 1956 with the goal of finding coordinated solutions to the payment difficulties experienced by debtor nations in connection with bilateral debt owed to member countries, (b) *consent solicitations* to bondholders under the terms of the bonds' indenture to amend the terms of the bonds (in most cases through the collective action clause mechanism (CACs) which allows for a qualified majority of holders (as opposed to requiring unanimous consent as used to be the norm) across aggregated series of bonds to consent to the restructuring) and *exchange offers* to exchange the old bonds for new bonds with more favorable terms which could include principal haircuts, shortening of maturities and/or a reduction in coupon, (c) *bilateral restructurings*, negotiated directly between the sovereign and a single creditor or a group of official and/or private creditors, (d) the *Debt Service Suspension Initiative (DSSI)*, a mechanism launched by the G20 in April 2020 (expired in December 2021) as a result of the economic fallout triggered by the COVID-19 pandemic aimed at delivering temporary debt service suspension for the poorest countries, allowing them to redirect these funds towards tackling the health and economic crises at hand,

and (e) the *Common Framework*, launched by G20 official creditors and Paris Club members, backed by the IMF and the World Bank, and addressed to DSSI-eligible countries while being more expansive than the DSSI; it seeks to align debt restructuring plans by official creditors and external private creditors, and, importantly, involves non-Paris Club official creditors such as China, India and Saudi Arabia.

While historically most of the emerging market sovereign debt restructurings have involved external debt (i.e., debt denominated in non-local currency and/or governed by non-local law) a number of the recent restructurings, in particular in Ghana also include a domestic debt restructuring component. These domestic restructurings involve some of the same issues as the external debt restructurings but also add another layer of political context as a significant portion of the domestic debt may be held by important domestic actors, such as pension funds and financial institutions.

The intertwining of different creditor types and restructuring forums underscores the multifaceted nature of sovereign debt restructurings. For instance, a nation may engage in Paris Club negotiations to restructure official debt also utilizing consent solicitations to address bonds held by external private creditors. The choice of restructuring forum often reflects the creditor composition, the legal and financial characteristics of the debt, and the broader economic and geopolitical context. The overarching goal remains to achieve a coordinated approach that ensures the debtor nation can meet its obligations while maintaining a pathway to economic recovery and growth.

As explored in this article, the experiences of African nations like Zambia, Chad, Ghana, and Ethiopia provide a real-world illustration of how these dynamics play out in the complex arena of sovereign debt restructurings.

The broader African experience (brief highlights)

The stories of sovereign debt restructuring in Africa are diverse, with each case presenting unique economic circumstances, challenges, and approaches to navigating its debt dilemma. Out of 10 low-income countries (LIC) marked as being in debt distress on a list of countries eligible for the IMF's Poverty Reduction and Growth Trust (PRGT) as of August 2023, eight were African nations.[1] Similarly, nine out of 10 countries in a similar list by the World Bank's Joint Bank-Fund Debt Sustainability Framework for LIC are African.[2]

Recent years have seen an increase in African debt accumulation (the continent's debt-to-GDP ratio increased by more than 24% in the decade of the 2010s, with some regions in Africa increasing it by more than 50%), driven by the countries' policy goals and plentiful lending from Chinese sources.[3] The external debt composition of Africa's DSSI-eligible countries has seen a shift over the past decades from debt primarily owed to Paris Club sovereign states, multilateral financial institutions, and private banks (from 28% of GDP in 2006 to 11% in 2020) to, in more recent years, China (who has become the continent's second largest creditor after bondholders) (from 2% of GDP to 18%) and private bondholders (from 3% of GDP to 11%).[4] In the two decades leading up to 2020, bilateral debt (mainly to Paris Club members) went from 52% to 27% of Africa's external debt stock, while debt owed to external private creditors rose from 17% to 40% during the same period (by 2020, 21 African countries had issued more than $155 billion in Eurobonds).[5]

1 See "Towards sovereign debt restructuring in Africa: comments and recommendations", United Nations Economic Commission for Africa, ECA Policy Brief No. ECA/22/026; 2022.
2 "Debt Sustainability Analysis (DSA)", Debt & Fiscal Risks Toolkit, The World Bank.
3 Moreira, Emmanuel Pinto. Debt Dynamics and Financial Stability in Africa. No. 2014. Policy Center for the New South, 2023.
4 Chabert, G, Cerisola, M. and Hakura, D. "Restructuring Debt of Poorer Nations Requires More Efficient Coordination". IMF Blog. Published April 7, 2022.
5 Moreira, Emmanuel Pinto. "Debt Dynamics and Financial Stability in Africa." No. 2014. Policy Center for the New South, 2023.

A new platform: the Common Framework's promise

The Common Framework emerged as a significant hope for addressing African sovereign debt challenges, and to address the DSSI's shortcomings. It has yet to overcome significant challenges, and has taken an extended period of time to implement in certain cases, but progress is emerging.

Where the DSSI did not require private creditors to provide relief (only one did on a voluntary basis), the Common Framework requires the debtor country to seek from its bilateral and private creditors terms comparable to those negotiated with a Common Framework committee (formed by G20 and Paris Club official bilateral creditors).[6]

The Common Framework has so far successfully produced restructuring agreements between two African nations and their respective creditors (including China, in both cases a significant creditor). In early 2021, Chad, Ethiopia, and Zambia signed up with the Common Framework for debt relief negotiations. Chad and Zambia secured deals with their official creditors in November 2022 and June 2023, respectively. Ethiopia's progress has been delayed due to the country's ongoing civil war. Ghana officially requested to restructure its bilateral debt under the Common Framework platform in January 2023, and an official creditors committee in connection therewith was created in May.

Brief country-specific overview

Zambia

Zambia's economy has been challenged in recent years, grappling with escalating external debt, dwindling foreign reserves, and a shrinking economy. The COVID-19 pandemic only exacerbated these challenges, leading to a default in late 2020 — the first African nation to default in the COVID-19 era. That year, Zambia was due to pay $1.7 billion to service its debt, more than 8% of the country's GDP for 2020.

Zambia signed up with the DSSI and, subsequently, the Common Framework. In June 2023, the country secured a deal to structure $6.3 billion of its debt ($4.1 billion of which is owed to the Export-Import Bank of China alone), and, prior to that, approval by the IMF in August 2022 of a $1.3 billion 38-month extended credit facility arrangement.

Chad

Chad's economic narrative is a mixture of internal conflicts, fluctuating oil prices, and hefty external debt. The country sought debt relief from the DSSI, which granted it until December 2021. Chad initiated negotiations with its official bilateral creditors under the Common Framework and reached an agreement in November 2022 to restructure nearly $3 billion of external debt, becoming the first country to achieve a debt treatment agreement under the Common Framework.

Ethiopia

Ethiopia's call for debt restructuring came amidst a backdrop of escalating debt vulnerabilities and a civil war that broke out in November 2020. The country requested treatment under the Common Framework in early 2021, but progress has been significantly slow due to the country's civil war which ended November 2022. In August 2023, China agreed to suspend Ethiopia's payments on its debt to China maturing in 2023 and 2024 as part of the Common Framework negotiations.

Ghana

Ghana's economic narrative over the recent years has been a blend of robust growth trajectories and the challenges of mounting public debt. The country's public debt rose from 63% of it GDP in 2019 to 88.1% at the end of 2022 (of which 45.7% of GDP was domestic debt and 42.4% external), with debt service-to-revenue at an all-time high of 127% in 2020 (among the highest in the world).[7] Ghana defaulted on its external debt in December 2022. The debt restructuring efforts commenced with a focus on domestic debt, with a successful exchange exercise of approximately $18.3 billion

6 See Breydo, Lev E. "Health of Nations: Preventing a Post-Pandemic Emerging Markets Debt Crisis." Nevada Law Journal, vol. 23, no. 2, Spring 2023, pp. 463-532.

7 "Ghana: Joint World Bank-IMF Debt Sustainability Analysis." World Bank Group. Published May 2023.

in local bonds (denominated in both local currency and US dollars) commenced in December 2022 and finalized in September 2023, which allowed the country to reduce the cost of debt servicing and extend maturities.[8]

Ghana also made an official request for debt restructuring under the Common Framework in January 2023. In May 2023, an official creditor committee co-chaired by China and France was constituted under the Common Framework, which represented a cooperative step between the Paris Club and Ghana's other official bilateral creditors aimed at reworking $5.4 billion of the country's bilateral debt. This significant step was crucial for securing a $3 billion 36-month extended credit facility arrangement from the IMF (with an immediate disbursement of $600 million).[9] Most recently, Ghana has reached a staff level agreement with IMF in connection with unlocking a second disbursement of funds under the IMF extended credit facility and has announced that it is now focused on restructuring its external private debt as well.

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8 Republic of Ghana: Investor Presentation." Ministry of Finance of the Republic of Ghana.
9 "IMF Executive Board Approves US$3 Billion Extended Credit Facility Arrangement for Ghana", International Monetary Fund, Press Release No. 23/151, published May 17, 2023.

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