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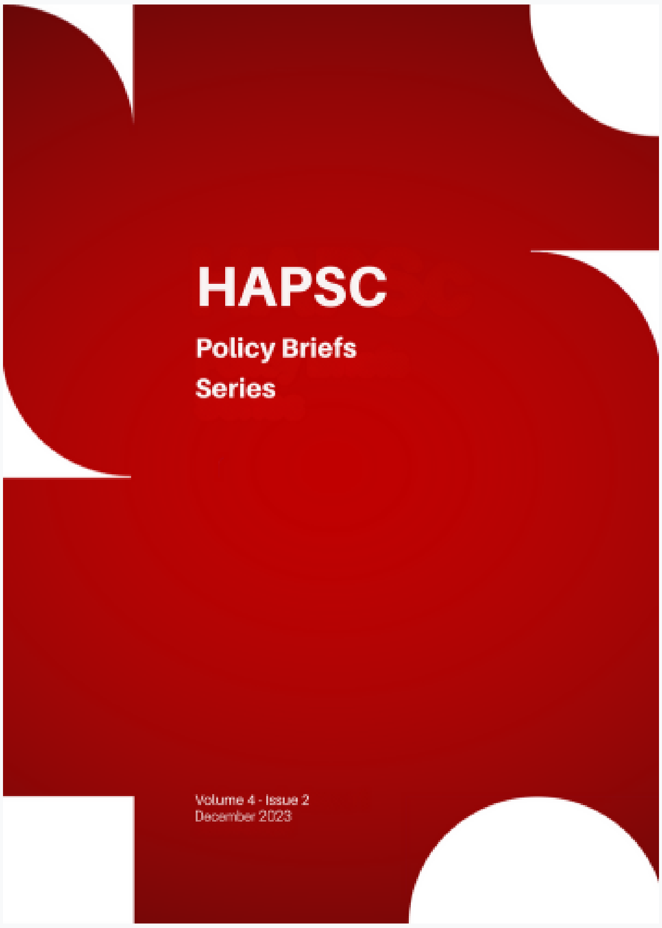

Comparative Analysis of Debt Restructuring Strategies in Developing Economies: A Case Study of Ghana, Zambia, and Sri Lanka

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Comparative Analysis of Debt Restructuring Strategies in Developing Economies: A Case Study of Ghana, Zambia, and Sri Lanka[1]

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Abstract

The issue of global debt distress is a matter of great concern, not just for the affected developing countries but also for developed countries and international organisations. According to the United Nations Development Program (2022), 54 developing economies are currently grappling with severe debt problems. During the period of 2020 to 2022 Ghana, Zambia, and Sri Lanka, representing the African and Asian regions, have found themselves in dire financial straits. This study aims to discover the common and specific reasons that led to the mounting debt crises in these three countries. The study describes the tax revenue challenges and governance issues, middle income trap and China's role in debt restructuring discussions as common challenges apart from country specific challenges. Timely discussions with the International Monetary Fund (IMF) and expedited agreements with creditors, and updated debt restructuring mechanisms are drawn to attention in this study.

Keywords: developing countries, developed countries, debt distress, debt restructuring, IMF.

Introduction

A least 54 developing economies are suffering from severe debt problems. Together they represent little more than 3% of global GDP but 18% of the global population, more than 50% of people living in extreme poverty, and 28 of the world's top-50 most climate vulnerable countries. Much in line with the history of debt relief, efforts have still not caught up to the seriousness of the unfolding debt crisis (United Nations Development Program, 2022). Debt challenges in low-income countries are far from where they were in the 1990s before the Heavily Indebted Poor Countries (HIPC) initiative, both in terms of debt levels and accumulation of arrears. However, they have been on the rise for the last decade, in a context of low interest rates, high investment needs, limited progress in domestic revenue mobilization, and often constrained public financial management capacity. They have been further aggravated by the COVID-19 crisis and now by the fallout of the war in Ukraine (International Monetary Fund, 2022).

Common Challenges in Ghana, Zambia, and Sri Lanka

The debt crises in Ghana, Sri Lanka, and Zambia share a common theme of policy mismanagement that has given rise to structural imbalances in their respective economies. While each of these

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countries faced unique challenges—Sri Lanka with excessive money printing and disruptive agricultural policies, Ghana with impractical election promises, and Zambia with allowances for specific employment and climate vulnerabilities—the underlying problems were not unique to these cases. These nations have grappled with inadequately structured tax systems, the middle-income trap, and the challenges of restructuring bilateral debt with China. The following Table 01 summarises the reasons for debt crises in the three countries.

Table 1: Summary of Debt Crises in Ghana, Zambia and Sri Lanka

Country	Ghana	Zambia	Sri Lanka
Total External Debt US$ (Billion)	29.1 (By Dec 2022)	26.6 (By Dec 2020)	49.6 (By Dec 2022)
External Debt as a % of GDP	42.4% (2022)	72.9% (2020)	74.7% (2022)
Date of Default	December 2022	June 2020	April 2022
Date of IMF Grant	May 2023	August 2022	March 2023
IMF Agreement	US$3 billion Extended Credit Facility 36 Months	US$1.3 billion Extended Credit Facility 38 Months	US$3 billion Extended Fund Facility 48 Months
Country specific reasons for debt crisis	Increasingly unconstrained domestic financing	Higher rates of poverty, adverse climate changes, inefficient public investment drive	Protracted twin deficit, excessive money printing
Common reasons for debt crisis	Low economic growth rate, losing investor and lender confidence, local currency depreciation, depleted international reserves, policy missteps, COVID-19, Ukraine-Russia war		
IMF Restructuring deal	Started restructuring domestic debt before the IMF assistance was granted.	Restoring sustainability through fiscal adjustment and debt restructuring	Restructure both domestic and foreign debt.
Specific terms	The ECF program aims to restore macroeconomic stability, ensure debt sustainability, and lay the foundations for higher and more inclusive growth.	creating room in the budget for much-needed social spending. Strengthening governance and reducing the risk of corruption, including by improving public financial management.	Foreign debt excludes multilateral debt.
Common terms	Focus on structural reforms and prior actions if needed under ECF and EFF schemes.		

Source: International Monetary Fund (2023), Central Bank Annual Report (2022), External Resource Department of Sri Lanka (2023)

Specific Challenges

Besides the common reasons including lack of foreign reserves, domestic currency depreciation and policy missteps, country specific reasons have worsened the debt crises by leading to negative impacts on the economies. Initiatives like Highly Indebted Poor Countries (HIPC) available to lower income countries like Zambia signal the timely requirement of proper mechanisms to address the global debt distress among the developing nations especially remaining in the middle-income category.

The composition of Sri Lanka's sovereign debt has recorded a notable rise in both domestic and foreign debt, particularly during the period from 2020 to 2022. Several inherent weaknesses of the economy, further exacerbated by policy lapses, steered the country towards a multifaceted disaster. Ill-timed tax reductions, an ill-equipped attempt to swiftly adopt organic agriculture, the depletion of the country's official reserves amidst futile attempts to maintain an untarnished debt servicing record, the delay in the exchange rate adjustment, and the failure to pay heed to several early warning signals caused tremendous shockwaves across the economy (Central Bank Annual Report, 2022).

The financial mismanagement and unrealistic political pledges of tax breaks and subsidies in Ghana hastened the country's economic collapse. The main tax reforms were the elimination of the financial services, import tariffs, and real estate VAT/NHIL, as well as the tax reductions on the national electrification programme, public lighting fee, and special petroleum tax rate. According to Donkor (2023), when Ghana decided to make high school education (including boarding) completely free, reinstate allowances for nursing and teacher trainees, eliminate several taxes enacted by the previous government, and construct a factory in each of the country's 261 districts, these impractical political promises that were made solely to win the elections and remain in power to enrich them had a significant negative impact on the economy.

Although the circumstances were significantly different in Zambia, fiscal imbalances also increased the pressure on debt. Zambia encountered economic shocks from climatic vulnerabilities and restored allowances for certain employment-related benefits, which put more strain on the national economy. All three case studies experienced the same outcomes: the inability to pay down foreign debt in foreign currencies made it necessary for these countries to rely on private credit markets in order to get foreign exchange for debt servicing and necessary imports, which eventually compounded and resulted in sovereign defaults. Akiwumi (2022) pointed out that as a low-income country grappling with mounting debt over decades, Zambia faced economic contractions due to its strong reliance on export earnings, falling copper prices and continuous lending from abroad. Zambia faces significant development challenges exacerbated by climate vulnerabilities, which have created a difficult dichotomy for policymakers. The government's growth strategy has focused on export-led growth from commodities, which relies on foreign exchange revenue from volatile international markets. When prices fall, foreign exchange revenues fall, putting pressure on servicing external debt. With the start of the debt distress, foreign lenders refused desperate pleas from Zambia to suspend interest payments, even for a few months, draining Zambia's foreign cash reserves and finally leaving no option for Zambia, but to default.

IMF Financial Assistance

All three countries consulted the IMF as the last resort to their debt crises, and the IMF showed willingness to offer support under certain conditions. Due to their lower-middle-income status, Ghana and Sri Lanka were treated differently from the low-income country, Zambia. Ghana and Sri Lanka had to agree to restructure their domestic debt before receiving financial assistance, while Zambia had the opportunity to ignore domestic debt restructuring.

Ghana received a US$3 billion Extended Credit Facility (ECF), Sri Lanka a US$3 billion Extended Fund Facility (EFF), and Zambia a US$1.3 billion ECF. Zambia stood out as the only nation among the three to benefit from the HIPC initiative, which enabled the restructuring of debts with senior creditors (multilateral creditors) such as the World Bank and Asian Development Bank. This safeguarded their development goals from being compromised by unsustainable debt and gave access to more robust forms of debt relief. This stark difference marks the 'middle-income trap' as part of the ongoing global debt crisis, as debt-distressed countries requiring additional concessional financing are predominantly of middle-income status, highlighting the need for better mechanisms to address debt distress beyond the traditional measures. Wijewardena (2018) explained that as a lower middle-income country, Sri Lanka lost its access to concessional financing and was stuck in the middle-income trap since it was elevated to the World Bank's middle-income level in 1997.

The Role of China in Debt Restructuring Negotiations

Following a more than decade-long boom in overseas lending and investment, China's Belt and Road Initiative (BRI) has come under pressure, as many recipient (debtor) countries in the developing world experience financial distress. It has already been documented that Chinese state creditors have responded to this crisis by reducing new overseas lending flows to the Global South and by negotiating dozens of sovereign debt restructurings (Horn et al., 2023). According to IMF statistics, China accounted for around 17.6% of Zambia's external debt, and while in Ghana this is only 3%, this debt is collateralized against natural resources such as cocoa, bauxite, and oil. China is Sri Lanka's largest bilateral creditor, to whom Sri Lanka owes around 45% of its bilateral debt by 2022. Because China is such a major bilateral creditor and faces its own domestic debt pressures, this created additional challenges when restructuring debt as part of Sri Lanka's IMF agreement.

Debt servicing payments comprise a significant source of China's government revenue due to its status as a major global bilateral creditor. Hence, China is cautious not to set a precedent for generous and straightforward debt restructuring, as this may open the door to serial defaults on bilateral debts through the Belt and Road Initiative, further exacerbating economic pressures. Considering these issues, as a strategic creditor with less preference for losses, China typically prefers lengthy extensions on debt repayments and resists any reductions in the outstanding principal.

This was the experience of Zambia, who agreed a deal with The Export-Import Bank (Exim) of China agreed to reduce the coupon on its US$4 billion in recognized official claims to 1% for the remainder of Zambia's IMF program. The Zambian agreement with China is to pay interest rates as low as 1% until 2037 and push out maturities on US$6.3 billion in bilateral debt to 2043, representing an average extension of more than 12 years.

After Presidential level discussions, Sri Lanka has confirmed that it has reached a deal with China, regarding US$4.2 billion of debt and it is a positive sign for the second IMF tranche receipt which will help settling arrears owed to multilateral creditors while expediting the debt restructuring process. This may give reassurances to Ghana, who are yet to finalise a debt restructuring deal with China, as it aims for a flexible and cordial response from creditors with the support of the IMF. However, the difficulties faced by Ghana, Zambia, and Sri Lanka when restructuring their bilateral debt with China may ward off other potential defaults in the developing world.

Possible Solutions

Both Sri Lanka and Ghana as lower middle-income countries defaulted before the debt restructuring process. Developing countries defaulting before initiating the debt restructuring process show relatively higher losses for investors and suggest that reaching out to the IMF before a default is crucial to prevent rejection by potential lenders. This situation should serve as a wake-up call for the World Bank, IMF, and other multilateral organisations to evolve mechanisms that address this unprecedented debt crisis and promote better initiatives for economic development. Without effective debt restructuring, relief, or forgiveness, middle-income debtor nations risk falling into a debt trap where economic policies focus solely on servicing unproductive debt repayments to creditors and propping up an unfair global financial system.

As previously indicated, the HIPC is a programme that is only available to low-income nations in order to protect them from unmanageable debt impeding their ability to develop. But medium-income nations, who are trapped in a "middle income trap" with little recourse to concessional financing because of antiquated, arbitrary income classification, are the main players in the current global debt crisis. Under the HIPC, countries can access significantly more lenient restructuring circumstances and receive 100% debt forgiveness. Therefore, these economies might have the right to restructure their debt in order to pay off senior creditors, or multilateral lenders, including the World Bank and Asian Development Bank. However, because they are lower middle-income nations, Ghana and Sri

Lanka are not qualified to restructure their debts to senior creditors. One of China's primary defences against the postponement of common creditor discussions is the restructuring of the debts owing to senior creditors.

The amount of opportunity cost that emerging nations must bear is another significant obstacle brought on by the ongoing debt crisis. Not only does Sri Lanka spend a large portion of its public revenue on servicing its external debt, but it also forgoes expenditure on infrastructure, healthcare, education, and other vital public services that help to reduce poverty and advance economic development. It is imperative that creditors acknowledge and tackle the opportunity cost associated with debt servicing. The government of Zambia managed to negotiate a payment of only US$750 million instead of the initial US$6.3 billion. By lowering debt commitments, Zambia is able to allocate more funds to other development initiatives and encourage sustainable growth, which would strengthen the country's economy and make it better capable of handling debt in the medium and long terms. This was further enhanced by US$188.8 million in funding from the World Bank and US$75 million from the IMF to implement new development projects in Zambia. In the Sri Lankan context, IMF conditionalities influence changes to institutional structures, job opportunities, salaries, tax subsidies, etc. Hence, the Sri Lankan government and the Central Bank of Sri Lanka (CBSL) need to ensure that the transparency and accountability of the IMF program are maintained throughout the procedure and that the maximum level of relief is gained through adjustments to the principal and interest rates during the restructuring process.

Prolonged debt restructuring procedures have resulted in rising debt loads over time, as seen in nations like Zambia. Sri Lanka must move quickly and proactively in its interactions with its creditors in order to avoid incurring further financial losses. In order to protect the country's financial stability and minimise any potential negative economic effects from prolonged debt restructuring, prompt consultations are essential. Being a big creditor to developing nations like Sri Lanka, China has a big part to play. Comprehensive debt restructuring is required to provide governments with the financial room they need to pay down their debt on long-term infrastructure projects, while also making sure they can finance public sector institutions, social spending, and development projects that are vital to the recovery of the economy. Even while nations view IMF aid as a last choice, certain of the IMF's conditionalities—such as its austerity measures—exacerbate vulnerabilities and disparities. Economic development requires access to other sources of concessional finance to meet the opportunity costs of debt in order to overcome the obstacles posed by IMF policies.

Conclusion

Despite historical debt relief efforts, the global response has inadequately addressed the crisis, worsened by the COVID-19 pandemic and the Ukraine conflict. Ghana, Sri Lanka, and Zambia serve as illustrations of this crisis, characterized by policy mismanagement leading to structural imbalances. They grapple with poorly structured tax systems, the middle-income trap, and challenges in restructuring bilateral debts with China, exacerbated by issues like excessive money printing and fiscal mismanagement. All three nations sought IMF assistance, but disparities arose due to Ghana and Sri Lanka's middle-income status. Ghana and Sri Lanka had to restructure domestic debt, while Zambia benefited from the HIPC initiative, safeguarding its development goals. China's role in debt restructuring, particularly through the Belt and Road Initiative, significantly contributes to the challenges faced by Zambia and Sri Lanka. The prolonged debt restructuring process incurs substantial opportunity costs, hindering vital sector investments. The IMF's involvement in conditionalities and the call for transparent, accountable processes underscore the urgency for global mechanisms addressing the unprecedented challenges faced by middle-income nations, aiming to ensure economic development without succumbing to a perpetual debt trap.

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