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The UK's role in tackling the debt crisis facing lower-income countries

Summary

Lower-income countries have been plunged into a debt crisis that is preventing them from addressing the needs of their people or responding to the climate emergency, threatening a wave of political instability. Thirty-two African countries now spend more on paying external debts than they do on healthcare. Twenty-five African countries spend more on external debt repayments than they do on education.

Urgent debt relief is being blocked by the failure of bilateral, multilateral and private creditors to agree on sharing the burden of debt restructurings. The G20 initiatives in response to the crisis have neglected to include robust processes to require banks, hedge funds and oil traders to agree as much debt relief as governments.

The vast majority of lower-income country debt contracts are governed by English or New York law. This means that the UK could pass legislation to ensure that predatory minority creditors cannot undermine collectively agreed restructurings. This would protect countries which have negotiated a debt restructuring from being sued by predatory creditors seeking payment in full, as well as benefit responsible private creditors, allowing them to participate in restructurings without fear of losing out to competitors or reneging on any fiduciary duty to maximise returns for investors.

The UK played a key role in ensuring the success of the global initiative to address the last debt crisis by passing the Debt Relief (Developing Countries) Act in 2010, which ensured that no creditor could sue for more than they would have got if they had participated in debt restructurings agreed under the Heavily Indebted Poor Countries Initiative.

This new debt crisis provides an opportunity for the UK to play a similar global leadership role and rebuild relationships with lower-income country partners, at no cost to the taxpayer. The UK can frame legislation on the global stage as a key element of a wider agenda to strengthen and expand the Common Framework, in order to address the critical financing gaps facing lower-income countries.

The debt crisis

Lower-income countries have been facing increasingly unsustainable debts since the 2008 financial crisis, with debt payments increasing by over 200% between 2010 and 2024, reaching their highest level since the mid-1990s. The economic shocks imposed on lower-income countries from the pandemic have significantly exacerbated the situation. For the 69 countries they assess, the IMF say that 36 are in debt distress or at high risk of being so, up from 17 in 2013.

As a result, resources needed to respond to energy and food price crises, the climate emergency and other locally determined needs are increasingly being diverted to debt repayments. In 2023, African countries spent over 50 times more on external debt than they received in aid from the UK, and 50% more than total aid to the region.

Lower-income countries simply cannot afford to invest in mitigating and adapting to the impacts of the climate crisis, and in preparedness for climate-related disasters such as hurricanes and floods. This means that climate-related disasters will continue to have devastating effects on unprepared communities.

Delays in the Common Framework process

The Common Framework for Debt Treatments Beyond the DSSI was announced by the G20 in November 2020 in response to the growing debt crisis triggered by the pandemic. However, in more than three years since it was established, only four countries (Chad, Ethiopia, Ghana and Zambia) have applied. All have faced long delays in completing restructurings, which are discouraging other countries from applying.

The key reason for the delays has been the reluctance of some private creditors to provide equal levels of debt cancellation to that agreed by government creditors. The participation of private creditors in debt restructuring is critical: 41% of lower-income country external debt repayments are due to Western private creditors between 2023-2029, compared to 33% to multilateral institutions and 12% to Chinese public and private lenders.

The Common Framework requires private creditors to take part on a fair and equitable basis, recognised in the principle of comparability of treatment. Of the four countries which have applied for debt relief through the Common Framework:

- Chad failed to get any debt relief from its main private creditor, UK-based Glencore, and Glencore will be repaid 50% more than government creditors

- Ethiopia has been negotiating for three and a

half years but has yet to reach any debt relief agreements

- Zambia has been negotiating for over three and a half years. In spring 2024 it finally reached a debt relief agreement with bondholders, but one which will see these private companies paid 13% more than governments, including the UK. Other private lenders to Zambia, including UK-based Standard Chartered and Investec, are still to agree to debt relief
- Ghana reached a deal with is bondholders in June 2024 which is comparable to the debt relief offered by governments such as the UK. However, other private lenders, including banks in the UK, have yet to agree to debt relief.

There has been some progress, particularly in Ghana's deal with bondholders. This can potentially provide precedents for faster agreements in the future, incentivising more countries to apply to the Common Framework.

However, Zambia and Ghana have faced long delays in reaching agreements with private creditors: over 18 months in the case of Ghana, and well over 3 years for Zambia. These delays are the result of the lack in the Common Framework of a process to enable deals to happen in a timely manner. The potential for holdout creditors to sue defaulting countries in the English courts creates significant risks and uncertainty both for countries and responsible creditors.

The UK has a unique opportunity to strengthen the legal framework to ensure that future restructurings under the Common Framework treat all creditors fairly, as in the case of the Ghana deal, without the long delays that have been seen up to now. 90% of bonds issued by countries eligible for the Common Framework are governed by English law, including all bonds of Zambia and Ghana, as well as countries like Kenya that need debt restructuring but are nervous of requesting it. By eliminating the risk of vulture fund litigation, UK legislation would provide clarity to negotiations and strengthen the hand of defaulting countries and responsible creditors in agreeing to equal treatment.

There is a precedent for UK legislation to facilitate debt restructuring processes: the **Debt Relief (Developing Countries) Act 2010** prevents a private creditor from suing a borrowing government for more than it would have received if it had taken part in the Heavily Indebted Poor Countries process, the previous major debt relief initiative.

What reform would look like

The UK could pass legislation to incentivise private creditors to take part in debt relief. Possible legislative options include:

a) Replicate the 2010 Debt Relief (Developing Countries) Act by stating that no creditor can hold out for more than government creditors will receive through a Common Framework debt restructuring

b) Initiate a debt payment standstill once a country applies for debt relief, so long as it is negotiating in good faith. This would give debtor countries greater confidence that applying for debt relief is legitimate and protect them from being sued during the negotiation process. Such protection is standard practice for corporate debt restructurings.

Legislation would ideally be passed alongside similar legislation in New York, to minimise the risk of lenders avoiding contracts under English law. Similar proposals are being advanced in New York.

About Debt Justice

We are a UK charity working to end poverty caused by unjust debt through education, research and campaigning.

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About Christian Aid

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