Are we heading for another developing world debt crisis?

Larry Elliott

Western bank loans for projects in Africa were to be paid off via rising commodity prices. At least that was the theory …

Newly built fishing vessels dock at Maputo in Mozambique. Scandal surrounds a $2bn loan for a tuna fishing fleet which has so far generated little or no revenue. Photograph: Adrien Barbier/AFP/Getty Images

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Global interest rates are rising. Poor countries are finding it tough to pay back money borrowed from banks in anticipation of a commodity windfall that never materialised. Stir in some dirty dealing that has seen funds stolen and what do you have? That's right: the makings of another debt crisis.

Poor country debt was supposed to have been sorted back in 2005, the year the Guardian changed from a broadsheet to its Berliner format. Now, 13 years later, we are changing format again and debt is back albeit in a different form. Last time, the focus was on public debt, money that poor-country governments owed to the International Monetary Fund, the World Bank and individual rich nations – and which was mostly forgiven as a result of the Gleneagles G8 agreement in 2005. These days, the issue is private-sector debt and while as yet only a handful of countries – mostly in sub-Saharan Africa – are in serious trouble, the warning signs are there. The IMF and the World Bank both know it.

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Africa needs more private-sector investment because debt relief and western aid have not been enough on their own to bring about economic modernisation. And in the years immediately after the 2008 financial crisis investing in Africa was attractive.

Debt relief and better financial management meant African countries looked more stable. The money creation process known as quantitative easing meant western banks and other financial institutions were awash with funds. Ultra-low interest rates in the developed world meant investors were scouring the world for higher yields than they could obtain at home. Many African countries were also exporters of commodities that were in high demand due to China's rapid growth. Deals were done in which western banks lent money for projects in African countries, with the debt to be paid off by the proceeds of rising commodity prices.

That was the theory. In practice, some ropey deals were done, of which a prime example is the one made in London five years ago between Credit Suisse and Russia's VTB bank to lend $2bn to two companies in Mozambique backed by the government in Maputo.

The money was supposed to be for a tuna fishing fleet and for a navy to protect the boats operating in Mozambique's territorial waters. Credit Suisse and VTB trousered $200m between them in fees, but the loans were never revealed to the Mozambique parliament, the IMF, the financial markets or the Mozambique people.

A report into the deal by the corporate investigations company Kroll concluded that the two companies were inadequately managed and had generated no meaningful revenue. At least a quarter of the money is unaccounted for, with some suspicion that it was spent on military equipment. Jamie Drummond, the director of the development campaign group One says that it is not clear the money ever turned up in Mozambique after being sent to two offshore companies in Abu Dhabi. For sure, though, not a single tuna has been landed. Mozambique has paid a heavy price for defaulting on the debt, which has been sold on to vulture funds. The IMF, miffed at being lied to, has suspended its programme and the loss of financial support has meant public services are being cut. The scandal has rightly attracted the attention of the FBI, which is investigating whether the banks facilitated corruption.

Although this is a particularly egregious example of a deal that has gone badly wrong, Mozambique is not the only country in difficulty. The Jubilee debt campaign said that at the end of 2017, 28 countries were rated as in debt distress or at high risk of debt distress, up from 22 at the end of 2016, and 15 in 2013. The number of countries classified as low risk has more than halved – from 24 in 2013 to 11 currently.

This is not yet a full-blown debt crisis but it could easily become one. The commodity boom is over, China is growing less rapidly and the cost of servicing loans taken out in foreign currencies is becoming more expensive as interest rates rise in the developed world.

To lessen the threat of a rerun of what happened during the debt crisis of the early 1980s (when the windfall gains from oil producing countries were recycled into loans to Latin America) action should be taken now.

At the international level, there needs to be better monitoring of how vulnerable countries are to rising debt. There is a certain complacency about the fact that most of the current debt is owed to the private sector; history shows that ultimately it will end up as public debt.

For years, there has been a campaign for a bankruptcy system that would treat countries like companies. This, though, has been relentlessly opposed by countries such as the US and the UK, where the powerful financial sectors make money out of bad debts.

Not only should western governments back a sovereign debt bankruptcy scheme, the should also insist that all new debt include clauses that offer protection from vulture funds, companies that seek to make a profit on debt they have bought on the cheap.

Developing countries need to do more – a lot more in some cases – to tackle corruption, but so do the banks. One idea is a Transparent Lending Covenant, under which banks would make the full details of loans public. Interestingly, the idea is being pushed by Tidjane Thiam, who took over as chief executive of Credit Suisse after the Mozambique loan was agreed. It's not hard to see why. The tuna deal stank in every way. It was bad for Mozambique, bad for the City and bad for Credit Suisse.

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