



# The impact of Coronavirus (COVID-19) and the global oil price shock on the fiscal position of oil-exporting developing countries

30 September 2020

The double blow of Coronavirus (COVID-19) and the oil price shock is hitting oil-exporting developing countries particularly hard at a time when the fossil fuel industry is facing a process of structural decline. Although some countries might weather the current crisis on the back of sovereign wealth funds or relatively low public debt levels, this will not be the case for the majority of fragile oil-exporting countries, many of which are resource dependent and were already grappling with high levels of debt and multifaceted economic and social fragility before the present crisis. Some countries may find themselves entering a spiral of unsustainable borrowing on the back of the current turmoil, as oil-exporting developing countries have experienced an increased reliance on short-term and expensive non-concessional private borrowing in recent years, a significant proportion of which is backed by oil collateral. A timely and coherent response is needed, encompassing both concessional lenders and private financiers, to create fiscal space in oil-exporting developing countries, reduce the risks of unsustainable debt, corruption and illicit financial flows (IFFs), and catalyse a transition to a cleaner and more sustainable future.



## **Fragile, oil-exporting developing countries will be hard hit by the consequences of the Coronavirus (COVID-19) pandemic, and the opportunity exists to assist these countries to transition towards a low-carbon, more diversified and resilient economic future**

Countries that are net exporters of oil are experiencing an unprecedented double blow; a global economic contraction driven by the COVID-19 pandemic and an oil market collapse with the benchmark price for United States crude oil, the West Texas Intermediate, briefly going negative for the first time in history (in April 2020). Based on an oil price of USD 30 per barrel, the International Energy Agency projects that oil and gas revenues for a number of key producers will fall by between 50 to 85% in 2020, compared with 2019, yet the losses could be larger depending on future market developments (IEA, 2020<sup>[1]</sup>). The present crisis is happening in the wider context of a structural decline in the market for fossil fuels, driven by a commitment towards decarbonisation by a number of countries as well as the wider technological changes that are gradually making renewable energies the preferred energy option (Lahn and Bradley, 2020<sup>[2]</sup>; Elgouacemi et al., 2020<sup>[3]</sup>).

The current crisis is expected to hit oil-exporting developing countries particularly hard, for two reasons:

- First, the dependence of many of these countries on a single commodity for their exports and revenues renders them extremely vulnerable to market volatility. Although the largest share of commodity-dependent countries<sup>1</sup> globally are in sub-Saharan Africa, oil and gas make up the majority share (over 60%) of total merchandise exports in a range of developing countries, including Algeria, Islamic Republic of Iran, Iraq, Libya, and Timor-Leste (UNCTAD, 2019<sup>[4]</sup>). In the period 2011-2013, the proceeds of crude oil sales by the top ten sub-Saharan Africa oil-exporting countries amounted to more than 50% of their combined government revenues and more than 75% of export earnings (Gillies, Guénat and Kummer, 2014<sup>[5]</sup>). Indeed, UNCTAD reports that despite the global focus on energy transitions, and repeated calls to diversify their economies, some countries are more concentrated on commodities than ever (UNCTAD, 2020<sup>[6]</sup>). Other developing countries are still looking to expand their oil sectors as a source of future economic growth.
- Second, many of these countries were in vulnerable positions already before the current crisis, and further deterioration may exacerbate existing fragilities. Over half of low and lower middle-income countries dependent on oil and gas for their exports and revenues are classified as 'fragile'.<sup>2</sup> Decision makers in resource-rich countries have frequently struggled to translate resource wealth into poverty reduction and sustainable development, performing poorly across a number of development metrics, including on economic growth (Sachs and Warner, 1995<sup>[7]</sup>), democratic governance (Ross, 2012<sup>[8]</sup>), and conflict prevention (World Bank, 2011<sup>[9]</sup>). Although variation amongst countries exist, oil-exporting developing countries frequently score 'weak', 'poor', or 'failing' on metrics for good governance (NRGI, 2017<sup>[10]</sup>), with decision makers often having been found to overspend on consumption and wasteful infrastructure projects while neglecting priority sectors such as education and health (de la Croix and Delavallade, 2009<sup>[11]</sup>). The result is that social services in oil rich developing countries are often deficient and fail to cater to the most vulnerable populations. Although pockets of efficiency in the form of more capable and resourced state institutions often do exist in these countries, these institutions have tended to focus on the extraction of additional resources rather than on providing public goods that enhance the collective welfare (Hertog, 2010<sup>[12]</sup>; Soares de Oliveira, 2007<sup>[13]</sup>).

In the context of these mounting pressures, opportunities exist for official development assistance (ODA) and particularly blended finance to be deployed to assist oil producing developing countries to transition towards a cleaner, more diversified and resilient future.



## With Coronavirus (COVID-19), an already volatile market has reached a flashpoint, accentuating the drawbacks of high dependence on non-renewable resources

The global oil price has become increasingly volatile<sup>3</sup> since the 1970s. The advent of *futures* trading brought about greater speculation in the market. Increasing demand in developing countries, as well as rising supply led by new production in the United States, have additionally contributed to fluctuations in recent years. Yet the fallout of the current COVID-19 pandemic has taken everyone by surprise, pushing oil prices to a new low. Such was the turmoil that the benchmark for US crude oil fell into negative territory for the first time ever in late April, and the price of Brent Crude, the benchmark for Europe and the rest of the world, also fell significantly (Figure 1).

Although prices have since recovered, it is unlikely that there will be the same buoyancy in prices as witnessed following the 2008 global economic recession. Aided by technological advances and the rapidly decreasing cost of renewable energy, a growing commitment towards decarbonisation, and waning investor appetite, the fossil fuel industry is faced with the prospect of structural decline (Lahn and Bradley, 2020<sup>[2]</sup>). In the current context, it is plausible that oil prices may not fully recover to the levels seen pre-COVID-19 as the world transitions to cleaner forms of energy (BNP Paribas, 2020<sup>[14]</sup>). These stark projections underscore the perils of over-reliance on fossil fuels in resource-rich developing countries, and present an opportunity to place decarbonisation at the centre of recovery agendas.

**Figure 1. Oil price developments, 2000-2020**



Note: Price developments crude oil in USD dollars, from 2000 until April 2020.

Source: BBC (2020<sup>[15]</sup>), *BBC Coronavirus: Oil price collapses to lowest level for 18 years*, <https://www.bbc.com/news/business-52089127> (Accessed 24 Sept. 2020).

Current conditions in the oil market are due to a number of factors impacting both supply and demand;



- On the demand side, containment measures and economic disruptions related to the COVID-19 outbreak have led to a slowdown in production and mobility worldwide, producing a significant drop in global demand for oil. In April, the International Energy Agency (IEA) estimated that demand was down 30% compared to a year ago, reaching a level not seen since 1995 (IEA, 2020<sup>[16]</sup>). Faced with a significant glut in demand, producers were scrambling for facilities to store surplus crude oil, with stocks reaching an all-time high in June 2020. Since then, the pressure on storage capacity has eased somewhat as the effect of production cuts takes hold and the market starts to rebalance (IEA, 2020<sup>[17]</sup>).
- On the supply side, arrangements that have historically allowed oil producing countries to respond collectively to drops in demand have so far not been sufficient to curb production, signaling the reduced traction of multinational solutions in recent years. Just as the global impact of the COVID-19 crisis was becoming apparent in March 2020, the members of the OPEC+ alliance (OPEC members plus other oil producers amongst them the Russian Federation) failed to extend their agreement to cut production, resulting in some producers, including Saudi Arabia and Russia briefly flooding the market (Blas and Pismennaya, 2020<sup>[18]</sup>). With oil demand starting to collapse as lockdowns took hold, an agreement to cut production was eventually reached by OPEC+ on 12<sup>th</sup> April 2020. The agreement, which involved cutting the collective daily output of these countries by almost one quarter for the next two months, represented the largest cut in the history of the producer cartel (Brower, 2020<sup>[19]</sup>). Yet, the rapidly evolving crisis and its impact on oil demand, makes it unclear whether the intervention will be sufficient to rebalance the market as soon as the OPEC+ countries had anticipated or if at all.

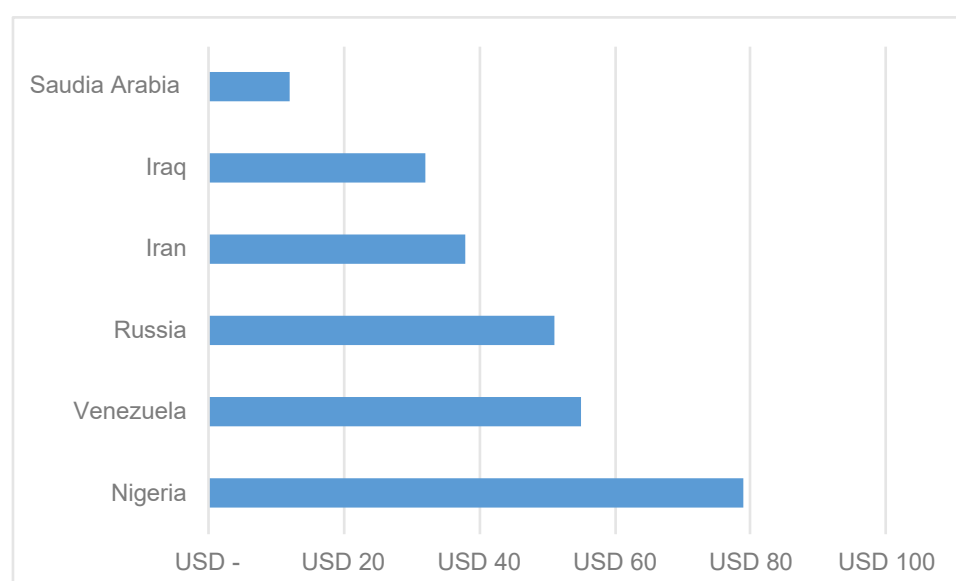
### **The oil price fall will aggravate existing vulnerabilities in oil-exporting developing countries, and could push countries towards a tipping point of a macro-fiscal crisis, and social and political unrest**

Many oil producing developing countries are non-diversified, sector-dependent economies, *with oil contributing the majority of their exports and government revenues*. The current fall in oil prices is limiting the ability of these countries to respond to the multidimensional domestic pressures produced by COVID-19, at a time when more money is needed to finance service delivery, mitigate health risks and ease macroeconomic pressure. In March of this year, the IEA estimated that key oil producing countries, including Iraq, Nigeria and Angola, would likely see a drop in their net income for 2020 of 50%-85% compared with 2019 (IEA, 2020<sup>[1]</sup>). This would amount to the lowest income received from the sector by these countries in over two decades, and the IEA has cautioned that revenues could fall further depending on future market conditions. Accentuating the challenges, there has been a decline in investor appetite for fossil fuel projects, and with the onset of COVID-19, companies have been shelving new projects and permanently shutting-down high-cost operations in response to the oil price collapse (IEA, 2020<sup>[1]</sup>). Smaller or new producer countries are expected to be hardest hit by the drop in discoveries and investments (Petroleum Economist, 2020<sup>[20]</sup>).

The scale of the current oil price shock will vary by country depending on their export concentration, as well as their estimated oil reserves and cost of production. For example, Saudi Arabia and Iraq can produce oil relatively cheaply, not needing a price of more than approximately USD 30 per barrel to *break even*, while countries like the Bolivarian Republic of Venezuela (“Venezuela”) and Nigeria depend on a price of over USD 50 per barrel (Statista Research Department, 2020<sup>[21]</sup>) (Figure 2).



**Figure 2. The breakeven oil price, USD per barrel, for a selected number of countries (2015)**



Note: Data on the breakeven oil price is only available for a limited number of countries.

Source: The Economist (2016<sub>[22]</sub>). Sale of the century? <https://www.economist.com/briefing/2016/01/09/sale-of-the-century> (Accessed 23.09.2020)

Low cost oil-producers are anticipated to be able to continue producing for a substantial amount of time even in a low-carbon scenario. For countries with higher cost reserves, discontinuing production might be necessary. The current crisis presents new incentives and brings an urgency to the efforts of countries to halt or reverse costly fuel subsidies to free up fiscal space and stem pollution, and to diversify towards less carbon-intensive industries (Pezzini and Halland, 2020<sub>[23]</sub>; OECD, 2018<sub>[24]</sub>). Yet tighter public finances are also expected to limit the funds available for public services and infrastructure projects, and changing gears will require carefully calibrated contextual approaches. At the onset of the COVID-19 crisis, foreign exchange reserves were considered high by historical standards but these are expected to be insufficient to meet the multifaceted demands that developing countries now face (UNCTAD, 2020<sub>[6]</sub>).

The longer term systemic issues that characterise many oil dependent developing countries – including their tendency to direct money away from priority sectors such as health in favour of rent-generating institutions (Karl, 1997<sub>[25]</sub>) – will also impact on their resilience capacities. Historically, many resource-rich countries have exercised limited fiscal prudence and heavily invested in the extractive sectors to the exclusion of others (Corden and Neary, 1982<sub>[26]</sub>). Diversification efforts are often also stymied or complicated by factors such as poor conditions for private sector growth, weak competitive capabilities and entrenched political interest in fossil fuel production activities (Lashitew, Ross and Werker, 2020<sub>[27]</sub>; IEA, 2018<sub>[28]</sub>; Elgouacemi et al., 2020<sub>[3]</sub>).

As has been the case in many fragile developing countries since independence in the 1950s and 1960s, the stability of resource-rich fragile economies is often based on political power-sharing arrangements among elites political factions, underwritten by rent creation and distribution mechanisms (Cooper, 2002<sub>[29]</sub>). In other words, where countries are rich in resources, resource rents tend to provide the backbone for distributive regimes (Soares de Oliveira, 2007<sub>[13]</sub>; de Corral and Schwarz, 2013<sub>[30]</sub>). As a result, the sharp contraction of financial inflows from the oil sector that many countries are now experiencing has the potential to exacerbate existing fragilities by sparking political instability and social unrest. Although patterns of rent distribution can take different forms – such as fuel subsidies targeting the middle-class in Nigeria and Angola, direct government contracting in South Sudan, and social distribution programmes for the poorest in Venezuela – the common trend is that the political elites of oil-exporting





countries recurrently distribute rents in strategic ways, to those who are seen as crucial to consolidating their position in power (Barma et al., 2011<sup>[31]</sup>). A fall in distributive power resulting from the structural decline in the demand for oil and exaggerated by COVID-19 could make it harder for decision makers in these countries to keep competitive constituencies happy, generating increased risks of domestic upheavals and instability. Whether the reduction of rent distribution capabilities *directly* impacts upon the larger populations in these countries depends upon how inclusive such distributive schemes were before the crisis. Should oil rents dry-up, social unrest and conflict could follow as a result of the breakdown in political power-sharing arrangements.

Many oil-exporting developing countries are experiencing intensified capital outflows due to heightened economic uncertainty and perceived risks of political upheavals. Known as a ‘flight to safety’, investors are scrambling to move their assets to benefit from the security and stability of advanced economies. Banks in offshore financial hubs have noted a significant rise in activity so far in 2020 (Williams, 2020<sup>[32]</sup>), and there has been a growth in demand for *golden visa* schemes, which allows wealthy individuals trade investments for residency (PRNewswire, 2020<sup>[33]</sup>). Oil exporting countries have historically proven particularly vulnerable to capital flight, accounting for 55% of total outflows from Africa between 1970 and 2015 (Ndikumana and Boyce, 2018<sup>[34]</sup>). Although money that finds its way across borders *illegally* is trickier to measure, existing literature warns of increased risks of illicit outflows under current conditions, where large amounts of money are being moved and oversight and audit functions are overstretched (OECD, 2020<sup>[35]</sup>). With the extractives sector particularly susceptible to corruption – the OECD Foreign Bribery Report shows that one out of five foreign bribery cases comes from the extractive sector, by far the highest of any industry (OECD, 2014<sup>[36]</sup>) – illicit outflows are expected to increase among oil exporting countries during the current crisis.

### **Debt risks that had already increased before the crisis due to the particular profile of oil-exporting developing countries are expected to worsen**

Many oil exporting countries had high debt levels at the onset of the COVID-19 pandemic, having responded to the lower commodity prices from 2014 with increased borrowing. From 2013 until the end of 2018, oil-exporters’ median debt-to-GDP grew from 31 to 54%, significantly faster than that of their resource-poor counterparts. Angola and the Republic of Congo saw their debt levels more than double during the five-year period, while the debt level of Equatorial Guinea grew five times larger (Calderon and Zeufack, 2020<sup>[37]</sup>). Cameroon, Chad, and the Republic of Congo, and Ecuador approached the International Monetary Fund (IMF) before the crisis for programme financing and/or lines of credit, and Angola, Equatorial Guinea and Gabon had already entered into IMF’s Extended Fund Facility, demonstrating that the difficulties these countries faced in self-financing even in times of higher oil prices (IMF, 2020<sup>[38]</sup>).

The risks of heightened debt faced by these countries is closely tied to the changing composition of their debt portfolio, away from traditional concessional sources of financing, from multilateral and bilateral partners, towards non-Paris Club governments and private creditors (OECD, 2020<sup>[39]</sup>). In the case of commodity exporters in sub-Saharan Africa, debt held by non-Paris Club countries including the People’s Republic of China, accounted for 90% of total bilateral debt at the end of 2016 (Calderon and Zeufack, 2020<sup>[37]</sup>). Yet, the largest share of long-term public debt in low-income countries is held by private creditors (bondholders, banks and commodity traders), amounting to 41% in 2018 (Watkins, 2020<sup>[40]</sup>). In some oil-exporting countries the situation is more extreme, like in Chad, where 49% of total debt is to private lenders (see Box 1).

What distinguishes loans from private creditors and non-Paris Club governments from those of the traditional concessional lenders is that financing from these sources typically comes at shorter maturities and higher interest rates, translating into costlier external debt servicing. Since 2010, the cost of servicing



Africa's total public external debt has increased by about 4% (Calderon and Zeufack, 2020<sup>[37]</sup>), an increase driven by the higher cost of private sector loans. Private creditors account for 55% of the continent's external interest payments, or USD 6 billion, in 2016, compared to 28% to bilateral and 17% to multilateral financiers (Jubilee Debt Campaign, 2018<sup>[41]</sup>).

Another feature of many of the new loans extended by non-Paris Club governments and private sector actors is that they are *resource-backed loans*, where the repayment is made in the form of natural resources, often times crude oil, as opposed to traditional loans, which are repaid in cash. These loan agreements often entail repayment in kind, based on volumes of natural resources and where the quantities are valued at an agreed benchmark price. Collateralised loan agreements with commodity traders as well as bilateral lenders in both Chad and Angola followed this model. Alternatively, repayment terms might be set in value terms or equivalent where the resource acts as the source of the income revenue stream or serves as collateral (Mihalyi, Adam and Hwang, 2020<sup>[42]</sup>).

The IMF reports that collateralised loans have been on the rise in low-income countries (LICs) in recent years, amounting to approximately 20% of commercial debt issuance in 2016-2017 (Imam, 2019<sup>[43]</sup>). Although beneficial for countries in lieu of more conventional sources of financing (such as Eurobonds and unsecured bilateral credits), collateralised lending agreements come with particular risks. For one, the markets for such loans are often uncompetitive, and the few actors who offer such loans typically do so through private rather than public channels. Commodity trading firms have become increasingly active in this space in recent years, with one trader reporting a 600% increase in collateral loan activity between 2013 and 2019 (Trafigura, 2020<sup>[44]</sup>). Risks appear to be significantly elevated in the case where these types of loans are extended by commodity trading firms, given that they often come both with shorter maturity and higher costs (Mihalyi, Adam and Hwang, 2020<sup>[42]</sup>).

Another of the risks associated with resource-backed loans is that they are often more difficult to restructure. A number of these loans are held by creditors who are not part of the typical forums for debt rescheduling, such as the Paris Club or the Institute of International Finance. The presence of resource backed loans might also complicate the co-ordination of creditors and therefore the debt resolution processes, as these loans are often treated as more senior to other, unsecured debt (Mihalyi, Adam and Hwang, 2020<sup>[42]</sup>). To the extent that resource-backed borrowing is seen as negatively impacting a country's ability to service future loans, countries that have heavily subscribed to these type of loans might also find that their future access to concessional sources of financing is jeopardised (Imam, 2019<sup>[43]</sup>).

Collateralised loan agreements are characterised by their greater opacity, including lending terms and fees that are often undisclosed. Resource-backed loans are often excluded from countries' official debt statistics or databases, and only more recently have these type of loans been brought on the agenda by initiatives like the Extractive Industries Transparency Initiative (EITI). One explanation for the lower degree of oversight and accountability surrounding collateralised lending agreements is that both governments and state owned enterprises, including national oil companies, may be empowered to borrow, with or without an explicit state guarantee or Parliamentary approval. A recent report by the Natural Resource Governance Institute (NRGI), found that of all the resource-backed loans identified in sub-Saharan Africa and Latin America, in as many as 40% of the cases, the borrower was a SOE (Mihalyi, Adam and Hwang, 2020<sup>[42]</sup>).

In some cases, lenders contribute to the greater opacity surrounding collateralised loan agreements. Non-Paris Club and private creditors are typically not subject to the same levels of scrutiny or safeguards that govern other lenders. For instance, there is no specific regulation governing the lending practices of commodity traders, who are the holders of many of the resource-backed loans extended to the countries in question over recent years. For the most part, the financial institutions who regularly help traders finance these private loan arrangements, only extend their risk analysis to their counterparty, the trading company, with a limited view on the ultimate borrowers in the oil-producing country and the country's fragility landscape.



The opaqueness of these complex loan agreements means that, amongst other things, the sustainability of the country's public debt or overall fiscal position becomes harder for national governments (and their partners) to grasp. In the case of the Republic of Congo, the country's official debt-to-GDP ratio had to be adjusted upward by over 50% overnight in 2017 after the IMF learnt of debt owed to commodity traders Glencore and Trafigura, which had previously been unknown (White, 2019<sup>[45]</sup>). The risk is therefore high that countries might continue to borrow using these type of collateralised instruments, until they arrive in a position where they have difficulties servicing them, i.e. over-borrowing. The latter scenario played out in the case of the Republic of Congo in 2017. The country only revealed the extent of its resource-backed loans (70% of total public external debt) once it was forced to seek assistance from the IMF. At this stage, the country's debt servicing burden, which was estimated to reach an average of USD 1.5 billion (about 12.5% of GDP) between 2019 and 2022, had become unmanageable. A large part of Congo's debt servicing was on debt owed to commodity trading firms (IMF, 2019<sup>[46]</sup>).

That oil-backed loans are hard to oversee and are typically off-budget – even if they end up being the state's responsibility when crisis strikes – significantly adds to the danger that these funds might be misappropriated or diverted. On several occasions, including in the Republic of Congo and in Angola, corrupt intermediaries have been linked to the securing of these deals. There are instances where the loans cannot be accounted for, as was the case during a UN investigation in South Sudan. The investigation detailed how the Government of South Sudan had received resource-backed loans totalling just under USD 400 million from commodity traders in 2017 and 2018, some of which was later linked to arms purchases (Mednick, 2019<sup>[47]</sup>). The greater discretion that these loans offer to the people in positions of authority are of course part of their appeal for borrowing countries. Research also shows that resource-backed loans are particularly popular amongst poorly governed states (Mihalyi, Adam and Hwang, 2020<sup>[42]</sup>).

## **Despite the risks involved, oil-exporting developing countries can be expected to try to borrow their way out of the current crisis**

In the context of a progressive structure decline in the demand for oil, oil-prices might never recover to its pre-crisis levels, and many oil-exporting developing countries will need to brace for long lasting trade and fiscal deficits, which could produce a long-term decline in GDP (IMF, 2020<sup>[48]</sup>).

Diversification away from fossil-fuel income and carbon-intensive industries is a *sine qua non* for long term recovery. Yet, in the short term, oil-exporting developing countries, like other countries, are likely to turn to borrowing in an effort to manage the current multidimensional crisis and shrinking fiscal space. The list of over 90 countries that have so far requested emergency financing from the IMF include oil-exporting countries like Nigeria, Iran, and Ghana (IMF, 2020<sup>[38]</sup>). In April, the IMF stated that it was responding to this unprecedented number of calls for emergency financing with USD 100 billion in emergency loans to low-income countries, in addition to making available USD 1 trillion in lending capacity. The IMF also expanded its *Catastrophe Containment and Relief Trust* (CCRT), a donor-funded programme of debt relief for low-income countries. The World Bank similarly announced that it would deploy up to USD 160 billion in financing, including over USD 50 billion of IDA resources on grant and highly concessional terms (World Bank, 2020<sup>[49]</sup>). Still, concessional financing is likely to be insufficient and financing from official and private sector creditors will be needed to fill the financing gap.

In line with recent trends, and in the absence of viable alternatives, oil-exporters are expected to turn to private creditors and non-Paris Club governments to address their financing gaps. Yet, access to international capital markets is severely curtailed, reducing the scope for rolling over maturing liabilities. Most financiers are also expected to favour safer assets and therefore not be willing or capable to take on the high risks that these oil-exporting developing countries present (IMF, 2020<sup>[50]</sup>). The credit rating agency S&P Global downgraded a number of high-profile sovereign ratings in March 2020, including Nigeria,





Mexico, Angola, Ecuador and Oman, following the fall in oil prices, in turn impacting on the type of financing they can access and on what terms. Nigeria's credit rating was downgraded by the credit rating agencies to what they refer to as "junk" territory, while Angola and Ecuador are considered by the same agencies to be in the "default danger zone" (Jones, 2020<sup>[51]</sup>).

Given the likely increased demand for financing, commodity trading firms may seek to position themselves favourably vis-à-vis producer countries, possibly by extending financing in return for access to fossil fuels, potentially locking these countries into an unsustainable industrial future. Producer countries and their national oil companies can be expected to be harder pressed to find buyers in the current market environment. Commodity trading firms, on the other hand, have well-developed risk management capabilities and storage facilities (although these are expected to reach saturation point in the very near future), giving them significant leverage vis-à-vis producers. Under these conditions of tightening fiscal liquidity, the risks are high that oil producing developing countries contract non-commercial loans from private creditors on suboptimal terms and under conditions that leave scope for corruption and illicit financial flows.

Given that oil price may never fully recover and that oil reserves could become stranded, many oil producing developing countries face an increasingly uncertain future. A timely and coherent responses is needed: one that creates fiscal space; reduces the risks of unsustainable debt, corruption and illicit financial flows; and builds resilience through cleaner and more diversified industrial policy. Whether through ODA, blended finance or private sector investments, this is the moment to catalyse a transition to a cleaner and more sustainable future.



### Box 1. Oil-backed loans to Chad: Taking cues from the past

The case of Chad exemplifies some of the issues involved in contracting oil-backed loans. Plagued by years of civil strife and extreme levels of poverty, Africa's tenth biggest oil exporter bet big on the surge in oil prices after 2010. The country contracted large oil-backed loans in 2012-2013, in an effort to kick-start its economy and to gain greater national control over the oil sector. Chad turned to the world's largest commodity trader, Glencore. Glencore gained the exclusive right to buy all the oil that Chad's national oil company collected through production or royalties at a significant discount. The revenue stream from these sales constituted 16% of total government revenues. In return, Glencore provided two rounds of prepayments, a form of resource-backed loan, of USD 600 million and USD 1.45 billion, equal to 4.5 % and 10 % of Chad's GDP at the time (ITET, 2017<sup>[52]</sup>). Although the terms of the deal were initially unknown, subsequent restructurings revealed that the loan was initially four years and had an interest rate of around LIBOR +6.6-7.5 %, significantly higher than the rate charged on average resource-backed loan provided by Chinese policy banks to these governments, which typically lie around 1-3% (Mihalyi, Adam and Hwang, 2020<sup>[42]</sup>).

Resource-backed loans like prepayments are often considered relatively safe from the side of the creditor, who use the natural resources as collateral to mitigate the risk of payment difficulties. In the case of Chad, the debt was serviced through direct deduction from the proceeds of government-oil cargoes sold by Glencore. It is more difficult to hedge against the risk inherent to these loans on the side of the countries, as Chad discovered after it had contracted the loans.

When oil prices dropped in late 2014 by as much as 54%, the net proceeds of Chad's biggest oil project no longer covered the debt service. The government approached Glencore for rescheduling, and in December 2015, the resource-backed loans with a total value of USD 1.45 billion were rescheduled on non-concessional terms (IMF, 2017<sup>[53]</sup>). While the maturity of the loans was extended from four to over six years, the imposition of restructuring fees meant that the present value of the debt increased. Soon after the initial rescheduling, it became apparent that it was insufficient and that Chad still struggled to meet budget needs as debt consumed nearly all of its oil profits, the country's main source of revenue. In 2018, a second restructuring deal for the still more than USD 1 billion loan was struck, extending the majority of the loan until 2030 (Bloomberg, 2017<sup>[54]</sup>). Although the restructured loans rendered more favourable terms to the country, and better provisioned for the volatility in oil prices, the repayment of the prepayment agreement will continue to consume significant parts of Chad's oil revenues for years to come. With oil constituting about half of government revenues and 90% of exports, this debt servicing will without doubt limit the resources available to bring the country closer to achieving the SDGs.

## How to help mitigate the challenges and risks facing oil-exporting developing countries and help build resilience

As the previous sections have shown, the current crisis will hit oil-exporting developing countries particularly hard due to, amongst other factors, their high resource dependence, which exposes them to significant market volatility and climate risks, as well as their existing socioeconomic and political fragilities. Several of these countries entered the crisis with already high debt levels and are now experiencing a double blow due to the global economic contraction fuelled by the COVID-19 pandemic and significant decline in oil prices. **Going forward, the short-term focus will be on freeing up fiscal space in transparent and accountable ways, avoiding a downward debt spiral, and ensuring that the recovery is based on a cleaner, more diversified and sustainable future.**

Several measures could improve country macro-fiscal space without weakening discipline:



- **Help countries ease the burden of external public debt servicing.** Following the joint call by the IMF and the World Bank on 25 March 2020 and backing from G7 finance ministers and central bankers in their statement of 14 April 2020, G20 countries on 15 April 2020 agreed to a “debt service standstill”, a time-bound suspension of debt service payments for the poorest countries that request forbearance (G20, 2020<sup>[55]</sup>). This moratorium was an important step forward to provide immediate liquidity, however, ultimately a moratorium only defers the problem as it does not waive the repayment of the principal debt. Moreover, if, as is likely, the shock is not transient and the temporary debt standstill proves insufficient, the moratorium could be extended to 2021. However, for the longer run, efforts beyond the Debt Service Suspension Initiative will be necessary. Such efforts, to be pursued on a country-by-country basis, could include the writing down of debts and/or the conversion of existing loans into new instruments.
- **Ensure that private creditors participate in the moratoria.** Despite the G20 calling for the participation of private creditors in the current debt moratorium (G20, 2020<sup>[55]</sup>), this has not yet been agreed. The Institute of International Finance (the main forum for co-ordinating private creditors) has recommended that private creditors voluntarily grant debt payment forbearance for countries eligible to the standstill for a fixed period of time and on request – similar to what the official sector has announced (Institute of International Finance, 2020<sup>[56]</sup>). As of August 2020, no requests to private lenders had been made. Reaching an agreement amongst private creditors on a suspension of debt service payments for interested countries is important, given that debt to private creditors makes up a significant part of total external debt and that this debt is more burdensome for debtors given its shorter maturities and higher interest rates. The IMF estimates that USD 16 billion in debt servicing is due to private creditors from African countries in 2020, which is projected to constitute more than 10% of the fiscal revenues of these countries (IMF, 2020<sup>[50]</sup>).
- **Include commodity trading companies in debt suspension discussions.** An agreement between private creditors to suspend debt service payments should also include commodity trading companies, given their growing importance as lenders to oil-exporting developing countries. This group of companies does not currently participate in the main forum for co-ordinating the stance of private creditors, the Institute of International Finance, which primarily represent the financial industry. Commodity traders are also not part of the recently launched Africa Private Creditor Working Group, established to represent private creditors and assist in co-ordination with African governments and other debt providers. Through existing connections with the commodity trading industry and insights into that industry’s role as financier (as evidenced by ongoing research in OECD Development Co-operation Directorate on illicit financial flows and commodity trading<sup>4</sup>), the OECD and its member states could leverage their roles to engage commodity trading firms to participate in co-ordinated discussions with private creditors.

In the current scenario borrowing is expected to increase. Given the composition of countries’ debt portfolio before the crisis, the expectation is that further credit provided to oil-exporting countries will arrive in the form of collateralised debt. Thus, it will be important to support ongoing efforts to strengthen countries’ debt management capacity and institutions, such as the joint World Bank-IMF Debt Management Facility.

**To enhance the sustainability and reduce the risk of corruption or illicit financial flows, loan arrangements could include:**

- **Enhanced due diligence.** Enhancing due diligence would mean that lenders, including private creditors such as commodity trading firms (together or without the participation of financial institutions), consider the overall debt profile of its counterparty as part of their assessment of a country’s creditworthiness. Building on the Institute for International Finance’s Voluntary Principles for Debt Transparency, commodity trading firms can contribute to lowering the risk of over-borrowing by giving due consideration to the debt sustainability of borrowers (Institute for International Finance, 2019<sup>[57]</sup>). Where lenders find reasonable grounds for doubt as to debt



sustainability, they would be encouraged to engage with the authorities on this issue, and to communicate with the IMF or the World Bank who could factor this into their Debt Sustainability Analysis. Such exchange of information could take place on a permanent platform established for this purpose, and could be hosted by the OECD or another relevant institution. It is important that the institutional system is in place to centrally collect such data in a way that protects commercial confidentiality.

- **Debt distress clauses.** To help limit the unsustainable and harmful accumulation of debt, new loan agreements could include specific clauses that trigger renegotiation, for instance where oil price shifts occur up or down by some agreed margin, or as a result of pandemics, and natural disasters. In considering such proposal, it would be important to offset the risk that such a debt distress clause lead to higher financing costs for countries, given it potentially increases the risk borne by creditors.
- **Broaden the reach of debt tracking mechanisms.** Obligations to report on commodity-backed loan arrangements including where these are issued by national oil companies and held by commodity trading companies should be included as part of the World Bank Debtor Reporting System (DRS) database, as recommended in the January 2020 IMF and WB G20 note on “Public Debt Definitions and Reporting in LIDCs”. Information on collateralised debt agreements is generally scarce, and has shown to significantly undermine efforts to gauge the true debt and fiscal positions of borrowing countries. Greater disclosure of commodity-backed loan agreements would build on the ongoing work of Extractive Industries Transparency Initiative (EITI), which includes disclosures of resources-backed loans in a commercially sensitive manner.

Besides managing the immediate fiscal crisis and risks of unsustainable debt, corruption and illicit financial flows, building future resilience in oil-exporting developing countries implies investing in cleaner energy and industrial policies and diversifying these economies away from a dependence on carbon-intensive industries.

***Seizing the opportunity of a green recovery, development finance (ODA in particular), could assist oil dependent countries to catalyse their transition in at least two ways:***

- **Help oil producing economies plan for and transition towards cleaner more diversified energy and industrial policies.** Although the current crisis provides the impetus for oil dependent economies to diversify towards a cleaner and more sustainable development policies, there are no blue prints to for this. Each country will require a carefully calibrated national transition plans that meaningfully accounts for the opportunities and constraints (including in the areas of skills, technology and resources) of the given context etc. The “Building Back Better” approach, advocated by the OECD (2020<sup>[58]</sup>), implies developing alternative and sustainable supply chains, whether from the agricultural sector or manufacturing. Opportunities to access the skills, knowledge and resources of donor countries, particularly oil producers, delivered through institutional twinning arrangements, other forms of capacity building, or analytical support, is welcome and could build on the considerable wealth of knowledge and experience built up by the IFIs (e.g. the World Bank Group) in these areas.
- **Leverage ODA to mobilise additional development finance to catalyse diversification and ensure a green recovery.** Established oil-producing countries can be expected to try to accelerate economic diversification in a response to the fall outs of COVID-19 and the ongoing structural decline in fossil fuel use and investments. Yet they are also expected to face difficulties in attracting high quality financing as investors are moving their assets to safer havens. As trillions of dollars are invested in low-yielding financial instruments, and as investors look for environmental and social returns in addition to financial gains, there is an opportunity for global policy makers to encourage alignment of development finance with the SDGs. Strengthening standards, providing



effective tools for alignment and risk sharing, and levelling the playing field through adequate regulations could assist countries in mobilising financing to support cleaner and more diversified activities. In addition to being a direct source of financing for countries transitioning towards cleaner, more diversified energy and industrial policies, ODA can help bridge the financing gap by aiding countries to mobilise additional financing from commercial sources through for instance blended finance arrangements (i.e. hybrid ODA investments) (OECD, 2020<sup>[59]</sup>).

For those countries still actively engaged in oil and gas production activities, the OECD Development Assistance Committee (DAC) is also exploring the means by which these oil producer states can manage and mitigate the risks of illicit financial flows and corruption, with two important areas of work emerging:

- **Strengthening national oil companies' commercial and financial risk management to enable integrity in commercial engagements and align with a process of progress decarbonisation.** Here again, blended finance or credit risk guarantees could promote higher standards of corporate governance, environmental risk management and social responsibility, and at the same time could serve to facilitate progressively decarbonised investments that set producer states on the path to an effective energy transition. In addition to substantially reducing the risks of debt distress, such engagements would positively lead to a situation where national oil companies are more conducive to the acceptance of financial due diligence, transparency and accountability.
- **Maximising the proceeds of oil sales reverting to national government budgets.** Enabling better management of risks at the national level through enhanced due diligence and effective use (and transference) of the contribution of natural resources to national budgets is central to fiscal stabilisation in the current context. The newly adopted Pillar IV on "Natural Resource Revenue Management" in the IMFs Fiscal Transparency Code, regular use of the new governance and anti-corruption framework for its Article IV consultations, and the ability to use exceptional policy protocols (including financial and performance audits of national oil companies and petroleum revenue collecting authorities) each provide an important means by which to enhance debt sustainability, and promote fiscal transparency and governance in these country contexts, supporting oil-producing developing countries to build back better.

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## Notes

<sup>1</sup> A country is commodity-dependent if commodities account for more than 60% of its total merchandise exports (in value terms) (UNCTAD, 2019<sup>[4]</sup>).

<sup>2</sup> Fragility is classified according to the OECD 2018 Fragility Framework (OECD, 2018<sup>[62]</sup>), oil and gas resource dependence is classified according to (IMF, 2012<sup>[61]</sup>), low- and lower middle-income countries (LICs and LMICs) are defined as countries with income per capita below a threshold level.

<sup>3</sup> 'Volatility' is understood as the difference between highest and lowest value during the same month.

<sup>4</sup> A multi-year programme of work on *Illicit Financial Flows in Oil and Gas Commodity Trade: Experience, lessons and proposals* was launched by members of the Anti-Corruption Task Team (ACTT) a subsidiary body of the OECD Development Assistance Committee (OECD-DAC) in March 2019.

## Acknowledgments

This brief was written by Rebecca Engebretsen, Policy Analyst, Effective, Inclusive and Accountable Institutions, under the guidance and supervision of Catherine Anderson, Team Lead, Effective, Inclusive and Accountable Institutions.

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