



TRADE AND DEVELOPMENT REPORT UPDATE

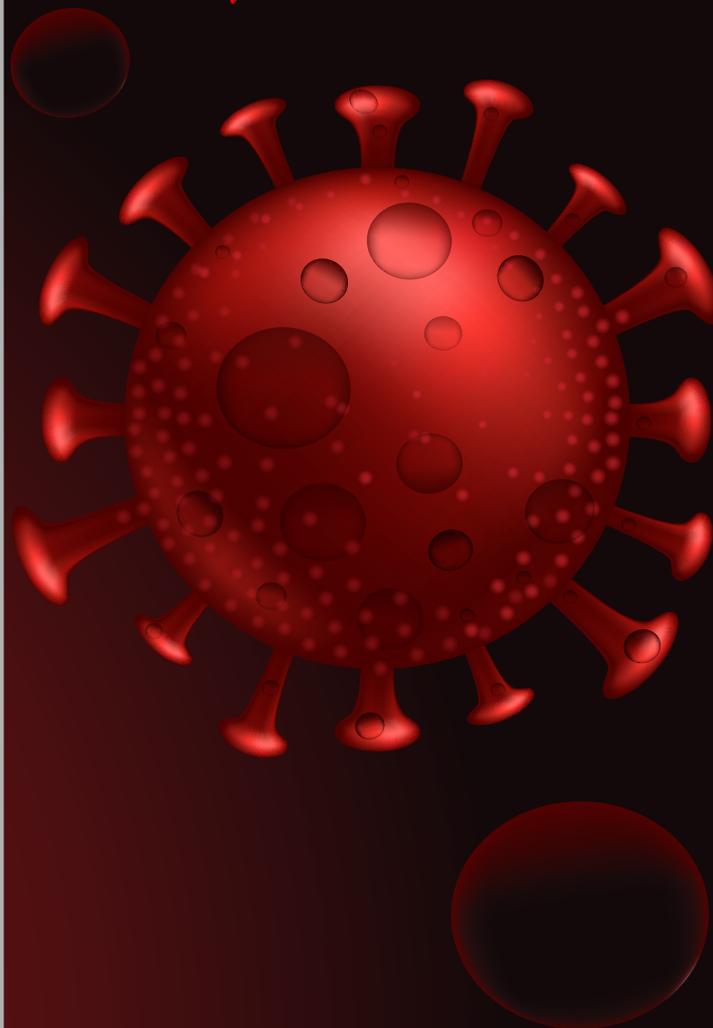
From the Great Lockdown to the Great Meltdown:

Developing Country Debt in the Time of Covid-19

APRIL 2020

EMBARGO

The content of this Report must not be quoted or summarized in the print, broadcast or electronic media before **23 April 2020, 15:00 GMT (17:00 Geneva)**.

UNITED NATIONS
UNCTAD**C** **VID - 19**

Introduction

The Covid-19 shock is posing unprecedented challenges to advanced country governments. As most have come to recognize, the economic crisis entailed by the pandemic is unique in that it combines a deep supply shock - arising from wide-ranging and prolonged lockdowns of entire economies – with consequent demand shocks – arising from a collapse in corporate investment plans, retrenchment of household spending, rapidly increasing unemployment and patchy social welfare systems reduced to their bare bones after decades of rentier capitalism – as well as radical uncertainty and heightened fragility in financial markets. As a consequence, policy makers have focused on the provision of massive stabilisation packages, designed to flatten both, the contagion curve of the pandemic as well as the curve of economic meltdown and financial panic, through a raft of cash transfers, credit lines and guarantees from governments to households and firms. Doing so depends on the ability of governments to borrow from their central banks – or for central banks to revert to their original role as bankers to their governments¹ – on the required scale, a concept often referred to as ‘fiscal space’. How to deal with this necessary accumulation of government debt in response to the crisis, and in particular, how to avoid the mistake of turning to austerity to make adjustments once the crisis has passed, is already beginning to tax the minds of policymakers in the advanced economies.²

If the challenges are huge in advanced economies, they are enormously more daunting in developing economies. While advanced country governments struggle to revamp administrative and regulatory frameworks and to break ideological taboos, developing countries cannot easily flatten the contagion curve by closing down their largely informal economies without facing the prospect of more people dying from starvation than from the Covid-19 illness. Moreover, even the most advanced high-income developing countries with relatively deep financial and banking systems do not have anywhere near the fiscal space that advanced economies can, in principle, unlock.

The vast majority of developing countries are heavily reliant on access to the ‘hard currencies’ of advanced countries – earned primarily through commodity and service exports, such as food, oil and tourism, and received through remittances from their diasporas as well as from access to concessional and market-based borrowing –to pay for imports and to meet external debt obligations. Their central banks cannot act as lenders of last resort to their governments at the required scale without risking catastrophic depreciations of their local against hard currencies, and therefore also steep increases in the value of their foreign-currency denominated debt as well as unleashing, potentially, destructive inflationary pressures.

This situation is all the more critical where developing countries already face high debt burdens. The Covid-19 shock has put a glaring spotlight on the difficulties arising from high and rising developing country indebtedness since it is set to turn what was already a dire situation into serial sovereign defaults across the developing world. It has, therefore, turbo charged the need to move from discussion to action on debt matters in developing countries.

Following a brief discussion of current debt vulnerabilities in developing countries, this update of UNCTAD’s Trade and Development Report 2019 lays out a series of steps that the international community will need to take if there is to be any hope of salvaging the Agenda 2030 and moving to a more resilient and sustainable future for all countries.

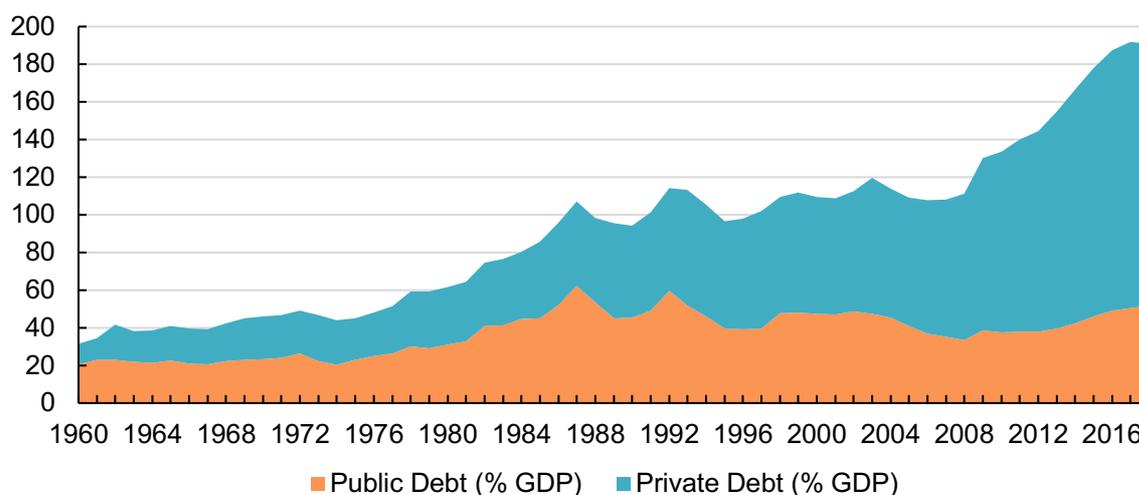
¹ See [S Kapoor and W. Buiter \(2020\) To fight the COVID pandemic, policymakers must move fast and break taboos, Vox Cepr Policy Portal, 6th April.](#)

² See [Emma Dawson \(2020\) We do not have to worry about paying off the coronavirus debt for generations, The Guardian, 22nd April.](#)

Developing country debt pre-Covid-19: Rising vulnerabilities and a looming wall of debt repayments

Covid-19 hits developing economies at a time when they had already been struggling with unsustainable debt burdens for many years.

Figure 1 Total Debt Stocks, all developing countries, 1960–2018
(Percentage of GDP)



Source: UNCTAD secretariat calculations based on IMF Global Debt Database.

As Figure 1 shows, at end-2018³ the total debt stocks of developing countries – external and domestic, private and public – stood at 191 per cent (or almost double) their combined GDP, the highest level on record. A developing country debt crisis, already under way prior to the Covid-19 shock, had many facets⁴, but two are worthwhile putting upfront in the context of ongoing debates about debt relief for the developing world in the aftermath of the Covid-19 shock. First, the unfolding debt crisis was not limited to the poorest of developing countries but affected developing economies of all income categories.⁵ Second, it has, by and large, not been caused by economic mismanagement at home, but by economic and financial mismanagement at the global level. Over the past decade, developing countries have witnessed a rapid and often premature integration into heavily underregulated international financial markets, including the so-called shadow-banking sectors, estimated to be in control of around half of the world’s financial assets.⁶

In this context, developing countries became highly vulnerable to massive but volatile flows of high-risk yet relatively cheap short-term private credit, on offer from financial speculators in search of higher yields on their investments than available to them in the near-zero interest monetary policy environment

³ Last date for which this data is available at present.

⁴ For more detail, see UNCTAD Trade and Development Report 2019: Financing a Global Green New Deal, chapter IV: Making debt work for development. UN Publication, Geneva.

⁵ See e.g. M. A. Kose, P. Nagle, F. Ohnsorge and N. Sugawara 2020. *Global Waves of Debt. Causes and Consequences*. World Bank Group, Washington DC, p. 12.

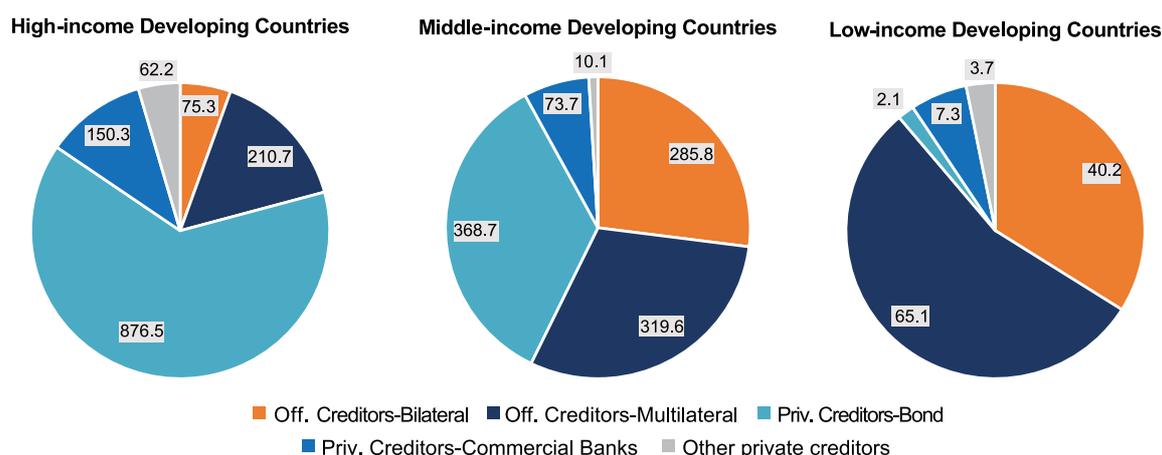
⁶ Financial Stability Report (2019). *Global Monitoring Report on non-Bank financial intermediation 2018*, February.

of their advanced home countries. This ‘push factor’, and the volatility of private capital inflows in combination with wide open capital accounts, has affected developing countries *whether or not* they had so-called strong economic fundamentals, such as relatively low public debt, small budget deficits, low inflation rates and high reserve holdings.⁷ An essential ‘pull factor’ leading developing countries to borrow at high risk in international financial markets was their dwindling access to concessional multilateral finance and a shift of Official Development Assistance (ODA) away from central budget support towards wider goals, such as climate change mitigation, migration management, good governance and post-conflict support, oftentimes determined by donor interests.

As a result, developing countries have seen a rapid build-up in private sector indebtedness, in particular since the Global Financial Crisis of 2008-09, accounting for 139 per cent of their combined GDP at end-2018 (see Figure 1). This trend has been most pronounced in high-income developing countries with relatively deeper domestic financial and banking sectors but has also and substantively affected middle- and low-income developing economies. It represents the largest contingent liability on public balance sheet in the event of a full-blown debt and financial crisis, not least in the shape of fledgling public-private partnerships, widely promoted throughout the developing world, but that may now quickly unravel in the wake of ‘sudden stops’ to their refinancing due to the Covid-19 crisis.

The fragility of developing country debt positions prior to the Covid-19 crisis was further increased by concomitant changes to the ownership and currency-denomination of their private and public debt. Thus, domestic bond markets were increasingly penetrated by non-resident investors and sovereign external debt held to a much larger extent than in previous episodes of developing country debt distress by private rather than official creditors, in particular in high- and middle-income developing economies (see Figure 2).

Figure 2 Long-term public and publicly guaranteed external (PPG) debt by creditor, all developing countries, debt stocks at end 2018
(Billions of current US dollars)

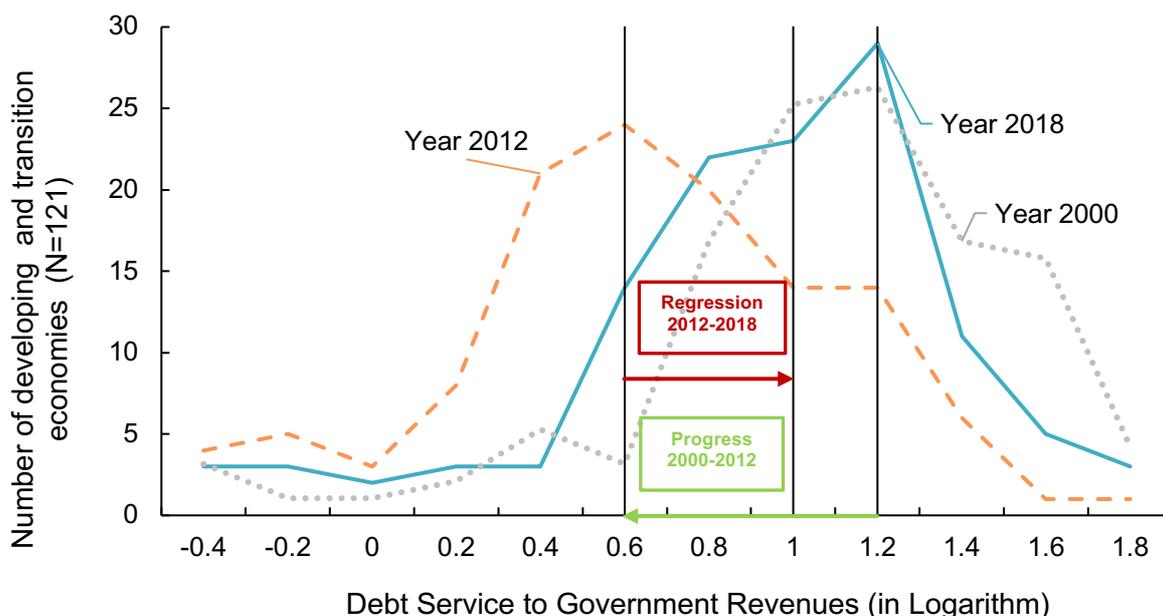


Source: UNCTAD secretariat calculations based on World Bank International Debt Statistics.

⁷ See e.g. Eichengreen, B. et al. 2017. *Are capital flows fickle? Increasingly? And does the answer still depend on type?* World Bank Group Policy Research Working Paper 7972. February. Washington DC.; Eichengreen, B. and P. Gupta. 2016. *Managing Sudden Stops*. World Bank Group Policy Research Working Paper 7639. April. Washington DC.

In the wake of these developments, much of the higher-risk borrowing by sovereigns has been accompanied by rising debt servicing costs with a negative impact on the fiscal space of many countries, compounded by a slowdown in growth relative to the period before the Global Financial Crisis of 2008-09 as well as by commodity price slumps.

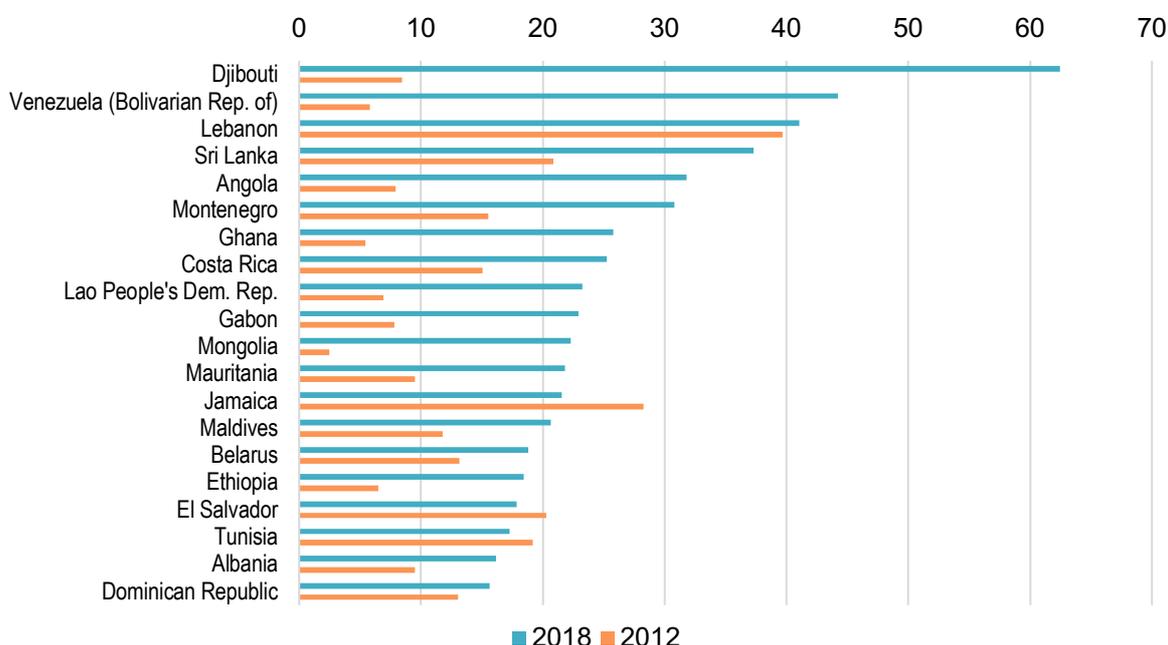
Figure 3 Ratio of debt service on long-term public and publicly guaranteed external debt to government revenues, 2000, 2012 and 2018 (in logarithm)



Source: UNCTAD secretariat calculations based on World Development Indicators (WDI), IMF World Economic Outlook (WEO), Economic Intelligence Unit database (EUI) and World Bank Quarterly External Debt Statistics (QEDS).

Figure 3 depicts the distribution of debt service burdens, as a share of government revenues, across developing countries in 2000, 2012 and 2018. While these had declined substantively between 2000 and 2012 (as indicated by the leftward shift of the distributions for 2000 to those for 2012 and by the fall in the distributions’ median value depicted by the green arrow), this progress has largely been reversed since then (as indicated by the rightward shift of the distributions for 2012 to those of 2018 and the by increase in these distributions’ median value depicted by the red arrow). Thus, servicing their external long-term public and publicly guaranteed debt cost developing country governments on average 6.5 per cent of their government revenues in 2012, but 10.3 per cent in 2018.

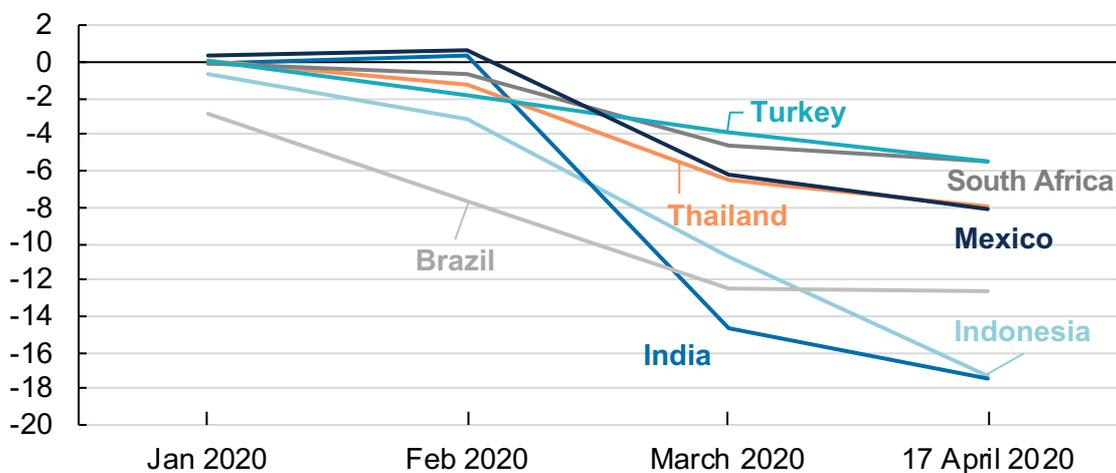
Figure 4 Ratio of debt service on long-term public and publicly guaranteed external debt to government revenues, top 20 developing and transition economies in 2018 (%)



Source: UNCTAD secretariat calculations based on *World Development Indicators* (WDI) and IMF *World Economic Outlook* (WEO).

However, the situation is much more severe in many developing countries where more than a quarter of revenues are absorbed by debt servicing (Figure 4). This includes a number of oil exporters, facing a particularly difficult moment given the collapse in oil prices, as well as middle-income economies that have witnessed a sharp outflow of portfolio capital since the start of the crisis (Figure 5).

Figure 5 Cumulative net non-resident portfolio capital outflows from selected developing countries, 24 January to 17 April, (Billions of current US dollars)

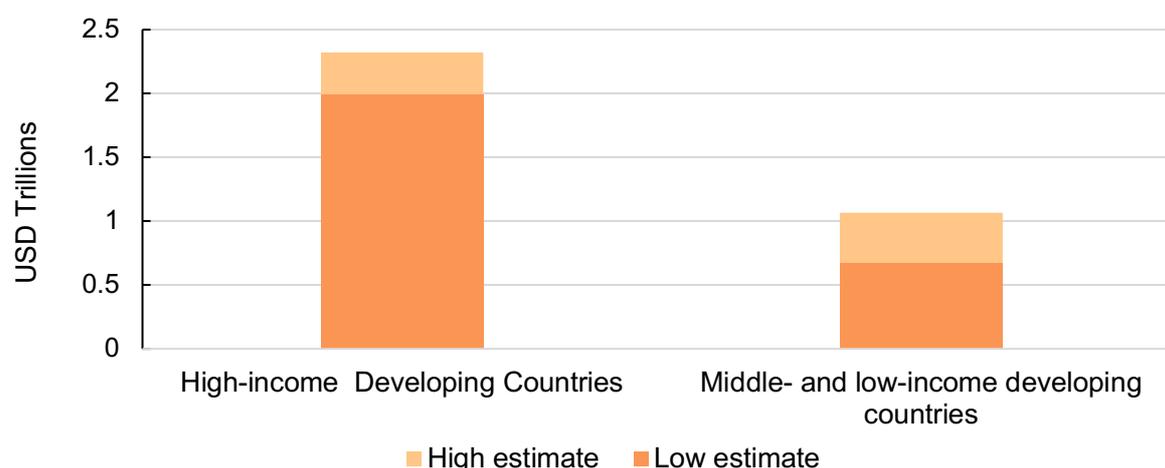


Source: UNCTAD secretariat calculations based on IIF *Daily Emerging Market Portfolio* database.

Note: Data for Brazil includes equity flows only; and for Mexico and Turkey debt flows only.

Predictably, developing countries will be facing a wall of debt service repayments throughout the 2020s, and in the context of deeply distressed economic circumstances. In 2020 and 2021 alone, these amount to between \$2 to \$2.3 trillion in high-income developing countries, and to between \$700 billion to \$1.1 trillion in middle- and low-income countries (see Figure 6).⁸

Figure 6 Redemption schedules for public external debt, all developing countries, 2020 and 2021 (Trillions of current US dollars)



Source: UNCTAD secretariat calculations based on World Bank *QEDS and World Development Indicators*, IIF *Global Debt Monitor* and IMF *Global Debt Database*.

Note: Data refer to sovereign debt for HICs and to public external debt for MICs and LICs.

Charlie Brown goes to Washington: ⁹ The promise of relieving developing countries’ debt burdens in response to the Covid-19 shock ...

On 13 April, the IMF cancelled debt repayments due to it by the 25 poorest developing economies for the next six months. This debt cancellation is estimated to amount to around \$215 million.¹⁰ Moreover, on 15 April, G20 leaders announced their “Debt Service Suspension Initiative for Poorest Countries”.¹¹ This suspension of debt service payments (including principals and interest) from 01 May to the end of 2020 applies to 73 primarily low-income developing countries that are either eligible to borrow from the International Development Association (IDA) or are classified as least developed countries (LDCs) by the United Nations (UN LDCs).¹² For now, the initiative applies to all official bilateral creditors, with calls on private creditors to join on comparable terms, and on multilateral banks to consider joining should such a step be compatible with maintaining their current high credit ratings and low-cost lending capacities. Qualifying developing countries must make a formal request for forbearance to their creditor

⁸ The range estimates for redemption schedules for public external debt in 2020 and 2021 for all developing countries results from the combination of observed redemptions schedules for 44 developing countries, including major developing economies, and estimated redemptions for all others, considering their income group. Developing countries, especially within the same income group, show some degree of synchronization in their external debt redemption schedules, which is mostly shaped by the financial conditions prevailing in international financial markets. This explains why, as a whole, they periodically face “walls of maturity”: the bonds and the loans that they contract in international markets often come to maturity in the same time period. The estimation therefore consists in applying the distribution of redemption schedules relatively to public debt stocks from the 44 observed countries. The low and high estimates refer to the lower and higher bounds of the distribution, respectively, defined as the 10th and 90th percentiles.

⁹ Recalling one of the cartoon character Charlie Browns’ best known comments “I have been repeating the same mistakes in life for so long now I may as well call them traditions”

¹⁰ See e.g. <https://jubileedebt.org.uk/press-release/reaction-to-215-million-of-debt-cancellation-by-imf>

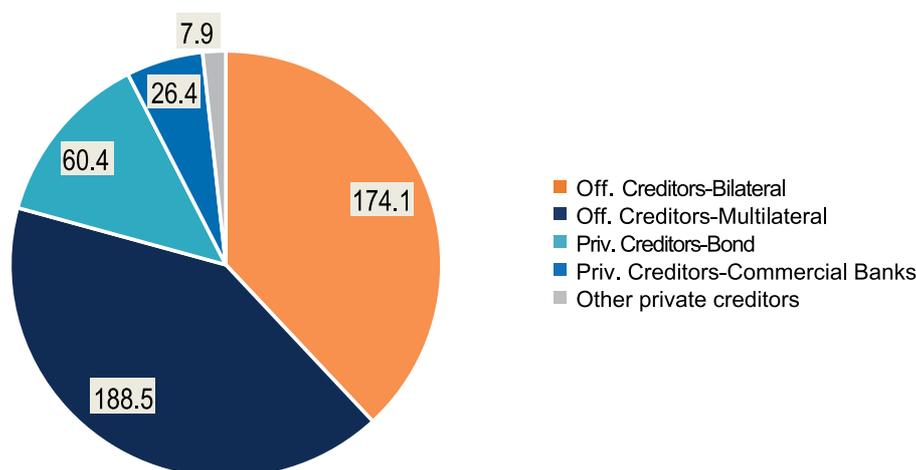
¹¹ *G20 Finance Ministers and Central Bank Governors Meeting, Communiqué, 15 April 2020*, Annex II, p. 12-13.

¹² Of the 76 IDA-eligible developing countries, 4 (Eritrea, Sudan, Syria and Zimbabwe) are excluded due to protracted non-accrual status. Of the UN LDCs, only Angola is not also an IDA-eligible country and therefore included.

countries and their eligibility for the initiative is conditional on a number of factors, including an active borrowing status with the IMF (or a request for financing from the IMF), the use of the temporarily freed-up resources for increased health and economic spending in response to the Covid-19 crisis, and full disclosure of all public sector debt obligations (with the exception of commercially sensitive information).

Current estimates suggest that this initiative covers around \$20 billion of public debt owed to official bilateral creditors in the eligible countries in 2020. An additional \$8 billions of such debt payments might be included, if all private creditors joined the initiative, and a further \$12 billion if the same was the case for all multilateral creditors¹³ However, this amounts to a relatively small part of the long term public and publicly guaranteed external debt stocks these countries had accumulated at the end of 2018, as Figure 7 shows.

Figure 7 Long-term public and publicly guaranteed external (PPG) debt by creditor in developing countries benefiting from the G20 debt service payment suspension initiative, 2018
(Billions of current US dollars)



Source: See Figure 2 above.

Initiatives such as these are welcome since they provide urgently needed fiscal “breathing space” to crisis-ridden developing countries, but they do not constitute debt relief of any kind. Quite the contrary, by linking eligibility to new or ongoing borrowing, even if on concessional terms, the initiative prioritizes concessional lending (and therefore new debt) over debt relief. Moreover, suspending debt repayments only through the end of 2020 relies on the all but heroic assumption that the Covid-19 shock to developing economies will be swift and short, and “business as usual” will resume in 2021 to the extent that developing countries joining the scheme will be in a position to shoulder debt service repayments suspended in 2020 over the next three to four years. But given the wall of debt service repayments already facing many developing country governments in 2021 (see Figure 6) and beyond, in combination with the wider macroeconomic impacts of the Covid-19 crisis on export revenues, commodity prices, government revenues and reserve holdings, as well as new concessional borrowing incurred during the crisis, this is unlikely to be the case. And of course – with few exceptions such as Nigeria, Ghana, Pakistan and some Small Island Developing States – middle- and high-income

¹³ See e.g. <https://jubileedebt.org.uk/press-release/reaction-to-215-million-of-debt-cancellation-by-imf>

developing countries are excluded, despite many of these economies facing unsustainable debt burdens and potential financial meltdowns.

.... and what needs to be done: Time for a “Global Debt Deal” for the developing world

In the wake of the Covid-19 crisis, developing countries will require massive liquidity and financing support to deal with the immediate fall-out from the pandemic and its economic repercussions. As both UNCTAD and the IMF have estimated, these liquidity and financing needs amount to at least \$2.5 trillion. Clearly, debt relief measures will cover only a part of these needs, with new allocations of Special Drawing Rights and a grant-based ODA Marshall Plan to support health and social expenditures providing faster avenues to deliver urgently needed cash injections. Both the IMF and the World Bank also announced enhanced lending facilities for developing country members to help deal with the crisis. The IMF has increased access limits to its Rapid Credit Facility, for now until October 2020, from 50 to 100 per cent of annual country SDR quotas and to 150 per cent on a cumulative basis. Together with its Rapid Financing Instrument, the Fund’s emergency financing is expected to amount to around \$100 billion. The World Bank has put in place a \$14 billion fast-track package to respond to immediate health and economic needs and envisages to use around \$160 billion in longer-term financial support over the next 15 months. However, these are debt-creating financing instruments and though involving fewer conditionalities and a faster approval process, in the case of the Fund, eligibility still depends on familiar (and arguably under current conditions highly restrictive) criteria, including, inter alia, the country’s debt being sustainable or on track to be sustainable, and that it is pursuing appropriate policies to address the crisis.¹⁴

Well-designed debt relief – through a combination of temporary standstills with sovereign debt reprofiling and restructuring – is essential in that it addresses not only immediate liquidity pressures but has the potential to resolve problems of structural insolvency and long-term debt sustainability. As has been pointed out, the Covid-19 shock only puts the spotlight on what had already been a fast-evolving sovereign debt crisis across the developing world. The devastation it is likely to cause unless decisive action is taken, should be more than sufficient motivation for the international community to finally move towards a coherent and comprehensive framework to deal with unsustainable sovereign debt.

Basic lessons from the pre-Covid-19 system of sovereign debt relief and restructuring

Debt relief mechanisms for developing countries, emerging gradually with the advent of recurrent and widespread developing country debt crises since the end of the 1970s, have been fragmented, ad hoc and insufficient to prevent sovereign debt crises or to resolve such crises sustainably, once these occurred (Box 1). In practice, the pre-Covid-19 ‘non-system’ to deal with potentially unsustainable debt positions suffers from a series of flaws and weaknesses which hamper the debtor economy’s ability to recover and impose undue social, political and economic adjustment costs:

- ***Too little too late:*** An early determination of whether a country is facing a liquidity or solvency crisis is essential for the orderly management of a debt problem. Under the current system, neither debtor governments (who fear a self-fulfilling crisis and reputational risk) nor creditors (who fear taking undue losses) have an incentive to recognize a situation of over-indebtedness

¹⁴ On the limits of the \$1 trillion of available funding in total from the IMF see D. Lubin, The IMF’s \$1 trillion lending power is not all it is cracked up to be, Financial Times, 21st April.

and take early and comprehensive action. Overly optimistic forecasts about debt sustainability by international financial institutions accompanying emergency support only add to the delay. Thus, recent research shows that since 1970 49.7 per cent of sovereign restructuring episodes with private creditors have been followed by another default within a time window of three to seven years, and 60 per cent were followed by further restructuring.¹⁵

- **Lopsided resolution:** Unlike private firms, indebted States cannot go bankrupt. But the economic recovery needed to repair the government balance sheet requires a supportive international framework that allows the debtor country to conduct countercyclical policies which will enable it to restore its debt servicing capacity through investment, output and export growth, rather than income, expenditure and import contraction. The current international financial and monetary system, however, favours the latter. This is evidenced by the IMF’s “stand-by agreements” (SBAs) under which – even after some relaxation of conditionalities – access to associated credits typically include the requirement for fiscal and monetary austerity measures.
- **Non-cooperative creditors:** The shift from bank lending to bond financing has coincided with a general strengthening of creditor rights. This has provided new opportunities for vulture funds to buy defaulted bonds and aggressively pursue litigation procedures through the courts. Such actions have been particularly disruptive in the context of multilateral debt relief efforts. They have also highlighted the conflict between a purely private-law paradigm that seeks to enforce contracts at any cost and the logic of public law which is supposed to consider the wider economic and social consequences of legal actions. Courts have generally endorsed holdouts’ views, even at the expense of sovereign debt sustainability and the interests not only of the debtor country, but also of bondholders willing to reach a viable agreement.

A new ‘Global Debt Deal’ for developing countries

Argentina’s recent approach to its negotiations with its private and multilateral external creditors sets out some basic principles required to overcome these shortcomings (Box 2).¹⁶ A new “global debt deal” for developing countries should take note of these principles and, more generally, incorporate the following three basic steps.¹⁷

Step 1: Automatic temporary standstills: Longer and more comprehensive

The purpose of temporary standstills is to provide macroeconomic “breathing space” for crisis-stricken developing countries to free up resources, normally dedicated to service in particular external sovereign debt, for two interrelated uses: First, to facilitate an effective response to the Covid-19 shock through increased health and social expenditure in the immediate future and, second, to allow for post-crisis economic recovery along sustainable growth, fiscal and trade balance trajectories.

An effective ‘Global Debt Deal’ for the developing world should therefore allow for automatic temporary standstills

¹⁵ Guzman M. *Sovereign debt crisis resolution: will this time be different?* Presentation held at the 12th UNCTAD Debt Management Conference, November 2019.

¹⁶ For a wider discussion of the principles required to guide sovereign debt restructuring, see [UNCTAD, Trade and Development Report 2015](#), chapter IV, and the [Yale Journal of International Law, Special Issue on Sovereign Debt](#), Fall 2016, Vol 41, number 2.

¹⁷ See also United Nations (2020), *Debt and Covid-19: A Global Response in Solidarity*, April 17, New York.

- **on request** by developing country governments for forbearance, independently of their per capita income levels or other eligibility criteria or conditionalities, for an initial suspension period of one year from request, and with the possibility of further annual renewals based on recent debt sustainability assessments (see step 2 below).
- **on a comprehensive basis**, including all external creditors – bilateral, private and multilateral – primarily to safeguard against resources freed up by the suspension of debt service repayments to some creditors being used to meet repayment schedules of un-cooperative creditors
- **entailing an immediate and automatic stay on all creditor enforcement actions.** Creditors should not be able to seize assets or initiate court proceedings against any sovereign creditor that fails to make debt service payments during the pandemic. In addition, authorities in those jurisdictions that govern most emerging market sovereign bonds should cooperate by halting lawsuits against debtor countries already under way at the time of a temporary standstill arrangement coming into force.

Step 2: Debt relief and restructuring programmes: Restoring long-term debt sustainability

The “breathing space” gained under step 1 should be used to reassess longer-term developing country debt sustainability, on a case-by-case basis, based on the following key principles:

- The size and composition of debt relief or “haircuts”, if required, as well as the new redemption schedules for debt repayment on restructured sovereign debt obligations following resumption of debt service repayments, should be compatible with restoring and maintaining sustainable and inclusive growth paths, as well as fiscal and trade balance trajectories.
- Long-term sovereign debt sustainability assessments, and consequent restructurings where required, should take account of contingent liabilities, such as those arising from wide-spread public guarantees of new financing instruments and public-private partnerships.
- Sovereign debt restructurings and revised debt payment redemptions schedules should furthermore take account of investment requirements arising from the Sustainable Development Goals and the timely implementation of Agenda 2030.
- There must be a fair distribution of the burdens of required sovereign debt relief and restructurings between debtors and creditors, taking into consideration past histories of irresponsible lending by creditors as well as irresponsible borrowing by debtors, as appropriate.
- Respect for national sovereignty and expertise as well as national development strategies

Taking the successful outcome of the 1953 London Conference on German war debt, which cancelled around half of this debt under negotiation (see Box 1), as a benchmark of international solidarity, a target figure of around a trillion US dollars would appear reasonable in light of the debt burdens now crushing developing countries in the face of Covid-19.

Step 3: Establishment of an “International Developing Country Debt Authority’ (IDCDA)

In our highly interconnected world, financial stability has the qualities of a global public good. As such it is vulnerable to problems arising from missing or asymmetric information, free-rider behaviour and contagion effects. All these are present when the sustainability of sovereign debt becomes a policy challenge, the more so when the source of debt distress lies largely outside the countries themselves. Despite these problems having been visible in the inter-war period, the 1944 Bretton Woods agreement failed to establish an international framework for handling sovereign debt restructuring, with neither the IMF nor the World Bank tasked accordingly. As suggested above this institutional vacuum has been filled by ad hoc approaches to dealing with sovereign debt problems with a strong bias against borrowers, particularly from the developing world (see Box 1).

Taking forward steps 1 and 2, on the scale commanded by the impact of the Covid-19 crisis on developing country debt sustainability may thus well require putting into place an “International Developing Country Debt Authority” (IDCDA) mandated to oversee the implementation of comprehensive temporary standstills as well as case-by-case longer-term debt sustainability assessments and consequent sovereign debt relief and restructuring agreements.¹⁸

This could follow the path of setting up an autonomous international organisation by way of an international treaty *between concerned states*. Essential to any such international agreement would be the swift establishment of an advisory body of experts with entire independence of any creditor or debtor interests.

A proposal, such as the above, has, in the past, run into conflict with the interests of creditors.¹⁹ But governments in some debtor countries also oppose reform measures that could have the effect of lowering the volume of capital inflows and/or raising their cost, even when such measures could be expected to reduce instability and the frequency of emerging-market crises.

Many observers have been quick to dismiss such proposals as not only politically unrealistic but also technically impossible. However, as long as systemic failure continues to threaten global, as is clearly the case with the Covid-19 crisis, resistance to more fundamental reform of the international financial architecture must be overcome. A prescient remark, some two decades ago, by former chief economist of the IMF, Ken Rogoff, is worth recalling in this respect:

It is easy to fall into the trap of thinking that big institutional changes are unrealistic or infeasible, especially in the United States where macroeconomic policy institutions have generally evolved only slowly for the past few decades...Perhaps large institutional changes only seem impossible until they happen – at which point they seem foreordained. Even if none of the large-scale plans is feasible in the present world political environment, after another crisis or two, the impossible may start seeming realistic.²⁰

¹⁸ Carmen Reinhart and Kenneth Rogoff (2020). *Suspend emerging and developing countries’ debt payments*, Project Syndicate, 13 April. I have suggested that the IMF and the World Bank offer the appropriate forum to initiate such standstills, given their in house capacity and expertise, as well as an implicit, catalytic ability to crowd-in private creditors, although they acknowledge possible obstacles from powerful members with large voting shares. There is as yet no agreement, however, through an amendment of its Articles of Agreement, to empower the IMF in this regard. Moreover, as creditors themselves, it is doubtful that the Fund or the Bank could play an independent role in the subsequent steps required of a Global Debt Deal.

¹⁹ See for similar proposals UNCTAD’s Trade and Development Reports of 1986, 1998, 2001 and 2015.

²⁰ K. Rogoff (1999). International institutions for reducing global financial instability. *The Journal of Economic Perspectives*, 13 (4), fall, p.28.

Conclusion

Of utmost importance, in responding to both the Covid-19 shock to developing country sovereign external debt positions as well as to the fragility of such positions even prior to the Covid-19 shock is coordinated debtor country action to pro-actively shape future international agendas and agreements on developing country debt relief and restructurings. These have long failed to address the need for comprehensive, substantive and game-changing ways forward to deal fairly and efficiently with heavy and growing public debt service burdens across developing countries, precipitated by speculative and volatile international net portfolio capital flows from developed countries. In the wake of the Covid-19 crisis, both developing country debtors as well as developed nations' creditors should make it a priority to safeguard and promote future mutual dealing to shared longer-term benefit on equal terms.

Box 1: Debt relief and restructuring – a brief history

The only modern debt relief programme based on an international treaty is the 1953 London Agreement on Germany's war debt. The treaty, that brought all West Germany's official and private creditors to the table, excluded all debt incurred by Germany during the occupation of Europe in the Second World War and forgave over 50 per cent of the remaining war debt incurred prior to 1933 and after 1945. It furthermore allowed West Germany to postpone any further reparation claims from forced workers until after German reunification, if and when this would take place, limited the amount of export revenues that could be spend on debt servicing to 5 per cent of the total in any one year and allow low interest rates of between 0 and 3 per cent to be paid in Deutsche Mark. All debt service payments could be postponed in the event of an annual trade deficit, and West Germany could unilaterally suspend these altogether and seek renegotiated terms in the event of any substantial changes to its situation. Reunified Germany paid the last tranche of this debt in 2010.

The 1944 Bretton Woods Agreement did not include a regulatory framework to address sovereign debt relief or restructuring. Until the late 1980s, developing country difficulties in their external debt positions were addressed on a case-by-case basis. Mechanism to provide debt relief were limited to temporary standstills on external sovereign debt service payments owed to official bilateral creditors, whose prerogative it was to decide the duration and terms of any such standstills. As preferred creditors, the IMF, the World Bank and multilateral development banks were generally exempted from debt relief or restructuring programmes in exchange for the provision of exceptional concessional lending, tied to specific conditionalities, when required, with the repayment of such multilateral financing taking priority over bilateral debt. Thus, the G20 "Debt Service Suspension Initiative for Poorest Countries", agreed on 15 April 2020, largely replicates the status quo of the 1970s and 1980s.

With the advent of more wide spread and frequent developing country debt crises since the 1980s, two informal negotiation forums – the Paris Club, founded in 1956, for official bilateral debt owed to its creditor member states, and the London Club founded in 1976, to address sovereign debt owed to private creditors – gained wider attention. The Paris Club takes decisions by consensus, with its members agreeing to act as a group to protect their collective interests. Terms to allow for debt stock reductions (debt relief) for poor developing countries were first introduced in 1988 under the so-called "Toronto terms" and subsequently revised until the adoption of the "Naples terms" in 1994 that allow for up to 67 percent reduction of bilateral debt owed to its member states on a present value basis. The last debt relief programme agreed under these terms was for \$1.4 billion of Somalia's debt with Paris Club creditors in March 2020.

The London Club originally provided an ad hoc forum for debtor countries to renegotiate their commercial bank debt with member of the Club. Each "London Club" is formed at the request of a debtor country and dissolved on agreement of a restructuring, with negotiations led by an Advisory Committee that more recently has also included non-bank creditors, such as hedge funds holding sovereign bonds. Support to the negotiations, for example in the form of debt sustainability analyses is provided by the Institute of International Finance (IIF), founded in 1983, and an Economic Subcommittee. The IIF is the world's only global association of financial institutions, including most large commercial and investment banks, insurance companies, investment funds, trading companies, multilateral as well as export credit agencies. However, the London Club does not establish binding resolutions and there is currently no comprehensive mechanism for the restructuring of sovereign debt owed to private creditors, a situation that has provided ample opportunities for uncooperative creditors, or so-called vulture funds, to purchase distressed sovereign debt at a steep discount and aggressively litigate to recoup the debt's full value plus interest.

The 1989 Brady Debt Reduction Plan recognized that London Club sovereign debt restructurings were insufficient to resolve mounting developing country debt crises. Under the plan defaulted sovereign bank loans by London Club members were exchanged for cheaper collateralized tradeable

30-year bonds. In exchange for some amount of debt relief to poor developing countries by London Club members, multilateral and bilateral creditors provided the funds for debtor countries to buy back their remaining commercial debt and swap this for “Brady bonds” guaranteed by zero-coupon US Treasury bonds. The Brady Debt Plan, of which the new Brady bond were a part, also imposed strict macroeconomic austerity programmes on participating, mainly middle-income, developing countries.

Even so, debt owed to multilateral creditors in particular by poor developing countries, kept rising to increasingly unsustainable levels. This eventually led to the first international debt relief initiative, the Highly Indebted Poor Countries (HIPC) initiative in 1996. This initiative was followed in 2005 by its enhanced version, the Multilateral Debt Relief Initiative (MDRI) when it became clear that the HIPC initiative alone would be insufficient to restore long-term debt sustainability in eligible countries and achieve the Millennium Development Goals. Overall, both initiatives afforded around \$70 billion of debt relief to just over 30 poor developing countries. However, the initiative was criticized for leaving many middle-income countries in high debt distress in the lurch. While, for the first and so far only time, multilateral as well as bilateral creditors participated in these debt relief initiatives, commercial debt reductions were mainly channeled through the Commercial Debt Reduction Facility (DRF) of the International Development Association (IDA) that channeled donor funding to eligible countries to reduce this debt.

While these international debt relief initiatives succeeded in reducing external sovereign debt burdens substantively in beneficiary developing countries, this achievement has largely been reversed following the global financial crisis, with the renewed sharp rise of sovereign and private indebtedness across the developing world.

Box 2: Argentina's current approach to resolving its debt crisis

Notwithstanding country-specific detail, the Argentine government has laid out core principles that govern its approach to the restructuring of its public debt.²¹ These include the following:

- The overarching objective of sovereign debt crisis resolution must be to put the country's public debt on a sustainable path – along which its debt-to-GDP ratio fall persistently – that is compatible with long-term development strategies to foster domestic production, productivity and output capacities, facilitate structural diversification as well as social inclusion and therefore put the economy on a virtuous path to stable and sustained socio-economic development.
- In the shorter term, sovereign debt restructurings must allow “breathing space”, through appropriate stays on debt service repayments, for governments to resolve or mitigate core macroeconomic imbalances, externally as well as internally, through inclusive pro-growth policies rather than rash austerity adjustments. Thus, achieving a sustainable fiscal trajectory may require initial fiscal deficits to persist or even grow, alongside redistributive tax reforms, to minimize recessionary impacts and to achieve future balanced budgets on the basis of a dynamic growth path rather than deep depression. Similarly, achieving a sustainable trade balance path and avoiding recurrent balance of payment crisis requires policies to boost export earnings in line with domestic demand, rather than repressing the latter.
- In the wake of the Covid-19 crisis, any required “breathing space” to return economies to sustainable growth, fiscal and trade balance trajectories will have to be adjusted to allow them to absorb the immediate impacts of the crisis, in addition to resolving already existing macroeconomic imbalances and generating sufficient buffers against future exogenous shocks.
- Essential elements of a successful sovereign debt restructuring include sustainable interest payments on its external public debt in the medium- to long term as well as the linking of foreign currency-denominated debt service payments to the evolution of export earnings.
- At the end of a successful sovereign debt restructuring, debtor countries should be able to regain access to international financial markets at sustainable refinancing costs.

In the case of Argentina, the exchange offer made by its government to its external private creditors on 16 April combines specific proposals for the extension of repayment and grace periods with a 62 percent “haircut” on interest payments and a 5.4 per cent reduction in the face value of this debt. In a sign of difficulties to come, already, some private creditors are decrying the offer.²² What should be clear, however, is that the basic principles on which this proposal (as well as Argentina's ongoing negotiations about its multilateral debt with the IMF) is based are essential to ensure that the developing world can exit from unsustainable debt burdens, once and for all.

²¹ Address by Dr Martín Guzmán, Minister of Economy of the Argentine Republic, to Congress, 12 February 2020.

²² Smith, C. and B. Mander, “Bondholders reject Argentina's debt offer. Financial Times, 20 April 2020. Available at: <https://www.ft.com/content/558582bb-3e7e-45f0-a122-f4b0d2fb05be>