

First session of the Preparatory Committee for the fourth International Conference on Financing for Development

Multi-Stakeholder Round Table Discussion on “Debt and debt sustainability”

Wednesday, 24 July 2024, 15:00 – 16:30

Issue note

Background

Borrowing is critical for **financing investments in sustainable development**. Sovereign debt enables countries to invest in infrastructure, health, education, and other critical areas. Financing for productive investments can improve debt sustainability in the long run: a growing economy helps to raise domestic tax and other revenue. However, unsustainable debt levels can constrain policy space, hinder investment on the Sustainable Development Goals (SDGs), and lead to fiscal crises. High sovereign debt burdens also raise the cost of borrowing for private companies, impacting domestic business activity, further impeding growth. While the ideal way to escape onerous debt burdens is to grow out of debt, countries encumbered by severe debt challenges lack the capacity to do so.

The Addis Ababa Action Agenda (Addis Agenda) provides a comprehensive and forward-looking approach to debt and debt sustainability, building on the commitments related to external debt in the Monterrey Consensus and Doha Declaration. Member States commit to assisting developing countries in attaining long-term debt sustainability by fostering debt financing, debt management, and debt relief and/or restructuring when needed. Countries are encouraged to use innovative debt instruments to provide financial relief, such as debt swaps, and explore new financial instruments tailored to the needs of developing countries, particularly for those affected by social or economic shocks or natural disasters.

Monitoring and prudent management of liabilities are highlighted as critical to **debt crisis prevention**. The Addis Agenda highlights that both preventing and resolving unsustainable debt situations are shared responsibilities of both debtors and creditors. Implementation of guidelines for responsible lending and borrowing and strengthening analytical tools for debt management are encouraged. Member States advocate for enhanced debt transparency, and accurate and comprehensive debt data reporting. International financial institutions are urged to provide technical assistance to developing countries to enhance their debt management frameworks and build resilience against economic shocks.

When needed, **debt restructurings** should be timely, orderly, effective, fair and negotiated in good faith, aiming to restore public debt sustainability without compromising sustainable development. The agenda calls for legal and technical assistance to support countries facing disruptive creditor actions. The IMF and the World Bank are invited to continue strengthening their analytical tools for sovereign debt management,

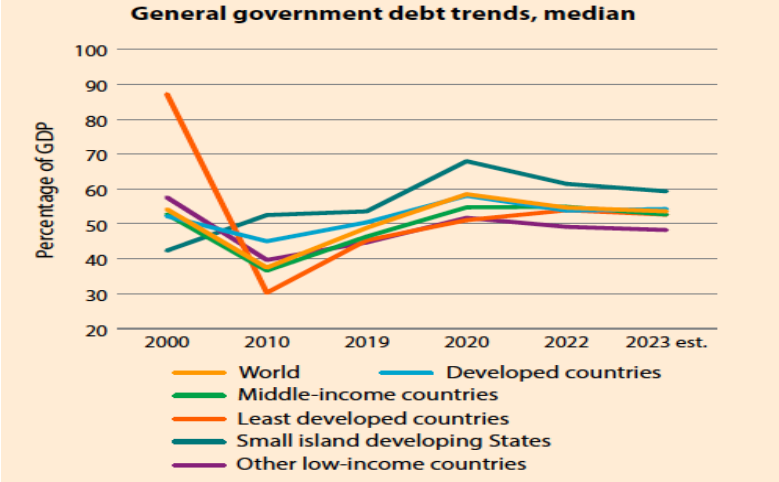
specifically debt sustainability analysis in an open and inclusive process with the United Nations and other stakeholders.

The importance of **legal and norm-setting efforts** is also highlighted, including national legislative steps to prevent holdouts by minority bondholders in restructurings and to strengthen domestic legislation to reflect guiding principles for effective, timely, orderly and fair resolution of sovereign debt crises.

How have we done?

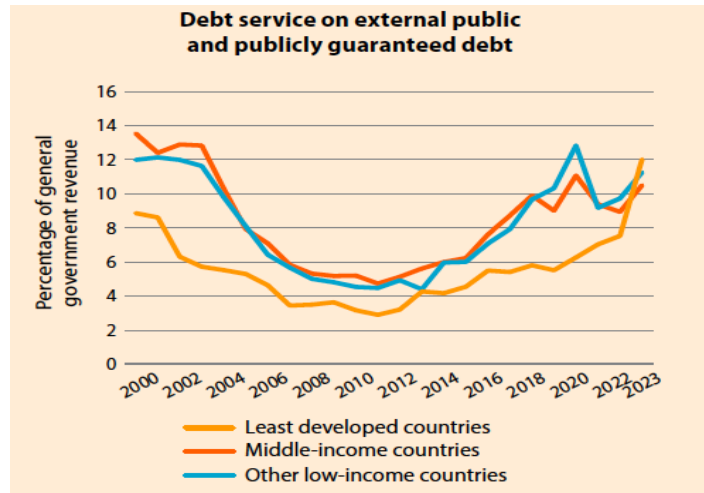
Since 2015, debt levels in developing countries have risen sharply, exacerbated by economic shocks, the COVID-19 pandemic, and global financial conditions (figure 1). This follows a decline in debt as a percentage of GDP in the early 2000s, in part due to the Heavily Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI) for the poorest countries.

Figure 1. Overall general government debt evolution in developed and developing countries, 2000–2023 (Percentage of GDP)



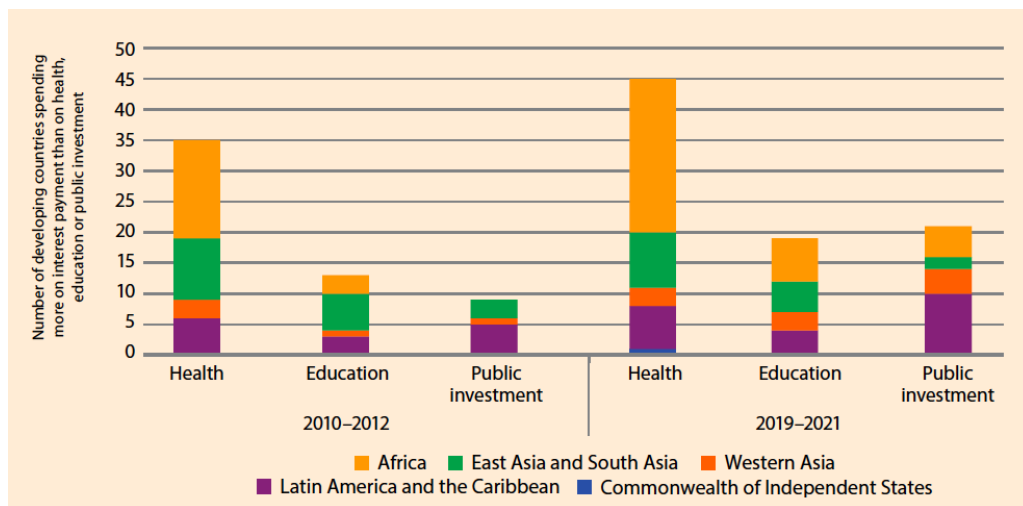
While debt levels stabilized after spiking during the pandemic in 2020, an increasingly complex debt instrument and creditor landscape – compounded by high debt servicing and refinancing costs – have led to higher debt vulnerabilities for many developing countries. Debt service burdens consume over a fifth of tax revenue in 25 developing countries, with the median debt service burden for least developed countries (LDCs) reached 12 per cent of government revenue in 2023, the highest level since 2000 (figure 2).

Figure 2. Debt service on external public and publicly guaranteed debt, median, 2000–2023 (Percentage of general government revenue)



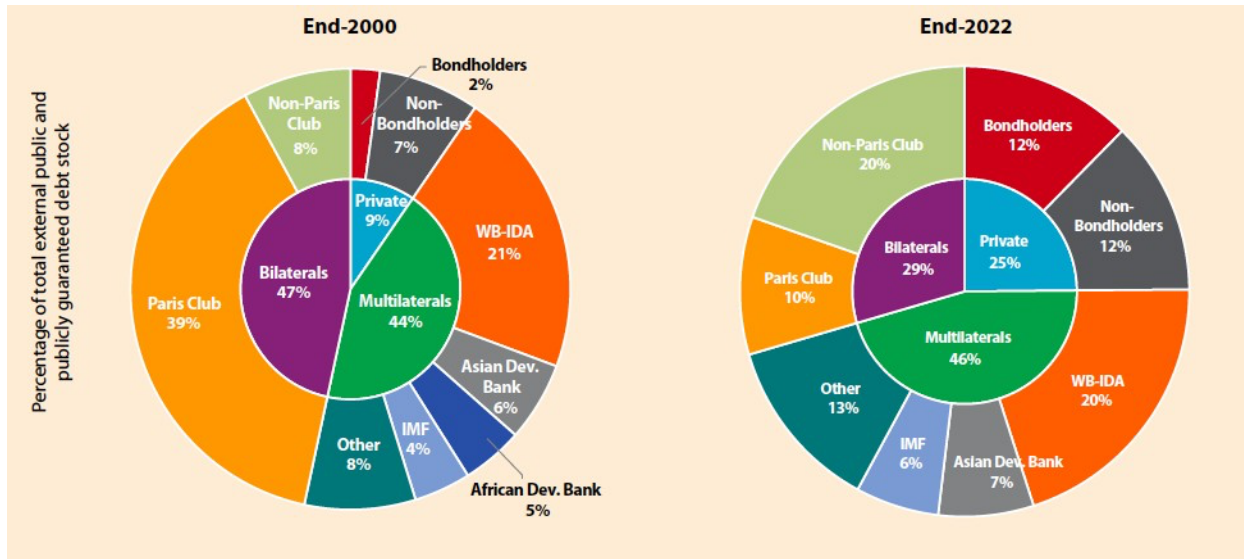
The cost of high debt servicing burdens in terms of lost investment in the SDGs can be enormous. High debt servicing burdens crowd out essential investments in health, education, and infrastructure. Forty-five developing countries, including 29 LDCs and other LICs, spend more on debt servicing than on health; 19, including 8 LDCs and other LICs, spend more on debt service than on education; and in 21, including 4 LDCs and other LICs, public investment is falling behind interest payments on public debt (figure 3).

Figure 3. Developing countries that spend more on servicing public debt than on health, education, and public investment, 2010–2012 versus 2019–2021



High debt service burdens in LDCs reflect both higher debt levels and the changing creditor landscape, including greater access to commercial borrowing with high borrowing costs. For LDCs and other LICs, the shares of external public debt held by commercial creditors and non-Paris Club official creditors more than doubled, from 17 per cent at end-2000 to 45 per cent at end-2022, while the shares of Paris Club and multilateral creditors declined from 83 per cent to 56 per cent, respectively (figure 4). Similar trends were observed among MICs and SIDS.

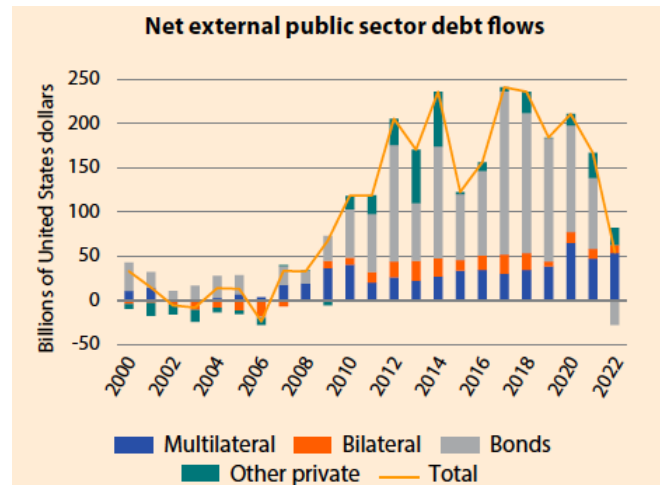
Figure 4. External creditor landscape in LDCs and other LICs (Percentage of total external public and publicly guaranteed debt stock)



In the most recent post-pandemic period, many developing countries have faced external liquidity pressures, with only scaled-up multilateral financing preventing a collapse in external financing. Since 2022, net debt inflows to developing countries as a whole would have turned negative if not for debt financing by multilateral institutions (figure 5).

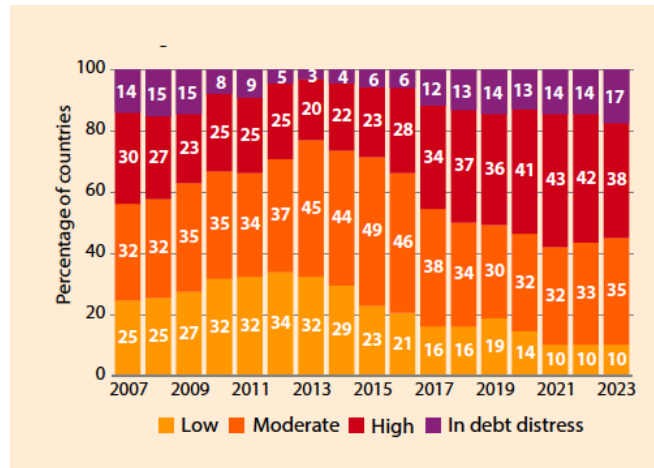
Refinancing costs and high debt repayments are expected to remain elevated in 2024 and 2025, in part due to the end of the Debt Service Suspension Initiative (DSSI) in 2021. In LDCs, for example, external debt service will hover around \$40 billion annually between 2024 and 2025, up from \$26 billion in 2021.

Figure 5. Net external public sector debt flows, developing countries, 2000–2022 (Billions of United States dollars)



Thus, the risks of fiscal crises and debt distress in developing countries remain high, particularly in LDCs and other LICs. As of 2023, more than half of all LDCs and other LICs are assessed as having a high risk of or in debt distress, twice the level in 2013, according to the IMF-World Bank Debt Sustainability Framework for Low- Income Countries (figure 6).

Figure 6. LDCs and other LICs: External debt distress ratings, 2007–2023 (Percentage of countries)



Actions and Challenges

Since 2015, significant efforts have been made to strengthen both debt crisis prevention and resolution, though improvements have not been sufficient to counteract growing debt challenges. Many developing countries continue to experience a sustainable development crisis due to debt service burdens crowding out needed SDG investments and high risk of debt distress.

Financing investments in sustainable development and strengthening debt crisis prevention

Innovative debt instruments can help enhance fiscal space, support investments in SDGs and climate action, and provide breathing space to countries facing exogenous shocks. Climate-resilient debt clauses automatically defer debt payments following certain climate events and natural disasters (such as droughts, earthquakes, flooding and extreme weather). Several official creditors (the African Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the World Bank, Canada, the United Kingdom and France) have committed to adopting such clauses in their lending. This is an important step in the debt architecture; previously, similar clauses had only been introduced in the context of restructurings, for example, in bond contracts by Barbados and Grenada, deferring repayment obligations in case of natural disasters.

There has also been increased interest in instruments such as debt-for-climate swaps or debt-for-nature swaps. Debt-for-climate and debt-for-SDG swaps allow countries to redirect debt service payments toward investments in sustainable development and climate action. They are useful for countries that have limited fiscal space for SDG investments, but are not a means to restore debt sustainability in countries with solvency challenges. There have been many debt-for-health and debt-for-nature swaps since the late 1980s; after a hiatus, they have regained popularity since 2015. Included in this are bilateral official debt swaps and more complex instruments that involve third parties providing funds with credit enhancements in order to buy back commercial debt at a discount. Yet, despite some successful examples, the uptake of debt swaps has remained limited, partly due to high transaction costs, and the lack of standardized frameworks.

Since 2015, debt management frameworks and capacity-building efforts by international organizations have improved debt recording, monitoring, and reporting systems. Across the countries eligible to borrow

from the World Bank's International Development Association (IDA), 23 per cent do not disclose any debt data, a significant improvement from 40 per cent three years ago. The lack of technical expertise and institutional capacity in some countries hinders the effective implementation of debt management strategies and the utilization of debt sustainability analyses. A review of 60 developing countries found that less than half require the preparation of key debt-related publications in their domestic legal framework.

On the creditor side, reporting by commercial creditors has been limited. The OECD's Debt Transparency Initiative built a repository for Institute of International Finance members to disclose their loans to developing countries, though to date very few private sector lenders have disclosed any loans.

Debt restructuring

The international debt architecture has seen important reforms of debt restructuring mechanisms, particularly since the outbreak of COVID-19. The G20 Debt Service Suspension Initiative (DSSI) provided cash-flow relief to eligible countries through extended rescheduling and reprofiling of debt. The G20 Common Framework was subsequently put in place to provide deeper relief for qualifying countries that request treatment on a case-by-case basis. The Global Sovereign Debt Roundtable (GSDR), established in 2023, promotes dialogue on processes and practices to foster common understanding of key bottlenecks and ways to address them.

Analytical tools to support debt restructurings are also being strengthened. The IMF and World Bank have enhanced their Debt Sustainability Framework to provide more accurate and forward-looking analyses of debt sustainability. In late 2023, a review of the IMF-World Bank Debt Sustainability Framework for Low-Income Countries was launched to formally assess the effectiveness of the existing framework and re-examine its fundamental features. However, debt sustainability analyses still do not reflect the need to achieve the SDGs and climate transition and could feature more accurate debt projections based on a better accounting of the varied effects of fiscal policy on growth.

The lack of a comprehensive and inclusive debt resolution framework has led to delays and inefficiencies in addressing debt crises. Private creditor participation in debt restructurings led by the Common Framework remains challenging, leading to inequitable burden-sharing. As a result, the implementation of the G20 Common Framework has been slow, with only one country successfully completing a debt restructuring under this mechanism.

Several areas of improvement have been highlighted to strengthen the Common Framework to deliver more quickly, including the need for: (i) greater clarity on the steps and timelines of the Common Framework process, enabling the early resumption of financing; (ii) introduction of a debt service suspension for the duration of the negotiation to alleviate liquidity constraints, avoid the accumulation of arrears and incentivize quicker resolutions; (iii) clarity on the parameters and processes to assess and enforce comparability of treatment with private creditors; and (iv) expanding coordinated debt treatments to highly indebted non-Common Framework-eligible countries that would benefit from such coordination, as they are recipients of large financing from both official and private sector creditors.

Legal and norm-setting efforts

Several jurisdictions have advanced efforts to resolve debt crises through domestic legislation by protecting developing countries from aggressive creditor actions and facilitating smoother debt

restructuring processes. These include legislative provisions that limit the ability of bondholders to sue countries for full repayment after buying distressed debt at deep discounts. New draft legislation in New York State, for example, would limit the recoverable amount for creditors to what the United States Government would receive if it were a creditor holding an eligible claim, or allow debtor countries to submit their own restructuring plans through the New York courts. Nonetheless, not all proposed initiatives have become law, and enforcement issues, creditor resistance and insufficient political will have sometimes stymied efforts.

The way forward and guiding questions for discussion

Heavily indebted countries face several overlapping challenges. Some have lost access to affordable finance to weather crises. Some continue to service their debt but are weighed down by high debt service burdens that severely limit SDG investment. High debt stocks then translate into high borrowing costs, which impacts the costs of capital for private investment, making some SDG investments – such as in clean energy – that would be financially competitive in developed countries unattractive in developing countries, while impeding economic activity and growth.

In light of the changes in the global debt landscape since 2015 and the commitments of the Addis Agenda that remain unfulfilled across i) addressing limited fiscal space for SDG investment; ii) strengthening debt crisis prevention; iii) improving debt resolution, when necessary, and advancing legal and norm-setting efforts, it will be critical to develop new solutions.

Amongst others, solutions that have been proposed include: liquidity support, when needed, such as through debt pauses or rescheduling interest payments on net present value-neutral terms; an array of financial tools (e.g., credit enhancements, buy-backs, exchanges, and market based exchanges or swaps) to address debt to commercial creditors; increased transparency, capacity and legal support to countries undergoing negotiations with commercial creditors; reforms to the Common Framework; and other legal and statutory measures.

1. Financing investments in sustainable development

- How can the international community better help countries with high debt burdens have space for investment in the SDGs, productivity and future growth? What tools or mechanisms are available or could be developed to lower the cost of borrowing and address high debt service burdens that crowd out SDG investments?
- What would the appropriate institutional structures to support these efforts? Can existing institutions be utilized or are new institutions needed?

2. Strengthening debt crisis prevention

- What are the most critical policy efforts needed to prevent debt crises and reflect the current global landscape and increased systemic risks?
- How can the use of contingent debt features be made more systematic?
- How can legal frameworks and institutional capacity in creditor and debtor countries be further strengthened to support public debt transparency?

3. Debt restructuring

- What new technical support and advisory services are needed to help debtor countries navigate negotiations in a complex creditor landscape?
- To achieve faster and sufficiently deep debt restructuring for insolvent countries, how can the international community address the creditor coordination challenge and the power imbalances between debtor countries and creditors?
- How can existing debt restructuring frameworks and policies be strengthened to incentivize faster debt restructuring?
- How can debt sustainability assessment frameworks be improved to inform the appropriate scale of debt relief and policy responses to broader debt challenges faced by countries?

4. Legal and norm-setting efforts

- How can the international community, as well as national and sub-national jurisdictions, enhance legal and norm-setting efforts for commercial debt restructuring?
- Which aspects of the sovereign debt architecture should be assessed to support concrete steps for further reforms?