



SOVEREIGN DEBT WORKOUT MECHANISMS: THE G20 COMMON FRAMEWORK AND BEYOND

Introduction

The first three Financing for Development Conferences, which led respectively to the Monterrey Consensus, the Doha Declaration and the Addis Ababa Action Agenda (AAAA), stressed the role of sovereign external debt as an important tool for mobilizing resources for public investments towards achieving sustainable development. However, sovereign external debt for developing countries carries the perpetual risk that foreign currency earnings must be generated, which depends significantly on exogenous factors, such as external demand and terms of trade.

Developing countries' debt sustainability has deteriorated substantially since the AAAA. Cascading crises intensified what was already an unsustainable position for many developing countries on the eve of the COVID-19 pandemic. A development crisis is underway, with external and public debt service draining resources away from the 2030 Agenda and the Paris Agreement ambitions.

To address this crisis, it is necessary to respond to the call of the first three FfD conferences for a mechanism to ensure a timely, orderly, fair and effective debt workout for developing countries. Section 2 proposes a two-step approach to fill this implementation gap in the FfD process.

The problem with the status quo

The total external debt of developing countries grew from US\$4.9 trillion in 2010 to an estimated US\$11.4 trillion in 2023. The annual costs of servicing this debt increased more than proportionally from US\$0.53 trillion to over US\$1.4 trillion over the same period. However, countries' debt experience is highly variable and influenced by their income level and level of international financial integration. We identify three distinct groups: Emerging Market Economies (EMEs), which are primarily upper-middle-income countries that integrated into the global capital market in the 1990s; Frontier Market Economies (FMEs), which are mostly lower-middle-income countries that

RELEVANT ACTION AREAS



ABOUT THIS SERIES

The Financing Policy Brief Series has been prepared by the Inter-agency Task Force on Financing for Development to inform the substantive preparations for the Fourth International Conference on Financing for Development (FfD4), to be held in Sevilla, Spain, from 30 June to 3 July 2025.

The Inter-agency Task Force on Financing for Development is comprised of more than 60 United Nations Agencies and international organizations. The policy briefs in this series were not subject to review by Task Force Members, and represent the views of the authoring organizations.

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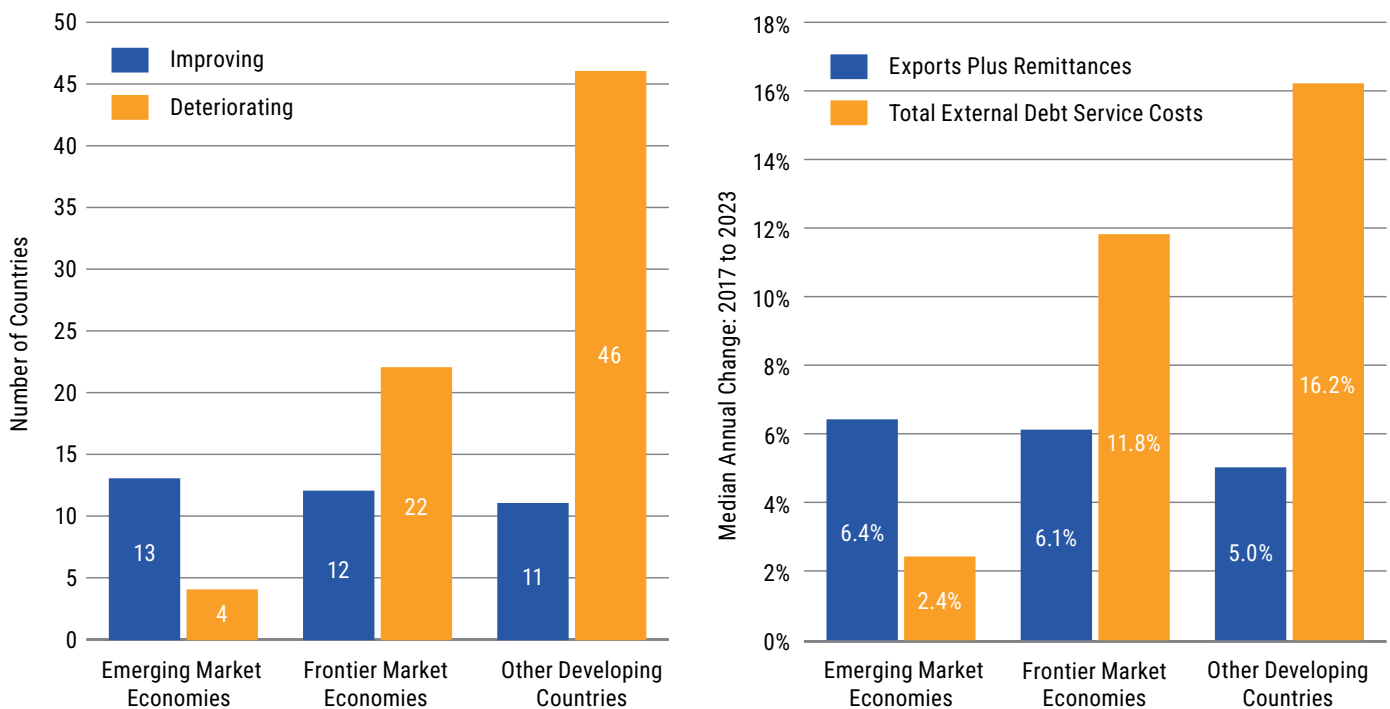


integrated after the 2008 Global Financial Crisis and Other Developing Economies (ODEs) that are mainly lower-middle and low-income countries, which have limited financial integration and remain reliant on official financial flows (Figure 1).

Overall, 67 per cent of developing countries experienced faster increases in the costs of servicing their external debt than in their earnings from exports and remittances between 2017 and 2023 - signaling a relative deterioration in their external debt sustainability, a diminishing capacity

to pursue their respective development and climate agendas, and an increased risk of debt distress. Although only 24 per cent of EMEs (4 countries) were affected, 65 per cent of FMEs (22 countries) and 81 per cent of ODEs (46 countries) experienced this deterioration (Figure 1). Therefore, significantly more developing countries have deteriorating external debt dynamics than is captured by the IMF's current (April 2024) assessment that 34 Poverty Reduction and Growth Trust (PRGT)-eligible countries are either at high risk of, or already in, debt distress.

Figure 1.
Number of EMEs, FMEs and ODEs with improving and deteriorating external debt sustainability (left) and median changes in export and remittance earnings and external debt service costs (right)



Source: UNCTAD calculations based on World Bank International Debt Statistics and IMF World Economic Outlook.

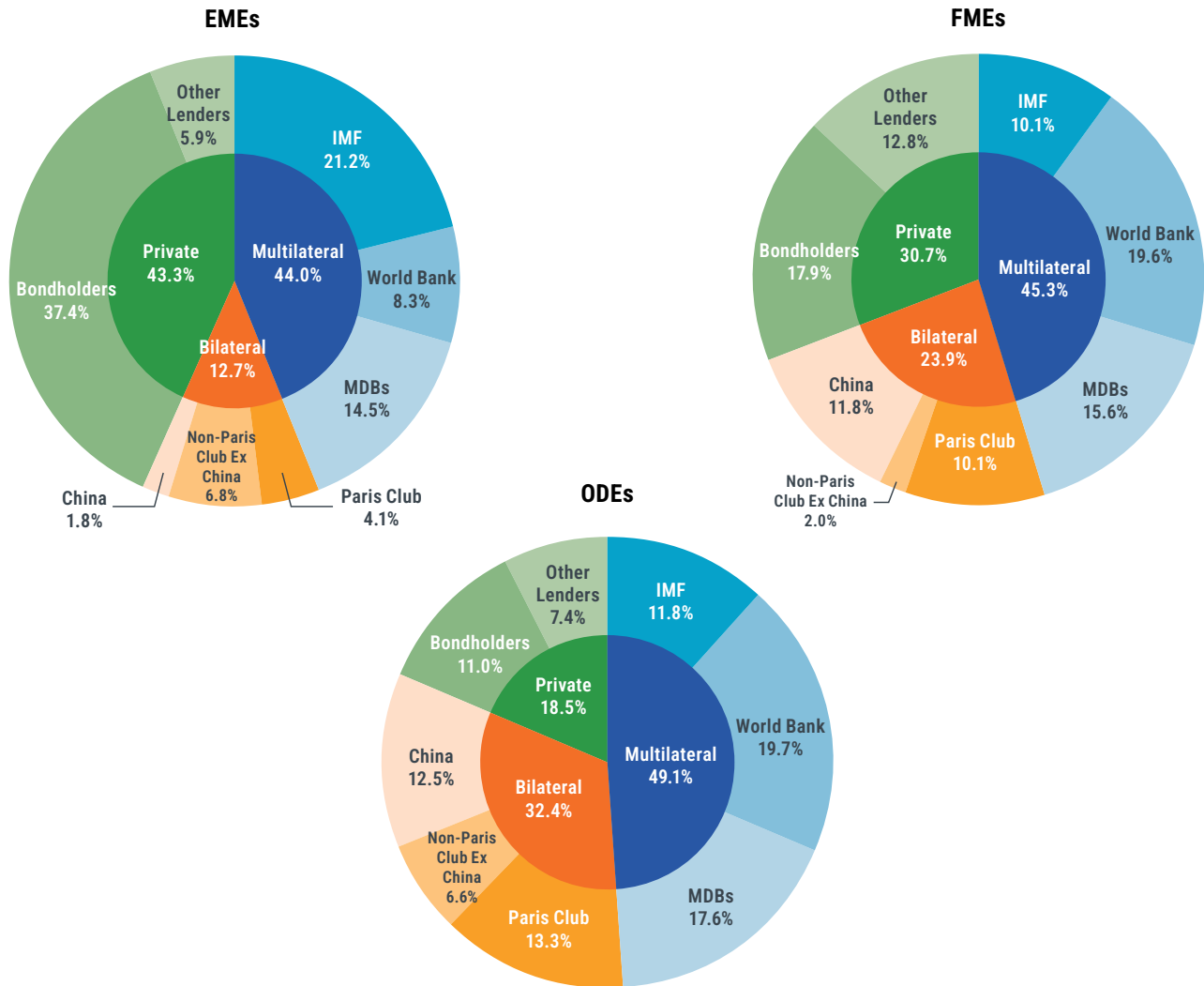


A significant driver of the distinct growth rates of debt service costs is the exposure of each group to different external creditors and their lending terms (Figure 2). All groups owe a high proportion of debt to multilateral creditors. While some of this is concessional, the cost of the non-concessional share is subject to market-related variations and surcharges. Higher levels of global financial integration are associated with an increased exposure to private creditors, primarily bondholders, and a lower exposure to bilateral creditors – particularly members of

the Paris Club – while less integrated country groups are associated with higher exposure to non-Paris Club bilateral creditors, especially China.

This analysis highlights that the need to access mechanisms to reprofile and restructure their external debt is likely to extend beyond low-income countries and that private creditors are responsible for a significant share of the public and publicly-guaranteed debt of EMEs (43 per cent) and FMEs (31 per cent).

Figure 2.
Creditor profile of EMEs, FMEs and ODEs with deteriorating external debt sustainability (2022)



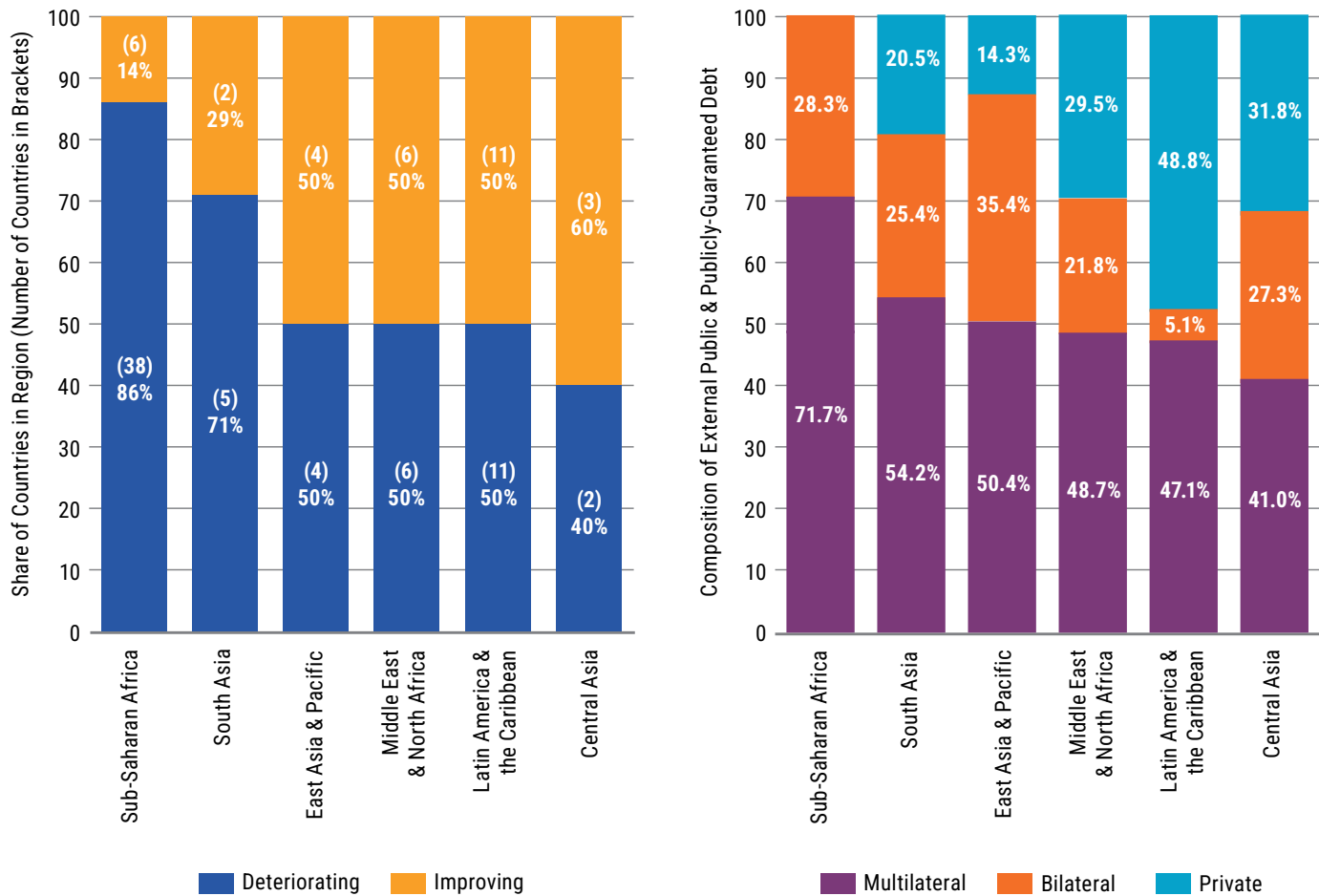
Source: UNCTAD calculations based on World Bank *International Debt Statistics* & IMF *World Economic Outlook*.



From a regional perspective, the proportion of countries with deteriorating external debt sustainability is much greater in sub-Saharan Africa and South Asia, and relatively lower in Central Asia. The creditor composition of these regions also varies significantly (Figure 3).

In addition, 28 (or 82 per cent) of the PRGT countries at high risk of or in debt distress have been stuck in this situation since at least 2019. At the same time, countries facing solvency challenges are not using debt workout mechanisms, such as the G20 Common Framework for Debt Treatment Beyond the Debt Service Suspension Initiative, as expected.

Figure 3. Share & number of countries with deteriorating and improving external debt sustainability by region (left) and the creditor profile of deteriorating countries (right)



Source: UNCTAD calculations based on World Bank *International Debt Statistics* & IMF *World Economic Outlook*.



🌸 A proposed approach

Sovereign external debt distress has historically been handled through long, ad hoc workout mechanisms based on voluntary negotiations between the debtor country and its foreign creditors. This approach has trapped developing countries in a vicious cycle of market access loss, capital flight, economic recession and financial sector instability that has set development progress back. The situation has worsened with the growing complexity of the debt landscape, encompassing a proliferation of official and private lenders, a growing variety of debt instruments and an increasing presence of non-resident investors in domestic sovereign debt markets.

The G20 Common Framework is the primary multilateral approach to addressing developing countries' debt challenges after the COVID-19 pandemic. While it is a welcome initiative and improves upon past mechanisms by involving non-Paris Club G20 members in official bilateral creditors' negotiations, it still has flaws. Necessary improvements include finding ways to reduce the burden on debtor countries to ensure similar debt relief from private creditors to that received from official creditors; greater emphasis on debt relief through debt cancellation, rather than only extending maturities and reducing interest rates; and improved transparency about the process.

The Common Framework's shortcomings must be addressed in the short term to ensure an improved sovereign debt relief solution for addressing the unfolding debt and ongoing development crises in developing countries. The Global Sovereign Debt Roundtable has helped streamline sovereign debt restructurings and shorten timelines. However, an enhanced Common Framework should also: include an automatic debt service extending eligibility to those middle income countries that are currently excluded; and provide tools to incentivise or enforce private creditors' participation.

Alongside improving the Common Framework, work towards a stable and permanent institutional framework to deal with sovereign debt is urgently required. The first step is creating a multilateral sovereign debt workout

mechanism aligned with sustainable and climate-resilient development to provide a definitive solution for debt crises. It must address a major fault line in the global debt architecture: sovereigns are treated as commercial entities in international finance but lack the legal protections of corporate bankruptcy. Previous FfD outcome documents called for such a mechanism to ensure fair burden-sharing, just treatment of creditors and debtors and timely, orderly, fair and effective debt restructurings for all developing countries at the brink of, or in, debt distress.

The next step is to establish a global debt authority to oversee the multilateral sovereign debt workout mechanism and promote or implement other substantive changes of a statutory and contractual nature in sovereign debt management. This includes development-focused debt sustainability analysis, a borrowers' club, the regulation of capital flows and innovative financial instruments - such as state-contingent clauses and Climate Resilient Debt Clauses - to prevent debt crises and ensure resilience. This authority could also support countries in strengthening domestic legislation to reflect guiding principles for effective, timely, orderly and fair resolution of sovereign debt crises, as the AAAA called for.

This proposed two-step approach will need support from a broad set of member States and actors, including courts and international financial institutions. The road forward could start with small beginnings, as the UN Trade and Development details in the *Trade and Development Report 2023*.

🌸 Conclusion

Many developing countries are prioritizing servicing external debt service and avoiding sovereign default at the cost of achieving sustainable and climate-resilient development. Besides having to deal with the associated stigma, they are deterred from embarking on a process of debt restructuring because an appropriate mechanism is either unavailable (for most middle income countries) or is slow, cumbersome and costly (for countries eligible for the G20 Common Framework).



UN Trade and Development believes that parallel approaches to this problem are required. Steps must be taken to fix the most significant flaws in the Common Framework. However, work to develop a stable, permanent and universally available institutional framework to deal with sovereign debt must commence urgently. The latter entails creating a multilateral sovereign debt workout mechanism and establishing a global debt authority to oversee this mechanism.