

ADDRESSING SOVEREIGN DEBT CHALLENGES IN THE ERA OF COVID-19 AND BEYOND: THE ROLE OF THE UNITED NATIONS

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Traditionally, sovereign debt problems of developing countries have been discussed mostly at institutions representing the creditors, such as the Paris Club, and at the International Monetary Fund, but they have also been addressed by the United Nations, mostly in the context of its international conferences on financing for development. Although the views of the United Nations on debt are not widely known, they are highly relevant in the post-COVID-19 context, as inflationary pressures could lead to tightened global financial conditions and exacerbate debt vulnerabilities in developing countries. The present paper provides an overview of sovereign debt restructurings from the 1980s, a summary of the debt situation of Asia and the Pacific as a case study and a review of the views of United Nations on debt issues. It also offers suggestions to improve the global debt architecture based on such views by highlighting the importance of linking debt sustainability with sustainable development in debt restructuring workouts and through a hub-and-spoke institutional arrangement to disseminate prudential debt management practices and promote transparency.

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The COVID-19 pandemic has caused an extraordinary socioeconomic crisis throughout the world. To control the spread of the deadly virus and reduce pressure on overwhelmed health systems, governments have imposed unprecedented social distancing policies, including lockdowns, business closures and travel bans. These

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emergency policies have succeeded in flattening the curve of contagion and saved lives, but they also have resulted in the sudden disappearance of millions of jobs, and countless business being brought to be verge of bankruptcy. These socioeconomic consequences have been met with a robust and fast policy response. According to the International Monetary Fund (IMF) (2020a), the global fiscal response as of September 2020 – which included additional spending, temporary tax cuts and liquidity support to businesses through loans, guarantees, and capital injections – amounted to \$11.7 trillion, or close to 12 per cent of global gross domestic product (GDP). The global monetary response has been equally aggressive, with central banks of the G10 countries expanding their balance sheets by \$7.5 trillion, and 20 emerging market central banks deploying asset purchases for the first time (IMF, 2020b).¹

The global fiscal response, however, has been highly uneven across countries, with 85.9 per cent of which coming from advanced economies.² The fiscal policy response of developing countries has been limited due to financial constraints, including the need to continue servicing foreign currency-denominated debts amid sharply diminished inflows of foreign exchange. In addition, while some emerging developing countries were able to issue new debt in international bond markets in the second half of 2020 and in 2021, others were severely hit by the collapse of international travel and tourism and by a significant decline in foreign direct investment, international remittances and commodity prices.

Overall, the increases in government spending and declines in government revenue has resulted in a global increase of the average general government debt over GDP ratio of 15 percentage points, from 83.6 per cent in 2019 to 98.6 per cent in 2020. The increase was higher for advanced economies, 18.9 percentage points, followed by emerging economies, 9.3 percentage points, and low-income developing countries, 5.8 percentage points (IMF, 2021a). The sharp increase in public debt resulting from the COVID-19 pandemic has added to risks that were building up before the pandemic. According to the World Bank, since 2010, the world has experienced the largest, fastest and most broad-based episode of sovereign and corporate debt build-up in the past 50 years (Kose and others, 2021). Going forward, the debt vulnerabilities of low-income developing countries, approximately 60 of which are in debt distress or at high risk of debt distress, are expected to remain high, with less room for further borrowing and with rising debt services compared to tax revenues (IMF, 2021a; Georgieva and Pazarbasioglu, 2021).

¹ The Group of 10 includes Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland and the United Kingdom of Great Britain and Northern Ireland.

² Author's calculations based on data from the IMF Database of fiscal responses to COVID-19. Available at www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19 (updated as of 11 September 2021).

Heavy debt build-ups and the risk of sovereign debt distress among developing countries, in turn, poses serious challenges to economic growth, poverty alleviation and sustainable development. The World Bank estimates that in 2020, the number of extreme poor increased by 97 million or 11.6 per cent compared to 2019 (Mahler and others, 2021).³ Moreover, as the experiences of Latin America in the 1980s or Greece after the global financial crisis of 2008 suggest, debt crises can cause protracted stagnation that lasts for many years. Considering the additional investment requirements needed to achieve the Sustainable Development Goals and implement the Paris Agreement, a debt overhang affecting a large number of developing countries is a worrisome prospect.

To address debt problems caused by the pandemic in developing countries, the Secretary-General of the United Nations (United Nations, 2020) has proposed a three-phase approach: (a) a debt standstill to provide immediate breathing space for all countries that need it; (b) provide additional, targeted debt relief for countries that require support beyond a temporary suspension of debt service; and (c) address structural issues in the international debt architecture to prevent defaults leading to prolonged financial and economic crises in future.

The first phase has been addressed by the Debt Service Suspension Initiative (DSSI) of the G20, launched in April 2020 and closed in December 2021. The initiative provided additional fiscal space to low-income countries by postponing their debt service to official creditors. Of the 73 eligible countries, 48 had joined the initiative as of 23 November 2021.⁴ While the temporary relief provided by the initiative has been welcome, the beneficiaries will likely need additional support going forward. In this regard, the G20 Riyadh Leaders Summit endorsed the Paris Club agreement to launch a “Common Framework for Debt Treatments beyond the DSSI” (Paris Club, 2020).⁵ The purpose of the Common Framework is to coordinate Paris Club and non-Paris Club creditors in the provision of debt relief to DSSI eligible countries on a case-by-case basis. The Common Framework has the potential to address phases 2 and 3 of the Secretary-General’s approach but its implementation to date has been rather slow, with only three countries – Chad, Ethiopia and Zambia – having requested debt relief under it.

³ Extreme poverty is measured using the international poverty line of \$1.90/day.

⁴ www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative. Accessed on 11 December 2021. Eligible countries to DSSI include the 72 countries eligible to borrow from the International Development Association (IDA) of the World Bank plus Angola.

⁵ See also annex 1 of the statement released after the Extraordinary G20 Finance Ministers and Central Bank Governors’ Meeting on 13 November 2020. Available at www.imf.org/-/media/Files/News/news-articles/english-extraordinary-g20-fmcbg-statement-november-13.ashx.

Traditionally, sovereign debt problems of developing countries have been discussed mostly at institutions representing the creditors, such as the Paris Club, and at the International Monetary Fund (IMF). They have also been addressed by the United Nations, mostly in the context of its international conferences on financing for development. The views of the United Nations on debt are not widely known, but they are highly relevant in the post-COVID-19 context, specifically because potential tightened global financial conditions in response to inflationary pressures could further exacerbate debt vulnerabilities in developing countries.

The rest of the paper is organized as follows: section I provides an overview of sovereign debt restructurings from the 1980s leading to the latest developments. Section II contains a discussion on the debt situation of Asia and the Pacific as a case study to assess the suitability of the current global debt architecture to solve debt difficulties going forward. Section III provides a review of the views of the United Nations on debt issues, including debt restructuring, and in section IV, some ideas to improve the global debt architecture based on such views are offered.

I. AN OVERVIEW OF SOVEREIGN DEBT RESTRUCTURINGS SINCE THE 1980S

A sovereign debt restructuring can be defined as an exchange of outstanding sovereign debt instruments, such as loans or bonds, for new debt instruments or cash. Sovereign restructurings were unusual before the 1980s, and most of them involved the rescheduling of sovereign debts with official bilateral creditors through the Paris Club. This is because sovereign debt with commercial creditors was rare until the 1970s. During that decade, the breakdown of the Bretton Woods system, the OPEC oil shocks, and the recycling of petrodollars resulted in a major increase in global liquidity, part of which was channelled as loans from commercial banks to developing countries (Lissakers, 1991).

The debt crisis of the 1980s

A debt crisis began in 1982 when a number of middle-income countries were unable to service their debts with commercial banks as a result of a jump in interest rates and a drop in commodities prices in the previous years. As a result of the crisis, the number of restructuring deals leaped to 268 in the 1980s, compared to only 45 in the twenty-five years between 1955 and 1980. The total value of these debt restructurings increased even more substantially, from \$20 billion between 1955 and 1980 to \$600 billion in the 1980s.⁶

⁶ Author's calculations based on data from Das, Papaioannou and Trebesch (2012).

The restructuring of developing countries' sovereign debts with their commercial bank creditors during that decade was a complex and drawn-out process in which borrowers and commercial banks engaged in repeated negotiations to reschedule debt services. Although the borrowers were clearly facing a problem of solvency and not just liquidity, it was only at the end of the decade, through the Brady Plan of 1989, that a resolution was attained. This inefficient debt restructuring process resulted in a "lost decade" for the borrowers, characterized by an interruption in their access to capital markets, limited investment, and stagnant growth and development.

The Brady Plan provided options for the exchange of outstanding bank debt for long-term bonds. While the characteristics of the so-called Brady bonds varied from country to country, two basic bond options were par bonds and discount bonds. Par bonds had the same face value as the outstanding bank debt, but the interest rate was fixed and below the market rate. Discount bonds had a lower face value than the debt outstanding, generally with a discount of between 30 and 50 per cent, and market-based, floating interest rates. The principal of par and discount bonds was secured at final maturity through zero-coupon instruments.⁷

The Highly Indebted Poor Countries (HIPC) Initiative

While the debt crisis of the 1980s was renowned for the protracted negotiations between middle-income countries and commercial banks, low-income countries indebted with bilateral official creditors were also facing difficulties. In fact, between 1955 and 2010, most of the debt restructuring episodes were with bilateral official creditors. In the 1980s, there was a total of 268 debt restructurings of which 167 were through the Paris Club, compared to 101 with commercial creditors.⁸

Until the late 1980s, restructuring negotiations with the Paris Club only rarely included reductions in the face value of debts. This started to change in 1988, when the Paris Club adopted the Toronto terms, which allowed for a reduction of 33.33 per cent in the stock of debt of poor countries. These were replaced in 1991 by the London terms, which allowed for a debt reduction of 50 percent, and in 1994 by the Naples terms, which allowed countries eligible to receive loans from the International Development Agency (IDA) of the World Bank to have between 50 and 67 per cent of their debts cancelled. Subsequently, in 1999, the Cologne terms allowed countries

⁷ In the case of United States dollar-denominated debt, issuing countries purchased from the United States Treasury zero-coupon bonds with a maturity corresponding to the maturity of the individual Brady bond. The zero-coupon bonds were held in escrow at the Federal Reserve until the bond matured, at which point the zero-coupons would be sold to make the principal repayments. For more details on the Brady Plan, see Trade Association for the Emerging Markets (EMTA) (2021).

⁸ Author's calculations based on data from Das, Papaioannou and Trebesch (2012).

eligible to the Highly Indebted Poor Countries (HIPC) Initiative to have 90 per cent of their debts cancelled (Paris Club, n.d.). See also Weiss (2013).

The HIPC debt relief programme was created by the World Bank and IMF in 1996 to reduce some multilateral debts as a complement to the bilateral debt forgiveness offered by the Paris Club (Weiss, 2006). The initiative is ongoing. As of March 2021, 37 countries, 31 of which are in Africa, received debt relief through it (IMF, 2021b). Between 1998 and 2010, members of the Paris Club engaged in 82 debt restructuring episodes with countries participating in the HIPC Initiative.⁹ As of March 2021, two additional countries – Eritrea and Sudan – became eligible for HIPC Initiative assistance.

Eligible countries for HIPC Initiative assistance must also be eligible to borrow from IDA and fulfil the following conditions: (a) have a strong track record of economic reforms under World Bank and IMF-sponsored programmes; (b) possess a debt burden that is unsustainable after bilateral debt relief has been applied; and (c) have developed a poverty reduction strategy paper (Weiss, 2006; IMF, 2021b). Unsustainable debt was initially defined as a debt service-to-exports ratio exceeding 250 per cent, but the threshold was lowered to 150 per cent in 1999.

The provision of debt relief under HIPC Initiative involves two stages. In the first stage, a candidate country for debt cancellation establishes a three-year track record of good economic performance under existing IMF and World Bank lending arrangements. During this period, the country receives debt reduction from Paris Club official creditors under the Naples Terms. Other bilateral and commercial creditors are expected by Paris Club members to offer similar or better debt restructuring deals. This stage culminates in a “decision point,” in which it is determined whether the country requires additional debt relief and how much it should receive. During the second stage, the country must continue to establish a track record of good economic policies and implement its poverty reduction strategy. During that stage, the country’s bilateral debts are rescheduled under the Cologne terms of the Paris Club. The second stage ends at a “completion point,” in which countries’ debts are permanently cancelled according to the debt relief determined at the “decision point” (IMF, 2021b).

In 2005, the HIPC Initiative was supplemented by the Multilateral Debt Relief Initiative with the goal of accelerating progress towards achieving the Millennium Development Goals. This initiative allowed for 100 per cent relief on eligible debts by three multilateral institutions – IMF, the World Bank, and the African Development Fund – for countries completing the HIPC Initiative process. In 2007, the Inter-American Development Bank decided to provide additional debt relief to the five HIPCs in the Western Hemisphere (Weiss, 2006).

⁹ Author’s calculations based on data from Das, Papaioannou and Trebesch (2012).

A global statutory approach: the sovereign debt restructuring mechanism

By the time that the Paris Club and HIPC Initiative provided debt relief to low-income countries through partial debt cancellations, bondholders had replaced commercial banks as the main creditors of middle-income developing countries, a consequence of the Brady Plan. However, this change did not reduce the need for debt restructurings: between 1991 and 2000, there were 53 commercial debt restructuring deals for a total value of \$242 billion.¹⁰

The emergence of sovereign bonds as the leading source of private finance of developing countries brought new complexities to debt restructuring processes. As Krueger (2001) noted, the sovereign debt restructurings of the 1980s were “protracted but generally orderly processes.” At that time the major creditors were commercial banks, which negotiated with a debtor through a steering committee representing a large percentage of the total debt to be restructured. The banks had incentives to be cooperative, to safeguard future business with the debtor and to comply with bank regulations in their home country (Krueger, 2001).

In contrast, bondholders are a heterogeneous group with diverse goals in debt restructuring processes. While some will be interested in a rapid and orderly restructuring that will preserve the value of their claims, others will prefer a disorderly process that will allow them to buy distressed debt cheaply in secondary markets in the hope of making a large speculative profit (Krueger, 2001). Individual bondholders also have the recourse of litigation with a defaulting sovereign and are not bound by financial regulators. The unfortunate consequence of this situation is that debtor countries will, in the words of Anne Krueger (2001), “go to extraordinary lengths to avoid restructuring their debts to [...] private creditors.”

To address these complex collective action problems, IMF launched a proposal to set up a sovereign debt restructuring mechanism in November 2001, which was endorsed by most, but not all, of the IMF executive directors by April 2003. The proposal, as described by Hagan (2005, p. 336), focused on addressing the problem of holdout creditors through “a legal framework that would enable a qualified majority of creditors to make critical decisions, including, but not limited to the acceptance of the final restructuring terms, that would be binding on all private creditors holding external claims”.

Three important characteristics of the proposed sovereign debt restructuring mechanism were the following (Hagan, 2005):

¹⁰ In comparison, there were 101 commercial debt restructurings in the 1980s for a total value of \$200 billion. Author’s calculations based on data from Das, Papaioannou and Trebesch (2012).

- (a) The aggregation of claims across different instruments, regardless of whether there is a contractual voting framework that links these instruments;
- (b) A centralized dispute resolution forum would be given exclusive jurisdiction over all disputes that may arise during a restructuring proceeding;
- (c) Both contractual and judgment creditors would be included in restructuring processes under the sovereign debt restructuring mechanism.¹¹

The sovereign debt restructuring mechanism proposal required an amendment to the IMF Articles of Agreement, for which the support of a minimum of three fifths of its members holding 85 per cent of the voting power was needed. Although the United States of America, which at that time held 17.14 percent of the IMF voting power, was initially favourable to the proposal, in April 2003 the country withdrew its support for it. Hagan (2005) suggested that an important reason for the withdrawal of support for the sovereign debt restructuring mechanism by the United States was a strong preference for resolving debt restructurings through market-based, contractual approaches. The successful introduction of collective action clauses in bonds issued under New York law in early 2003, to be discussed in the next section, provided an opportunity to improve such approaches.

Market-based contractual approaches strengthened: collective action clauses

Because of the failure of the proposed sovereign debt restructuring mechanism, direct negotiations between debtors and bondholders continued to be the main modality of debt resolution between sovereign States and their commercial creditors. A bond is a legally binding contract between the issuer and the bondholders, and any modification of its terms requires agreement among all the parties in accordance with the terms of the contract. Collective actions clauses are contractual provisions that permit a majority or supermajority of holders of a multi-creditor debt instrument such as a bond to make decisions that bind all holders of the instrument (Buchheit and Gulati, 2020).

Collection actions clauses were introduced in 1879 in corporate bonds governed by English law. The clauses allowed a modification of the terms of the bond for all holders provided that a voting threshold, typically 75 per cent of the principal, is reached. These clauses were largely absent in bonds issued in the United States until 2003, when majority restructuring provisions became standard in bonds governed by New York law. According to Hagan (2005, p. 320), this breakthrough was attributable to concerns among both market participants and emerging-market issuers that in

¹¹ A judgement creditor is defined by the Cambridge Dictionary as “a person or company that a court of law has decided has the legal right to receive money from another person or company”.

the absence of a market-based instrument to facilitate debt restructurings, “there was a greater likelihood that the official sector would proceed with more forceful intervention, i.e. the establishment of some form of statutory debt restructuring framework.”

A weakness of both the English law collective actions clauses and the ones introduced under New York law in 2003 is that they operate individually for each series of a bond. If, for instance, the clause requires holders to hold a minimum of 75 per cent of the outstanding principal to agree to a restructuring proposed by the issuer, a holdout creditor or group of creditors could buy up more than 25 per cent of a particular series of a bond to block the restructuring proposal. To address this problem, a new generation of collective actions clauses introduced an aggregated voting procedure for restructuring decisions, along with the traditional series-by-series votes. The so-called “two-limb” collective actions clauses were first included in a bond issued by Uruguay in 2003. It required an affirmative vote of the holders of 85 per cent of the outstanding principal of all series of affected bonds plus a vote of $66\frac{2}{3}$ per cent of each individual series of bonds to be considered in the restructuring.

The rationale for including both series-by-series votes and an aggregate vote was to avoid the so-called “ganging up” problem, by which a majority of holders can force a restructuring that offers a bad deal to holders of one or a few specific series. To illustrate this, Buchheit and Gulati (2020) consider a hypothetical example under which the issuer proposes to restructure series 1 through 9 of a 10-series bond on very generous terms while offering the holders of series 10 to a 90 per cent write off of the principal. If there is only a collective vote by the holders of the 10 series, they will agree to a deal that would be very detrimental to holders of series 10 of the bond.

While “two-limb” collective actions clauses are effective in protecting minority holders from a detrimental restructuring, the per-series vote can still be subject to holdout creditors who could block a multi-series restructuring deal by buying 34 per cent of a single series. The importance of the “holdout problem” was clear in the Greek debt restructuring of 2012. Of the 36 series of bonds governed by English law, the holders of only 17 series voted to accept the restructuring proposal, while holdout creditors who had acquired blocking positions derailed the restructuring of the remaining 19 series. It is unlikely that this problem would have been completely solved with Uruguay-style “two-limb” collective actions clauses. To reduce the influence of holdout bondholders, in 2013 “two-limb” collective actions clauses were introduced and made mandatory for all eurozone sovereign bonds issues, but with lower voting thresholds: $66\frac{2}{3}$ per cent for the aggregate vote and 50 per cent for the series-to-series vote (Buchheit and Gulati, 2020).

The latest generation of collective actions clauses proposed by the International Capital Markets Association in 2014, known as “enhanced” collective action clauses allow for modifications in the terms of a sovereign bond in three possible ways (Buchheit and Gulati, 2020):

- (a) Pursuant to a series-by-series vote with a 75 per cent voting threshold;
- (b) On an aggregated basis by a two-tier vote with a $66\frac{2}{3}$ per cent vote of the entire aggregated universe of bondholders and a 50 per cent vote of each series in the aggregated pool, similar to the model eurozone collective actions clauses;
- (c) Pursuant to a single, 75 per cent vote of the entire aggregated universe if and only if the proposed modification is uniformly applicable to all affected series.

The debt restructurings of Ecuador and Argentina in 2020 used the second option of enhanced collective actions clauses. The third option, which allows for a “single limb” voting procedure, is an important innovation in collective actions clauses, which has received support from IMF (2014). The requirement that any modification of the bond terms should be uniformly applicable across series aims at avoiding the “ganging up” problem discussed above, while reliance on a single vote to all series being restructured prevents holdout bondholders to block a deal by acquiring more than 50 per cent of a single series. As of December 2021, however, there had not been any sovereign bond restructurings based on the single limb option of the International Capital Market Association’s enhanced collective actions clauses.

Overall, the introduction of collective actions clauses in the early 2000s seems to have had a favourable effect on the efficacy of sovereign debt restructurings with bondholders. According to data compiled by Asonuma and Trebesch (2016), the median duration of debt restructurings declined from 60 months over the period 1991–2000 to 37 months over the period 2001–2010 and 10 months over the period 2011–2020.¹² In addition, the proportion of debt restructurings that occurred post-default also decreased, from 83 per cent over the period 1991–2000 to 68 per cent over the period 2001–2010 and 29 per cent over the period 2011–2020. This improvement, however, hides important differences across countries. During the period 2001–2010 debt restructurings that occurred post-default had a median duration of 136 months. In addition, the percentage of sovereign debt restructurings that involved creditor litigation increased from approximately 25 per cent to 50 per cent throughout this decade (Schuhmacher, Trebesch and Enderlein, 2018).

¹² Author’s calculations based on the database of Asonuma and Trebesch (2016). Available at <https://sites.google.com/site/christophtrebesch/data>. The data for 2020 is as of September of that year.

Recent views and developments in debt restructuring

In an evaluation of the experience of debt restructurings with private creditors since 2014, IMF (2020c) pointed out that they tended to proceed smoothly, were largely pre-emptive and had shorter average duration and higher average creditor participation than in the past, although not for all countries. Although it considered collective actions clauses to have been largely effective in resolving sovereign debt cases, the IMF assessment notes some gaps that could pose challenges in future, including the following:

- (a) The large outstanding stock of international sovereign bonds that lack enhanced collective actions clauses, making them more vulnerable to holdout creditors;
- (b) The existence of other forms of debt, such as syndicated loans or sub-sovereign debt, which often lack majority restructuring provisions for payment terms;
- (c) Increased use of collateral and collateral-like instruments, which has the potential to complicate sovereign debt restructurings;
- (d) The perennial issue of information asymmetry preventing common understandings of the perimeter of the restructuring operation and how each claim will be classified.

The International Monetary Fund proposes various options to address these challenges. These include strengthening contractual arrangements, expanding the use of enhanced collective actions clauses, adding majority restructuring provisions in loan agreements and considering state-contingent clauses to protect sovereigns from exogenous downside risks. The report mentions the potential usefulness of the so-called “anti-vulture funds” legislation to provide additional protection against holdout creditors and makes a strong call to the international community to enhance debt transparency and help borrowing countries strengthen their debt management capacity through technical assistance. Finally, the report points out that current instruments may not be sufficient in a major global debt crisis affecting many countries. Accordingly, additional financial and statutory instruments may be required. Among the latter, the report mentions international law options, such as a United Nations Security Council resolution, which could be used to limit creditor recovery or the timing of suits or to immunize specified assets from attachment by creditors.¹³

¹³ The only precedent of a United Nations resolution used to that effect is described in section III.

The possibility of a global debt crisis is not farfetched.¹⁴ A recent article by Bulow and others (2020) warns that “there is brewing in the background a growing need for debt restructurings in numbers not seen since the debt crisis of the 1980s” and calls official creditors to “be prepared to act as needed.” The authors note that, historically, official lenders have taken much larger losses than private lenders in sovereign debt restructurings, contradicting the assumption that the official sector is senior to the private sector. They also note the very long time to resolve default episodes, which historically has averaged seven years and involved multiple restructurings. One reason for such long resolution times is that both debtors and creditors have expected that delays will help both sides bargain for larger infusions from official creditors.

For debt restructuring processes to be fairer and more efficient, a greater degree of inter-creditor equity and fair burden sharing, especially between official and private creditors, is called for in the report. Also suggested in the report are the following: an increase in the transparency of debt data and debt contracts to facilitate more expedient creditor-debtor negotiations and allow both parties to identify which bonds are at risk of holdout or litigation tactics; and the preparation of realistic economic forecasts that incorporate downside risks to facilitate an earlier identification of cases in which large write-downs will be necessary.

In response to these concerns, the Common Framework for Debt Treatments beyond the DSSI was proposed at an extraordinary meeting of the G20 finance ministers and central bank governors on 13 November 2020 as a mechanism to restructure debt obligations of selected developing countries. Its main characteristics are the following:

- (a) *Eligibility*: All countries eligible to participate in the Debt Service Suspension Initiative (DSSI);
- (b) *Initiation of the process*: Upon request of debtor countries;
- (c) *Assessment*: The need for debt restructuring will be assessed through the IMF-World Bank debt sustainability analysis and the collective assessment of the bilateral creditors;
- (d) *Eligible debt*: Public and publicly guaranteed debt with a maturity of at least one year;
- (e) *Data disclosure*: Applying debtors will provide the necessary information regarding all public sector debt, “while respecting commercially sensitive information”;

¹⁴ See, for example, Kharas (2020) and Spiegel, Schwank and Obaidy (2020).

- (f) *Participation of bilateral creditors:* All bilateral creditors, including members of the G20 and the Paris Club plus others on a voluntary basis, will participate in restructuring exercises;
- (g) *IMF programme:* Debtors receiving support will engage in an upper credit tranche (UCT) IMF-supported programme;
- (h) *Debt write-offs:* Although discouraged, they will be considered if needed;
- (i) *Burden-sharing:* There will be fair burden-sharing among official creditors. Private creditors will be expected to offer a treatment at least as favourable as what is offered by official creditors.
- (j) *Creditor coordination:* The debtor will sign a memorandum of understanding with participating creditors. The debtor will be required to seek from all its other official bilateral creditors and private creditors a treatment at least as favorable as the one agreed in the memorandum of understanding. The debtor will be required to provide signatories of the memorandum of understanding regular updates on the progress of its negotiations with its other creditors.

As was noted in the introduction, as of December 2021 only three countries – Chad, Ethiopia, and Zambia – have requested debt relief through the Common Framework, all of them between the end of January and the beginning of February of 2021. In June 2021 a creditor’s committee for Chad, comprised of China, India, France, and Saudi Arabia, was established (Jubilee Debt Campaign, 2021). The 12-member creditors’ committee for Ethiopia, led by China and India, was established in September 2021 (Paris Club, 2021), and the creditor’s committee for Zambia still needed to be established as of the end of 2021 (Georgieva and Pazarbasioglu, 2021).

Chad is important as a test case of the success of the Common Framework in bringing private creditors to the negotiating table and having them agree to offer a deal at least as favourable as the one offered by official creditors. The country’s private debt of \$1 billion is owed to a syndicate led by Glencore, an Anglo-Swiss commodities trading company (Jubilee Debt Campaign, 2021). Because the debt is collateralized with future oil shipments, the creditors are in no hurry to commit to a restructuring deal, as they will get paid as long as the country continues to export oil.

Based on the initial experience of the Common Framework, Georgieva and Pazarbasioglu (2021) propose four areas for improvement: (a) clarify the different steps and timelines of the process; (b) consider a comprehensive and sustained debt service payment standstill during the duration of the negotiations to provide relief to the debtor at a time of distress and incentivize creditors to speed up progress and

the creditor's committee for Zambia still needed to be established as of the end of 2021 (Georgieva and Pazarbasioglu, 2021). towards a debt restructuring deal; (c) clarify further how the comparability of treatment of official and private creditors will be effectively enforced, including through the implementation of the IMF arrears policies; and (d) expand the Common Framework to other, currently non-eligible highly indebted countries that can benefit from creditor coordination.

On the third point, the IMF "lending into arrears" policy has allowed the organization to lend to a sovereign with arrears to external private creditors, only if the country is making a "good faith effort" to reach a collaborative agreement with its private creditors (Buchheit and others, 2019). This policy provides financial space for debtors to take more time, if needed, to negotiate an appropriate debt restructuring deal.

II. DEBT IN ASIA AND THE PACIFIC IN THE AFTERMATH OF THE COVID-19 PANDEMIC: A CASE STUDY

To assess the suitability of the current debt architecture, recent debt data from the Asia-Pacific developing countries were analysed. Following ESCAP (2021a), the countries are grouped into three categories: (a) countries that are eligible for Common Framework treatment, (b) countries not eligible for Common Framework treatment with below investment grade credit ratings, and (c) countries not eligible for Common Framework treatment with investment grade credit ratings. Table 1 shows the composition of the three groups of countries.

The rationale for the classification is that countries eligible for Common Framework treatment are expected to access that debt restructuring mechanism under the aegis of IMF. Of the 34 Asia-Pacific countries included in the World Bank International Debt Statistics database, the majority, 20 countries, fall into this category.¹⁵ The other two categories, which include seven countries each, group countries not eligible for Common Framework treatment, dividing them according to whether their credit ratings are investment grade. The rationale for distinguishing between them is that countries with investment grade credit ratings have access to global capital markets on better terms than those that do not.

¹⁵ The World Bank International Debt Statistics database includes an additional Asian country, the Islamic Republic of Iran. This country is not included in the analysis because of its very low access to foreign exchange and external debt due to political sanctions.

Table 1. Country groups for debt analysis

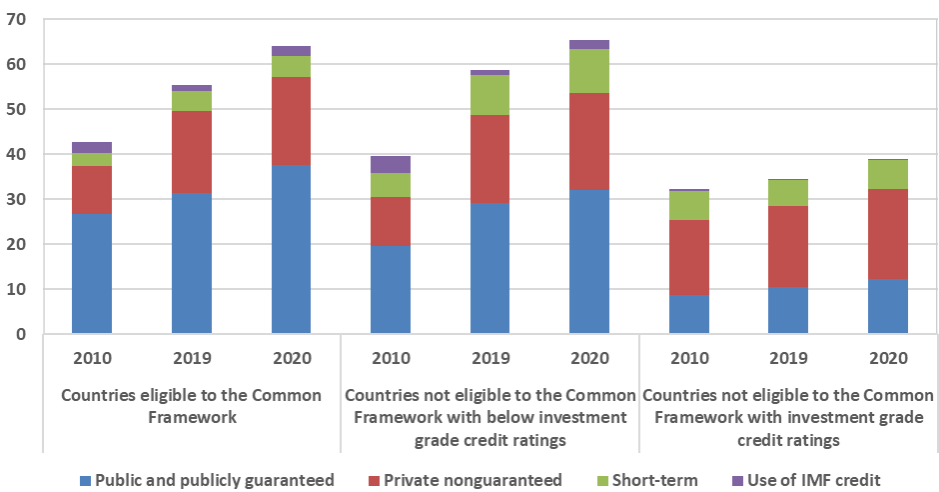
Country group	Countries
(1) Countries eligible for Common Framework treatment	Afghanistan, Bangladesh, Bhutan, Cambodia, Fiji, Kyrgyzstan, the Lao Peoples Democratic Republic, Maldives, Myanmar, Mongolia, Nepal, Pakistan, Papua New Guinea, Samoa, Solomon Islands, Tajikistan, Timor-Leste, Tonga, Uzbekistan and Vanuatu
(2) Countries not eligible for Common Framework treatment with below investment grade credit ratings	Armenia, Azerbaijan, Georgia, Sri Lanka, Turkey, Turkmenistan and Viet Nam
(3) Countries not eligible for Common Framework treatment with investment grade credit ratings	China, India, Indonesia, Kazakhstan, the Philippines, the Russian Federation and Thailand

Source: Author, based on data from World Bank, COVID-19: Debt Service Suspension Initiative. Available at www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative (accessed on 14 December 2021); and Trading Economics, Credit rating. Available at <https://tradingeconomics.com/country-list/rating> (accessed on 14 December 2021).

As a result of the COVID-19 pandemic, the level of indebtedness of the Asia-Pacific developing countries increased substantially in 2020. The increase was largest for the group of countries eligible for Common Framework treatment, 8.7 percentage points of GDP, followed by the countries not eligible for Common Framework treatment with below investment grade credit rating, 6.6 percentage points of GDP, and the countries not eligible for Common Framework treatment with investment grade credit rating, 4.5 percentage points of GDP (figure 1).

Figure 1 also shows that the category of countries not eligible for Common Framework treatment and with credit ratings below investment grade had the highest average debt-to-GDP ratio in 2020, 65.3 per cent, and experienced the fastest increase in the ratio since 2010, 25 percentage points. In contrast, the countries not eligible for Common Framework treatment and with investment grade credit ratings had the lowest debt-to-GDP ratio in 2020, 39 per cent, and it has increased the least since 2010, 6.7 percentage points. With regard to the composition of the external debt, the share of the public and publicly guaranteed debt decreased across the three groups. In 2020, this share ranged from slightly above 30 per cent for the countries not eligible for Common Framework treatment with investment grade credit ratings to close to 60 per cent of the total for the countries eligible for Common Framework treatment. In the first group of countries, more than 50 per cent of the debt is private non-guaranteed.

Figure 1. Total external debt stocks, percentage of the GDP, by country group



Source: Author, based on data from World Bank, “International debt statistics”, Data Bank. Available at <https://databank.worldbank.org/source/international-debt-statistics> (accessed on 14 December 2021).

Regarding terms of borrowing, they improved significantly between 2019 and 2020. As shown in table 2, the average interest rate on new loans for all countries decreased by one full percentage point, from 2.8 percent in 2019 to 1.8 per cent in 2020, while the maturity was extended slightly. These favourable conditions applied to the three groups of countries considered in the analysis. The group of countries eligible for Common Framework treatment had the lowest interest rates and longer maturities because of their access to concessional credit lines.

As shown in figure 2, the countries eligible for Common Framework treatment recorded the most rapid increase in their public and publicly guaranteed external debt between 2019 and 2020, 6.2 percentage points of the GDP, followed by the countries not eligible for Common Framework treatment with credit ratings below investment grade, 2.8 percentage points, and the countries not eligible for Common Framework treatment with investment grade credit ratings, 1.7 percentage points.

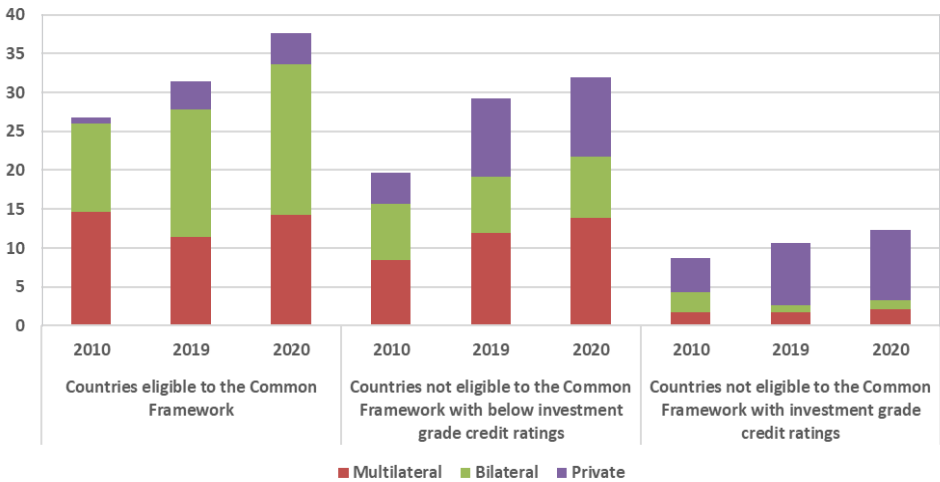
Table 2. Average interest rate and maturity of new public and publicly guaranteed external debt in 2019 and 2020, by country group

	Average interest on new external debt commitments (per cent)		Average maturity on new external debt commitments (years)	
	2019	2020	2019	2020
Countries eligible for Common Framework treatment	2.3	1.4	25.8	26.5
Countries not eligible for Common Framework treatment with below investment grade credit ratings	3.2	1.9	14.5	17.5
Countries not eligible for Common Framework treatment with investment grade credit ratings	3.5	2.7	18.1	16.9
All countries	2.8	1.8	21.6	22.3

Source: Author, based on data from World Bank, "International debt statistics", Data Bank. Available at <https://databank.worldbank.org/source/international-debt-statistics> (accessed on 14 December 2021).

From a longer-term perspective, the creditor composition of the public and publicly guaranteed debt changed between 2010 and 2020 in the three groups. In the case of the countries eligible for Common Framework treatment, the share of the multilateral development banks declined significantly, from 55 per cent in 2010 to 38 per cent in 2020. This drop was compensated by increases in bilateral debt, from 42.1 per cent in 2010 to 51.3 per cent in 2020, and debt to private creditors, from 2.8 per cent in 2010 to 10.6 per cent in 2020. In the countries not eligible for Common Framework treatment, the main change has been the growing importance of private creditors. Their share increased from 20.1 per cent in 2010 to 32.3 per cent in 2020 in the below-investment grade countries and from 49.9 per cent in 2010 to 73.1 per cent in 2020 in the investment grade countries.

Figure 2. Public and publicly guaranteed external debt stocks, percentage of the GDP, by country group



Source: Author, based on data from World Bank, “International debt statistics”, Data Bank. Available at <https://data.bank.worldbank.org/source/international-debt-statistics> (accessed on 14 December 2021).

To complete this overview of the impact of the COVID-19 pandemic on external debt in Asia and the Pacific, figure 3 shows the debt service-to-exports ratios by country and by country group.¹⁶ Debt services are for the public and publicly guaranteed debt on average for 2021 and 2022, and exports include goods and services. The figure includes two horizontal lines at 10 per cent and 21 per cent. These are the prudential thresholds for the debt services-to-exports threshold recommended by the Debt Sustainability Framework for Low-Income Countries of IMF and the World Bank.¹⁷

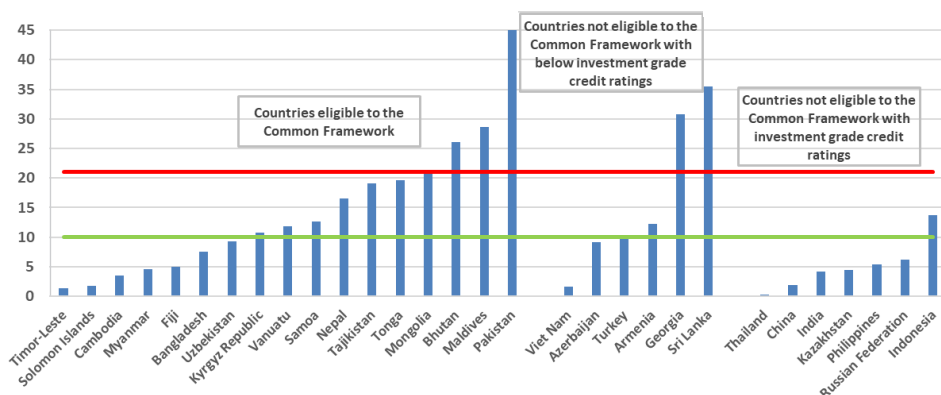
The figure shows that 16 out of 30 developing countries have debt services-to-export ratios below 10 per cent, eight are between 10 and 21 per cent, and six are above 21 per cent. Of the six above 21 per cent, four belong to the category of countries eligible for Common Framework treatment and two are countries not eligible for Common Framework treatment that have credit ratings below investment grade.

¹⁶ Afghanistan, the Lao People’s Democratic Republic, Papua New Guinea, and Turkmenistan were excluded because they lacked data on exports for 2020. The indicator in the figure is Sustainable Development Goal indicator 17.4.1.

¹⁷ According to IMF (2021c), the Framework suggests different indicative thresholds for debt burdens depending on the country’s historical performance and outlook for real growth, international reserves coverage, and the state of the global environment. Strong performers have higher thresholds.

If the debt situation deteriorates in 2022 and beyond due to increases in interest rates by the main central banks in an effort to contain inflationary pressures, the latter countries will be the most exposed because of their ineligibility for Common Framework treatment and difficulties to access global capital markets due to their below investment grade credit ratings.

Figure 3. Debt service on public and publicly guaranteed external debt, average 2021–2022, over exports of goods and services in 2020 (percentage)



Source: Author, based on data from World Bank, “International debt statistics”, Data Bank. Available at <https://databank.worldbank.org/source/international-debt-statistics> (accessed on 14 December 2021); and World Bank, Open Data. Available at <https://data.worldbank.org/indicator/NE.EXP.GNFS.CD> (accessed on 14 December 2021).

Coping with debt challenges during the pandemic

Despite the increasing debt pressures resulting from the COVID-19 pandemic, as of December 2021, no developing country in Asia and the Pacific needed to restructure its external debt. Countries with access to global capital markets were able to borrow at favourable terms helped by the abundant global liquidity driven by massive asset purchase programmes instituted by the developed countries’ central banks. Even some countries facing challenging circumstances, such as Maldives, which was badly affected by the collapse of the travel and tourism industry during the pandemic, were able to obtain financing in the global capital market. Maldives raised \$500 million through a series of issuances of sukuk (Islamic bonds), but the cost of this financing was high, at close to 10 per cent per year (Maldives Financial Review, 2021).

In addition, the international financial institutions contributed significant amounts of financing to assist developing countries amid the pandemic. By one estimate, they provided \$237.2 billion in COVID-19-related support in 2020, including \$102.9 billion by IMF, \$39.1 billion by the European Investment Bank, \$36.9 billion by the World Bank, and \$15.5 billion by the Asian Development Bank (Segal and Henderson, 2021).

Countries in the region also benefited from various global initiatives, including DSSI, mentioned in the introduction, and a new general allocation of special drawing rights (SDRs) for \$650 billion approved by the IMF Board of Governors on 2 August 2021. Out of 24 Asia-Pacific developing countries eligible to partake in DSSI, 11 countries chose to participate. ESCAP (2021a, pp. 17–18) estimated that their average potential savings from participating at the initiative were 1.9 per cent of their combined GDP. This amount, however, represented only 20 per cent of their average external debt services due in 2020 and 2021. Regarding the SDR allocation, the Asia-Pacific developing countries are estimated to have received 1.5 per cent of their 2020 GDP, on average, ranging from a minimum of 0.3 per cent for China to a maximum of 3.9 per cent for Tonga.

III. THE VIEWS OF THE UNITED NATIONS ON DEBT ISSUES, INCLUDING DEBT RESTRUCTURING

As an institution that seeks to address global challenges through deliberation, consensus-building and international cooperation, the United Nations has approached debt issues mostly through the establishment of normative principles. The Monterrey Consensus of 2002 emphasized “the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between the public and private sectors and between debtors, creditors and investors” (United Nations, 2003, para. 51). The Doha Declaration on Financing for Development of 2008 elaborated further on the need for principles for debt crisis prevention and resolution through “solutions that are agreeable and transparent to all” and “in cooperation with the private sector” (United Nations, 2009, para. 61). The proposed principles include the following:

- (a) Ensuring that debt resolution is a joint responsibility of all debtors and creditors, both State and commercial;
- (b) Recognizing that furthering development and restoring debt sustainability are the main objectives of debt resolution;
- (c) Strengthening transparency and accountability among all parties;
- (d) Promoting responsible borrowing and lending practices;

- (e) Improving debt management and national ownership of debt management strategies;
- (f) Facilitating equivalent treatment of all creditors.

The promotion of responsible borrowing and lending practices was further elaborated in the United Nations Conference on Trade and Development Principles on Responsible Sovereign Lending and Borrowing of 2012 (UNCTAD, 2012). The principles include the following: *Agency* – the recognition that sovereign borrowers have the obligation to act in the public interest; *Informed decisions* – the need for lenders to ensure that sovereign borrowers understand the implications of the loans they take; *Responsible credit decisions* – the need for lenders to ensure that sovereign borrowers have the capacity to repay the loan; *Transparency* – the need for borrowers to put in place and implement a comprehensive legal framework that clearly defines procedures, responsibilities and accountabilities in sovereign borrowing; *Disclosure and publication* – the need for borrowers to disclose terms and conditions of loans; and *Restructuring* – the prompt, efficient and fair restructuring of sovereign debt obligations if needed.

On debt restructuring, the General Assembly, in a 2014 resolution, decided to “*elaborate and adopt through a process of intergovernmental negotiations... a multilateral legal framework for sovereign debt restructuring processes* with a view, inter alia, to increasing the efficiency, stability and predictability of the international financial system and achieving sustained, inclusive and equitable economic growth and sustainable development...” (United Nations General Assembly, 2014, emphasis added). While the language in this resolution is about the adoption of a multilateral legal framework for debt restructurings, a similar idea to the failed sovereign debt restructuring mechanism proposed by IMF a decade before, an ad hoc committee established to provide further elaboration on such multilateral legal framework actually proposed a set of normative principles (United Nations General Assembly, 2015a). These principles were subsequently adopted by the General Assembly in a resolution entitled “Basic principles on sovereign debt restructuring processes” (United Nations General Assembly, 2015b). Notably, while the resolution was approved with 136 countries voting in favour and 41 abstaining, major creditor countries, such as Canada, Germany, Japan, the United Kingdom of Great Britain and Northern Ireland, and the United States voted against it.

The annex provides a comprehensive perspective of the views of the United Nations on debt issues by comparing the outcomes of the Monterrey, Doha, and Addis Ababa conferences on financing for development and the Basic Principles resolution. One of the principles on debt restructuring, the principle of sustainability, is consistently highlighted in the four documents. As spelled out in the Basic Principles resolution,

sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights. (United Nations General Assembly, 2015b, Principle 8)

This principle means that debt restructuring workouts need to provide enough financial space for debtors to invest in sustainable development. The principle of equivalent treatment of creditors (United Nations General Assembly, 2015b, Principle 5) has also been articulated in the Doha Declaration on Financing for Development, as noted above. This principle includes the duty of debtors to (a) not discriminate arbitrarily among creditors in the treatment they receive and (b) not exclude creditors or creditors groups from the restructuring process. The principle of sovereign immunity from litigation by foreign domestic courts (United Nations General Assembly, 2015a, Principle 6) builds on concerns about vulture fund litigation expressed in the Doha Declaration (United Nations, 2009, para. 60) and the Addis Ababa Action Agenda (United Nations, 2015, paras. 98 and 100). The principle of majority restructuring (United Nations General Assembly, 2015b, Principle 9) broadens language in the Addis Ababa Action Agenda (United Nations, 2015, paras. 98 and 100), which focuses only on restructuring of sovereign debt with bondholders, to include also sovereign debt with official bilateral creditors.

The principle of transparency (United Nations General Assembly, 2015b, Principle 3) has also been articulated in the Doha Declaration, as noted above, and in the Addis Ababa Action Agenda. The latter also invited "relevant institutions to consider the creation of a central data registry including information on debt restructurings." The principle that debt restructuring negotiations should be conducted in good faith by the sovereign debtor and its creditors (United Nations General Assembly, 2015b, Principle 2) was also hinted in the Addis Ababa Action Agenda. Finally, the principle of sovereignty (United Nations General Assembly, 2015b, Principle 1), which states that a sovereign state has the right to design its macroeconomic policy, including restructuring its sovereign debt, contrast with language in the Doha Declaration, which recommends borrowers to "strive to implement sound macroeconomic policies and public resource management" (United Nations, 2009, para. 64).¹⁸

¹⁸ Two remaining principles of the Basic Principles resolution have no precedent in the outcomes of the international conferences on financing for development. These are the principles of impartiality (Principle 4, that all institutions and actors involved in sovereign restructurings refrain from exercising any undue influence over the process or engage in actions that would give rise to conflicts of interest or corruption) and legitimacy (Principle 7, that the establishment of institutions and the operations related to sovereign debt restructurings respect the rule of law).

The outcomes of the three international conferences on financing for development cover various other issues related to debt in addition to debt restructuring. These include technical assistance to debtor countries “to enhance debt management, negotiations and renegotiation capacities, including tackling external debt litigation, in order to achieve and maintain debt sustainability” (United Nations, 2009, para. 64). Other issues considered, related to debt sustainability, include the following: (a) the usefulness of the IMF-World Bank debt sustainability analysis as a tool to promote prudent public debt management, (b) the disruption caused by natural disasters and social or economic shocks on debt sustainability and the need for debt relief for countries affected by them, and (c) the joint responsibility of borrowers and lenders in ensuring debt sustainability, as elaborated in the UNCTAD principles on responsible sovereign lending and borrowing. Regarding the latter, under the Addis Ababa Action Agenda, participants committed to work towards a global consensus on “guidelines for debtor and creditor responsibilities in borrowing by and lending to sovereigns, building on existing initiatives” (United Nations, 2015, para. 97).

In addition to soft law principles, the United Nations set up a precedent of direct intervention in a debt restructuring case through United Nations Security Council Resolution 1483, adopted on 22 May 2003, shortly after the collapse of the regime of Saddam Hussein in Iraq. Under this resolution, a stay on the enforcement of creditor rights to use litigation to collect unpaid sovereign debt of Iraq was implemented (Weiss, 2011). Specifically, under the resolution, all of the oil and gas wealth of Iraq was immunized from legal process until the end of 2007, and the Member States of the United Nations were instructed to freeze the remaining Iraqi assets in their jurisdictions and transfer them to the Development Fund for Iraq, which was internationally supervised and also immune (Gelpern, 2005). The significance of this resolution is that it showed that the official sector already has the tools to shield a sovereign borrower from its creditors, even without a statutory sovereign bankruptcy regime. This, however, is viewed as a special case in which there was a diplomatic consensus that the financial distress of Iraq would threaten international security.

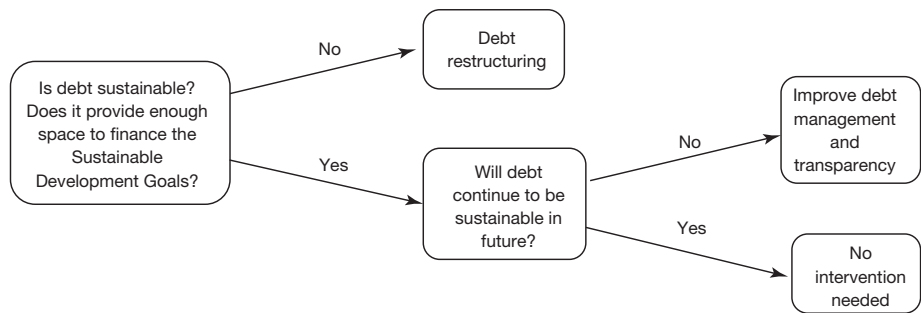
IV. THE ROLE OF THE UNITED NATIONS IN ADDRESSING UPCOMING DEBT CHALLENGES

The various views of the United Nations on debt issues discussed in the previous section can be summarized into a single message: the attainment of sustainable development requires that public debts are sustainable. Unsustainable debts can lead either to financial and macroeconomic disruption and harm to investments in sustainable development or to a situation of debt overhang in which a large share of the country’s savings need to be allocated to the payment of debt services, leaving little left for the country’s sustainable development. To be sure, debt sustainability

is also an important goal of other international organizations, such as IMF, but their focus is on financial and macroeconomic stability. What distinguishes the United Nations is the explicit link between debt sustainability and sustainable development.

There are two ways to achieve debt sustainability. The first one is when debt is already unsustainable, in which case the only option is debt restructuring. Notice that from the viewpoint of the United Nations, the definition of unsustainable debt includes a situation in which debt service payments restrict the capacity of the country to invest in sustainable development. However, if the debt is currently sustainable in that sense, there is a risk that it will become unsustainable in future. To prevent this possibility, the country may need to strengthen its debt management capabilities. Ensuring transparency through the timely disclosure of debt data is also important to facilitate the monitoring of the debt situation in the country and take preventive measures proactively, if needed, to preserve debt sustainability. These options are depicted in figure 4.

Figure 4. Debt sustainability flowchart



Source: Author.

As discussed in section I, some progress has been made regarding debt restructuring over the last few years. The enhanced collective actions clauses of the International Capital Markets Association proposed in 2014 have proven successful in facilitating the 2020 restructuring of debts with bondholders of Argentina and Ecuador, and the Common Framework may offer in future an effective option for the restructuring of debts with official and private creditors. However, a fundamental problem remains: the reluctance of debtors to initiate a debt restructuring process. There are many reasons behind this: fear that the country’s credit rating will be downgraded by the credit rating agencies; fear that the process will be disruptive to the country’s economy; and an elevated degree of uncertainty about the duration and outcome of

the process. As a result, it is not uncommon for policymakers of debtor countries to consider debt restructuring as the last resource option.

These fears are not unfounded. As pointed out by Asonuma and Trebesch (2016), most debt restructurings have occurred post-default, when there was no other option, but these have been more costly than pre-emptive restructurings occurring before default. Post-default restructurings have been characterized by higher haircuts for the creditors, higher output losses for the debtor, and longer negotiating times, making them a suboptimal solution. To address the reasonable concerns of debtors about restructuring their debts, it is crucial to improve the expediency, predictability, and effectiveness of debt restructuring processes.

If debtors have clarity about what to expect during a debt restructuring process and if the process can take a few months rather than a few years, they will be more willing to restructure pre-emptively, minimizing the costs mentioned above. The main purpose of the failed IMF proposal to set up a legal framework for sovereign debt restructuring, the sovereign debt restructuring mechanism, discussed in section I, was precisely to enhance the predictability and effectiveness of sovereign debt restructuring processes. Although the Common Framework still needs work, the recommendations of Georgieva and Pazarbasioglu (2021) discussed in section I are a good starting point to improve its design and implementation.

The United Nations has a very important element to contribute to the design of the Common Framework: its link to sustainable development. Sovereign debt workouts under the Common Framework should not focus narrowly on bringing countries back to financial sustainability: they need to ensure that the debtor will be able to invest in sustainable development and climate action as well.

How to operationalize this? One option to be considered is debt swaps.¹⁹ This idea was endorsed in the outcome document of the 2021 Financing for Development Forum of the United Nations Economic and Social Council: “We invite creditors and debtors to further explore, where appropriate and on a mutually agreed, transparent and case-by-case basis, the use of debt instruments, such as debt swap initiatives, for sustainable development and climate action” (ECOSOC, 2021, para. 64).

¹⁹ The Secretary-General in a policy brief issued in March 2021 suggested considering a range of options in debt restructuring negotiations, including debt swaps, debt buy-backs, credit enhancements, reprofiling or exchanging debt, and/or cancellation, depending on a country’s specific circumstances and debt challenges (United Nations, 2021).

Debt for climate swaps, in particular, are a promising mechanism to reduce debt burdens and provide financing to critical investments in climate mitigation and adaptation. As such, they can connect two important pillars of the Paris Agreement: a) the commitment of developed countries to provide \$100 billion per year on climate finance to developing countries and (b) the Nationally Determined Contributions (NDCs). The swaps can be particularly useful to fund conditional contributions in developing countries' NDCs, the implementation of which is contingent on the availability of international financial support (ESCAP, 2021b).

A direct connection between debt restructuring and investment in sustainable development through climate swaps could motivate debtors to engage in restructuring negotiations because it would guarantee that important development goals of the countries would be part of the outcome of the negotiations. Bilateral official creditors could also find the link between debt restructuring and sustainable development outcomes appealing because any haircut they take to their debt could count as a partial fulfillment of their climate finance obligations under the Paris Agreement or as overseas development assistance. Finally, private creditors may also find a debt restructuring deal that includes an element of investment in sustainable development appealing because it can open opportunities for additional investments in sustainable development in the debtor country in future.

To be sure, connecting debt restructuring with sustainable development requires additional elements compared to a purely financial deal. These include the implementation of suitable sustainable development projects or programmes and a mechanism for monitoring, reporting and verification of their implementation. However, the additional efforts are worthwhile as they are likely to make debt restructuring more appealing to both debtors and creditors and result in enhanced sustainability in the debtor, both financial and developmental.

Debt restructurings, however, are a costly solution for both debtors and creditors. A better option is to prevent debt from becoming unsustainable in the first place. In the outcome document of the 2021 Financing for Development Forum of ECOSOC, a balanced approach is proposed under which both debt restructuring and measures to prevent the buildup of unsustainable debts are considered: "Debt restructuring should be coupled with addressing... systemic debt vulnerabilities, improving fiscal policies and ultimately managing debt in a more transparent and sustainable manner" (ECOSOC, 2021, para. 67).

The prevention of episodes of unsustainable build-ups of sovereign debt is not different conceptually to the prevention of unsustainable commercial debts in a national context. Both can be addressed through the design and implementation of suitable financial regulations. The difference is that while domestic financial markets

are regulated by national institutions, such as central banks or securities and exchange commissions, there is no supranational regulatory authority for sovereign debts at the global level.²⁰

This does not mean that sovereign debt markets do not need to be regulated. Quite the opposite, sovereign lending and borrowing are plagued with agency problems, time inconsistency, information asymmetries and moral hazard issues. As Gelpern (2012, p. 3) wryly puts it: “Public officials borrow in the name of the people, but not in their interest; ...disclosure is faulty; ...[and] lenders who expect to be rescued by third-country taxpayers keep credit flowing to insolvent debtors.” In addition, in cases of default, a resolution is complicated by “sovereign immunity and the difficulty of reaching sovereign assets, [which] make debt contract enforcement unpredictable, ...[while] there is no bankruptcy procedure for sovereigns” (Gelpern, 2012, p. 9).

One option to regulate sovereign debt markets could be through an institutional arrangement similar to what is in place for the international coordination of national supervisors of banks and financial markets. This is characterized by a hub-and-spoke architecture in which a global institution (the hub) – such as Basel Committee for Bank Supervision (BCBS) and the Financial Stability Board (FSB) – coordinates the work of national regulatory bodies (the spokes) by issuing recommendations, providing capacity-building and collecting data for dissemination. These are examples of soft law because even though the rulings of BCBS and FSB are not formally binding, national regulatory bodies of banks and financial markets are willing to comply with them voluntarily.

A similar approach could be implemented as a basis for an international debt architecture, with a global sovereign debt coordinating body playing the role of the hub and the national debt management offices playing the roles of spokes. The functions of the hub would be similar to those of BCBS and FSB: it could issue norms and recommendations for the prudential issuance of sovereign debt, provide capacity-building, and collect information on sovereign debts from the debt management offices. Such institutional arrangements would provide recommendations and technical support for national debt management offices to help them improve their capacities and skills in preventing episodes of unsustainable debt build-ups. In addition, debt management offices participating in it would voluntarily disclose details of their sovereign debts, contributing in that way to enhancing international debt transparency. In the proposed arrangement, the spoke institutions, the debt management offices, already exist. What is missing is a hub institution to coordinate them.

²⁰ There are, however, supranational regulatory authorities at the regional level, such as the European Central Bank and the European Securities and Markets Authority.

In sum, the United Nations view of debt sustainability as intrinsically related to sustainable development is an important principle to inform future debt restructuring workouts. In that regard, debt for climate swaps, which provide an explicit link between debt reduction and sustainable development, could be a useful tool to consider. In addition, instituting a hub-and-spoke architecture to disseminate prudential debt management practices, provide capacity-building to debtor countries and enhance debt transparency can be an effective way to operationalize core ideas on prudential and responsible debt management discussed at the United Nations international conferences on financing for development. It is to be expected that ideas such as these will contribute to future global discussions on debt.

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ANNEX

A guide to the United Nations perspectives on debt issues

Selected contents on debt issues in the three international conferences on financing for development and the United Nations Basic Principles on Sovereign Debt Restructuring Processes are synthesized in the table below. The numbers in parentheses in the first three columns indicate paragraphs, respectively, of the Monterrey Consensus, the Doha Declaration and the Addis Ababa Action Agenda. The fourth column includes the corresponding basic Principles. The texts included in this table are selective, and some details are omitted for brevity.

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Sustainability	Sustainable debt financing is an important element for mobilizing resources for public and private investment (47). External debt relief can play a key role in liberating resources that can then be directed towards activities consistent with attaining sustainable growth and development (48).	...Furthering development and restoring debt sustainability are the main objectives of debt resolution (61). In debt renegotiations, we stress the need for full involvement of debtors as well as creditors and the importance of taking into account debtors' national policies and strategies linked to attaining the internationally agreed development goals... (63).	We recognize the need to assist developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief, debt restructuring and sound debt management, as appropriate (94). We believe that a workout from a sovereign debt crisis should aim to restore public debt sustainability, while preserving access to financing resources under favourable conditions.	Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors' rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
			<p>We further acknowledge that successful debt restructurings enhance the ability of countries to achieve sustainable development and the Sustainable Development Goals (98).</p>	<p>respecting human rights (Principle 8).</p>
Shared responsibility of debtors and creditors	<p>Debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations (47).</p>	<p>...Debt resolution is a joint responsibility of all debtors and creditors, both State and commercial (61). We underline that heavily indebted poor countries eligible for debt relief will not be able to enjoy its full benefits unless all creditors, including public and private, contribute their fair share and become involved in the international debt resolution mechanisms... (58).</p>	<p>We reiterate that debtors and creditors must work together to prevent and resolve unsustainable debt situations (97). We recognize that there is scope to improve the arrangements for coordination between public and private sectors and between debtors and creditors, to minimize both creditor and debtor moral hazards and to facilitate fair burden-sharing and an orderly, timely and efficient restructuring that respects the principles of shared responsibility (99).</p>	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Technical assistance/ debt management	<p>National comprehensive strategies to monitor and manage external liabilities...are a key element in reducing national vulnerabilities.</p> <p>Technical assistance for external debt management and debt tracking can play an important role and should be strengthened (47).</p>	<p>Technical assistance to manage debt and address debt problems can be crucial for many countries, in particular the most vulnerable. We reaffirm the importance of adequate capacities of debtor countries during debt negotiations, debt renegotiations and for debt management. In this regard, we will continue to provide developing countries with the necessary assistance, including technical assistance, upon request, to enhance debt management, negotiations and renegotiation capacities, including tackling external debt litigation, in order to achieve and maintain debt sustainability (64).</p>	<p>We encourage international institutions to continue to provide assistance to debtor countries to enhance debt management capacity, manage risks, and analyse trade-offs between different sources of financing, as well as to help to cushion against external shocks and ensure steady and stable access to public financing (95). We also welcome provision of financial support for legal assistance to least developed countries and commit to boosting international support for advisory legal services (100).</p>	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Highly Indebted Poor Countries (HIPC) Initiative	Continued efforts are needed to reduce the debt burden of heavily indebted poor countries to sustainable levels (49).	We stress the importance of continued flexibility with regard to the eligibility criteria for debt relief under HIPC and MDRI (57).	We will continue to support the remaining HIPC-eligible countries that are working to complete the HIPC process (94).	
Debt sustainability framework/analysis	The computational procedures and assumptions underlying debt sustainability analysis need to be kept under review (49).	We encourage the use of the joint IMF/World Bank Debt Sustainability Framework by creditors and debtors, as appropriate (64). Debt sustainability frameworks should also give due weight to the development needs of debtor countries, including benefits from expenditures and investment that have long-term social and economic returns (66).	We welcome the efforts of IMF, the World Bank and the United Nations system to further strengthen the analytical tools for assessing debt sustainability and prudent public debt management. In this regard, the IMF-World Bank debt sustainability analysis is a useful tool to inform the level of appropriate borrowing. We invite IMF and the World Bank to continue strengthening their analytical tools for sovereign debt management in an open and inclusive process with the United Nations and other stakeholders (95).	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Debt sustainability and exogenous shocks	<p>We stress the need for the International Monetary Fund and the World Bank to consider any fundamental changes in countries' debt sustainability caused by natural catastrophes, severe terms of trade shocks or conflict, when making policy recommendations, including for debt relief... (50).</p>	<p>Particular attention should be paid to keeping the debt sustainability frameworks under review to enhance the effectiveness of monitoring and analysing debt sustainability and consider fundamental changes in debt scenarios, in the face of large exogenous shocks, including those caused by natural catastrophes, severe terms-of-trade shocks or conflict (65).</p>	<p>We recognize that severe natural disasters and social or economic shocks can undermine a country's debt sustainability, and note that public creditors have taken steps to ease debt repayment obligations through debt rescheduling and debt cancellation following an earthquake, a tsunami and in the context of the Ebola crisis in West Africa. We encourage consideration of further debt relief steps, where appropriate, and/or other measures for countries affected in this regard... (102).</p>	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Principles for debt resolution	...We emphasize the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors (51).	We will intensify our efforts to prevent debt crises by enhancing international financial mechanisms for crisis prevention and resolution, in cooperation with the private sector, and by finding solutions that are transparent and agreeable to all. These mechanisms need to be underpinned by principles that have served us well in dealing effectively with many debt problems (61).		
Debt relief and ODA	We encourage donor countries to take steps to ensure that resources provided for debt relief do not detract from 17 ODA resources intended to be available for developing countries (51).	We recall our encouragement to donor countries to take steps to ensure that resources provided for debt relief do not detract from ODA resources intended to be available for developing countries (57).		

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Middle-income countries	We also encourage exploring innovative mechanisms to comprehensively address debt problems of developing countries, including middle-income countries and countries with economies in transition (51).	We emphasize that middle-income developing countries are mainly responsible for the achievement and maintenance of a sustainable debt situation and for addressing their external debt situation (59).		
Equitable treatment of creditors		More efforts are needed through international debt resolution mechanisms to guarantee equivalent treatment of all creditors... (60).		Equitable treatment imposes on States the duty to refrain from arbitrarily discriminating among creditors... Creditors have the right to receive the same proportionate treatment in accordance with their credit and its characteristics (Principle 5).

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Litigation		We are deeply concerned about increasing culture fund litigation (60).	We continue to be concerned with non-cooperative creditors who have demonstrated their ability to disrupt timely completion of the debt restructurings (98). We note legislative steps taken by certain countries to prevent these activities and encourage all Governments to take action, as appropriate. ... We will explore enhanced international monitoring of litigation by creditors after debt restructuring (100).	Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted (Principle 6).
New developments in sovereign debt		We recognize that a shift has occurred from official to commercial borrowing and from external to domestic public debt, although for most low-income countries external finance is still largely official (62).	We note the increased issuance of sovereign bonds in domestic currency under national laws, and the possibility of countries voluntarily strengthening domestic legislation to reflect guiding principles for effective, timely, orderly and fair resolution of sovereign debt crises (101).	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Majority restructuring	<p>We recognize that important improvements have been made since Monterrey in enhancing the processes for cooperative restructuring of sovereign obligations, including in the Paris Club of official creditors and in the market acceptance of new standard clauses of government bond contracts. However, we acknowledge the existence of stocks of sovereign bonds without those collective action clauses (98). We welcome the reforms to <i>pari passu</i> and collective action clauses proposed by the International Capital Market Association, and endorsed by IMF, to reduce the vulnerability of sovereigns to holdout creditors. We encourage countries, particularly those issuing bonds under foreign law, to take further actions to include those clauses in all their bond issuance (100).</p> <p>Majority restructuring implies that sovereign debt restructuring agreements that are approved by a qualified majority of the creditors of a State are not to be affected, jeopardized or otherwise impeded by other States or a non-representative minority of creditors, who must respect the decisions adopted by the majority of the creditors. States should be encouraged to include collective action clauses in their sovereign debt to be issued (Principle 9).</p>			

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Transparency	<p>(The principles for the resolution and prevention of debt crises include) strengthening transparency and accountability among all parties (61). We stress the need to address the implications of (the significant increase in the number of official and private creditors) through improved data collection and analysis (62).</p>	<p>We welcome the continuing activities in setting methodological standards and promoting public availability of data on public and publicly guaranteed sovereign debt and on the total external debt obligations of economies, and more comprehensive quarterly publication of debt data. We invite relevant institutions to consider the creation of a central data registry including information on debt restructurings. We encourage all Governments to improve transparency in debt management (96). We recall the need to strengthen information-sharing and transparency to make sure that debt sustainability assessments are based on comprehensive, objective and reliable data (97).</p>	<p>Transparency should be promoted in order to enhance the accountability of the actors concerned, which can be achieved through the timely sharing of both data and processes related to sovereign debt workouts (Principle 3).</p>	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Responsible borrowing and lending		<p>The principles for the resolution and prevention of debt crises include promoting responsible borrowing and lending practices (61).</p>	<p>Maintaining sustainable debt levels is the responsibility of the borrowing countries; however, we acknowledge that lenders also have a responsibility to lend in a way that does not undermine a country's debt sustainability. In this regard we take note of the UNCTAD principles on responsible sovereign lending and borrowing. We will work towards a global consensus on guidelines for debtor and creditor responsibilities in borrowing by and lending to sovereigns, building on existing initiatives (97).</p>	

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Good faith			We affirm the importance of debt restructurings being timely, orderly, effective, fair, and negotiated in good faith (98).	Good faith by both the sovereign debtor and all its creditors would entail their engagement in constructive sovereign debt restructuring workout negotiations and other stages of the process with the aim of a prompt and durable re-establishment of debt sustainability... (Principle 2).
Debtors' macro-economic policy/sovereignty		Borrowers should strive to implement sound macroeconomic policies and public resource management, which are key elements in reducing national vulnerabilities (64).		A sovereign State has the right, in the exercise of its discretion, to design its macroeconomic policy, including restructuring its sovereign debt (Principle 1).

Topic	Monterrey Consensus on Financing for Development 2002	Doha Declaration on Financing for Development 2009	Addis Ababa Action Agenda 2015	Corresponding United Nations Basic Principles on Sovereign Debt Restructuring Processes
Impartiality	Impartiality requires that all institutions and actors involved in sovereign debt restructuring workouts... enjoy independence and refrain from exercising any undue influence over the process and other stakeholders or engaging in actions that would give rise to conflicts of interest or corruption or both (Principle 4).			
Legitimacy	Legitimacy entails that the establishment of institutions and the operations related to sovereign debt restructuring workouts respect requirements of inclusiveness and the rule of law, at all levels. The terms and conditions of the original contracts should remain valid until such time as they are modified by a restructuring agreement (Principle 7).			