Addressing debt vulnerabilities of the least developed countries

CHAPTER 3

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A. Introduction 45

B. Debt vulnerabilities of the least developed countries 45

1. External debt and trends 46
2. Debt sustainability indicators for the least developed countries 49

C. Multilateral and bilateral debt relief initiatives 58

1. International cooperation on debt relief 59
2. Bilateral debt relief and South–South cooperation 60

D. Addressing the debt crisis 63

1. Multilateral and bilateral response to the debt crisis 64

E. Conclusions 67

Annex 68

References 75

A. Introduction

Debt crises in least developed countries (LDCs) were a possibility long before the COVID-19 pandemic and the emergence of the polycrisis. External debt stocks have reverted to levels last seen in the 1990s prompting the launch of the Heavily Indebted Poor Countries (HIPC) initiative by the International Monetary Fund (IMF) and the World Bank in 1996. Debt service on public and publicly guaranteed debt (PPG) in LDCs in 2022 was three times higher than in 2011. Moreover the number of LDCs in debt distress or at high risk of distress has increased. In 2019, total external debt service in LDCs exceeded government expenditure on social sectors such as health and education (UNCTAD, 2022a), and these same sectors also faced enormous challenges during the pandemic. In 2021, LDCs spent 4 or 5 times more on PPG debt service and total debt service, respectively, than in 2009, which points to their deteriorating and unsustainable debt situations.

Most LDCs are facing structural current account deficits that are either widening or failing to improve. The risk of debt crisis has increased due to the low capacity of these countries to generate additional domestic resources. Their lack of sufficient fiscal space to bolster government expenditure during crises, and their inability to mobilize private investment also hurt their development prospects (UNCTAD, 2021 and 2022b, United Nations Global Crisis Response Group, 2023). Disasters linked to climate change intensified in some LDCs during the period 2021–2023, further eroding their already constrained fiscal space. As highlighted in chapter 1, a subdued global outlook did not dissuade monetary authorities in both developing and developed countries from aggressively hiking interest rates (or delaying policy rate revisions) to tackle inflation (UNCTAD, 2023a; United Nations, 2023a). Tighter monetary policy stances and a prolonged risk of recession in developed economies may exacerbate the risk of sovereign debt crises, particularly for LDCs that were already at high risk of debt distress prior to the COVID-19 pandemic. In April 2023, 6 LDCs were in debt distress (Malawi, Mozambique, Sao Tome and Principe, Somalia, the Sudan and Zambia), while 17 others (Afghanistan, Burundi, the Central African Republic, Chad, the Comoros, Djibouti, Ethiopia, the Gambia, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Liberia, Sierra Leone, South Sudan, Togo and Tuvalu) were at high risk of debt distress (IMF, 2023a).

This chapter seeks to examine the extent of the debt crisis among LDCs, understand its causes, and propose policy recommendations that could contribute to achieving Sustainable Development Goal 17.4 (i.e. "assist developing countries in attaining long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate, and address the external debt of highly indebted poor countries to reduce debt distress"). The rest of the chapter is organized as follows. Section B analyses public debt trends in the LDCs from 2000 to the present. The focus is on the composition of and structural changes in public debt, as well as the underlying factors contributing to debt vulnerabilities of the LDCs. Section C discusses bilateral and multilateral debt relief initiatives, and international cooperation on debt treatment. Section D highlights some initiatives that have the potential to unlock additional finance for the LDCs. Section E summarizes the chapter.

The number of LDCs in or at high risk of debt distress has increased since the global financial crisis of 2008–2009

B. Debt vulnerabilities of the least developed countries

The LDCs will need resilient growth in order to achieve structural transformation and reduce their dependence on official development assistance (ODA) for financing their development. In this regard, chapter 2 explored the extent to which LDCs are managing their fiscal space in the context of multiple crises. The present chapter views their debt build-up as a problem for fiscal policy in the face of multiple crises, and as a consequence of long-standing structural problems. Debt financing is necessary for the LDCs to expand fiscal spending during crises, and to meet their long-term development goals. However, this poses two challenges, both of which risk increasing their debt: (i) a temporary increase in public spending during crises is generally impossible without incurring greater debt because tax revenues are inadequate, and (ii) their level of economic development suggests inadequate public investments, which must be ramped up either through increased taxation or increased borrowing (Battaglini and Coate, 2008; UNCTAD, 2019, 2020a, 2021). Section B.1 highlights the trends in LDC debt, and why it is important to address the structural nature of the problem. It presents the debt positions of the LDCs and how their debt vulnerabilities have evolved since 2009. In some of the analyses, the trend is extended to 2005–2006, which coincides with the launch of the Multilateral Debt Relief

Initiative (MDRI) by the International Monetary Fund (IMF). The section also examines the impact of trade shocks on public debts. Section B.2 presents debt sustainability indicators, and highlights factors driving debt accumulation in LDCs.

1. External debt and trends

Structural imbalances fuelling least developed countries debts

Rapid growth in national income boosts the ability of a country to absorb and utilize debt and withstand economic shocks. Strong export performance, coupled with sustained long-term economic growth, improves the capacity of the countries to leverage debt financing when they are experiencing balance-of-payments constraints (UNCTAD, 2014a). During the period 2009–2021, the total gross domestic product (GDP) of LDCs grew at an average annual rate of 6.4 per cent, doubling from $599 billion to $1.2 trillion, but the share of their exports in GDP declined by an average annual rate of 1.7 per cent as the nominal value of their exports rose by a substantially lower margin than their GDP. In contrast, the external debt stock of the LDCs grew at an average annual rate of 9.6 per cent, with the external public debt component growing at an average annual rate of 8.1 per cent during the period.

The build-up of external debts in LDCs is a consequence of structural weaknesses that keep these countries trapped in a low growth pattern, and increase their vulnerability to external shocks. Most LDCs are dependent on primary commodities for the bulk of their exports and fiscal revenues. However, in order to accelerate diversification from primary production they run the risk of rapidly accumulating debt, especially if debt financing and fiscal outlays are not synchronized with long-term policies to support their structural transformation (UNCTAD, 2019 and 2021). A rapid growth in exports is associated with the capacity, especially among the resource-rich LDCs, to attract external financial resources, mainly foreign direct investment (FDI) and loans (Ampofo et al., 2021); but there is also a positive and direct link between public capital expenditure and public debt (UNCTAD, 2019).

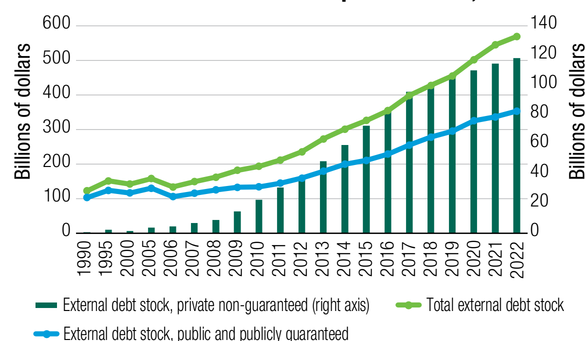
LDCs' dependence on commodities for exports and fiscal revenues leads to debt accumulation and jeopardizes structural transformation

According to the World Bank's *International Debt Statistics*, the total external debt stock of LDCs reached $569.5 billion in 2022 – a record, considering that it grew very little during the period 1990–2005, from $122.6 billion to $162.9 billion. In the aftermath of the global financial crisis, LDCs rapidly accumulated external debts, as interest rates and bond yields tumbled in developed countries, while commodity exports strongly rallied between 2010–2014 and 2016–2018. The PPG component of external debt surged during the period 2006–2021, at an average annual growth rate of 8 per cent, but as a share of total external debt stock, it declined from 82 per cent in 2005 to 62 per cent in 2021. However, in nominal terms, the PPG debt stock more than tripled, from $106 billion in 2006 to $353.4 billion in 2022 (figure 3.1).

More than half of the total PPG debt stock owed by LDCs in 2021 was due to Bangladesh (18.6 per cent), Angola (13.9 per cent), Ethiopia (8.4 per cent), and the United Republic of Tanzania (5.6 per cent) (figure 3.2). These countries, together with the Sudan, Senegal, Zambia, Uganda, Myanmar, Mozambique, the

Figure 3.1

External debt stock of least developed countries, 1990–2022

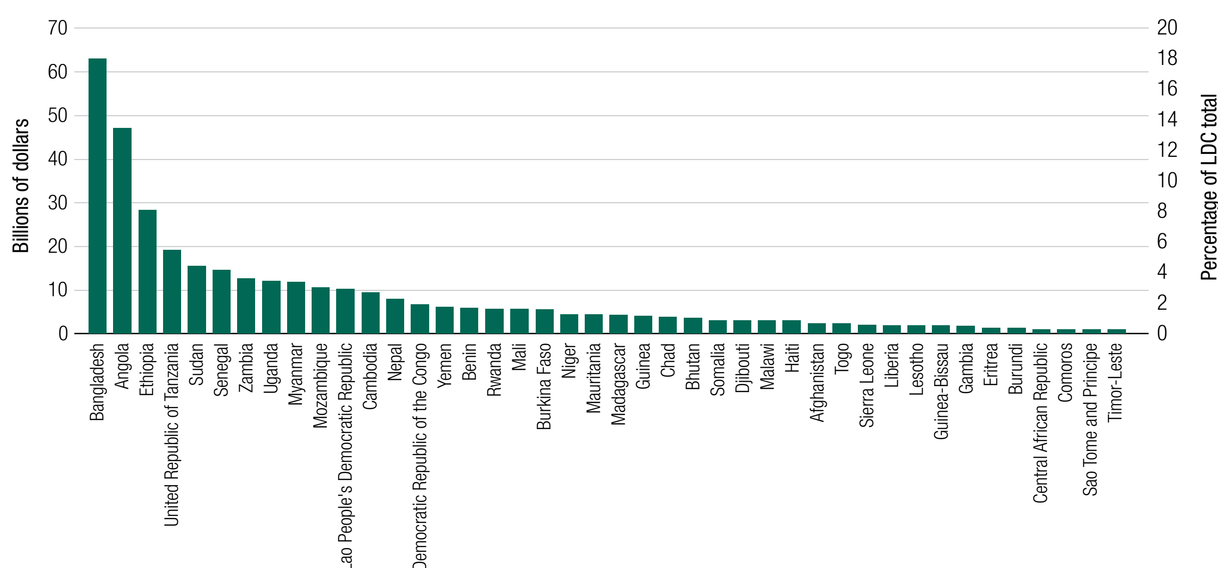


Source: UNCTAD secretariat calculations based on World Bank, *International Debt Statistics* (accessed March 2023).

Note: Data for 2022 are from UNCTAD, 2023b.

Figure 3.2

Public and publicly guaranteed debt stock and share of total least developed countries debt stock in 2021



Source: UNCTAD secretariat calculations based on World Bank, *International Debt Statistics* (accessed March 2023).

Lao People's Democratic Republic and Cambodia, in that order, accounted for 75 per cent of the total PPG debt stock of LDCs in 2021.

External debt complements domestic savings in fostering economic growth by plugging the external resource gap (defined as the difference between domestic savings and gross fixed capital formation), and has a positive impact on economic growth in capital constrained countries (UNCTAD, 2019). Some countries experience debt distress or are at high risk of distress for long periods, leading to assertions that the factors contributing to high debt accumulation are long-standing and structural in nature, and that debt relief efforts have a marginal effect unless they are complemented by reforms of domestic policies and institutions, and by economic structuring (UNCTAD, 2014b; Calcagno et al., 2015; UNCTAD, 2021). Weak macroeconomic policies and the political economy of the countries also reduce the effectiveness of development finance on economic growth, poverty reduction and structural change. Pervasive debt accumulation that follows debt relief or debt restructuring is therefore a feature of an economy that is suffering systemic challenges that affect debt sustainability. The fact that both official and multilateral flows are highly correlated with total debt service also points to an imperfect use of the international mechanisms for debt relief (UNCTAD, 2000; Easterly, 2002; Mustapha and Prizzon, 2015; UNCTAD, 2019). Further, the shift in the financing landscape following the global financial crisis, a growing share of loans from official bilateral lenders that are not members of the Paris Club, such as China, Kuwait and the Bolivarian Republic of Venezuela, and those of private creditors, have all contributed to the increasing complexity of LDC debt structures and debts issued at commercial rates and with shorter maturities (UNCTAD, 2019; Berensmann, 2019).

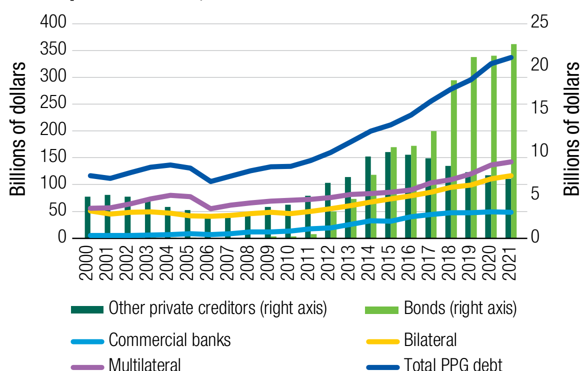
A substantial share of private credit with shorter maturities characterizes the debt structure of least developed countries

Debt owed by LDCs to private lenders and commercial banks has been on the rise since 2012. PPG debt stock in bonds grew rapidly, from $0.5 billion in 2011 to $22.6 billion in 2021. The amount owed to commercial banks increased from $5 billion in 2000 to $48 billion in 2021. The share of other private creditors increased during the period 2010–2015 from $4 billion to $10 billion, though it fell slightly to $7 billion in 2021 from a previous high of $10 billion in 2015 (figure 3.3).

Structurally, the largest component of PPG debt stock was held by multilateral creditors, at 42 per cent in 2021, down from 52 per cent in 2006, while the bilateral share in the PPG debt portfolio also declined slightly, from 39 per cent to 35 per cent. During this period, the shares owed to commercial banks and private creditors through bonds increased from 7 per cent and nil, respectively, to 14 per cent and 7 per cent, respectively. The debt structure remains predominantly multilateral, but the decline in the multilateral component of PPG loans in 2021 was quite sharp for 23 LDCs compared to 2009 (figure 3.4). The International Development

Figure 3.3

Public and publicly guaranteed external debt stock of least developed countries, 2000–2021



Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics* database (accessed March 2023).

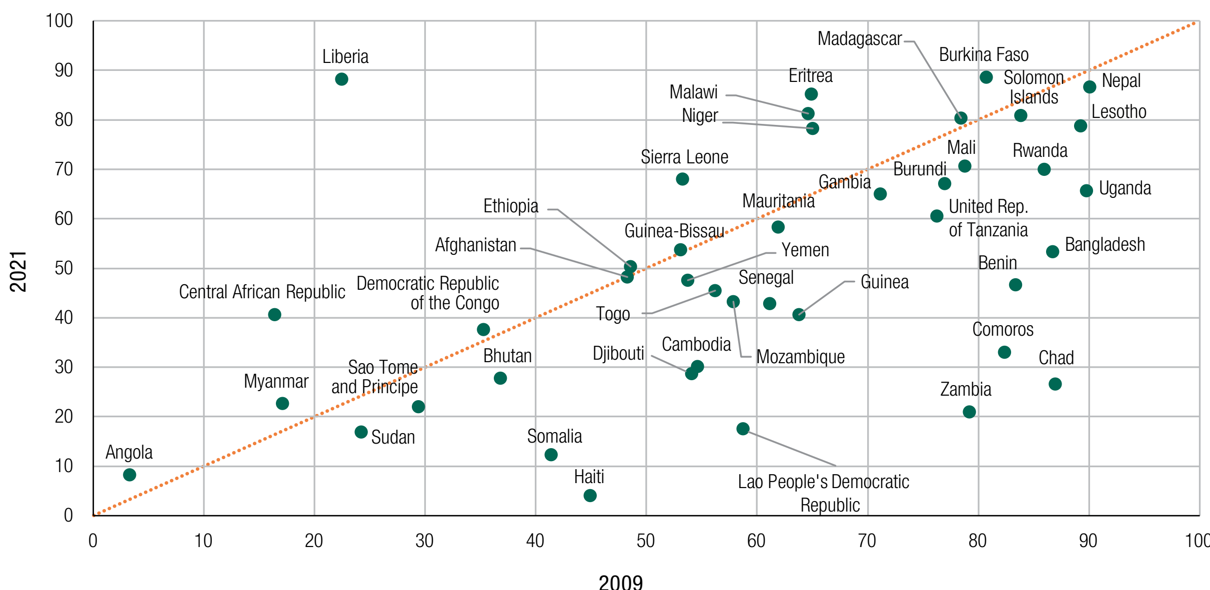
the share of bonds declined from 4.2 per cent in 2014 to 2.7 per cent of PPG debt stock in 2021, despite the country's ability to borrow on blend credit terms.[1]

Export concentration adds to debt challenges

Primary commodities, which constitute the bulk of LDC exports, face volatile prices and terms-of-trade shocks, contributing to the weak capacity of the LDCs to carry external debt sustainability (Coulibaly et al., 2019; UNCTAD, 2020b, 2022b). Negative price shocks tend to have devastating impacts on incomes, as experienced by fuel-exporting LDCs during the global financial crisis and by many LDCs at the peak of the COVID-19 pandemic in 2020. Since virtually all external debts of LDCs are denominated in foreign currencies, a slump in the price of their exports delivers a direct shock to their economies, which not only reduces their export earnings but also exposes these countries to foreign exchange risks (UNCTAD, 2022c). Angola, Chad, the Democratic

Figure 3.4

Share of multilateral debt in least developed countries' public and publicly guaranteed debt stock



Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics database* (accessed March 2023).
Note: The 23 LDCs are those below the 45-degree line and to the right of the 50 per cent point on the horizontal axis.

Association's (IDA) loan eligibility and creditworthiness criteria for loans extended by the International Bank for Reconstruction and Development (IBRD) also played a role, particularly for countries that were ineligible for IDA loans. For instance, in Angola, the share of bonds increased from 3 per cent of its PPG debt stock in 2014 to 17 per cent in 2021, and debt owed to commercial banks accounted for an average of 62 per cent of PPG debt stock in 2014–2021. Since Angola is not an IDA-eligible country, the multilateral component in its PPG debt stock only grew from 3 per cent in 2009 to 8 per cent in 2021. By contrast, an average of two thirds of Bangladesh's PPG debt stock was from multilateral sources, and

[1] Eligibility for IDA loans depend primary on an income criterion, defined as GNI per capita below an established threshold and updated annually ($1,315 in the fiscal year 2024). However, countries that are above the threshold but assessed to lack creditworthiness to borrow from the International Bank for Reconstruction and Development (IBRD) may also access IDA loans. Typically, there are countries that are IDA-eligible based on per capita income levels and also creditworthy for some IBRD loans, and these are countries that can blend, i.e., borrow from both IDA and IBRD (World Bank, 2023).

Republic of the Congo, Ethiopia, Guinea, the Lao People's Democratic Republic, Mali, Mozambique, Myanmar, Senegal, the Sudan, Uganda, the United Republic of Tanzania and Zambia experienced the greatest volatility in the value of their merchandise exports during the period 2009–2021 (UNCTADStat database).

During the period 2000–2007, merchandise exports were growing faster than debt in several LDCs, but trade shocks experienced in 2012, 2016 and 2018 reversed the gains made by some countries since the turn of the century (figure A3.1 to A3.6). The COVID-19 pandemic and its ramifications further deepened the crisis. For example, Angola's debt stock exceeded its exports for the first time in 2016, although both were rising until 2018. Due to the unique importance of fuel exports to that country's economy, the series of trade shocks were immediately transmitted throughout the economy, resulting in a massive increase in its PPG debt-to-GDP ratio, from 39 per cent in 2015 to 84 per cent in 2016 as output contracted (table A3.1). Thereafter, during the period 2017–2021 the debt-to-GDP ratio remained above 60 per cent (88 per cent in 2020 and 69 per cent in 2021) after a further shock in 2018. On the other hand, the debt-to-GDP ratios in 2021 remained below 50 per cent for several countries including Bangladesh, Chad, Liberia, Madagascar and Sierra Leone (table A3.1). For these countries, exports grew roughly at the same pace as debt stocks in 2006–2021, but trade shocks in 2012, 2016 and 2018 posed challenges for all LDCs (figure A3.1).

The indicator that more closely reflects the capacity of a country to retire international debt is the growth rate of its exports-to-debt ratio or more commonly, debt service-to-exports ratio. Some LDCs' exports either stagnated or declined after the global financial crisis (figure A3.2). For these countries, the rise in debt service cost marks a significant shift in their exposure to debt-related risks, as their export structures compounded their weak external positions. Zambia's exports exceeded its debt stock in 2006–2014, before sliding in 2015 as its debts soared (figure A3.3). In Mozambique, Nepal, the Niger, Rwanda and Sao Tome and Principe exports grew at a lower rate than their debt stocks after 2009. In the Comoros, Ethiopia, Haiti and Malawi, exports fell sharply or stagnated compared to the trend in their PPG debt stock in 2009–2021 (figure A3.2 to A3.4).

Cambodia, the Democratic Republic of the Congo, the Gambia, Lesotho and Solomon Islands consistently had more exports than debt during the period 2006–2021 (figure A3.5). Togo's exports were higher than its debt stock in 2010–2015, while Timor-Leste's exports grew more quickly than its external PPG debt in 2019 in a turnaround despite COVID-19 (figure A3.6). Contrary to the common trend, Solomon Islands marginally increased its debt stock to $140 million in 2021 from $118 million in 2011, while merchandise exports soared, from $215 million in 2010 to over $400 million per year in 2011–2019, and remained above $350 million in 2020–2021. The GDP of Solomon Islands in 2021 was $1.6 billion, with merchandise exports at $413.7 million, exceeding its debt stock which amounted to $141 million.

The debt vulnerability of LDCs worsens due to the shrinking share of commodities in world trade

2. Debt sustainability indicators for the least developed countries

Although debt levels increased across all country groups following the 2008–2009 global financial crisis, the period after the crisis marked a critical phase for the LDCs. As explained in chapter 2, changes to the international financial architecture have increased the vulnerability of low-income countries to debt. A major concern for the LDCs is their shrinking capacity to repay debt. In 2022, all indicators of external sustainability of the LDCs deteriorated: the ratio of total debt service to exports of goods and services rose to 18.9 per cent from 18.3 per cent in 2021, and the share of government revenue spent on servicing their debt rose to 17 per cent from 15.6 per cent in 2021. Meanwhile, the tightening of monetary policies in developed economies portends even higher borrowing costs for the LDCs in the short to medium term.

Most LDCs experienced a general trend of divergence between debt stocks and exports during the period 2009–2021, signalling high debt risk for countries with chronic current account deficits and high debt-to-GDP ratios. A sustained increase in merchandise exports was needed to maintain external sustainability, but they were adversely affected by a series of trade shocks. As explained in chapter 1, the COVID-19 pandemic and the multiple crises negatively affected their debt sustainability. This section provides a snapshot of debt sustainability trends, and the factors that have contributed to the rapidly deteriorating situation.

a. *Sustainability indicators show mounting debt burdens*

Rising debt-to-gross domestic product ratios

The pace of economic growth in LDCs was significantly affected by trade shocks and weaker global outlooks for the period 2009–2021. Lower interest rates following the global financial crisis created conducive conditions for LDCs to accumulate debts as borrowing costs tumbled. The soft terms did not last, however, and as growth of commodity exports and gross national income (GNI) per capita income faltered, LDCs fell deeper into a low growth pattern, weak investment and steadily rising costs of debt financing. As a result, PPG debt-to-GDP ratios in 2021 were up by more than 10 percentage points in 16 LDCs, and by more than 20 percentage points in 11 LDCs, compared to 2011 ratios. The average PPG debt- to-GDP ratio for LDCs reached 30 per cent in 2019 and 34 per cent in 2020, before contracting slightly to 32 per cent in 2021. Only Sao Tome and Principe, and Guinea achieved lower debt-to-GDP ratios in 2021 (table A3.1).

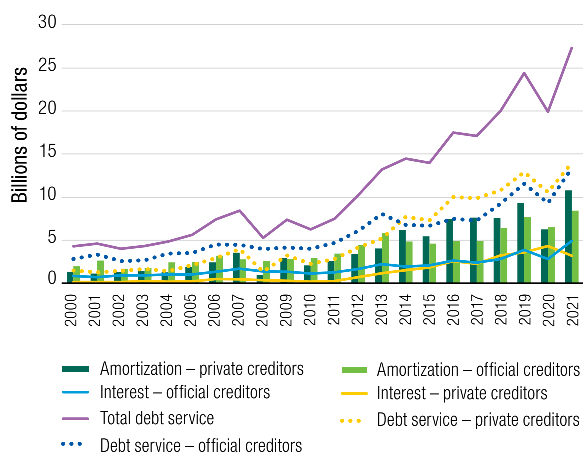
Increasing total debt and debt service ratios

In nominal terms, the debt service on PPG debt increased from $4.3 billion in 2000 to $27.3 billion in 2021 (figure 3.5). This is consistent with the change in the composition of LDCs' external debt since the global financial crisis. The increase in the share of private creditors in PPG debt has pushed up debt service to private creditors, which has surpassed debt service to official creditors since 2014. The bond component of debt service more than doubled during the period 2019–2022 compared to 2016–2018. Prior to the COVID-19 pandemic, debt service costs increased idiosyncratically, driven by higher interest and amortization obligations on an expanding debt stock, but after 2018 debt service costs surged as debts became more complex, with suboptimal maturity schedules and a rising share of private creditors, but also because LDCs generally pay a higher premium on bonds and other private loans.

PPG debt service as a percentage of exports of goods and services increased in 25 LDCs in 2019–2021 compared to 2009–2011. In the former period, 11 LDCs (Angola, Benin, Ethiopia, the Gambia, Lesotho, Mozambique, Nepal, the Niger, Rwanda, the Sudan and the United Republic of Tanzania) incurred PPG debt service costs equivalent to at least 10 per cent of their exports of goods and services (figure 3.6). Since most LDCs face structural balance-of-payments deficits, it may also be useful to consider PPG debt service as a percentage of exports of goods, services as well as primary income. This indicator shows that their debt service averaged 17 per cent of exports of goods, services

Figure 3.5

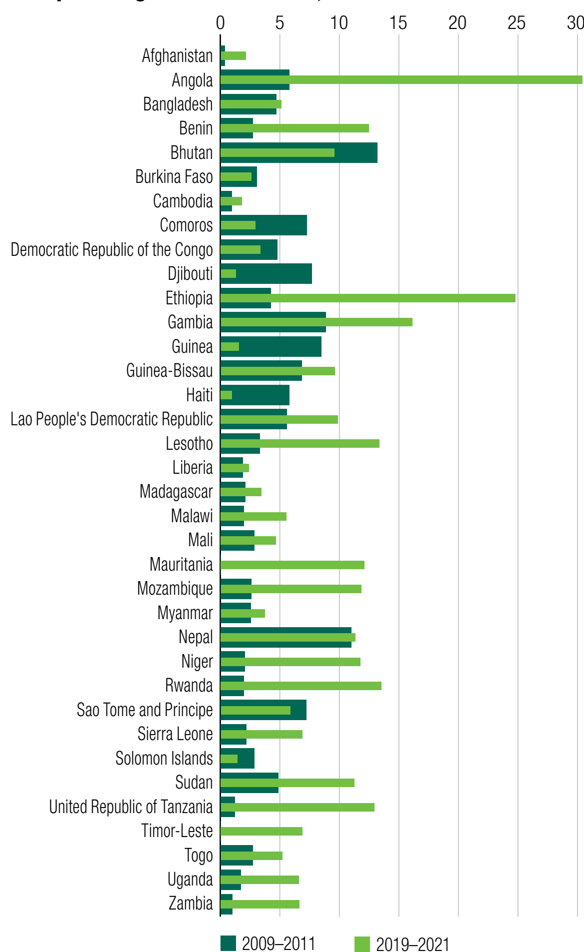
Debt service of the least developed countries, 2000–2021



Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics* database (accessed March 2023).

Figure 3.6

Public and publicly guaranteed debt service as a percentage of exports of goods and services, 2009–2011 and 2019–2021



Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics* database (accessed March 2023).
Note: Only countries shown for which data were available.

and primary income in 2021, up from 11 per cent in 2020 and 9.6 per cent in 2005. The LDCs incurring high debt service costs as a percentage of exports of goods, services and primary income in 2021 were Guinea-Bissau (36 per cent), Rwanda (30 per cent), the Sudan (27 per cent), Angola (26 per cent), Senegal (23 per cent), the Gambia (22 per cent), Ethiopia (21 per cent), Lesotho (18 per cent), Benin (18 per cent), Myanmar (17 per cent), the United Republic of Tanzania (15 per cent), Bhutan (15 per cent) and the Niger (13 per cent).

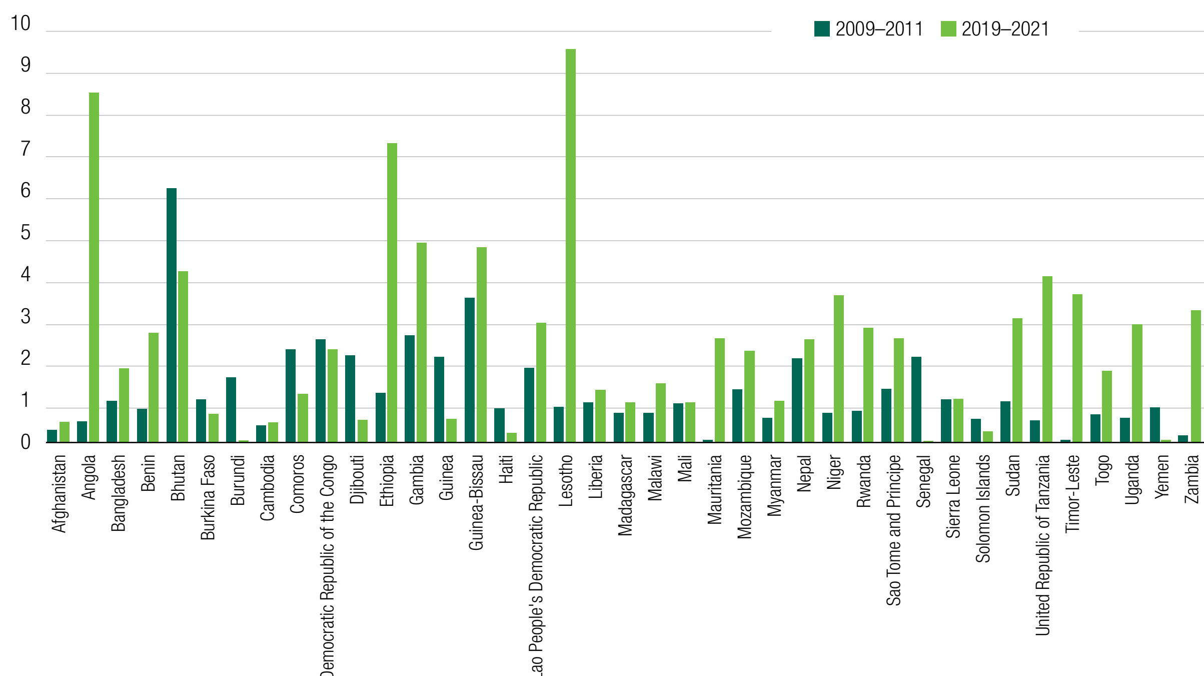
In 2019–2021, interest payments on external debt as a percentage of exports of goods, service and primary income exceeded 5 per cent: for Angola (8 per cent), Ethiopia (7 per cent) and Lesotho (9 per cent). In general, 18 of the 34 LDCs with complete data paid more interest on PPG debt, on average, as a percentage of exports of goods and services in 2019–2021 than in 2009–2011, and the rise in debt service costs was quite significant for Angola, Benin, Ethiopia, the Gambia, Lesotho, the Niger, Rwanda, the Sudan, Togo, Uganda, the United Republic of Tanzania,and Zambia (figure 3.7). It is a matter of concern if the uptick in interest payments is not transitory, particularly for countries where interest payments averaged more than 10 per cent of government expenditure in 2019–2021, as in Angola (33 per cent), Bangladesh (22 per cent), the Lao People's Democratic Republic (14 per cent), Malawi (19 per cent), Mozambique (14 per cent), Myanmar (14 per cent), Senegal (10 per cent), Togo (16 per cent), Uganda (16 per cent) and Zambia (34 per cent). Further, in Bangladesh and Malawi, government expenditure on interest outstripped capital expenditure in 2017–2021; and in Angola, Bangladesh, the Gambia, Madagascar and Zambia, government expenditure on goods and services was lower than their interest payments in 2017–2021.

These unsustainable trends show unbalanced debt portfolios, due partly to the rise in debts that are

LDC debt has been shifting from mostly public to private lenders, thus raising borrowing costs and endangering debt sustainability

Figure 3.7

Interest payments on public and publicly guaranteed debt as a share of exports of goods and services



Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics database* (accessed March 2023).
Note: Interest payments are just a fraction of debt service cost.

A sustained increase in high-value merchandise exports is needed to maintain debt sustainability in LDCs

contracted on unfavourable terms despite debt relief efforts through initiatives such as the HIPC and MDRI, and in the aftermath of the global financial crisis (Coulibaly et al., 2019). They also show that LDCs face a higher exchange rate risk, as their external debts are still predominantly issued in foreign currencies, which are stronger than domestic currencies. As a result, resources tend to be pooled in a few major currencies, leaving indebted LDCs with limited choices over currencies and credit terms for borrowing. Exchange depreciation accounted for some of the substantially greater debt vulnerabilities of LDCs as the dollar appreciated against major currencies and currencies of emerging markets and developing economies during the period 2018–2021 (Obstfeld and Zhou, 2023; UNCTAD, 2023c). The dollar appreciation affected 32 LDCs, which reported that at least 50 per cent of their PPG debt was denominated in United States dollars during 2019–2021. In only five LDCs, at least one tenth of their PPG debt was valued in Special Drawing Right (SDR) units in 2019–2021, while in 25 LDCs at least one fifth of their PPG debt was denominated in currencies other than the dollar, euro, Swiss franc and SDR units (World Bank, *International Debt Statistics* database, accessed March 2023). Currency compositions of debt, unbalanced debt portfolios between long-term and short-term debts, as well as among different categories of creditors with different risk appetites, can become challenging in a macroeconomic environment that has prevailed since 2021 to the present. In the current macroeconomic environment, domestic fiscal policy space is therefore important, as it determines the capacity of the LDCs to leverage all sources of financing, including debt, as well as their potential to build the economic depth needed to retire debts in the future.

b. Misalignment of official development assistance architecture with least developing countries' development needs

Grants and concessional finance were traditionally associated with ODA, but since the global financial crisis, the share of debt in ODA flows to LDCs has increased, and so too has private credit on commercial terms (UNCTAD, 2019 and 2021). Private investment flows and portfolio investments normally fill the financing gap in other developing countries, but for the LDCs, private flows are concentrated in a few economies, and in any case are not adequate.

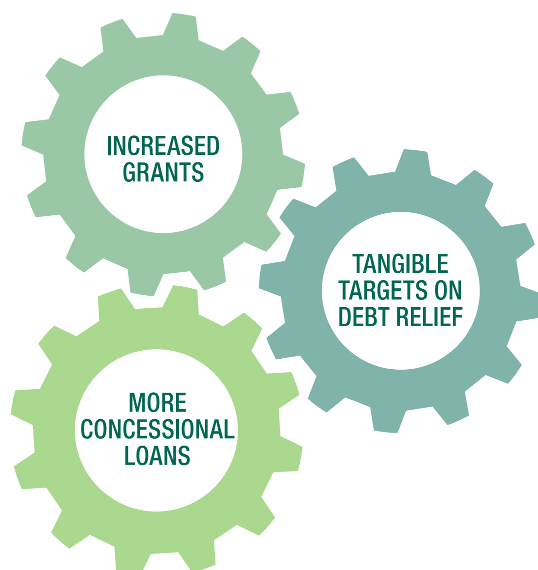
As noted in chapter 2, domestic savings, and hence investments, remain low, thus increasing the pressure to fill the external resource gap with debt. There is a growing urgency in the LDCs to achieve the Sustainable Development Goals and other international agendas, including the Paris Agreement, as well as to implement the Doha Programme of Action. Investment is key to delivering a vibrant manufacturing sector and a sustainable economy driven by innovation and a well-developed infrastructure. For the LDCs, priorities also include ending hunger and eradicating poverty, as well as providing clean energy, and water and sanitation, among others. Domestic resources are simply not enough to meet all the investment requirements to fulfil these many goals, but delaying implementation may also mean paying a higher cost in the future.

Although grants constitute the largest share of ODA, the current architecture is debt creating, compared with traditional aid which is associated with grants. Since 2013, the loan component of ODA to LDCs had averaged 9 per cent, but it climbed to 15 per cent in 2020 as borrowing increased during the COVID-19 pandemic. Equities, which constitute a negligible share of ODA, increased from $48 million in 2010 to $106 million in 2013, but a year later they declined to $52 million, and remained procyclical and volatile throughout the period 2015–2021. Also, like FDI, equity financing was concentrated in a few LDCs, with 12 LDCs (Angola, Bangladesh, Cambodia, the Democratic Republic of the Congo, Ethiopia, Mozambique, Myanmar, Nepal, Senegal, Uganda, the United Republic of Tanzania and Zambia) accounting for 85.7 per cent of the investments in 2009–2021. ODA equity investments also pale in comparison to FDI receipts by LDCs which averaged $21.4 billion in 2017–2021, although in aggregate terms, FDI receipts were less than ODA and remittances, respectively, in 2000–2021.

Total FDI receipts peaked at $38.6 billion in 2015, before plunging to $18.3 billion in 2018.[2] Total FDI receipts of LDCs were consistently lower than net inflows of personal remittances in 2000–2021, and in 2021 they were lower than the average for the period 2016–2018 in 19 LDCs (Afghanistan, Bangladesh, Burkina Faso, the Comoros, Guinea, Haiti, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Myanmar, Rwanda, Sierra Leone, Solomon Islands, the Sudan, Tuvalu, the

[2] The data is from World Bank, *World Development Indicators* database, accessed March 2023.

Making LDC debt financially sustainable requires:



United Republic of Tanzania and Zambia). However, FDI receipts in LDCs recovered in 2019–2021, despite low investor confidence associated with the COVID-19 pandemic. Although total FDI receipts reached $25.2 billion in 2021, they remain insignificant compared with personal remittances that have been rising steadily since 2017 and reached $55 billion in 2021. The top five recipients of FDI among LDCs in 2021 (Mozambique, Ethiopia, Cambodia, Senegal, and Myanmar, in that order) accounted for 68.7 per cent of total net receipts, while Angola and Zambia saw net FDI outflows. The low volume aside, receipts fluctuated considerably, reflecting the marginalization of LDCs in global financial markets, the nature of investments they attract – which mostly target minerals, fossil fuels, power generation and other selected sectors – and the inability of some LDCs that have weak productive capacities to stimulate further investments and domestic linkages.

Leveraging private capital towards national development priorities is a challenge for many LDCs because the domestic policy environment alone is not adequate to attract private capital flows, even when deliberate policies are put in place to target the private sector. Capital flows to markets with low risk, but the investment risk ratings for LDCs are often unfavourable, and are often affected by credit rating downgrades. Apart from the business environment created by competent and quality government institutions and the civil service, investors are also attracted by growth prospects offered by natural resources, security guarantees for their investments and liquidity in the financial system. As a result, financing models for attracting blended finance, whether from ODA, equities or FDI, tend to overburden the public purse with credit guarantees, tax waivers, subsidies, and other concessional terms. Given that private sector investors are rational and tend to take calculated risks, the low private investment in the sector may imply a capital market problem rather than a public finance problem. Where commercial banks or private lenders can effectively serve investors and absorb the associated investment risk in the productive sector, it is inefficient and counterproductive for the government to offer unlimited external credit guarantees to investors (UNCTAD, 2019; Delevic, 2020).

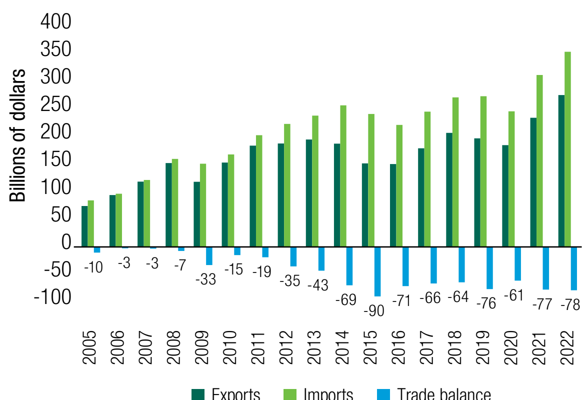
c. Increasing frequency of trade shocks and widening trade gaps

The external solvency of LDCs mainly depends on their export earnings. Fluctuations in export earnings, which are linked to commodity price movements, supply-side bottlenecks and exogenous shocks, are a major source of balance-of-payments imbalances in these countries. Volatile export earnings exert pressure on government revenues, foreign currency reserves, exchange rates and domestic prices of tradeable goods.

Primary commodities have endured a sustained deterioration in terms of trade, as evidenced by their declining share in world trade. In 2022, 65 per cent of LDC exports were primary commodities (including fuels), and their value was a mere 0.7 per cent of total world exports. Put differently, LDCs contributed just 2.2 per cent to world exports of primary commodities, including fuels. The trade deficit of LDCs widened from $43 billion in 2013 to $90 billion in 2015, and slightly recovered in 2016–2020, before slipping again in 2021 as well as 2022 as world trade normalized (figure 3.8). This was largely driven by a growing merchandise trade deficit with the rest of the world. Specifically, LDCs were net importers of all food items (SITC 0 + 1 + 22 + 4) and manufactured goods (SITC 5 to 8 less 667 and 68) in 2016–2021, and their trade surplus in fuels (SITC 3) has declined since 2018. Discounting the net trade impact of fuels, imports of LDCs would have fallen by 11.5 per cent, but exports would have contracted by 23.4 per cent during the period 2016–2021. Thus fuels have contributed significantly to narrowing current account deficits for LDCs as a group, but they also worsen the deficit among non-oil exporters when the price of oil remains inflated as it has been since the onset of the recovery from COVID-19.

Figure 3.8

Least developed countries' total trade in goods and services at current prices, 2005–2021



Source: UNCTAD secretariat calculations, based on UNCTADStat database (accessed March 2023).

World merchandise trade reached $24.8 trillion in 2022, up from $17.5 trillion in 2020, with manufactured goods accounting for 64 per cent of total merchandise exports.[3] The value of world exports of primary commodities (excluding fuels), precious stones and non-monetary gold increased from $3.1 trillion in 2020 to $4.2 trillion in 2022, but as a share of world exports, it declined marginally from 17.9 to 16.9 per cent. World exports of manufactured goods rose by $3.5 trillion (28.1 per cent growth) in 2022 compared to 2020. For LDCs, merchandise exports reached $275 billion in 2022 compared to $184.5 billion in 2020, as world trade recovered from pandemic-related shocks. However, LDCs' export structure is undesirably concentrated in commodities, with the share of primary commodities, including fuels, amounting to 64.7 per cent of exports in 2022 compared to 63.8 per cent in 2020, as the share of fuels recovered from 16.9 to 23.8 per cent of LDC exports in 2020–2021. The share of manufactured goods shrank from 35.4 per cent in 2020 to 34.4 per cent in 2022, while the share of ores, metals, precious stones and non-monetary gold fell by 2.9 percentage point in 2022 compared to 2020, even though their export value rose from $55.1 billion to $74.2 billion in 2020–2022. It will be important for LDCs to increase the share of manufacturing in their exports if they are to play a significant role in world trade, and for trade to contribute to narrowing their balance-of-payments deficits. This can only be achieved by accelerating structural change, expanding into relatively higher productivity activities, and reversing decades of specialization patterns that have skewed production and trade towards primary commodities, with limited domestic value addition in manufactures (UNCTAD, 2019, 2021 and 2022b).

The growth rate of debt stocks outpaced that of export earnings, implying elevated debt risks

Growth rates, 2013–2021 (percentage)

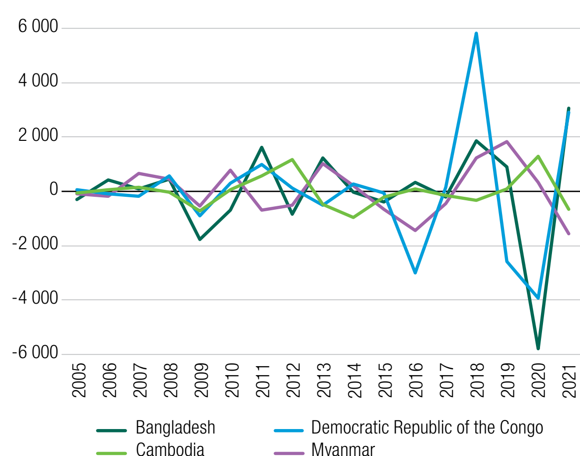
Primary commodity exports also expose LDCs to price fluctuations and market instability. To illustrate the vulnerability of commodity exporters to trade-related systemic shocks, consider the trend of the top five LDCs ranked by merchandise export value in 2021: Bangladesh, Angola, the Democratic Republic of the Congo, Cambodia and Myanmar. The cyclical pattern of exports shows that there were at least four negative shocks to their exports in 2005–2021, particularly in 2009, 2014, 2018 and 2020. Their exports either fell or rose as the shocks played out in subsequent years (figure 3.9). Angola's exports suffered major trend digressions in 2009, 2015, 2016 and 2020, with huge slumps in its fuel exports as oil prices crashed. And in the Democratic Republic of the Congo and Bangladesh, supply chain shocks suffered during the COVID-19 pandemic inflicted a larger negative impact to exports compared with the relative gains by both countries from positive price shocks in 2016–2019, especially by the Democratic

[3] UNCTAD calculations based on UNCTADStat, accessed June 2023.

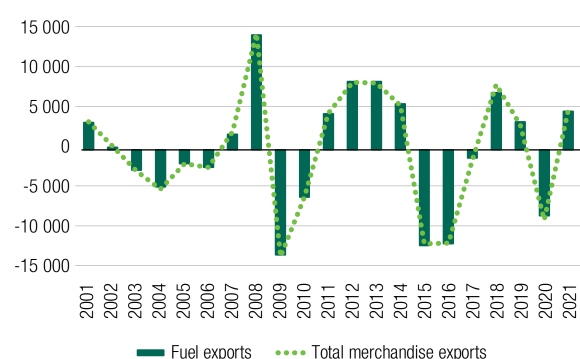
Figure 3.9

Cyclical component[4] of exports, selected countries, 2005–2021

Panel A



Panel B – Cyclical component of Angola's exports, 2005–2021



Source: UNCTAD secretariat calculations, based on UNCTADStat database (accessed March 2023).

Republic of the Congo. Cambodia's exports performed better during the pandemic, bolstered by its strategic geographic location and proximity to major trade routes in South-East Asia.

The cyclical pattern of exports also shows that recent trade shocks have been more pronounced, resulting in LDCs suffering major setbacks in exports. This made them more vulnerable to debt, as the shocks eroded export revenues and slowed economic growth. It is critical for the LDCs to break this cyclical pattern of exports because of its adverse impact on their economic growth and balance of payments. Building productive capacities, diversifying the export base, and structurally transforming their economies could contribute to reducing the impacts of trade shock due to an excessive concentration of exports (UNCTAD, 2020b; 2022b). The lack of diversification of exports is also associated with larger swings in the cyclical component of export trends, and lowers the mean trend growth rates of exports and GDP respectively.

d. Domestic debt and recourse to foreign sovereign bonds

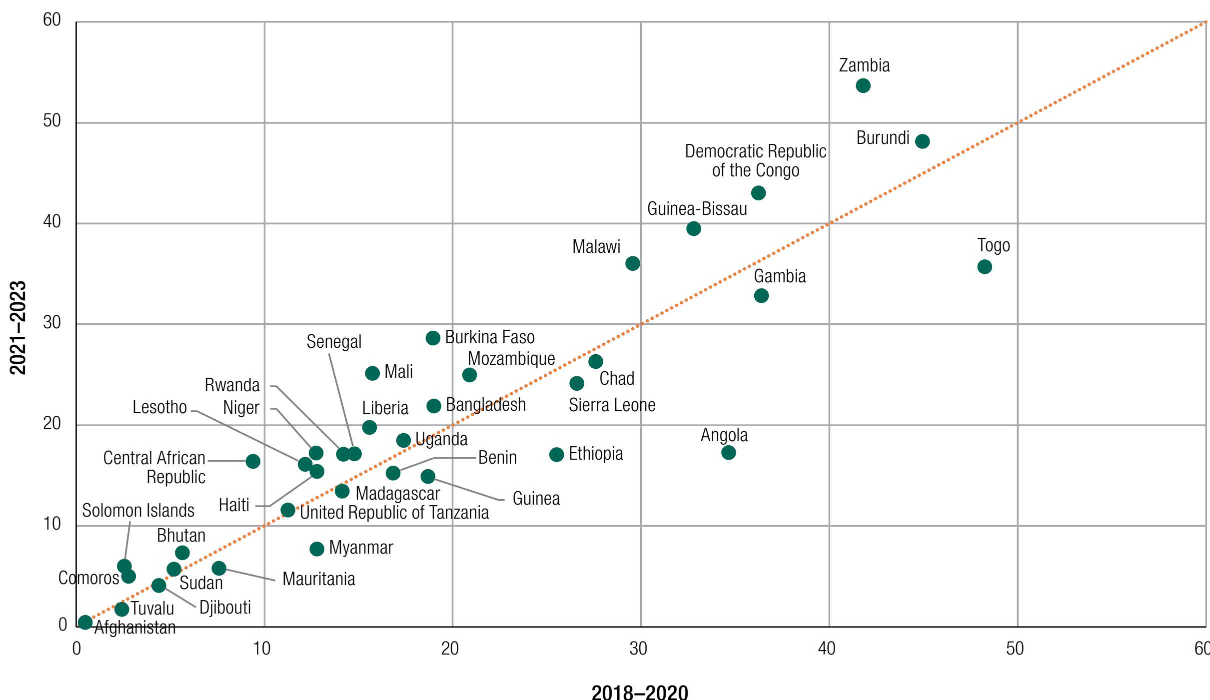
An increase in claims on central governments, which includes loans to central governments net of deposits, may signal a growing debt problem, especially if government domestic debt consistently dominates credit issued by the financial sector. Credit to the private sector increased slightly, from an average of 21 per cent of GDP in 2015 to 24 per cent in 2020, while claims on central governments declined by almost a similar margin, from 26 per cent in 2015 to 24 per cent in 2020. The private sector's demand for credit is often driven by requirements for investment capital and cash flow to cover operating costs and business operations. When the government dominates the domestic credit market, liquidity constraints on the private sector may push up borrowing costs and demand for short-term credit by firms, as investors prefer short-term projects over longer term investment projects that offer lower returns (Fosu and Abass, 2019).

Among LDCs for which data were available, domestic credit provided by the financial sector as a share of GDP averaged 32.3 per cent in 2020, compared to 15.5 per cent in 2015. During the same period, domestic credit to their governments increased slightly, from an average of 5.1 per cent of GDP to 7.7 per cent, while domestic credit to the private sector increased from 20.9 per cent to 23.9 per cent of GDP. Domestic debt in local currency is considered safer because it entails lower exchange rate risk when the issue is traded locally and held predominantly by residents. For 22 of 36 LDCs for which data were available, domestic debt as a share of GDP rose during the period 2021–2023 compared to 2018–2020, and remained above 30 per cent in five countries: Malawi (36 per cent), Guinea-Bissau (40 per cent), the Democratic Republic of the Congo (43 per cent), Burundi (48 per cent) and Zambia (54 per cent) (figure 3.10). The ratio of domestic debt to GDP declined in 2021–2023 for the Gambia (33 per cent) and Togo (36 per cent) compared to 2018–2020, but nevertheless remained above 30 per cent, while in Angola it fell significantly, from 35 per cent to 17 per cent over the same period.

[4] The Hodrick and Prescott (HP) filter is a procedure for decomposing a time series, x_i, $i = 1, \ldots, n$ into a trend component, t_i and a cyclical component, c_i, which measure the deviation from the long-term growth of the variable (i.e., $c_i = (x_i - t_i)$). The trend component is estimated from solving a constrained minimization problem of the squared digression from trend: $\min_{t_1, \ldots, t_n} \sum_{i=1}^{n} (x_i - t_i)^2 + \lambda \sum_{i=2}^{n-1} (t_{i+1} - 2t_i + t_{i-1})^2$, for $\lambda > 0$. For more details, see Cornea-Madeira, 2017 and de Jong and Sakarya, 2016).

Figure 3.10

Domestic debt as a share of gross domestic product, 2018–2020 and 2021–2023



Source: UNCTAD secretariat calculations, based on various IMF Staff Country reports (accessed June 2023).
Note: Data for 2023 are projections.

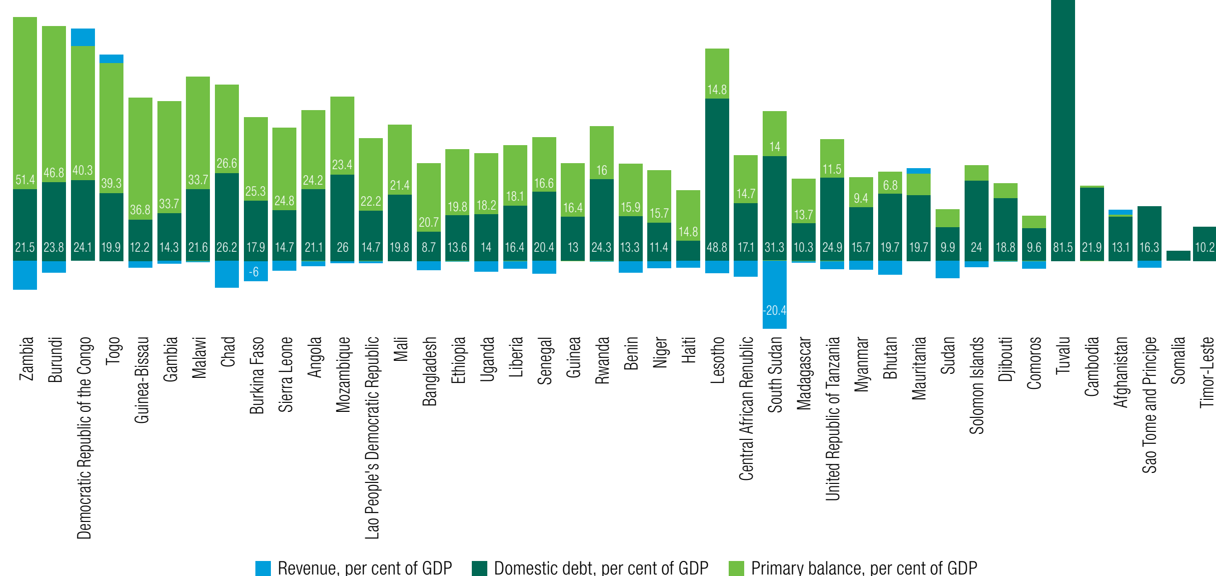
In general, domestic public debt backed by tax revenue and other domestic resources mobilized by the government may slash resource gaps at lower cost when fiscal discipline is complemented by central bank independence in domestic credit allocation. A trade-off between external debt and domestic debt may arise due to costs associated with currency and maturity mismatches, as well as from a desire to lower the risk of international exposure (Panizza, 2008; United Nations, 2023b). However, maintaining credibility in government financing and spending decisions is crucial, as repressive financial policies may reduce the creditworthiness of debt denominated in domestic currency, especially in contexts of high inflation and low growth (Amstad et al., 2020). As noted earlier, interest rate hikes in 2021–2023 impacted liquidity and balance sheets amidst inflationary pressures, which saw the consumer price index almost quadruple in LDCs, from an average of 390 in 2018 to 1,489 in 2021. The ongoing adjustment to interest rates in 2023 has raised domestic debt costs and piled pressure on already constrained fiscal spaces.

The vulnerability of the domestic financial system to domestic credit risk may be low for LDCs in which tax revenue exceeded domestic credit to government relative to GDP. However, claims on central government net of deposits were significantly higher than tax revenue as a percentage of GDP in some LDCs, including Angola, Bangladesh, the Central African Republic, Myanmar and the Sudan, and only marginally higher in Zambia. In 2019–2023, domestic debt as a share of GDP exceeded tax revenue in 24 of 39 LDCs, including Zambia, Burundi, the Democratic Republic of the Congo, Togo, Guinea-Bissau, the Gambia, Malawi, Chad, Burkina Faso and Sierra-Leone (figure 3.11). Critically, claims on central government as a percentage of broad money grew at average rates of more than 10 per cent in 2016–2020 compared to 2011–2015 in Angola, Burundi, Liberia, Sierra Leone, South Sudan, the Sudan and Zambia. In South Sudan and the Sudan the growth rates were high in both periods. The credibility of the financial sector in these countries could deteriorate if their fiscal positions are left unchecked. Thus the onus is on both central governments and monetary authorities to commit to viable inflation targets, and to maintaining prudence in spending policies.

In the context of a fragmented external financing landscape and liquidity constraints in LDCs' domestic financial markets, some of these countries have resorted to issuing foreign bonds abetted by commodity windfalls and sizeable foreign reserves. Between 2009 and 2022, African LDCs issued a combined total of $23.1 billion worth of Eurobonds,

Figure 3.11

Share of least developed countries' public financial positions in gross domestic product, 2019–2023 (percentage)



Source: UNCTAD secretariat calculations, based on various IMF Staff Country reports (accessed June 2023).
Note: Only countries shown for which data were available. Data for 2023 are projections.

denominated mostly in United States dollars. The interest rates on these instruments are quite high, for example LDCs paid between 5 and 10 per cent on 10-year bonds, compared to almost zero, and in some cases negative, rates in the United States and Europe in 2019. This is in part due to LDCs' poor credit ratings, and a mismatch between the instrument's duration and its use (Mureithi, 2021). An analysis of the issued Eurobonds shows that they have been used to finance maturing debt obligations, fiscal budget deficits and large infrastructure projects (Mureithi, 2021; *The East African*, 2023; and Smith, 2023). Benin is the first African LDC to have issued an SDG Eurobond dedicated exclusively to financing high impact projects aimed at achieving the Sustainable Development Goals (box 3.1).

Box 3.1 **Benin's inaugural Sustainable Development Goals bond issue**

In July 2021, Benin issued its inaugural Eurobond to finance projects related to the Sustainable Development Goals. The Government prioritizes the most urgent Goal targets, and projects are selected based on their "SDG sensitivity". A total of 57 projects are eligible, grouped into 12 categories based on a comprehensive set of criteria that define the context of the intervention and the scope of expenditures. The projects are further classified into four pillars of the Goals, namely population (with an allocation of 72.2 per cent of the funding), prosperity (11.1 per cent), planet (14.9 per cent) and partnerships (1.8 per cent) (Benin, Presidency, 2022).

A steering committee selects eligible projects according to a set of criteria. Certain activities are excluded from funding, such as expenditures on fossil fuels, tobacco, alcohol, gambling, production and trade in arms, or defence and security equipment. By July 2022, the following goals had been achieved:

- Reached 2.6 million beneficiaries of an extended vaccination programme (1.1 million of whom are children younger than 1 year).
- Provided free malaria treatment to almost 700,000 poor people.
- Extended and densified drinking water distribution networks from 321 km (2017) to 859 km.
- Opened 16 programmes as part of the creation of the City of Innovation and Knowledge project, benefiting 1,647 people.
- Increased coverage to 25 municipalities (approximately 5.7 million people) of the PANA Energy Project, which seeks to improve the resilience of the energy sector to the impacts of climate change.
- Installed 13 climate resilient solar PV mini power plants in some off-grid locations in Benin.
- Set up and operationalized an interoperability platform for all government ministries of Benin.
- Restored 150 hectares of the coastal zone.

Box 3.2 The African regional bond market: Growth potential but inflated borrowing costs

African LDCs are tapping into the regional bond market, which is supported by the African Development Bank (AfDB) and other subregional development banks. The AfDB bond portfolio is denominated in various foreign currencies. It includes social bonds (AfDB, 2017), green bonds, and environment, social and governance (ESG) bonds (AfDB, 2022). In 2022 alone, the AfDB issued a 1 billion euro 5-year social bond and a 1.25 billion euro 7-year social bond, a 1.5 billion Swedish krona 5-year green bond and 19 billion Ugandan shillings ESG bond (approximately $5 billion) (AfDB, 2022). As at 30 June 2022, the AfDB had committed $3.8 billion to 45 eligible green projects and $6 billion to eligible social projects across Africa.

Subregional development banks too have engaged in issuing bonds to finance some projects in their portfolios. The ECOWAS Bank for Investment and Development issued a 240 billion West African CFA Franc (XOF) bond programme on the financial market of the West African Economic and Monetary Union (WAEMU) in 2021 (EBID, 2021). The Eastern and Southern African Trade and Development Bank issued a 7-year unsecured Eurobond valued at $650 million, and it is in the process of developing a regional local bond issuance programme as a way to diversify its bond issuances (TDB, 2021). The West African Development Bank (BOAD) successfully issued a €750 million sustainability bond in 2021 aimed at increasing funding for projects intended to have strong social and environmental impacts in WAEMU countries. The bond has a 12-year maturity, and debuted with an interest rate of 2.75 per cent (BOAD, 2021).

Compared to the Eurobond market, the regional and subregional development banks focus on high-impact projects that have an environmental sustainability component. However, bonds in this segment still attract higher interest rates than bonds issued in developed economies. Boosting capitalization of the regional bond market could unlock financing, particularly for corporate sector borrowers seeking growth markets in the African Continental Free Trade Area. Market capitalization of corporate bonds as a percentage of GDP in sub-Saharan Africa was only 1.8 per cent, while market capitalization of government securities averaged 14.8 per cent in 2010 (Mu et al., 2013). The size of the economy and its level of development along with the size and level of development of the banking sector, are critical considerations for investors. At the same time, investor confidence in the market is strongly influenced by trade openness, the quality of institutions, investment profiles, and macroeconomic conditions (including fiscal balances, interest and exchange rates), as well as the presence or absence of capital controls (Mu et al., 2013; Essers et al., 2014; Eichengreen and Luengnaruemitchai, 2004; Berensmann et al., 2015). The fact that bond issuances by African LDCs are oversubscribed demonstrates strong investor interest in the African market. However, the scope for expanding the issuance of bonds will continue to be constrained by exorbitant costs, market risks and higher premiums on rollover risks. Recourse to foreign bond issuances is therefore contributing to undue debt accumulation in African LDCs.

The projects aim to provide important social and human development benefits, but very few of them have revenue-generating potential, and therefore do not necessarily help reduce the country's indebtedness. Rwanda recently issued a $620 million foreign bond to boost strategic projects in productive sectors, and to retire its debut $400 million Eurobond that matured in May 2023 (*The East African*, 2023). The matured 10-year bond issued in 2013 debuted at an interest rate of 6.62 per cent, while the new bond was listed at 5.5 per cent, with 84.5 per cent of existing bond holders from previous bond issues retained. Investor confidence lends credibility to government policies, and could improve the viability of public projects on which the debt resources are spent (Smith, 2023; Rwanda, Ministry of Finance and Economic Planning, 2023).

C. Multilateral and bilateral debt relief initiatives

LDCs require urgent support to prevent their debt situation from turning into a wider systemic crisis. Global efforts by the international community need to focus on reducing the debt burdens of these low-income countries. However, the fragmentation in the international financial assistance architecture, as discussed in chapter 2, particularly among Paris Club and non-Paris Club official creditors, along with other shortcomings, will continue to enhance the debt vulnerabilities of the LDCs. The Global Sovereign Debt Roundtable launched in December 2022 by the World Bank, IMF and the Group of 20 (CDP, 2023) reconvened in April 2023 in Washington, D.C., during which parties showed a greater willingness to address sticky issues. These include guarantees to protect the interests of multilateral development banks (MDBs) and common treatment of sovereign creditors. The MDBs are expected to offer more grants and concessionary lending which, in the case of the World Bank, would require expanding the pool of resources available to low-income countries, including the IDA/World Bank Fund for the Poorest (Gold and Saldinger, 2023; IMF, 2023b).

Debt relief may be offered in various ways, including through debt cancellation, restructuring, reduction of stock or debt service obligations, and debt service

suspension. It should be noted, however, that the Group of 20 Common Framework, discussed below, seeks to broaden debt relief from official and private creditors on comparable terms, and to facilitate faster debt rescheduling through maturity extensions and interest rate reduction rather than through outright debt cancellations (UNCTAD, 2023b). Official bilateral creditors may find it easier to offer debt cancellations when they are the main debt partner, but other incentives, such as trade and investment linkages, may also play a role. On the other hand, imprudent behaviour of private agents and fragmented interests among sovereign lenders may give rise to ad hoc arrangements and protracted debt workout negotiations (UNCTAD, 2015). Debt cancellation may involve partial or full reduction of debt either through the principal component and/or interest; debt restructuring, on the other hand, alters the terms of a debt, often in favour of a debtor, and could involve debt write-offs to reduce the principal and interest, or a change in the timing of debt repayments. It is common for creditors to offer only rescheduling of debt to resolve liquidity problems, but treating insolvency alone is not effective. Suspending debt service, as well as other measures taken during debt restructuring are only effective if the debtor country prudently utilizes the proceeds of the restructured debts and/or any additional flows it receives during the process.

At the present juncture, LDCs require more financing options at scale, and on conditions that are favourable. Because of their weak economies and high vulnerability to economic shocks and other crises, the most suitable external financing for LDCs, other than more expensive private financing options, should include an increase in ODA grants and concessional loans. There is therefore a need for more precise targets and predictable amount of financing on grant and concessional terms. An increase in such flows could reverse the unsustainable debt trends, balance the debt profiles between commercial and private debt stocks, and increase multilateral and bilateral share of debts offered on sustainable terms. A reformed international financial architecture could achieve some of these aims by facilitating the most vulnerable countries' access to liquidity and addressing their long-term financing needs, including making the financial architecture more responsive to their requirements in times of crises (United Nations, 2023c). The discussions that follow highlight some debt relief initiatives, and the scope for improving their impacts on LDCs.

1. International cooperation on debt relief

LDCs facing debt burdens require urgent injections of liquidity through various instruments, including official assistance in the form of grants and concessional loans. Difficulties in accessing international capital markets raises the cost of borrowing for LDCs, they often resort to syndicated loans with shorter maturities and borrowing from private creditors who offer no safeguards at times of debt distress. This is one of the reasons for the marked increase in their costs of debt service. Countries that are at risk of – or are already experiencing – debt distress will need to safeguard their fiscal space as a matter of urgency in order to prevent further erosion due to the ramifications of the polycrisis. For these countries, the international community should address not only immediate liquidity pressures, but also their structural insolvency and long-term debt sustainability issues (UNCTAD, 2020c).

Fulfilled pledges and predictability of grants and concessional loans could improve liquidity of debt-distressed LDCs

The importance of international coordination of the debt relief efforts of official bilateral and multilateral creditors, commercial banks and other private lenders cannot be overemphasized. For many years, UNCTAD has been advocating for a multilateral framework for debt resolution – a process that would require coordination among official multilateral and bilateral creditors as well as private creditors (UNCTAD, 2015, 2020c, 2023a). Official creditors would be familiar with the complexity of achieving compatibility and coherence in debt treatment clauses among creditors when a country requests debt restructuring from its creditors. Although it is arguably easy for parties to agree debt restructuring terms when creditors share common views on debt, for example among Paris Club members, it takes longer to build consensus with other official bilateral and private creditors (commercial banks, bond holders and other private creditors) because of differences in approach, valuation of debt and commercial interests (Goldman, 2014; UNCTAD, 2015). The discussion in this section focuses on selected multilateral frameworks for debt relief and their relevance to the present debt situation of the LDCs.

a. *United Nations initiatives for debt workout*

The 2008–2009 global financial crisis was a setback for the MDRI launched by the IMF in 2006. As debt situations worsened, it became increasingly clear that there was need for an effective, coordinated international debt workout plan for debt distressed

Debt workout mechanisms, beyond providing liquidity support, should also address the structural vulnerabilities of LDCs

countries that depended not just on a limited number of creditors, but rather, on the entire spectrum of official multilateral and bilateral lenders, as well as private creditors. A multilateral approach to debt resolution is still needed to improve coordination among creditor and debtor countries through negotiations to prevent sovereign debt defaults. By facilitating and accelerating the process of debt resolution between countries and their creditors, such a framework would help maintain investor confidence during debt workouts. And by avoiding protracted negotiations over debts, it would directly improve confidence in the sovereign States involved. This is important for LDCs because these countries often suffer from negative perceptions by investors, even when their sovereign debts are low. Moreover, a multilateral framework could offer stability and fairness unlike bilateral arrangments with private and official creditors which may fail to guarantee sustainability for poor lenders in debt distress.

General Assembly resolution 69/319 on Basic Principles on Sovereign Debt Restructuring Processes adopted in September 2015[5] specifically aimed at promoting accountability, transparency and cooperation between debtors and creditors in resolving debt situations. Among its principles is the need to safeguard the policy space of the debtor country to exercise its discretion in the design of its macroeconomic policy, including the restructuring of its sovereign debts, and crucially, that debt restructuring should be a last resort (United Nations, 2015). The resolution is hailed as a standard bearer on setting principles for treating protracted debt situations. Although the nine principles contained in the resolution are non-binding, they set the bar for debt resolution workout mechanisms that seek to address the needs of developing countries. Obviously, debt workouts should go beyond debt rescheduling and debt service suspension, as these do not resolve the debt crises of low-income countries. For some of the countries, a reduction in the present value of debt would have a significant impact and help bring debt to sustainable levels.

The Least Developed Countries Report 2021 (UNCTAD, 2021) called for the setting up of a contingency financing facility to ease debt service for countries when specific factors affect their ability to service their debt, such as natural disasters, wars or geopolitical tensions, which have an adverse impact on their GDP or commodity exports, or any other factors that might increase their vulnerability to shocks. Depending on credit terms, the debt service of countries experiencing such unexpected events could, for example, be automatically suspended until such time as their interest repayments do not exceed their GDP growth rate and other income-indexed measures. The practicality of state-contingent debt instruments[6] was tested during the COVID-19 pandemic and reviews of their usefulness abound. For instance, the instrument only becomes active when disaster or crisis strikes, resulting in huge losses to the economy. If the contingent event is global, lenders may also be exposed to the same risks, and therefore may not be inclined to offer relief (Cohen et al., 2020). In general, rescheduling of debt, including standstill provisions, does not solve debt crises other than postponing the inevitable, but reduction of the present value of debt goes a long way towards reducing debt.

2. Bilateral debt relief and South–South cooperation

Bilateral debt relief plays an important role in reducing the debt burdens of LDCs. During the period 2006–2021, LDCs received $25.2 billion in ODA debt relief, most of it between 2006 and 2014 (figure 3.12). However, official bilateral flows related to debt relief have been falling, accounting for only $1.6 billion during the period 2019–2021. The top five recipients were the Democratic Republic of the Congo (32 per cent), Myanmar (20 per cent), Liberia (7 per cent), Somalia (6 per cent) and Bangladesh (5 per cent). Beneficiaries during the period 2006–2021 were Togo (4 per cent), the United Republic of Tanzania (4 per cent), Zambia (4 per cent), and Guinea (3 per cent). During the period 2015–2020, debt forgiveness or reduction amounted to $3.3 billion, and rescheduled debt was $0.4 billion, but new external debt contracted by LDCs reached $200.5 billion, eclipsing the additional $167.4 billion

[5] See https://daccess-ods.un.org/tmp/7142791.15200043.html.

[6] State-contingent debt instruments (SCDIs) are debt instruments that link a sovereign's debt service payments to its capacity to pay, depending on world variables or events. The contingencies have to be defined in advance so that when conditions are met, the country can avert a debt crisis.

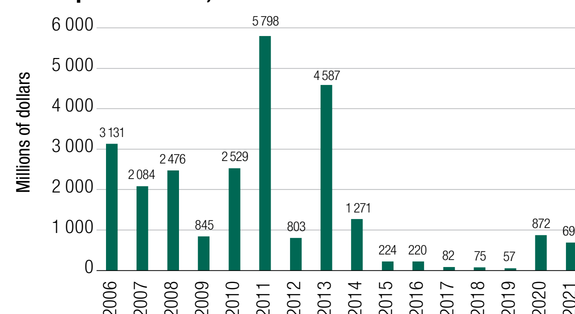
debt accumulated during 2007–2014.[7] More than half of the new external debt (62 per cent) was public and publicly guaranteed. The mismatch between debt relief received and the newly contracted debt shows that LDCs are facing not only large-scale financing challenges, but also debt management problems that keep their overall indebtedness at unsustainable levels. The drying up of aid and debt relief was particularly apparent in 2015–2021, when debt stocks and debt service costs escalated.

Looking ahead, there is the need for substantial liquidity support to LDCs in debt distress or at risk of distress. Developed countries also need to scale up disbursements of official flows, including ODA, in line with their commitments, as the financing gap also carries a cumulative negative impact on development in low-income countries. Some of the short-term loans accumulated by the LDCs, for example, arise from their need to bridge the gap between commitments and disbursements from official creditors, as well as higher future costs of postponed investments. South–South sharing of experiences on debt management issues, including assessing public and external finance needs, is critical for countries that are in debt distress or at risk of distress. The UNCTAD Sustainable Development Finance Assessment Framework, for instance, provides policymakers with tools for assessing whether their countries are on track to meeting existing external debt obligations without compromising their ability to achieve the Sustainable Development Goals.[8]

Debt relief provided by official creditors can be more effective if it involves a comprehensive reduction of debt stocks with corresponding cuts in debt service costs (UNCTAD, 2020c). Of course, the nature of LDC's debt problems varies, from short-term liquidity problems related to a shortfall in tax revenues due to economic shocks, to long-term insolvency linked to structural economic weaknesses. The effectiveness of bilateral debt relief in these instances depends on how aid flows assist the recipient country smoothen its fiscal revenue gap in the short-term, while also addressing its long-term structural limitations. However, with ODA already low, bilateral aid flows earmarked for debt relief should not be substitutes for other types of aid, as doing so would add to the unpredictability of aid flows and worsen the procyclical

Figure 3.12

Official development assistance debt relief received by least developed countries, 2006–2021



Source: UNCTAD secretariat calculations, based on data from OECD *Creditor Reporting System* database (accessed April 2023).

impacts that increase insolvency risks of the recipient countries. Establishing the real capacity of LDCs to repay debt is therefore critical in resolving their debt crisis in the long-term, in addition to substantially reducing the present value of their debts stocks (Chuku et al., 2023; UNCTAD, 2021b).

Frequent situations of debt overhang and increased demand for emergency lending and debt restructuring simply confirm that the debt vulnerabilities of the LDCs have reached crisis level. Bilateral partners could increase aid flows to the stricken countries, and by providing debt relief, they could broadly help those countries deal with debt overhang and free up resources for more social spending. The latter was the focus of G7 debt relief considerations from as far back as its meeting in Toronto, Canada, in 1988,when partial debt forgiveness, longer maturities and low interest rates were highly recommended (Bjerkholt, 2004). In 1990 at its meeting in Houston, United States, the G7 called for more concessional rescheduling for the poorest countries, and for increasing the grant element of debt reduction from about 27 per cent to 67 per cent (Easterly, 2002). This was in recognition of the fact that debt rescheduling alone was inadequate to bring down debts unless additional steps were taken by the international community to decisively deal with the crisis. At the same time, beneficiaries of substantive debt reductions would also need to urgently implement structural reforms and channel new resources towards building productive capacities and improving their trade performance (Easterly, 2002; UNCTAD, 2020b).

The Group of Seven is currently aligned with the Group of 20 on debt issues, and in particular, the member States are committed to working closely with the Group of 20 and international organizations to, among others, "advance the work on multilateral development banks evolution; promote voluntary SDR channelling; secure resources for Poverty Reduction and Growth Trust and Resilience and

[7] UNCTAD secretariat calculations based on World Bank, *International Debt Statistics* database (accessed June 2023).

[8] The framework has been applied to a number of countries, including Indonesia and Sri Lanka, under the Debt Management and Financial Analysis System (DMFAS) programme (Lockwood, 2022).

Sustainability Trust; address debt vulnerabilities" (European Council, 2023: paragraph 7). During the COVID-19 pandemic, the Group of 20 announced a Debt Service Suspension Initiative (DSSI) to assist low-income countries facing liquidity problems. The initiative waived debt service obligations for 73 eligible countries, of which 41 were LDCs. Of the $5.4 billion debt service deferral extended by bilateral creditors in 2021, 21 LDCs that regularly report their data to the World Bank benefited from about $2.1 billion in deferred debt service.[9]

a. Group of 20 Common Framework for Debt Treatments: Beyond the Debt Service Suspension Initiative

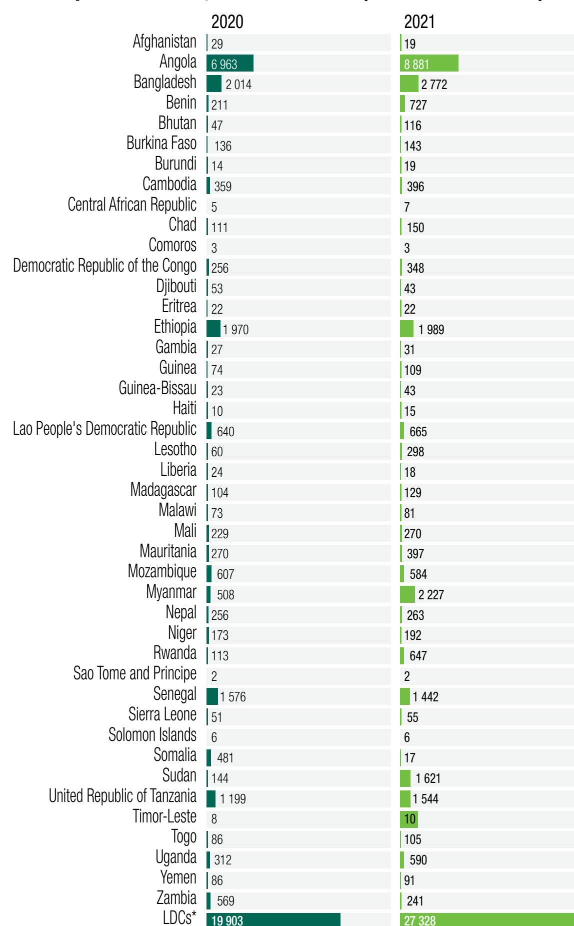
As the DSSI – launched during the pandemic – expired, the Group of 20 announced a new initiative in 2022 aimed at assisting countries facing protracted debt problems. The framework offers no debt write-off or cancellation, but it is envisaged that such measures may apply if a country meets certain IMF/World Bank criteria, and if all participating creditors collectively consider the case to be deserving of such treatment (Paris Club, 2021). The Common Framework may broaden the participation of creditors in addressing long-standing debt resolution constraints, since it is endorsed by the Paris Club and other major non-Paris Club members. However, there are still many official creditors who have not endorsed it, due to unresolved questions about burden-sharing by official bilateral creditors, the role of MDBs, and eligibility for debt treatment, which depends on the IMF/World Bank Debt Sustainability Analysis Framework for Low-Income Countries.

At present, the impact of the Common Framework on debt distressed countries is minimal, since countries have to apply on a case-by-case basis. Besides eligibility, the financial impact of the entire process is a major concern. For instance, despite the DSSI extending into 2021, the total PPG debt service for the LDCs rose from $19.9 billion in 2020 to $27.3 billion in 2021, as all LDCs experienced larger debt costs in 2021 compared to 2020, except for Angola, the Comoros, Djibouti, Liberia, Mozambique, and Sao Tome and Principe (figure 3.13). Deferred debt service through the DSSI varied as a share of total debt service actually paid by LDCs in 2021, ranging from $0.4 million to $835.8 million. In nominal terms, Angola benefited from the largest deferral in debt service among LDCs in 2021, while some other countries benefited from significant debt deferments as a share of the actual PPG debt service paid, such as Zambia (144 per cent), Djibouti (70 per cent),

[9] See https://www.worldbank.org/en/programs/debt-statistics/dssi.

Figure 3.13

Public and publicly guaranteed debt service of least developed countries, 2020 and 2021 (millions of dollars)



Source: UNCTAD secretariat calculations based on World Bank, *International Debt Statistics* database (accessed May 2023).

Note: Data for Kiribati, South Sudan and Tuvalu are not available.

Mauritania (53 per cent), the Comoros (45 per cent), and Sao Tome and Principe (44 per cent) (table 3.1).

Other official creditors of developing countries, particularly those with systemic influence on the debt of the LDCs, could help resolve protracted debt situations and prevent further deterioration of LDCs' debt situation. More than half of all LDCs will need debt relief and support measures that go beyond preserving the interests of creditors and averting default. Debt restructuring, for example, should contribute to fostering economic growth and poverty reduction in the distressed countries, as was the case during the implementation of the MDRI in 2005 (World Bank, 2022). Potentially, implementation of debt standstill provisions under the Group of 20 Common Framework may allow multilateral banks to extend emergency lending and other assistance while the countries are negotiating debt restructuring. When requesting debt restructuring, countries at high risk or in debt distress require quicker debt workouts.

Table 3.1

Debt service deferred under the Debt Service Suspension Initiative, 2021

	Debt service deferred through DSSI (million of dollars)	Deferred debt service as a per cent of PPG debt service in 2021
Afghanistan	4	23
Angola	836	9
Burkina Faso	16	11
Burundi	0	2
Chad	2	1
Comoros	1	45
Democratic Republic of the Congo	35	10
Djibouti	30	70
Ethiopia	76	4
Gambia	3	8
Guinea	36	33
Lesotho	2	1
Madagascar	3	3
Mali	28	10
Mauritania	212	53
Mozambique	154	26
Myanmar	76	3
Nepal	51	19
Niger	21	11
Sao Tome and Principe	1	44
Senegal	69	5
Sierra Leone	4	8
United Republic of Tanzania	101	7
Togo	20	19
Zambia	347	144

Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics* database (accessed May 2023).

This could be made possible by other bilateral lenders and private lenders committing to terms offered by the majority of the country's lenders, including the participants of the Group of 20 Common Framework (Cheng et al., 2018; United Nations, 2023c). In addition, wider reform of the international debt architecture is needed to address the shortcomings of the international financial system, and to brighten the prospects for transparent and coordinated debt workouts (UNCTAD, 2023b; United Nations, 2023c).

Debt distressed LDCs are likely to remain at risk unless debt relief efforts are ramped up and the international financial architecture begins to address core issues that have contributed to the debt crisis. Those issues include structural weaknesses of the countries, and elements of the polycrisis such as geopolitical tensions that affect international trade (UNCTAD, 2023d). Implicitly, serial debt restructurings suggest the need for structural reforms, particularly for LDCs that experience deterioration in their trade and capital flows following any significant debt restructuring (Cheng et al., 2018; UNCTAD, 2023d). Treating insolvency problems is necessary but not sufficient, as the recurrence of the debt crisis in the LDCS has shown. The long-term effects of structural factors have not been adequately addressed by debt relief initiatives, and the international financial architecture has long ignored the structural weaknesses of the countries in lending and debt treatment decisions. It is therefore critical for developed-country partners to treat debt relief as additional to other official flows such as ODA, since substituting debt relief for other official flows tends to distort the impacts of ODA in recipient countries. As much as LDCs in distress need emergency lending, such debt would only have a positive impact on economic growth and resilience if the resources provided complement other debt relief efforts, rather than inflating lending. LDCs need a clear path out of unsustainable debt patterns through a series of lifelines such as grants, concessional loans and a debt treatment mechanism that is responsive, transparent and efficient in resolving unstainable debt situations.

D. Addressing the debt crisis

LDCs at risk of debt distress require an immediate injection of liquidity to prevent the crisis from degenerating into a socioeconomic catastrophe in the poorest countries. Conditions dictate that more grants and concessional finance be mobilized to bring debt to sustainable levels and safeguard the fiscal space the countries desperately need to pursue their long-term goals. As global efforts intensify to achieve sustainable consumption and production (Goal 12), and accelerate climate action (Goal 13), LDCs have also set ambitious goals through their nationally determined contributions (NDCs) to meet climate commitments. However, given their diminished access to concessional financing and grants from multilateral and bilateral official sources, LDCs are resorting to syndicated loans, bonds and commercial credit. The result is the evidently unsustainable debt patterns that have disproportionately raised their debt service costs, and markedly increased the share of short-term loans in their debt portfolios.

Possible responses from multilateral and bilateral partners are discussed in section D.1 below. The proposals are neither exhaustive nor unique to the LDCs, but their implementation could address

some of the financing gaps in LDCs. In view of the structural nature of the debt issues, section D.2 reiterates the need for special investment vehicles in the implementation of the Doha Programme of Action.

1. Multilateral and bilateral response to the debt crisis

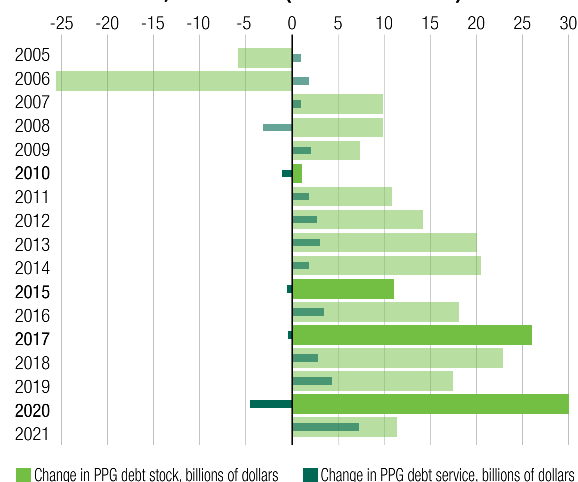
The structural nature of the debt crisis requires a rethink about the international financial architecture at the multilateral level to make it more responsive to the needs of developing countries. Among the proposals for revamping that architecture are the need to reform governance in the key players of the international financial system (i.e. the MDBs), and enhance coherence through a representative apex body (United Nations, 2023c). A development-focused approach, particularly through a multilateral framework for sovereign debt workout, could provide an effective, efficient and equitable mechanism for managing debt crises while safeguarding the development needs of vulnerable countries like the LDCs (UNCTAD, 2023b).

Economic shocks have deeper socioeconomic repercussions for the LDCs than for any other country groups, and their vulnerability is greater owing to their inability to mitigate the shocks with their own domestic resources. As the recovery to the COVID-19 pandemic gathered pace in developed and other developing countries, many LDCs were still reeling from the crisis (UNCTAD, 2021). Countries in distress or those facing a looming debt crisis need timely access to short-term external liquidity to enable them to navigate through the multiple external shocks. Lack of access to emergency financing is one of the reasons for unsustainable debt structures in LDCs, especially during periods of stochastic and systemic shocks. Although a debt service standstill may offer relief, accumulation of arrears could be counterproductive, and may dampen the impact of debt rescheduling. In addition to providing short-term liquidity to countries in distress or at risk of debt distress, the structural nature of debt in LDCs dictates that debt treatment should also contribute to addressing long-term structural imbalances by supporting their economic growth and resilience (United Nations, 2023c; UNCTAD, 2023b).

Unmet financing needs are accumulating in LDCs as their access to long-term financing diminishes, with the global financial system focusing on developed and emerging markets and on short-term and high interest rate debt instruments. In this environment, LDCs are paying 5 to 8 times more on new sovereign debt compared to developed countries' debt. The increase in LDCs' debt stocks reflects these inflated

Figure 3.14

Annual change in public and publicly guaranteed debt stock and debt service, 2005–2021 (billions of dollars)



Source: UNCTAD secretariat calculations based on World Bank, *International Debt Statistics* database (accessed May 2023).

debt service costs. Moreover, the impact of financing on LDCs' long-term development goals is either negative – because the cost of debt exceeds the social benefits – or subdued as a result of their increased vulnerability to debt distress (United Nations, 2023d). In 2011–2021, the average annual growth of LDC's PPG debt stocks exceeded $15 billion in seven of those years, and was higher than $10 billion in 2021 and 2015, following major shocks in both cases. The annual increase in debt service doubled in 2021 compared to 2019, and the trend was generally upwards before the pandemic (figure 3.14).

Addressing the liquidity crunch

Emergency lending on concessional and affordable terms can help the LDCs overcome liquidity constraints. The rollover risk of LDC sovereign debts can be reduced drastically by increasing debt maturities and softening terms to ease the debt pressure. This is particularly relevant for LDCs whose domestic financial position has deteriorated since the pandemic, with primary deficits widening as tax revenues have fallen short of government expenditure. An increase in multilateral sovereign lending should ideally be matched by an increase in other official flows, particularly ODA, and long-term financing for investments that can enhance growth and the capacity of the LDCs to structurally transform their economies. Multilateral creditors and other partners could assist the LDCs by converting maturing short-term loans into long-term loans on better terms.

Despite its limitations, the Group of 20 Common Framework has the potential to improve creditor

coordination and increase prospects for faster debt resolution. However, lessons from previous umbrella initiatives point to gaps in achieving comparability of treatment, eligibility of other developing countries, predictable time lines, and private sector participation and that of other stakeholders (UNCTAD, 2023b). For instance, a large share of LDC debts is owed to countries that are not members of the Paris Club. China (box 3.3), followed by India, Saudi Arabia, Kuwait, Libya, the Republic of Korea, and the Bolivarian Republic of Venezuela were owed 60 per cent of the PPG debts of LDCs in 2021, with China's share more than doubling in 2009–2021 (table 3.2). Cooperation with, and seeking comparable debt relief from, these countries, including maturity extensions, interest rate reductions and debt write-offs, could ease the economic hardships of the vulnerable LDCs. A wider multilateral approach is needed, especially one that ensures clarity and transparency in the lending and debt relief initiatives of the donors.

Table 3.2

Share of bilateral public and publicly guaranteed debt held by partner countries, 2009 and 2021 (percentage)

	2009	2021
China	17.7	40.7
Japan	15.0	15.4
Russian Federation	6.8	6.8
India	3.5	5.8
Saudi Arabia	5.4	4.8
France	6.0	4.3
Multiple lenders	3.2	3.1
Republic of Korea	1.1	3.0
Kuwait	5.5	2.5
Venezuela (Bolivarian Republic of)	0.6	1.6
United States of America	6.3	1.4
Libya	1.9	1.1
Italy	3.2	1.1

Source: UNCTAD secretariat calculations, based on World Bank, *International Debt Statistics* database (accessed May 2023).

Box 3.3 China, as a major creditor, is critical to debt resolution in the least developed countries: The case of Zambia

According to the World Bank's *International Debt Statistics*, China is a major bilateral creditor to LDCs. In 2021, it held $68 billion, or 41 per cent, of the combined bilateral and commercial bank PPG debt owed by LDCs. In Zambia in 2021, for example, the PPG bilateral debt stock reached $4.2 billion, 78 per cent of which was from China. China also held 22 per cent of the $2.3 billion of Zambia's PPG commercial bank debt. In total, 58 per cent of Zambia's bilateral and commercial PPG debt was held by China.

On the margins of the Summit for a New Global Financing Pact in June 2023, Zambia announced that it had reached an agreement with China and other major creditors to restructure its external PPG debt amounting to $6.3 billion, subject to further negotiations. The initial agreement with China and France, the co-chairs of its official creditors committee, sets in motion a process whereby the debtor and creditors define the parameters of the restricted debt. Zambia will seek to restructure at least $8 billion of its large external debt stock of close to $12.5 billion in PPG debt alone.

The restructuring will be guided by the Group of 20 Common Framework. Zambia's experience reflects many of the challenges that LDCs face in dealing with their diverse creditors. Reaching consensus with multiple creditor partners that have different views on debt treatment, and the role of commercial banks/development banks is very tricky. For example, the proposals being drawn up by Zambia cover only bilateral debts, although bondholders may also join the negotiations as their holdings continue to trade at distressed levels. For them, agreeing to a 40 per cent cut in the net present value of the sovereign bond would be ideal at the present market valuation of less than 50 per cent (Bloomberg, 2023). Important implications of the restructures revolve around the stock of debt owed to China. Some of the parameters that will matter include:

- A significant share of the debt owed to China will be treated as commercial debt, including debt owed to the Industrial and Commercial Bank of China. Only $4.1 billion of debt owed to the Export-Import Bank of China is categorized as bilateral debt (*Reuters*, 2023).
- Commercial partners may push for shorter maturities at higher interest rates (Bloomberg.com, 2023). The negotiations should seek equal treatment from private lenders, in line with the Group of 20 Common Framework, as well as better terms. An ideal situation would be to lower interest rates to below 1 per cent, cap interest rates on new debt, and extend maturity on restructured debt to over 20 years.

The success of the Group of 20 Common Framework and other multilateral approaches to debt treatment will depend on fundamental changes to that framework. The presence of China and other systemically important lenders to the LDCs would be critical in such discussions.

While Chinese lending is often criticized for its complexity, confidentiality, and other strict terms (Gelpern et al., 2022), the case of Zambia shows that China is willing to take part in multilateral debt resolutions. This, and other cases where China is involved, will provide valuable lessons for multilateral debt resolution. In addition, it will provide important lessons for LDCs in managing their external debt, including in the design of contracts, management of risks and negotiations on debt restructurings.

Implementing measures that align with the structural characteristics of least developed countries' debts

Although the IMF provides emergency lending to LDCs through facilities such as the Rapid Credit Facility (RCF) which is open to all countries eligible for the Poverty Reduction Growth Trust (PRGT) fund, some conditionalities attached to the funds may be restrictive amidst the rising debt vulnerabilities of the LDCs. The facilities are also notoriously underfunded as they rely on donor pledges to keep interest free loans flowing to the poorest countries. Early and deep restructuring of debt should be extended in a coordinated manner to all LDCs in debt distress or at high risk of debt distress.

A debt reduction initiative that has received renewed attention recently is the debt-for-nature swap (box 3.4).

Box 3.4 **What are debt-for-nature swaps?**

Debt-for-nature swaps may provide the much-needed financial resources to invest in some initiatives that could help mitigate the effects of climate change. They offer a promising mechanism for LDCs to address some environment-related challenges for limited types of projects. Under these arrangements, resources which normally would be spent to service debt may be provided to a country to support climate-friendly initiatives while alleviating its debt burden (Georgieva et al., 2022). Depending on their designs, such swaps can improve budgetary alignment with environment/climate objectives and foster green transformation. The swaps may also improve the impact of debt relief, provided the resulting resource reallocation does not reduce ODA and the recipient country's fiscal allocations to other development priorities. Specifically, debt-for-nature swap contracts do not unlock new resources; rather, they redirect debt obligations to a project that could have been covered by the creditor (Sheik, 2018; Chamon et al., 2022). The latter may prove challenging for countries in debt distress that also face primary deficits. One of the risks posed by debt-for-nature swaps is that it may simply involve the reallocation of resources from other environmental areas in the beneficiary country, and thus they may not provide any additional net benefit to environmental conservation. Indeed, the reallocation may result in a misalignment of priorities.

Moreover, debt-for-nature swaps may only provide short-term financing that is insufficient to address the long-term investments needed for a recipient country to adapt adequately to climate change. The interlinked nature of climate projects may also oblige the beneficiary government to channel additional resources for environmental purposes over and above the equivalent "forgiven" debt. This is usually the case for environmental projects spread over longer periods compared to the life of the forgiven loan. The context of the LDCs is challenging because their fiscal positions in 2019–2023 deteriorated as domestic debt exceeded revenue in 22 of 42 LDCs for which data were available. A total of 17 of the 22 were running primary deficits, implying that current government programmes cost more than could be covered by the tax revenues they were collecting (figure 3.11). Fifteen of these countries also had historical payments that were higher, as net interest payments absorbed a larger share of government expenditure. In the current environment, debt-for-nature swaps may only become relevant if the terms are not complex, and if the cost implications for beneficiary countries are minimized.

In 2003, the Government of Germany extended debt relief to Madagascar, whereby debt amounting to 23.3 million euros was cancelled in exchange for the Government of Madagascar's allocation of funding equivalent to 13.8 million euros in counterpart funds over a 20-year period through a proposed Madagascar Foundation for Protected Areas and Biodiversity. The Government made an initial capital contribution of 1.7 million euros, and a further 425,000 euros were to be paid in annual instalments up to 2023 (Moye and Paddack, 2003). The commitment was in euros, and under the agreement, the Government also committed to set up the Foundation. In this example, the debt-for-nature swap contributed not only to reducing Madagascar's debt and protecting the environment, but also strengthened the capacity of the country's institutions and ability to mobilize resources for the environment.

The following are a few more recent examples of debt-for-nature initiatives involving bilateral arrangements:

- France, along with the World Wide Fund for Nature (WWF) entered into a swap arrangement with Madagascar in exchange for $20 million in conservation funds in 2008.
- France entered a swap agreement with Mozambique to pardon a 17.5 million euro debt in exchange for 2 million euros in conservation funds in 2015, 10 million euros in budget support, and 5.5 million euros for vocational training (Club of Mozambique, 2016).
- France, through its development agency (*Agence française de développement*), allocated 315 million euros in 2016 under the Debt Reduction-Development Contract (*Contrat de Désendettement et de Développement*, C2D) initiative. Under the initiative, amounts that are due as debt service are transferred to the country in the form of a grants to finance poverty reduction programs. LDCs eligible for C2Ds include the following LDCs that are also HIPCs: Burundi, the Democratic Republic of the Congo, Guinea, Liberia, Madagascar, Malawi, Mauritania, Mozambique, Myanmar, Rwanda, Sierra Leone, Somalia, the Sudan, Uganda and United Republic of Tanzania. The initiative is both a debt cancellation and a swap in the sense that the beneficiary countries are still obliged to repay the maturities on the uncancelled portion of its debt, which then is transferred in the form of grants to earmarked programs selected by mutual agreement with the partner countries (AFD, 2016)

This instrument may operate in the same manner as a simple bilateral debt swap, but with a conditionality attached relating to the environment or nature. Thus, the debtor country must commit to spend on a specific climate action the equivalent of the debt service due to the bilateral creditor, and in return the indebted country's debts are restructured or reduced accordingly. The limited availability of climate finance targeting investments in adaptation in the LDCs makes the initiatives attractive, especially if it can unlock climate finance for adaptation while also addressing the debt burden. However, examples of successfully completed debt-for-nature swap programmes show that the resources involved are small, and therefore not desirable for countries with large investment needs for adaptation or for countries that face imminent fiscal/liquidity risks, as the process of implementing the swaps is long, and sometimes costly for both bilateral partners to the swap (Hebbale and Urpelainen, 2023; Georgieva et al., 2022).

E. Conclusions

This chapter examined the debt vulnerabilities of LDCs in order to understand factors that led to their recurring debt crises and proposed policy recommendations that, if implemented, could contribute to achieving Sustainable Development Goal 17.4. LDCs are in a prolonged debt crisis, and while debt levels have increased among all country groups since the 2008–2009 global financial crisis, the aftermath of that crisis marked a critical phase for LDCs as debt trends reverted to pre-HIPC levels prior to the COVID-19 pandemic. The COVID-19 pandemic played a major role in worsening the debt situation of LDCs, particularly those suffering from chronic current account deficits, and widening domestic resource gaps.

It is evident that structural factors are at the centre of the high debt accumulation and recurring debt crises in LDCs. First, the buildup in the external debt is linked to their weak economies that are trapped in low growth patterns. Second, their undiversified economies are both a consequence and a cause of commodity dependence on primary exports that are continuously losing share in world trade. Third, a shift in the debt structure of LDCs has been underway since the end of the global financial crisis and subsequent changes to the ODA architecture. A substantive share of private credit with shorter maturities characterizes the debt structure of LDCs. However, the debt structure remains predominantly multilateral, although the decline in the share of multilateral debt has been quite drastic for some countries.

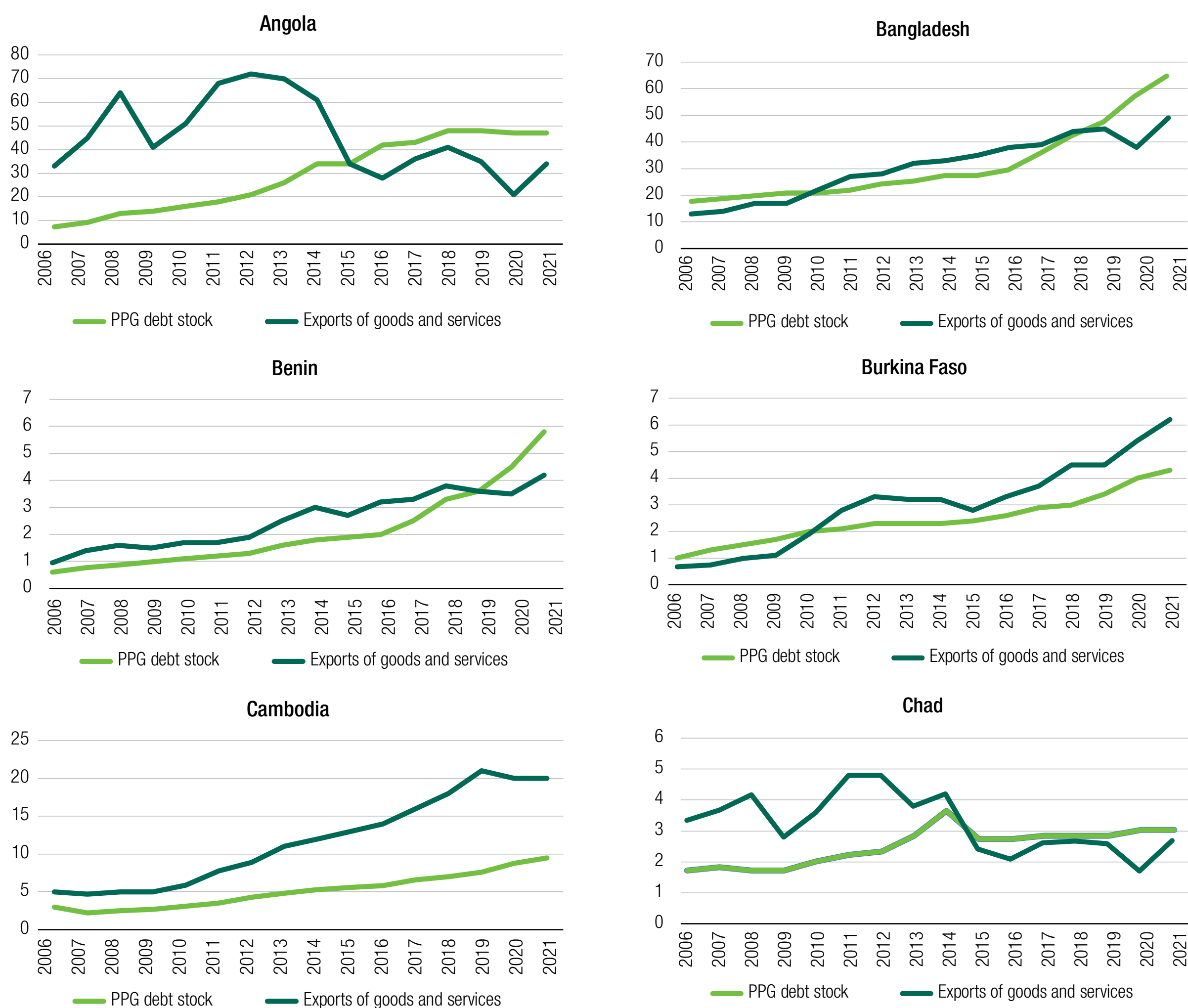
The debt crisis in the LDCs is developing at several levels and worsened by the increasing frequency of trade shocks and widening trade gaps. Export volatility exert pressure on government revenue and are a major source of balance of payments imbalances in commodity dependent economies. LDCs in debt distress and at risk of distress need a clear path out of unsustainable debt patterns through a series of lifelines, such as grants, concessional loans and a debt treatment mechanism that is responsive, transparent and efficient in resolving unstainable debt situations. Debt and liquidity management in the LDCs should be responsive to the different circumstances of the countries — particularly those that are facing long-term, structural imbalances, and liquidity constraints. Left to the dictates of lenders, the conditionalities imposed can often erode LDCs' policy space and weaken government control over their monetary and fiscal policies. It is also critical for developed-country partners not to substitute debt relief for official development flows, including ODA. Similarly, emergency lending during crises should be sparingly used as a complement to debt relief efforts rather than as an opportunity to inflate debt stocks of the MDBs. In the present circumstances, there are a number of initiatives that could help alleviate the debt burden of LDCs. For instance, some LDCs could benefit from a temporary debt standstill arrangement to postpone payments during the transition period of debt restructuring. In addition, progress should be made in establishing debt workout mechanisms at the multilateral level to enable countries to resolve debt situations without recourse to legal processes that may not respond appropriately to sovereign financing requirements.

Addressing long-standing structural economic weaknesses could avert their procyclical debt vulnerabilities. However, there is also a need for a commensurate international response to the debt crisis by addressing systemic issues that affect the debt sustainability of the LDCs. Such a response should include changes to the international financing architecture and to conditionalities imposed by MDBs, as well as greater transparency in bilateral financing arrangements and debt treatment mechanisms. Granting all LDCs access to IDA loans and increasing international financing assistance mainly in the form of grants would ease the financing pressure and foster conditions for balancing debt portfolios between long-term and short-term debts. Moreover, different categories of creditors would help spread interest rate risks and dampen the effect of speculative investors, particularly in the prevailing global economic climate of high interest rates and inflationary pressures.

Annex

Figure A3.1

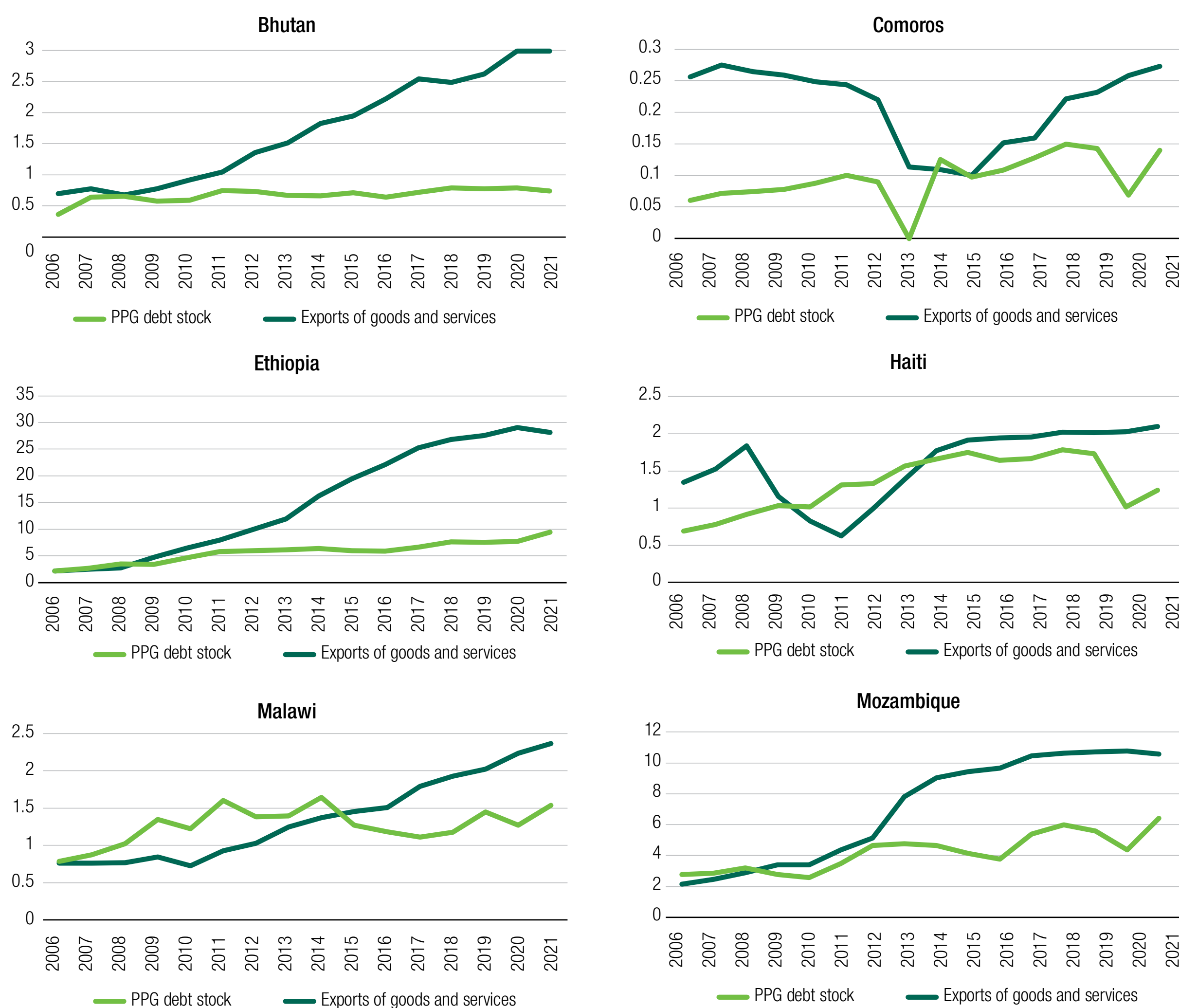
Public and publicly guaranteed debt stock and exports, selected countries, 2006–2021 (billions of dollars)



Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023).

Figure A3.2

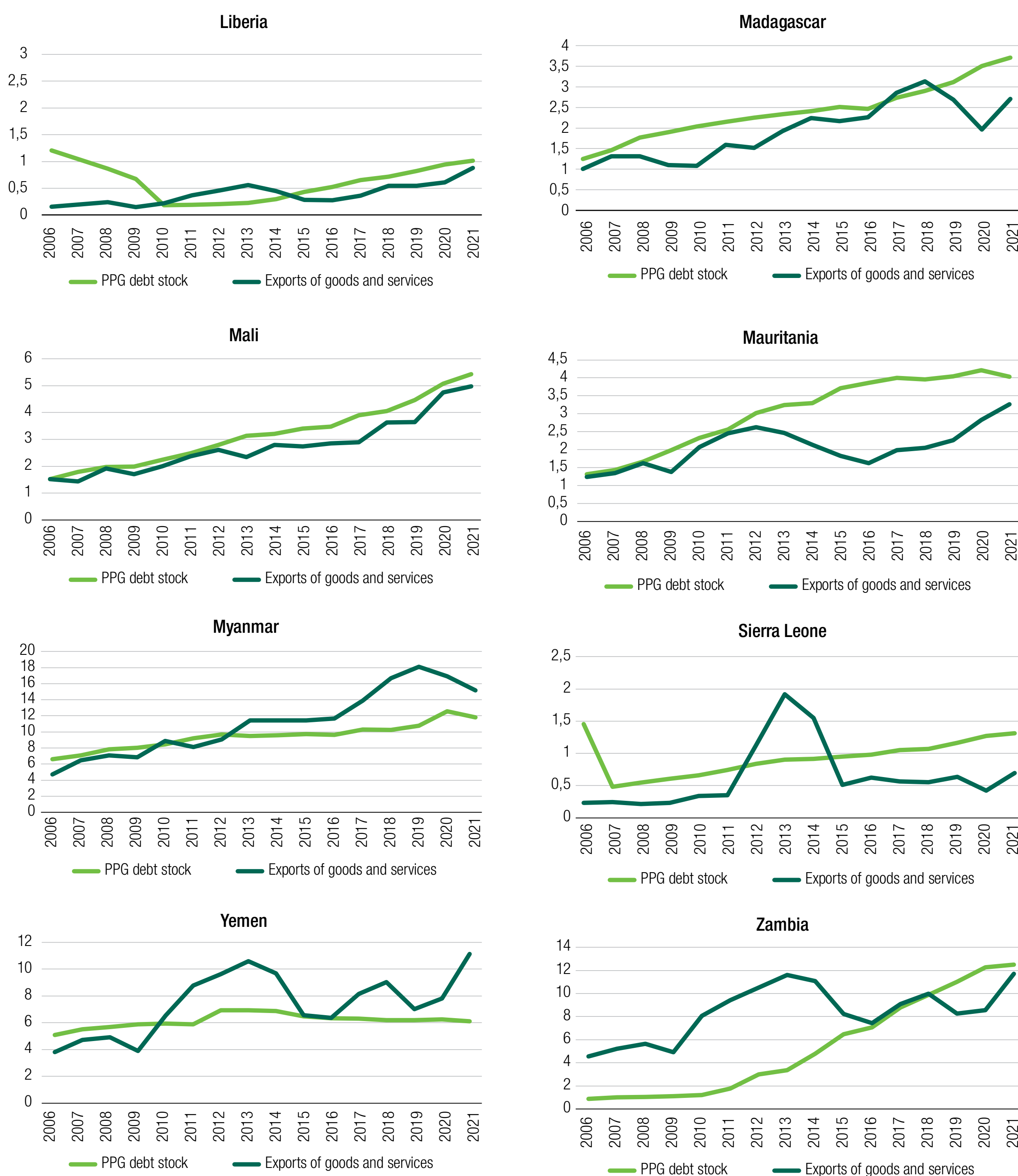
Public and publicly guaranteed debt stock and merchandise exports, selected countries, 2006–2021 (billions of dollars)



Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023).

Figure A3.3

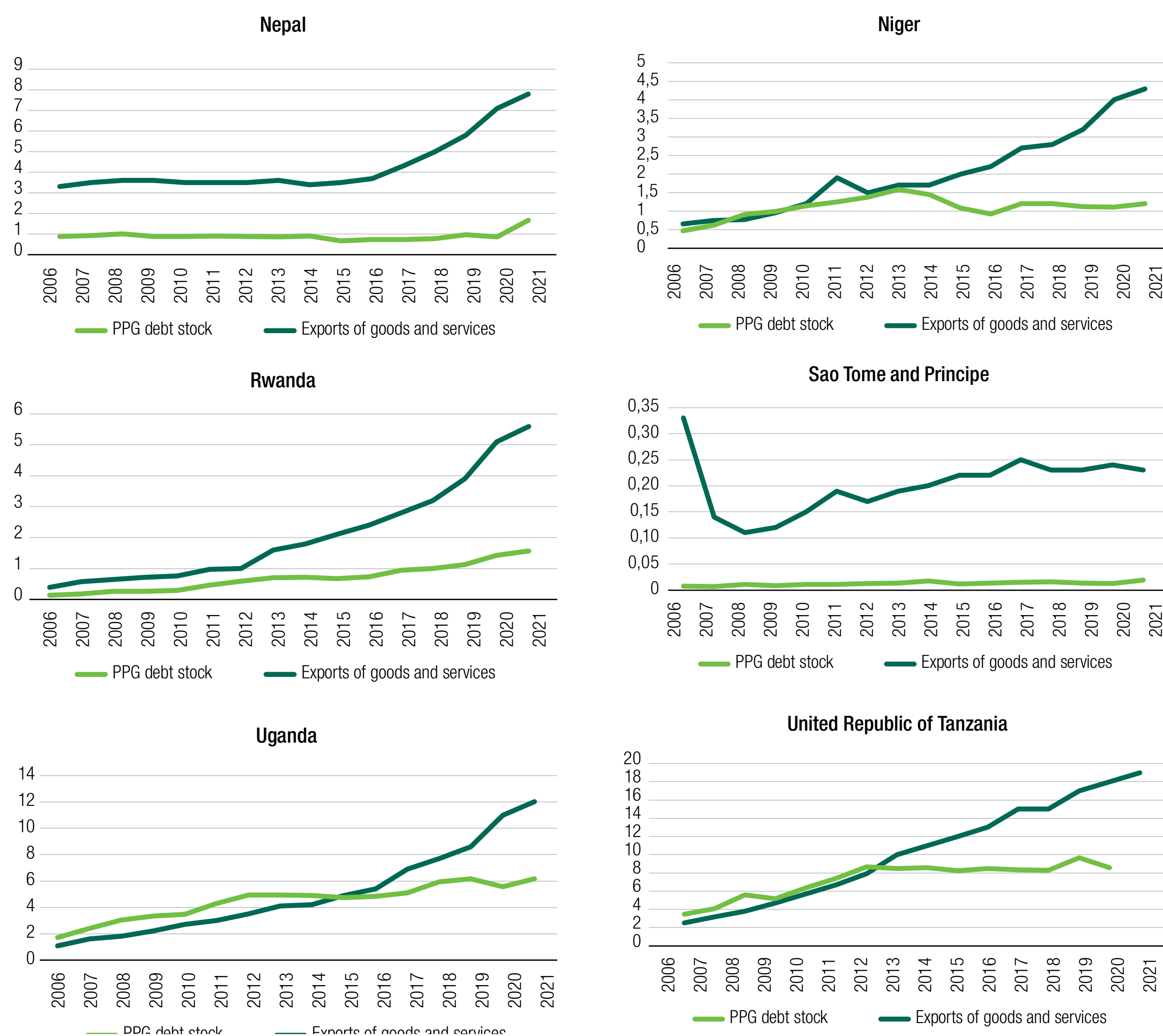
Public and publicly guaranteed debt stock and merchandise exports, selected countries, 2006–2021 (billions of dollars)



Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023).

Figure A3.4

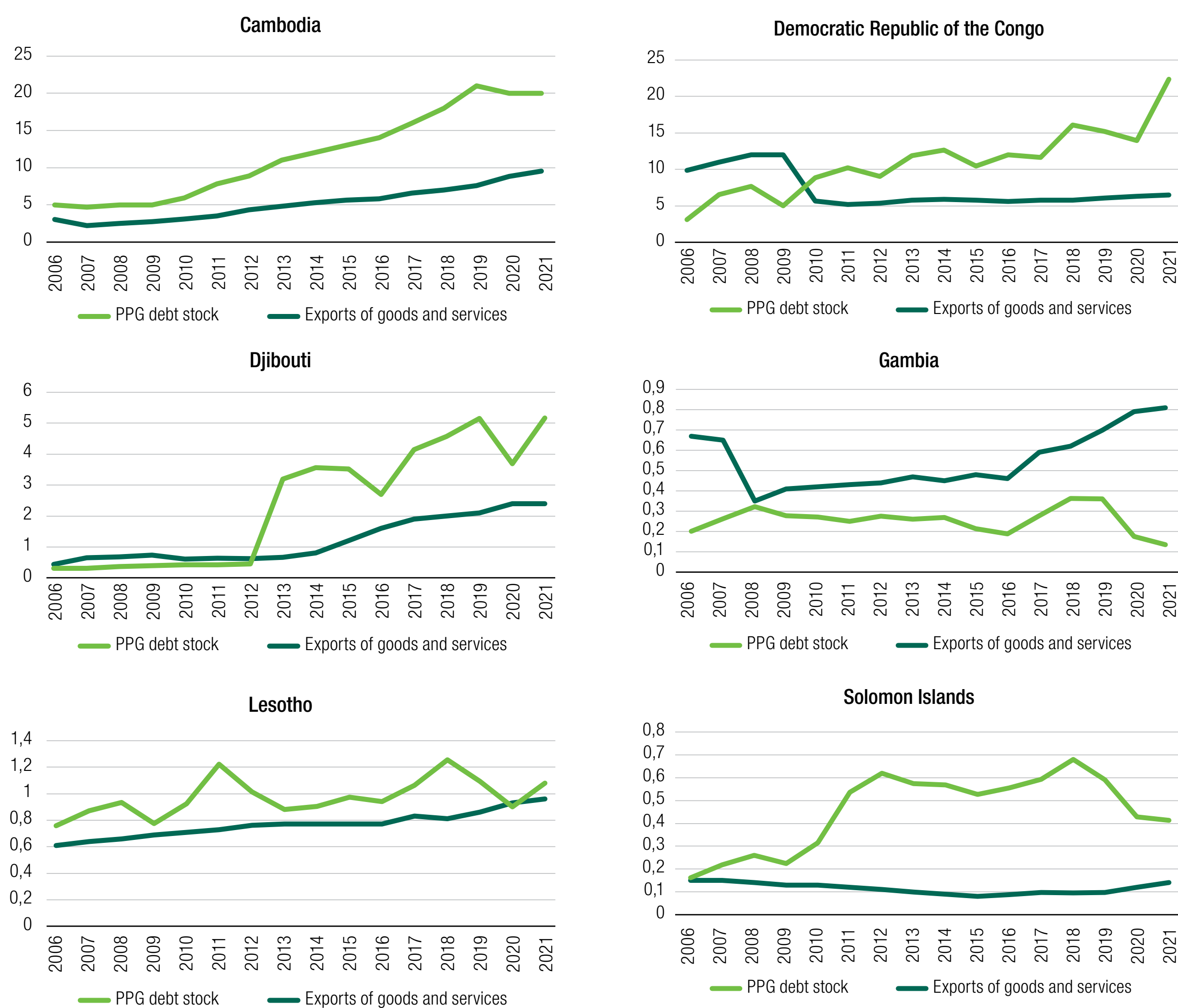
Public and publicly guaranteed debt stock and merchandise exports, selected countries, 2006–2021 (billions of dollars)



Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023).

Figure A3.5

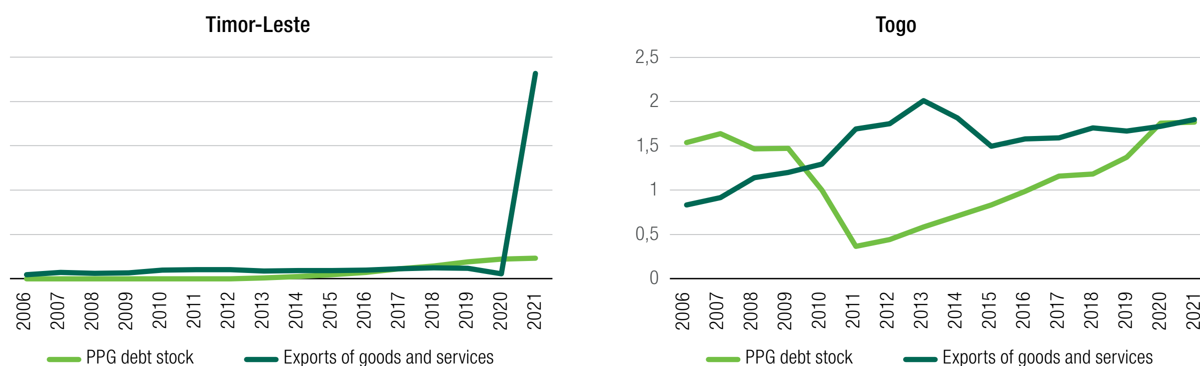
Public and publicly guaranteed debt stock and merchandise exports, selected countries, 2006–2021 (billions of dollars)



Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023)

Figure A3.6

Public and publicly guaranteed debt stock and merchandise exports, selected countries, 2006–2021 (billions of dollars)



Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023)

Table A3.1

Public and publicly guaranteed debt stock as a percentage of gross domestic product

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Afghanistan	13	20	19	17	13	11	10	10	10	10	11	10	11	10	10	13
Angola	14	14	14	20	19	17	17	20	24	39	84	62	62	69	88	69
Bangladesh	26	24	22	21	18	17	18	17	15	14	11	12	13	13	15	15
Benin	9	9	9	10	12	11	12	13	13	17	17	20	23	25	28	34
Bhutan	80	66	55	63	59	59	76	86	96	97	103	104	102	103	128	118
Burkina Faso	15	17	16	18	19	17	18	17	17	20	20	20	19	21	22	22
Burundi	97	94	77	22	19	16	18	16	15	13	15	15	16	18	20	20
Cambodia	41	26	25	26	27	27	31	32	31	31	29	30	28	28	34	35
Central African Republic	60	51	42	15	18	12	12	19	21	25	23	19	19	19	18	17
Chad	22	20	17	19	19	18	18	22	26	24	26	28	25	25	28	25
Comoros	37	35	29	29	27	24	22	10	10	10	15	15	19	19	21	21
Democratic Republic of the Congo	68	65	59	64	26	20	18	18	16	15	15	15	12	12	13	12
Djibouti	57	77	68	70	54	52	47	33	37	48	62	70	70	69	74	69
Eritrea	65	65	69	55	63	49										
Ethiopia	14	13	10	15	22	25	23	25	29	30	30	31	32	29	27	25
Gambia	63	51	23	28	27	31	31	34	37	35	31	39	37	39	43	40
Guinea	70	49	43	45	43	44	13	16	17	18	21	18	17	17	24	22
Guinea-Bissau	154	135	109	116	115	21	23	23	26	30	28	32	34	41	57	58
Haiti	18	16	18	10	7	5	7	9	12	13	14	13	12	14	14	10
Lao People's Democratic Republic	74	69	59	59	53	49	44	43	42	46	46	49	52	54	56	55
Lesotho	34	38	38	40	32	28	31	33	32	33	37	36	32	35	42	39
Liberia	108	75	50	38	9	8	7	7	9	13	15	19	21	25	31	29
Madagascar	20	17	17	20	20	19	19	19	19	22	21	21	21	22	27	26
Malawi	19	17	14	14	10	12	17	23	23	23	28	20	19	18	18	19
Mali	22	22	20	19	21	19	22	24	22	26	25	25	24	26	29	28
Mauritania	34	33	32	42	41	38	45	45	50	60	60	59	53	50	50	40
Mozambique	23	24	23	29	31	30	31	46	51	59	81	79	72	70	77	67
Myanmar	56	45	34	27	22	17	17	16	15	15	16	17	15	16	16	18
Nepal	36	34	28	28	22	16	16	16	15	15	15	15	15	17	21	21
Niger	14	13	11	13	15	22	16	17	16	20	22	24	22	25	29	29
Rwanda	12	14	13	13	12	14	14	20	21	24	27	31	34	38	50	50
Sao Tome and Principe	232	96	58	67	74	81	68	62	58	69	65	65	55	53	51	45
Senegal	14	14	14	18	20	20	24	24	25	30	32	40	48	52	57	52
Sierra Leone	77	22	22	25	26	25	22	18	18	23	27	28	26	29	31	32
Solomon Islands	24	21	18	16	14	11	9	8	7	6	6	7	6	6	8	9
Somalia								41	36	33	32	32	36	32	38	39
Sudan	27	22	21	24	20	19	25	25	21	19	15	12	49	51	62	45
Timor-Leste								1	2	3	4	7	9	9	10	6
Togo	65	62	44	44	29	9	12	14	15	20	16	18	17	19	23	21
Uganda	11	13	12	9	10	11	13	14	13	15	19	22	23	24	30	30
United Republic of Tanzania	13	15	13	16	18	19	20	22	23	26	26	27	27	28	28	28
Yemen	27	26	21	23	19	18	20	17	16	15	20	24	29			
Zambia	7	7	6	7	6	8	12	12	18	31	34	34	38	47	68	56
LDCs (average)	41	34	28	27	25	21	20	21	22	25	28	28	29	30	34	32

Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023).

Table A3.2

Tax revenue and claims on central government, 2011–2015 and 2016–2020 (percentage)

Country	Tax revenue (percentage of GDP)	Claims on central government (percentage of GDP)	Claims on central government as a percentage of of broad money, average annual growth rate	Tax revenue (percentage of GDP)	Claims on central government (percentage of GDP)	Claims on central government as per cent of broad money, average annual growth rate
	2011–2015			**2016–2020**		
Afghanistan	7.6	-5.9	-0.7	9.7	-7.5	-3.2
Angola	13.9	-3.1	1.5	9.7	11.1	14.3
Bangladesh	8.8	14.8	3.5	7.3	13.6	4.3
Benin		-2.3	0.5		0.6	1.7
Bhutan	14.1	2	0.3	14.2	3.4	0.3
Burkina Faso	13.6	-0.5	0.7	14.7	0.8	0.9
Burundi		8.9	9.4		25.1	17.4
Cambodia	12.5	-6.4	-2.8	17.1	-17.4	-4.4
Central African Republic	6.3	16.1	5.3	7.9	16.8	4.2
Chad		2.2	5.6		11.9	8.7
Comoros		0.9	-2.2		2.1	2.5
Democratic Republic of the Congo		2	13.4		2.6	5.4
Djibouti		1.6	0		0.8	0.4
Eritrea		99.9	5.3			
Ethiopia	8.9			7.2		
Gambia		20	13.2		29	8.7
Guinea		13.5	2.6		13.8	9
Guinea-Bissau		6.8	7.5	9.9	8.5	-2.7
Haiti		1.2	2.6		6.9	7.5
Kiribati	18.9			24.3		
Lao People's Democratic Republic						
Lesotho	34.9	-16.4	-4.1	28.9	-5.1	5.6
Liberia	12.2	6.5	-0.1		8.8	11.9
Madagascar	8.7	3.8	6.4	9.9	5.4	2.7
Malawi	14.9	7.2	4	12.7	8.9	26
Mali	13.1	-1	3	14.3	4.1	5.2
Mauritania		7.9	-1.1		6.9	-0.9
Mozambique	20.5	-0.4	3.2	22.5	5.2	2.2
Myanmar	5.8	13.3	-0.9	5.9	19.9	8
Nepal	13.1	8	0.6	17.8	7.4	2.1
Niger		-0.8	-0.9		2	2.8
Rwanda	13.1	-4.5	-2.4	14.4	-2.8	-1.9
Sao Tome and Principe		-3.1	-2.8		-1.6	1.6
Senegal	15.8	1.2	-0.4	16.2	5	4.8
Sierra Leone		8.2	8.9		17.2	17.7
Solomon Islands	25.9	-12.1	-8.8	23.5	-8.2	1
Somalia				0		
South Sudan		11.2	62.2		43.2	102.1
Sudan	6.9	10.8	15.5	7.4	11.7	28.7
Timor-Leste	95.2	-38.9	-9.4	20.8	-31	-9.6
Togo	17.2	3.9	-0.3	13.2	2.4	-0.3
Tuvalu						
Uganda	10.8	3.6	1.9	11.6	9.2	5
United Republic of Tanzania	10.6	3.8	5.5	11.6	3.4	0.5
Yemen		18.6	14.8			
Zambia	14.8	8.2	3.6	15.6	17.7	16.8
LDCs (average)	17.5	4.5	3.6	14.2	6.3	7.5

Source: UNCTAD secretariat calculations, based on UNCTADStat and World Bank, *International Debt Statistics* database (accessed March 2023).

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