As outlined in the previous chapter, to achieve the structural transformation implied by a Global Green New Deal and meet the goals of the 2030 Agenda, developing countries, supported by the international community, will need to scale up investment on an unprecedented scale, in both new areas of productive activity and infrastructure provision. Credit creation and the settlement of debt are at the heart of any such effort, as they can augment or constrain the massive mobilization of resources required of both public and private agents.

Modern banking and financial systems are accounting schemes for the clearance and settlement of credit and debt. Credit here provides advance means of payment, thus purchasing power, backed only by claims on current and future incomes, or debt (Schumpeter, 2008 [1934]: 107). As Keynes insisted, a principal role of the credit system should be to augment the productive powers of societies: “Credit is the pavement along which production travels and the bankers if they knew their duty, would provide the transport facilities to just the extent that is required in order that the productive powers of the community can be employed at their full capacity” (Keynes, 1930: 219–220). However, as he implied, and as has been found out at considerable cost over the past three decades, there is no guarantee that bankers do know their duty and that, therefore, a largely privatized and decentralized system of credit creation will automatically deliver prosperity for all.

From the perspective of economic development, there are three main implications. First, the essential role of credit is that it frees today’s investment from the shackles of yesterday’s accumulated savings, enabling productivity-enhancing investment to be stepped up. Second, the speed and direction of credit creation depend on lenders’ confidence in the repayment of debt and, more generally, in the value of financial and bank assets. Therefore, it ultimately depends on the credibility and effectiveness of the institutional and regulatory structures that govern credit creation. Third, the decoupling of credit and productive investment can generate economic pathologies which are antithetical to sustainable economic growth.

Private investment decisions are guided by expectations about sales prospects and future profits. High expected profits incentivize firms to invest. To the extent that the combined investment decisions of firms boost aggregate demand and allow for the profit expectations of individual firms to be realized, accrued profits also increase the capacity of firms to finance future investment out of retained earnings (TDR 2008: chap. IV, TDR 2016: chap. V). Those same expectations also generate demand for credit to launch an investment drive prior to the profits being realized and encourage banks to extend that credit. Similarly, public investment decisions are typically guided (or should be) not only by their desired social benefits but also by the expectation of higher incomes in the future resulting from such decisions, which in turn generate higher future tax revenues and crowd in private investment.

Successful domestic resource mobilization (DRM), in developed and developing countries alike, is therefore based on strong and reliable connections between credit, investment and profits, where profits are “simultaneously an incentive for investment, a source of investment and an outcome of investment” (Akyüz and Gore, 1996: 461). This profit-investment nexus is the basis for triggering virtuous cycles of rapid productivity growth, higher incomes and
expanded markets, at home and abroad, leading in
turn to higher levels of domestic investment, further
boosting productivity. While a robust profit–investment
nexus should mean that investment in leading
sectors can increasingly be financed out of retained
earnings, the accelerated pace of capital accumulation
overall, the evolution of national production systems
and their insertion into changing international pro-
duction chains, requires that targeted credit creation
(or debt finance) remains a necessary and useful
constant along the economy’s dynamic growth and
developmental trajectory.

But debt finance does not play this dynamic role
in domestic economic development by virtue of
some spontaneous process. Indeed, as noted in the
last chapter and discussed extensively in previous Reports, in the context of hyperglobalization, the
nexus between profits and investment has broken
down in many countries as profits have been used to
 augment dividends, to buy back stocks and to acquire
other businesses, often using opaque financial struc-
tures to hide how profits are being used (TDR 2015;
TDR 2017; and chapter V). Extending credit along
a broken profit–investment nexus will probably fuel
more inequality and instability.

Moreover, debt is a social and institutional rela-
tionship that builds on trust, as well as on shared
information and expectations between debtors and
creditors. It, therefore, requires the confidence of
lenders and borrowers alike in the ability of the
domestic banking and financial system, and of
monetary authorities and the state, to honour com-
mitments, preserve the value of financial and bank
assets and govern the speed and direction of credit
creation in the interest of both financial stability and
structural transformation. This can be a tall order,
since the social and economic upheavals that inevi-
tably accompany structural transformation can easily
run counter to financial stability.

Successful states have routinely intervened in pri-
ivate credit creation by building sectoral, regional
and subnational networks of credit institutions and
banks – often but not always state owned – with a
mandate to democratize access to finance for social
purposes and to facilitate the financing of transforma-
tional investment projects for which long-term
social returns were high but private profitability was
uncertain in the short term and private risks prohibi-
tive (see chapter VI). But, by and large, the power
of credit creation, with its enormous implications
for wealth creation, productive development and
social fairness in the economy, was and is vested
in decentralized private banking and financial sys-
tems. This has had varying effects. At times, it has
facilitated financial resource mobilization for pro-
ductive purposes through financial innovations
that provided increased access to long-term debt
in capital markets and lowered the short-term risks
of debt-financed private investment. But it has also
meant that economic growth has been punctuated
by frequent banking and financial crises, usually in
periods of high capital mobility and weak regulatory
constraints that resulted in excessive private credit
creation and “financial innovation” for short-term
speculative financial gain (Reinhart and Rogoff,

The main danger of decentralized and under-
or unregulated banking and financial systems is precisely
that credit (and liquidity) creation by commercial
banks and private financial institutions has no limits,
and therefore ceases to be linked to wider social or
collective economic objectives instead becoming “a
business” of its own in the service of private profita-
bility. Debates about the need for more encompassing
public control over what is, after all, a public good
– the management of credit creation in the interest
of the full and equitable development of a society’s
productive potential – are not new. Unsurprisingly,
however, they have seen a vigorous revival since the

From a developing country perspective, the main
domestic challenge for governments is to steer their
existing financial infrastructure towards supporting
a working domestic profit–investment nexus. This
entails an overt role for the state, primarily based
on their capacity to mobilize public credit creation
through borrowing from their central banks, and to
service their own debt by strengthening fiscal capaci-
ties and expanding their tax base, as new productive
investment opportunities arise and are created. To
sustain accelerated capital accumulation, private
credit creation through well-regulated domestic
banking and financial systems will gradually become
important, and states will need to fine-tune their
ability to govern the coordination between pub-
lic and private credit creation, including through
tailor-made and increasingly sophisticated financial
and debt instruments. Concomitantly, public plan-
ning and policy design capacities have to be kept
pace to implement industrial policy frameworks
and diversification strategies, promote technology
acquisition and technological learning, as well as mitigate income inequalities to further support virtuous productivity cycles and the process of structural transformation.

Even though most developing countries already possess the essential components of a financial infrastructure, including central banks, commercial banks and development banks, albeit with considerable variation in terms of depth and sophistication, the sheer scale of the productive investment required to achieve structural transformation and sustainable development within a meaningful time frame means that developing countries will have to rely on external financing, including external debt. In the context of late development, debt is often associated with external sovereign debt owed by developing country governments to foreign, private and official creditors, usually in foreign-denominated currency. In addition, hyperglobalization and the concomitant deregulation of cross-border financial transactions has increasingly facilitated private indebtedness in foreign-denominated currency, even in the poorest of developing countries.

Consequently, the ability of developing countries to manage public and private credit creation for development remains heavily dependent on the management of credit creation in advanced economies and on liquidity provision by international financial organizations, over which they have scarcely any control. Monetary policy in advanced economies essentially caters to domestic policy concerns in advanced economies and the interests of private creditors and financial lobbies, rather than the longer-term interests of developing countries. As noted in Chapter V, developing countries have become vulnerable to highly volatile private capital flows, driven by short-term investor expectations about global rather than country-specific economic dynamics. Sudden reversals of private capital inflows can adversely affect developing countries despite strong economic “fundamentals” such as relatively low public debt, small budget deficits, low inflation rates and high reserve holdings (Eichengreen et al., 2017). But the more open the developing economy and the more limited the domestic wealth base it has been able to generate, the weaker its fiscal base and therefore its ability to leverage domestic credit creation for structural transformation. Weak government finance then can contribute to reduce international investor (and creditor) confidence and encourage cross-border capital outflows. Resultant exchange-rate depreciations, rising debt burdens in foreign-denominated currency and deepening mismatches between long- and short-term assets and liabilities undermine external debt sustainability and amplify financial and debt distress. Instead of “firefighting” immediate liquidity constraints and hedging against future liquidity risks, with associated international seigniorage losses, as discussed in Chapter V, developing country governments should focus on adapting their own financial infrastructure to local needs and conditions and supporting the emergence of a sustainable domestic profit–investment nexus.

A coordinated reorientation of the management of international credit creation and liquidity provision to support developing countries’ efforts to govern their own public and private credit creation for development would have several positive effects. It would reduce the exposure of developing countries to detrimental external financial and macroeconomic shocks and, as argued in Section C of this chapter, it would also enable greater progress towards the 2030 Agenda.

At present, as discussed in Chapter II, the international Financing for Development (FFD) agenda pays little, if any, heed to such considerations. Rather, scaling up development finance is seen as a largely static reallocation exercise to direct existing financial resources (or savings) to meet the Sustainable Development Goals (SDGs). At the heart of this agenda is the idea that available public finance should be used to “leverage” international private finance, through blended financing instruments that allow investors to hedge against risk and, more generally, by “embarking on system-wide insurance and diversification of risk to create a large-scale asset class and mobilize significantly greater private sector participation” (EPG-GFG, 2018: 30). From this perspective, the emphasis tends to be on developing-country debt not being “a free lunch” (World Bank, 2019: 11–17), whereby its potential benefits, such as smoothing short-term macroeconomic fluctuations and helping to meet rising investment needs, can be outweighed by the potential cost of being considered “financially unsound” in the international financial markets, undermining investor confidence and eventually “crowding out” private investment, when debt service costs and domestic interest rates rise as a consequence.

Under current hyperglobalized conditions of sprawling unregulated finance networks and open capital
Section B of this chapter surveys the evolving landscape of developing-country debt, its fast-growing vulnerabilities in the context of hyperglobalized financialization, and the main recent trends. Section C takes account of the SDGs and of the impact of investment requirements arising from the timely implementation of the 2030 Agenda on developing-country debt sustainability. It finds that, if only the first four SDGs to address poverty, nutrition, health and education needs are to be met on time without any further deterioration of developing countries’ debt-to-GDP ratios, fairly drastic international public intervention in the form of increased official development assistance (ODA) and SDG-related debt relief would be required. On the assumption that such drastic public intervention lacks international consensus at present, section D explores alternative yet complementary avenues, at regional and international levels, to harness the power of publicly controlled credit creation for development. This includes expanding special drawing rights to fund climate-change mitigation more systematically, regional strategies by developing countries to leverage the power of own credit creation for their development, and proposals on how to disentangle sovereign debt restructurings, when these become necessary, from the tentacles of fast-proliferating and diverse creditor interests, through a few initial steps required to safeguard both the future growth potential of the sovereign debtor and its citizens as well as longer-term creditor interests.

B. Development and the business of debt

1. The global context: Private credit creation out of control

Global debt stocks amounted to $213 trillion at the end of 2017, up from $152 trillion in 2008 and just below $16 trillion in 1980. As a share of global GDP, global debt rose to 262 per cent in 2017, compared to 240 per cent at the onset of the GFC and 140 per cent in 1980. Much of this extraordinary increase was driven by the accumulation of private debt,
which rose more than 12-fold since the early 1980s to account for more than two thirds of total global debt stock in 2017. Public debt also increased substantially, doubling in the decade following the crisis to reach 84 per cent of global GDP (figure 4.1).

The explosion of global private debt since the early 1980s, both in absolute terms as well as relative to GDP, reflects more than three decades of financial deregulation and heavily privatized credit creation and financial intermediation in developed economies. The share of private debt in their GDP rose from 115 per cent in 1980 to well over 200 per cent by 2017. By contrast, the share of public debt in developed countries’ GDP remained fairly stable throughout the 1980s and 1990s, at 50–70 per cent, increasing markedly only in the aftermath of the GFC to over 100 per cent (figure 4.2 A).

Beginning with the Deposit Institutions Deregulation and Monetary Control Act of 1980 in the United States, financial deregulation resulted in several waves of bank consolidation creating “too big to fail” banks in financial centres, and a gradual shift towards market-based finance. By 1989, the Delors Report on economic and monetary union in the European Community called for “the complete liberalization of capital transactions and full integration of banking and other financial markets” (Committee for the Study of Economic and Monetary Union, 1989: 15) in a bid to step up the creation of European equivalents to United States “mega-banks” and to facilitate the growth of non-bank financial markets in Europe. The repeal of the Glass-Steagall Act in the United States in 1999 – allowing banks to integrate their commercial lending and deposit roles with their more speculative investment activities (so-called universal banking) – completed the dismantling of any serious regulatory constraints on the new global financial system of mega-banks operating alongside fast-proliferating networks of non-bank financial intermediaries. The latter have come to be known as the “shadow-banking” sector due to the deep opacity of its financial transactions (Dymski, 2018; see also chapter II of this Report).

This new system thrived on the creation of a whole arsenal of “financial innovations” both in banking as well as non-banking financial sectors – such as securitization, credit derivatives and special purpose vehicles – that increased the availability of credit by converting non-tradable financial assets into tradable securities, transforming liability risks into financial instruments and diversifying individual creditor risks. Repeated use of easy monetary policies in response to growing incidences of stock market “jitters”, and of course to the GFC, further fuelled speculative private credit creation and financial intermediation. With attempts at reregulation in the aftermath of the 2008 crisis remaining largely ineffective (TDR 2015; Engelen, 2018), shadow banking or “the subterranean credit system” of broker-dealers, money market mutual funds, hedge funds and insurance corporations among others (Guttman, 2018: 26), has expanded unabated. Since the GFC, non-bank financial intermediation has grown twice as rapidly as conventional and public banking, such that its share of total global financial assets (48.2 per cent) is now larger than that of commercial banks and public financial institutions (43.9 per cent) (FSB, 2019).

This wave of privatized credit creation and financial intermediation has had a devastating impact on the ability of developing countries to protect “their
shores” from the onslaught of speculative financial interests in search of high short-term yields, especially in conjunction with widespread capital account liberalization in the developing world (see chapter V). Both the Latin American debt crisis of the 1980s and the Asian financial crisis of 1997 were driven by excessive overseas lending from mega-banks competing with one another and with emerging shadow-banking actors for new customers and virgin territory (Dymski, 2018; Palma, 2002).

Since the GFC, a “new normal” seems to have set in by which developing-country debt has become fair game for financial investors in search of high short-term yields. As developing country governments struggle to deal with widespread exchange-rate volatility, a sluggish global economic recovery, flat commodity prices and mercurial cross-border capital flows, the worst case scenario becomes plausible, whereby developing country governments take on expensive debt in international financial markets to firefight liquidity constraints, and private actors take on such debt to bridge constraints on domestic credit creation, notwithstanding the high risks involved.

2. Developing country indebtedness: An increasingly “private affair”? In 2017, total developing-country debt reached its highest level on record, at 190 per cent of GDP (figure 4.2 B). This reflected a very steep increase in private indebtedness since the GFC, from 79 per cent in 2008 to 139 per cent in 2017. By contrast, public sector debt, which peaked at 63 per cent of GDP in the late 1980s, fell to 34 per cent in 2008. While the renewed rise of public indebtedness in developing countries to 51 per cent in 2017 is of concern for reasons discussed below, the unprecedented explosion of private debt should clearly raise the loudest alarm bells. It also constitutes the single largest contingent liability on public debt in the event of a debt crisis.

**FIGURE 4.2 Total debt, developed and developing countries, 1960–2017**

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

**Note:** Country groups are economic (income) groups as per UNCTADstat classification, see: https://unctadstat.unctad.org/EN/Classifications.html (accessed 2 August 2019).
Much of this private debt has been accumulated in high-income developing countries (HICs) with deeper domestic financial and banking systems and easier access to international financial markets. But the share of private debt in the GDP of HICs has also increased sharply since the GFC to reach 165 per cent of GDP in 2017. The public debt-to-GDP ratio of HICs rose from 34 per cent in 2008 to 50 per cent by 2017. Their overall indebtedness in 2017 thus stood at 215 per cent of GDP, by far the highest in the period covered, largely due to the sharp increase in private debt in the aftermath of the GFC (figure 4.2 C).

Both middle- and low-income developing countries have also seen strong upward trends in their overall indebtedness since 2012. This turning point coincides with the onset of the commodity price slump in the same year, with commodity prices, led by fuels, steadying only since 2016 and remaining significantly below their 2011 peaks for most product groups (UNCTAD, 2019a). In both cases, recent increases in overall indebtedness have also been marked by the faster rise of private relative to public debt, albeit at much lower levels of GDP share than in the case of HICs.

In 2016 and 2017, the total debt of middle-income developing countries (MICs) reached 106 per cent of their GDP, for the first time surpassing earlier peaks in the mid-1990s and early 2000s of around 100 per cent. During these earlier episodes of acute debt and financial distress, the rise in overall indebtedness was led by public sector debt, while private sector debt rose only very gradually, from 20 per cent in 1980 to around 30 per cent in the early 2000s. By contrast, in the current phase of rising debt burdens, private indebtedness increased quickly to 45 per cent of GDP in 2017, whereas the share of public debt in GDP only began to increase more pronouncedly since 2015, reaching just above 60 per cent by 2017 (figure 4.2 D).

In low-income developing countries (LICs), current overall debt burdens have not yet reached the high levels of the mid-1990s (111 per cent of GDP in 1993) but are getting close at 92 per cent of GDP in 2017. This signals a clear reversal of the positive impacts of the debt relief programmes of the 1990s and early 2000s, such as the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative. As with MICs, private sector debt as a share of GDP of LICs rose faster than that of the public sector, even if public debt remains predominant. At the height of the debt crises of LICs in the mid-1990s, the share of public debt in their GDP reached 101 per cent, compared to just over 9 per cent for the private sector. By 2017, public debt was 46 per cent of GDP, whereas private debt jumped to a remarkable 26 per cent of GDP, up from 12 per cent just prior to the GFC (figure 4.2 E).

Clearly, this recent steep rise of private sector participation in developing-country debt, across per capita income groups, was not warranted by sudden improvements to their domestic banking and financial systems since 2008. Instead, the driving force is more likely to have been global “push factors”, and in particular the relentless search by global financial investors for higher-risk but also higher short-term (expected) returns. Figure 4.3 A illustrates the extent to which deregulated credit creation and financial intermediation have targeted non-financial private sectors in emerging market economies over recent years.

While household debt also rose in emerging economies, from 25.4 per cent of GDP in 2011 to 40 per cent by 2018, the bulk of the overall increase in lending to private non-financial sectors was lending to non-financial corporations in these economies. Such lending increased from around 60 per cent of GDP just before the GFC to over 100 per cent in 2017, falling only recently due to rising financial distress in some of these economies (figure 4.3B). The steep increase in this lending since around 2012 is a prime example of “push factors” at work. In this case, original and leveraged quantitative easing in advanced economies reached corporate balance sheets in emerging market economies through several channels. By driving down yields on Treasury Bills and on safe financial assets more generally, central banks in developed economies sent asset managers and their clients scrambling for higher-yield and higher-risk investments, such as corporate bonds in emerging markets. In addition, central banks also bought Treasury Bills and asset-backed securities from commercial banks, who went on to lend to shadow-banking actors, such as hedge funds with high-risk investment strategies. Finally, quantitative easing cash also found its way to emerging economies through foreign direct investment, in particular in the form of intra-company loans that made up around 40 per cent of foreign direct investment in countries such as China and Brazil by 2014 (Chui et al., 2016).

Rising public debt in developing countries has been less prominent in the current build-up to rising overall...
developing-country indebtedness compared to earlier episodes of acute financial and debt distress, largely because of pressure from international financial institutions to contain this. Even so, developing country public (or central government) debt also has become more vulnerable to the vagaries of international financial markets and the “subterranean credit system” by virtue of the changing ownership of this debt.

As figure 4.4 shows, in the space of just about a decade and a half, the central government debt of major developing countries has gone from being owned by developing countries’ own banking systems and by foreign official creditors to being, if not entirely controlled, at least heavily dominated by the foreign, and to an extent domestic, shadow-banking sectors (non-banks). This fairly radical shift in the ownership of developing country central government debt signals a profound loss of control by developing country governments over the pace and direction of credit creation in their own economies, which is accentuated by the increased exposure of developing country private sectors to short-term financial investor and creditor interests.

3. Developing-country external debt: The falling threshold of debt distress

External debt issued in foreign-denominated currency poses particular challenges to developing country debtor nations, as they have to generate export earnings to meet these external public or private debt obligations. In a system of floating exchange rates, exchange-rate volatility will affect the value of the debt owed externally and that of export earnings in
opposite directions. If, in addition, much of public external debt is owed to international private creditors with short-term speculative interests and a growing share of external debt is held directly by private domestic entities rather than governments, the possibility of systemic debt distress in developing countries is real.

Total external debt stocks of developing countries more than doubled from $3.5 trillion in 2008 to an estimated $8.8 trillion in 2018 (figure 4.5 A). This was not balanced by concomitant GDP growth, so the ratio of total external debt to GDP consequently worsened from less than 22 per cent in 2008 to 29 per cent in 2018 (figure 4.5 B). This figure rises to 36 per cent if the Chinese economy is excluded. In the period 2008–2018, the external debt stock of China grew at a slightly higher rate than the average for all developing countries, albeit still at a modest 15.1 per cent of its GDP in 2018 (figure 4.5 C). By 2018, China accounted for 25.5 per cent of the total external debt stocks of developing countries and for 45 per cent of their combined GDP.

Over the past three years, developing-country external debt stocks also overtook their export earnings, with the ratio of external debt to exports reaching an average of 108 per cent since 2016, relative to 92 per cent for the past decade as a whole, signalling rising vulnerabilities. Moreover, long-term creditor holdings shrank to barely more than two thirds (68 per cent) of total external debt in 2018, with by now almost equal shares of public and publicly guaranteed external debt (PPG), at 51.8 per cent,
and private non-guaranteed external debt (PNG), at 48.2 per cent, respectively. Short-term external debt accounted for over 30 per cent of the total external debt stocks of developing countries in 2018, up from 24.5 per cent in 2008 (figure 4.5 B). This is a far cry from the start of the century when long-term debt accounted for 87 per cent of developing countries’ total external debt stocks and PPG debt made up three quarters of this.

In terms of regional trends, the most salient features are rising levels of both public and private sector external indebtedness in Latin America and the Caribbean, the rise of private sector external indebtedness in the African regions (albeit from low levels) and the renewed rapid increase in short-term external debt in East Asia and the Pacific.

While these regional trends reflect different trajectories, a rising number of developing countries now face acute debt and financial distress at relatively modest levels of external debt-to-GDP ratios. By mid-2019, the number of LICs at high risk of debt distress or already in debt distress, according to the International Monetary Fund (IMF), had almost tripled from 13 in 2013 to 32 in 2019 (of which 25 are at high risk and 7 are in debt distress), including 14 of the 34 LICs that earlier received debt relief under the Heavily Indebted Poor Countries or the Multilateral Debt Relief initiatives. At the same time, a growing number of HICs and MICs either have already experienced severe currency and debt crisis (most notably Argentina and Turkey) or are teetering on the brink of financial and debt distress, ranging from many Caribbean small island developing states to developing economies in South Asia and Africa. For larger and higher-income developing economies, 2013 seems to have been a turning point, after which they experienced a fairly drastic surge in financial stress episodes, as global financial instability impacted on domestic financial conditions through various channels such as capital flow reversals, commodity price and exchange-rate volatility and higher exposure to external private indebtedness (UNCTAD, 2019b).

As with developing countries’ total debt, much of this was due to the changing ownership patterns of developing-country external debt. In 1970, official multilateral and bilateral creditors accounted for almost 80 per cent of developing country PPG debt, but this share fell to just 40 per cent by 2018. In the 1980s the difference was made up by commercial bank lending, but this has now largely been replaced by bond finance in the international financial markets, which accounted for almost half of developing-country PPG debt in 2017 (figure 4.6). At the same time, private debt has risen to make up almost half of overall developing-country external debt, with a steady share of bond financing of around 20 per cent of overall PNG debt.

The increased risk profile associated with this changing composition of external developing-country debt is a main cause of the rising threshold of debt distress, relative to overall external debt-to-GDP ratios. Governments, facing exposure to sudden and steep increases in the cost of market-based PPG debt, are also coming up against a “wall of debt” contracted in international financial markets since the early 2010s that will come to maturity in the first half of
the 2020s. Moreover, unfettered access by domestic corporates to external debt poses systemic problems. Other than for China, where corporate bonds are predominantly domestically owned, large developing-country corporates rarely manage to hedge their foreign-currency debt exposure appropriately through assets held abroad. Their liabilities are therefore ultimately backed by foreign-currency reserves in the domestic economy. If this debt becomes unsustainable and is large enough, governments will have little choice but to transfer the bulk of this debt onto public balance sheets, making their own positions even more untenable.

In response, many developing country governments shifted to issuing domestic debt in local currency. But this is no panacea, for a number of reasons. Many developing countries lack the financial infrastructure to issue long-term government securities at a sustainable rate of interest, but still need to be in a position to pay off or roll over maturing short-term obligations. Hence, they may simply be trading exchange-rate for maturity mismatches. Moreover, domestic developing-country debt in the local currency is not immune to foreign takeover by short-term private investor interests. According to IMF research, in the early 2010s the foreign holdings of local-currency denominated government debt ranged from 40 per cent or more of total local-currency denominated government debt (in Indonesia, Peru and South Africa) to between 20 and 30 per cent in other MICs (Arslanalp and Tsuda, 2014).

4. The fall-out: Rising debt servicing burdens, weakened “self-insurance” and not much to show for it

Rising debt burdens along with increased risk profiles of this debt translated into rising debt servicing costs on public external debt from around 2012.

**FIGURE 4.7** Improvements in debt service burdens are reversing. Public debt service ratios, 2000, 2012, 2017

- **A. Debt service on public external debt as a share of GDP**

- **B. Debt service on public external debt as a share of government revenues**

*Source:* As figure 4.5.
Figure 4.7 looks at the distribution of debt service burdens across developing countries in 2000, 2012 and 2017. The year 2012 marks a clear turning point, as debt service burdens that had been declining since 2000 (relative to GDP and to government revenues) began to increase again from that year. In the first phase, the trend of decline was more pronounced in the case of debt service costs on PPG debt relative to government revenue than for the costs of servicing all external debt relative to GDP. However, disparities in this trend also grew, with slower progress for a group of countries comprising mostly LICs. After 2012, debt service costs started rising again, both for total external debt as a share of GDP and PPG debt as a share of government revenues, indicated by the rightward shift of these distributions in figure 4.7. This coincided with the end of quantitative easing in the United States, negative net capital flows, adverse commodity price shocks and increased exchange-rate volatility. By 2017, this reversal had not wiped out all of the earlier improvements — about half of these in terms of total external debt service as a share of GDP and about a third in terms of servicing PPG debt as a share of government revenues in the space of just five years — but the trend was clear.

The total servicing bill on long-term public external debt obligations of developing countries as a whole increased from 2.6 per cent of GDP in 2012 to 3.7 per cent in 2017. This was still below levels in the early 2000s of around 5 per cent but indicates a clear upward trend. Similarly, servicing their external long-term public-debt obligations cost developing country governments 9.5 per cent of their government revenues in 2012, but 12.7 per cent in 2017. These debt servicing costs also absorbed 7.5 per cent of developing countries’ export earnings in 2012, and 12.7 per cent in 2017. While the levels of the early 2000s (of around 24 per cent of government revenues going to service PPG debt and 15 per cent of export

### FIGURE 4.8
International reserve “cushions” are shrinking: International reserves, developing countries 2008–2018
(Percentage of short-term external debt)

Source: As figure 4.5.

### FIGURE 4.9
does growing private corporate indebtedness yield developmental results? Growth rates of private corporate debt and private capital stock, selected developing countries, 2008–2015

Source: UNCTAD secretariat calculations based on IMF Global Debt Database and IMF Investment and Capital Stock Data.
earnings) have not yet been reached, the reversal in just a few years of the improvements achieved until 2012 should be of concern, in particular since the steepest reversals have taken place in poorer economies. Thus, for example, PPG debt service costs in less developed countries as a percentage of their government revenue more than tripled from 4.1 per cent in 2011 to 15 per cent in 2018.

At the same time, developing countries’ ability to self-insure against the vagaries of international financial markets and against exogenous shocks to their economies has deteriorated rapidly over the past decade (figure 4.8). The ratio of international reserves to short-term debt is a standard indicator of this ability to self-insure. As figure 4.8 shows, this sharply decreased since 2009 across the developing world, led by HICs and MICs, with LICs following suit once the full impact of commodity price slumps and of their growing exposure to market risks was felt in the wake of their belated but very rapid integration into international financial markets. LICs have since tried to recover some degree of self-insurance through the renewed accumulation of international reserves, but this carries significant fiscal and economic costs, as described in chapter V.

Finally, a question arises over whether the rise of private indebtedness in developing countries, mostly by their non-financial corporations, has yielded results in terms of providing resources for long-term productive investment projects. Figure 4.9 suggests that it has not. Between 2008 and 2015, non-financial corporate debt grew considerably faster than investment in physical capital stock in the vast majority of developing countries for which such data are available (depicted by all observations situated below the 45-degree line in the figure).

C. Raising the bar: Developing-country debt sustainability and the Sustainable Development Goals

1. From short- to long-term debt sustainability: Rebalancing public and private interests

The previous section outlined the extent to which debt, in both the public and the private sectors, has become a dominant feature of the era of hyperglobalization. Nevertheless, in many countries, both developed and developing, rising levels of debt have failed to trigger a strong investment surge. This is of particular concern given that the structural transformation implied by a Global Green New Deal, and reflected in the SDGs, requires a large-scale investment drive. At a global level, chapter III estimated a 1 to 2 percentage-point increase in investment as a share of global income channelled into green investments, while previous UNCTAD research has, based on secondary sources, estimated an annual $2.5 trillion investment gap for developing countries in SDG-related sectors (UNCTAD, 2014). The kind of scaling-up implied by these estimates inevitably raises the question of developing countries’ debt sustainability, and in particular of the sustainability of their public debt levels.

Debt sustainability is an elusive concept for two main reasons. First, assessing whether or not a debt will be sustainable is, by definition, a forward-looking exercise littered with uncertainties about the long-term future trajectories of core macroeconomic variables and their interactions. Small debts may fast become unsustainable and large debts may remain sustainable over long periods of time, depending on a wide range of global and country-specific factors. Second, the analysis of debt sustainability also is an inherently normative exercise that addresses the question of what debt should be sustainable, given wider policy objectives such as, for example, meeting the SDGs.

Mainstream debt-sustainability analysis, encapsulated in the joint debt-sustainability frameworks of the IMF and the World Bank, takes the view that borrower solvency should be ensured all along the developmental growth path. Debt sustainability here is defined fairly broadly as a set of macroeconomic and policy variables consistent with excluding a number of events considered to send strong signals of future insolvency. These obviously include sovereign defaults but also the need for sovereign debt restructurings short of default, heightened rollover risks, and expectations of “improbably” large fiscal and current account adjustments required to avoid such events (IMF, 2013b: 4). Under this approach, whether or not a debt is sustainable is a short-term concern of meeting performance benchmarks defined independently of longer-term developmental goals, be this the general goal of raising living standards or more specific goals such as the SDGs. As a consequence,
domestic policy spaces, and in particular fiscal policy, are permanently constrained by the effort to ensure short-term debt sustainability as an end in itself.

In response to wide-ranging criticisms of the analytical foundations and operational detail of its debt-sustainability frameworks (e.g. Akyüz, 2007; Wyplosz, 2011; Guzman and Heymann, 2015), the IMF has undertaken several rounds of revisions. The latest of these, carried out in 2017 for the joint IMF and World Bank debt-sustainability framework for LICs, resulted in a more explicit consideration of the changing facets of debt vulnerabilities in these economies, including the role of domestic debt markets, and in increased flexibility and fine-tuning of core elements of the framework, such as baseline scenario projections, standardized stress tests and classifications of a country’s debt-carrying capacity. But the basic idea, that adjusting domestic resource use to meet external debt repayment schedules in every period takes priority over long-term national development strategies, has remained firmly in place.

An alternative approach that focuses on debt sustainability as an integral part of long-term national development strategies was suggested in the context of the United Nations Millennium Development Goals and has attracted renewed attention with the advent of the even more ambitious 2030 Agenda (Kregel, 2006; Pinto, 2018). In this view, developing-country debt sustainability should be assessed over the whole of a developmental cycle rather than at every point along the developmental growth path. In the early stages of development – or when investment requirements are particularly high, for example to meet the SDGs – debt, both domestic and external, should increase relative to overall economic performance, precisely to leverage the power of credit creation for developmental goals. Deteriorating debt ratios would therefore be a normal and necessary feature of these early periods. It is only when developmental targets are well on the way to being achieved that debt ratios can fall again and cumulative debt service obligations can be met without undercutting the very source of governments’ ability to repay debt, namely their economies’ productivity and income growth, and associated rising tax revenues and external earnings.

But for large-scale investment drives to be sustained in the early stages of development without disruption by major debt crises requires creditors’ willingness to roll over existing debt and to provide new external financing beyond the limited objective of bridging short-term liquidity constraints. As former Secretary-General Kofi Annan proposed in 2005, debt sustainability should therefore be defined relative to overall developmental goals or “as the level of debt that allows a country to achieve the Millennium Development Goals and reach 2015 without an increase in debt ratios” (United Nations, 2005: 2). Fast-forward to the 2030 Agenda, and the same challenge remains: that of providing interim finance to developing countries to achieve developmental goals while also safeguarding long-term debt sustainability.

Such a longer-term (and inter-temporal) approach to addressing debt sustainability in developing countries is all the more relevant, given that many of the SDGs – such as poverty elimination, nutrition, health, education, climate action, clean water and energy – require expenditures that yield high social returns, not only for the citizens of developing countries but for everyone, yet only distant and uncertain private financial returns. Nor are these expenditures that will immediately boost export capacities. Affordable external financing to support developing countries’ long-term debt sustainability with a view to their necessarily changing debt dynamics over the entire cycle of SDG-related investments is thus not an act of reckless charity, but one of collective reason. By contrast, the current short-term perspective on developing-country debt sustainability has developing countries locked into a (more or less) stable public debt-cum-low-growth scenario that risks systematic underinvestment in particular in those SDGs that yield the highest social returns.

2. Achieving the SDGs and development: The urgent need for multilateral action

The remainder of this section provides a brief analysis of the impact of meeting only the first four of the 17 SDGs (SDGs 1–4: poverty elimination, nutrition, good health and quality education) on developing-country debt sustainability, under different financing options. These are the SDGs that are expected to be met fully by public sectors (Schmidt-Traub, 2015). The analysis is based on a sample of 30 LICs and MICs across developing regions and consists of three components (see box 4.1 for more detail). The first of these components projects the impact of investment requirements arising from the four listed SDGs on the evolution of developing-country public (gross central government) debt until 2030. As, over the past decade, the share of
MAKING DEBT WORK FOR DEVELOPMENT

Total public debt in GDP has steadily increased in developing countries across income categories (see figure 4.2), a narrow focus on external public debt would provide an incomplete picture of current debt vulnerabilities. The second component estimates the resource challenge posed by meeting these SDGs by 2030 without an increase in public debt ratios, and thus following the alternative long-term definition of debt sustainability suggested in section C.1. The third component provides an overview of complementary domestic and international financing options to close the SDG debt-sustainability gap on time. Taken together, the different components of the analysis provide a useful overview of the financial challenges posed by the 2030 Agenda to developing-country debt sustainability.

BOX 4.1 The SDG debt-sustainability gap: Main methodological assumptions

The debt-sustainability analysis in this chapter operationalizes and updates the debt-sustainability definition proposed by former Secretary-General Kofi Annan in 2005 (United Nations, 2005). Updating this definition from the Millennium Development Goals to the 2030 Agenda, debt sustainability is defined here as the set of policies that allows a country to achieve the SDGs by 2030 without an increase in debt ratios. It prioritizes the financing requirements of the 2030 Agenda and establishes that debt sustainability must be viewed as support for a process occurring over time (Kregel, 2006).

The analysis takes the long-term evolution of total public debt (both domestic and external) as its core target variable. Even though, as pointed out, the most recent revision of IMF / World Bank debt-sustainability frameworks for LICs takes on board domestic as well as external public debt, formal and short-term debt-sustainability assessments by the international financial institutions remain, for now, largely focused on the extent to which external transfers of foreign-currency denominated foreign savings, whether private or public, can be sustained by meeting foreign creditor and international financial institution performance benchmarks on a continuous basis. By contrast, the current analysis systematically incorporates the growing role of domestic public debt in developing countries that has steadily increased again over the last decade across all income levels of developing countries (see figure 4.2). An additional consideration is that the SDGs under consideration are particularly reliant on public (domestic and external) financing given their strong and unrefuted public good features. These are SDG 1 (“End poverty in all its forms everywhere”), SDG 2 (“End hunger, achieve food security and improved nutrition and promote sustainable agriculture”), SDG 3 (“Ensure healthy lives and promote well-being for all at all ages”) and SDG 4 (“Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all”). The projected costs to achieve each of these goals are derived from research conducted by FAO et al. (2015), Stenberg et al. (2017) and UNESCO (2016).

The analysis has three main components. The first component projects the evolution of public debt under two scenarios: a “baseline scenario”, which excludes SDG-related expenditures, and a “SDG-scenario” for the four selected SDGs over the period 2018–2030. The second component of the analysis estimates the resource gap, in terms of additional GDP required, to meet the debt-sustainability criterion of no increase in current public-debt burdens (the SDG debt-sustainability gap). The third and final component analyses the costs and impact of different but complementary domestic and multilateral policies aimed at closing the SDG debt-sustainability gap.

Following from the focus on total public debt in developing countries and SDG investment requirements within a relatively short time-horizon, the macroeconomic framework underlying the projection of public-debt trends in the first component of the analysis prioritizes the financial dimension of debt sustainability, captured by the differential between interest and GDP growth rates. Specifically, public debt dynamics are driven by domestic and external interest rates, GDP growth rates, changes in domestic GDP deflators, changes in exchange rates and general government primary balances. Medium-term projections (up to five years) are strictly based on available data. Longer-term projections are informed by existing projections for individual countries, where available, or by five-year averages of the latest available data.

The SDG debt-sustainability gap in the second component of the analysis is defined as the difference between the primary fiscal balances consistent with the on-time achievement of the four selected SDGs and those required to meet the long-term debt-sustainability criterion of no increases in public debt-to-GDP ratios over the SDG-related developmental cycle.

For the third component – looking at the costs and relative impact of domestic and multilateral financing options to close the SDG debt-sustainability gap – the analysis, following empirical evidence (Gaspar et al., 2016, 2019; Manuel et al., 2018), introduces a number of basic assumptions in regard to the maximum contribution that
The first component of the analysis compares two different scenarios over the next decade. The “business-as-usual” or baseline scenario assumes that countries maintain current expenditure patterns and that short-term debt-sustainability requirements remain in place such that governments will continue to adjust internal resource use to servicing their external debt on an ongoing basis. Under this assumption (SDG baseline scenario in figure 4.10 A) average public debt for the sample developing countries is expected to increase from 47 per cent of GDP in 2018 to 51 per cent by 2030. The second scenario assumes that governments depart from “business-as-usual” to meet SDGs 1–4 on time and without external assistance other than current ODA grants (SDG public debt scenario in figure 4.10 A). Meeting the investment requirements of these SDGs would have a major impact on public debt, with the ratio of public debt to GDP increasing to 184.7 per cent of GDP by 2030, on average, for the sample group of LICs and MICs.

Under the SDG public debt scenario, LICs unsurprisingly experience the sharpest increase in public debt ratios rising to 286 per cent of their GDP by 2030 (figure 4.10 A). This reflects the fact that investment requirements to meet the four selected SDGs are particularly high. Furthermore, and given the current reality of relatively weak taxation systems and inadequate levels of ODA, more of the burden of additional investment requirements falls on public debt. This scenario thus pinpoints the growing concern that the most vulnerable countries and those in most need of urgent investments to meet the SDGs are the least likely to be able to afford these without triggering a debt crisis.

But challenges faced by lower-middle (LMICs) and upper-middle-income countries (UMICs) are also significant. Under the SDG public debt scenario, by 2030 public debt levels for these economies would reach between 100 and 150 per cent of their GDP by income classification, and between 130 and 140 per cent of GDP for Asia and Latin America, both of which have a higher share of LMICs and UMICs than LICs from a regional perspective (figure 4.10 A). These may be half the projected public debt ratios for LICs, but they are not therefore any more sustainable.

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a FAO et al., 2015, estimates the amount of resources required to accomplish SDGs 1 and 2. The cost assumption included in this exercise refers to a Poverty Gap Transfer programme designed to lift the income of the entire population of a country above a $1.75/day purchasing power parity line and the additional investments required to structurally overcome extreme poverty.

b Stenberg et al., 2017, estimate the resources required to achieve universal health coverage. This is defined as access for all people and communities to services that they need without financial hardship. The cost assumption included in the model refers to the public sector component of the total funding required to achieve this goal in the baseline scenario used by the World Health Organization.

c The Education 2030 Framework for Action sets two benchmarks on domestic financing for education: 4 to 6 per cent of GDP and 15 to 20 per cent of public expenditure (UNESCO, 2016). This is the range of resources required to ensure that every child and adolescent in LICs and LMICs has access to good-quality education from the pre-primary to upper-secondary level. The cost assumption included in this assessment refers to the lower limit of the range (4 per cent of GDP and 15 per cent of public expenditure).
The second component of the analysis looks at the resource gap that opens, if the four SDGs were to be met without an increase in current public debt burdens. Defined as the SDG debt-sustainability gap, this statistic measures the difference between the primary fiscal balance consistent with achieving the four listed SDGs by 2030 and that required to maintain stable public debt ratios. From this perspective, developing countries would, on average, require 11.9 per cent of their GDP in additional annual resources. The requirements vary across income categories and regions, with LICs needing, on average, additional annual resources equivalent to 21.6 per cent of their current GDP, while this figure falls to 9.6 and 3.3 per cent of their current GDP for LMICs and UMICs, respectively (figure 4.10 B). The SDG debt-sustainability gap provides a concise overview of the challenges and trade-offs faced by sample countries in balancing SDG investment requirements with debt sustainability and financial stability, and could usefully be employed to inform Integrated National Financing Frameworks designed to facilitate the development of country-owned financing strategies for the implementation of the SDGs (IATF, 2019: chap. II).

The final component of the analysis considers domestic and external financing options to close the SDG debt-sustainability gap by 2030 and avoid proliferating debt crises in developing countries. As figure 4.10 C shows, this would entail massive external assistance, in particular for LICs. In the case of LICs, improved DRM is estimated to contribute at most 13 per cent of the resources required over the next decade, with this figure rising to 53 and 80 per cent in LMICs and UMICs, respectively. Estimations for the DRM component to close the SDG debt-sustainability gap reflect initial conditions in terms of institutional capacities for tax collection and budgetary management as well as the scale of required SDG investments. The higher current tax revenue-to-GDP ratios, the more governments have already aligned the composition of public expenditures to reflect longer-term SDG commitments, and the more they have already managed to successfully combat illicit financial outflows from their economies, the higher the contribution DRM can be expected to make over the next decade. In poorer economies with lesser taxation capacities at present, there may be more space for improvements but, for the reasons mentioned, these may not easily be achieved or become effective only towards the end of the time remaining for SDG implementation. Even so, the DRM scenario errs on the optimistic side in this regard and assumes that poorer economies can, in effect, reach critical thresholds of tax revenue-to-GDP ratios, the more governments have already aligned the composition of public expenditures to reflect longer-term SDG commitments, and the more they have already managed to successfully combat illicit financial outflows from their economies, the higher the contribution DRM can be expected to make over the next decade. In poorer economies with lesser taxation capacities at present, there may be more space for improvements but, for the reasons mentioned, these may not easily be achieved or become effective only towards the end of the time remaining for SDG implementation. Even so, the DRM scenario errs on the optimistic side in this regard and assumes that poorer economies can, in effect, reach critical thresholds of tax revenue-to-GDP ratios of around 15 per cent to support a significant acceleration of GDP growth over the next five years (see box 4.1). On the other hand, the extent to which improvements in SDG-oriented DRM have already been achieved provides only a limited guide to further achievements, as these also depend on the scale of required
SDG-related investments. For example, while in some cases stringent efforts had already been made, by 2017, to allocate almost half of public expenditures to meet the selected SDGs, accomplishing these SDGs by 2030 would still require raising this share to three quarters of all public expenditures over the next few years.

The need for substantive and affordable external financial assistance to reach only the first four of the SDGs on time without triggering widespread debt crises in the developing world should therefore be beyond doubt. Whatever the risk-managing magic blended finance is meant to perform to attract private finance to the 2030 Agenda, as pointed out, this is neither likely nor expected to include the selected SDGs with particularly high and long-term social returns but also prohibitively low short-term private returns. The analysis therefore looks at two complementary multilateral public funding options. First, a special ODA programme for SDG-related public investments that would provide participating countries with concessional finance to cover around half of required investment after DRM contributions in LICs, around 35 per cent in LMICs and 17 per cent in UMICs. The envisaged increase in ODA under this special programme would be in line with the commitment by developed countries to meet the target of 0.7 per cent of their gross national income to be dedicated to ODA, restated in the Addis Ababa Action Agenda and under the assumption that these ODA resources went to budgetary rather than project-specific support.

Second, multilateral financial backstopping of developing country efforts to meet basic SDGs without incurring damaging debt crises would also require further efforts in the shape of SDG-related debt relief. However concessional, ODA lending still represents debt-creating capital inflows, with loan elements having steadily increased relative to grants over recent years (OECD, 2019). The scenario presented here is based on assumptions in regard to the evolution of DRM capacities and the modalities and scale of ODA that are, if anything, vigorously optimistic. Even so, debt relief remains a clear necessity, projected to have to finance around 37 per cent of public expenditures to meet only the first four of the SDGs by 2010 in LICs, around 13 per cent in LMICs, and less than 2 per cent in UMICs.

Table 4.1 summarizes the relative costs of the proposed SDG programmes across regions and income levels. Following from the above assessment, LICs stand to require the most multilateral support in the form of additional ODA and debt relief to meet the debt-sustainability criteria, amounting to annual transfers of 10.8 per cent of GDP through additional ODA and a debt write-down equivalent to 93.4 per cent of GDP by 2030. In the meantime, the relative costs for LMICs and UMICs would also remain substantial. Even in a scenario where efforts to increase DRM were to prove successful, LMICs would still require a combination of ODA equivalent to annual transfers of 2.9 per cent of GDP and debt relief equivalent to 17.7 per cent of GDP by 2030. These figures provide a sobering assessment of the degree of ambition required to meet the financing needs of the 2030 Agenda, in particular if allowing developing countries to meet developmental goals on a sustainable basis is the point of departure of debt-sustainability analysis as argued earlier on.

<table>
<thead>
<tr>
<th>TABLE 4.1 Sustainable Development Goals programme financing requirements</th>
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<tr>
<td>SDG debt relief programme 2030 (as percentage of GDP)</td>
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<tr>
<td>Africa</td>
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<tr>
<td>Asia</td>
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<td>Latin America</td>
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<td>LICs</td>
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<td>LMICs</td>
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<td>UMICs</td>
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Source: as figure 4.10.

The proposed framework to ensure developing-country debt sustainability over the next decade while also meeting the SDGs has a number of policy and research implications. First, as the assessment provided covers only four out of 17 SDGs, it strongly understates the need for multilateral action in coordination with domestic efforts for increased resource mobilization. As noted earlier, the four SDGs considered in this analysis are expected to be financed entirely out of the public purse, given their undisputed public good characteristics. However, it is unclear to what extent private finance can reliably be “leveraged”, and at sufficient scale, to meet other SDGs that also have strong public good features, such as environmental protection and climate-change mitigation or “infrastructure” investments – an excessively broad category of required investments, many
of which may not be as easily amenable to being transformed into a tradable and privately profitable “asset class” as suggested by the G20 (EPG-GFG, 2018). Thus, and if the 2030 Agenda is to be met on time, even larger SDG-related multilateral programmes than those suggested here might have to be contemplated.

Second, the proposed framework makes a number of assumptions that potentially affect results in opposing directions. It assumes that developing countries in the sample will be able to refinance themselves in domestic and external markets on commercial terms throughout the period of analysis regardless of the levels of their public debt levels, thus excluding the possibility of acute debt distress and loss of market access. As shown in section B of this chapter, some developing countries are already experiencing debt distress and need to lower their current levels of public (and private) debt, if they are to retain or regain market access. This results in a downward bias of estimations, since the SDG debt-sustainability gap and the need for external financial assistance will increase with the advent or intensification of debt crises in developing countries. On the other hand, the framework does not take account of the impact of large projected increases in government expenditures on domestic aggregate demand and long-term productivity growth. Clearly, these could lower public debt burdens in the future and reduce requirements for affordable external financial assistance through multilateral programmes over time, thus introducing an upward bias to current estimations. These estimation biases pushing in opposite directions cannot be assumed to cancel each other out, as they are highly dependent on complex country-specific characteristics and their interaction with global economic dynamics. A decisive factor, however, is time. For the relatively short time period under consideration of just over a decade until 2030, gradual aggregate demand and productivity increases might come, if not too late, at least quite late in the day to substantially lower current public-debt burdens. Meanwhile, further and deepening debt crises in developing countries remain a very real prospect. Of course, the faster and the more decisive multilateral financial assistance is now, the more this outlook might reverse in time.

Nevertheless, there clearly is a need for a more comprehensive dynamic debt-sustainability framework that includes the computation of feedback effects associated with investment in productive capacity, infrastructure and human capital (Guzman, 2018) and that looks beyond the immediate demands of meeting the 2030 Agenda.

Finally, the current framework highlights that, in relation to the 2030 Agenda specifically, but also looking further ahead, long-term debt sustainability in developing countries needs to be understood as a mutual national and multilateral responsibility. Developing countries must commit, as an utmost priority, to improved DRM, to strengthening the domestic profit–investment nexuses and to leverage credit (debt) for this purpose. But their ability to do so remains dependent on the political will of their development partners to manage the global economy in ways that are supportive of these domestic efforts. Therefore, there is an urgent need for international cooperation to enable greater tax mobilization, as outlined in chapter V, as well as to prevent the waste of domestic resources required for “self-insurance” in situations of volatile capital flows. These measures would contribute to easing the requirement for additional public debt that could become unsustainable.

Section D of this chapter turns to a broader consideration of constraints and possibilities in leveraging multilateral financial support for long-term debt sustainability in developing countries and considers a number of specific financing options and programme designs that could help to bolster development finance while also serving the planet and everyone’s natural environment, much in the spirit of the Global Green New Deal proposed by UNCTAD. In addition, developing country options to step up own financial fire-power for their developmental requirements are discussed. Finally, developing-country debt crises are already unfolding and, as pointed out, further crises cannot be excluded. Thus, the following section also looks at changes to existing sovereign debt restructuring processes that could help to limit detrimental fallouts for both sovereign debtors and their creditors.

D. Making development wag the debt tail

An agenda for improving conditions, policy options and the space to pursue those options in developing countries so as to better mobilize financial resources to meet their development goals must grapple with the significant challenges posed by debt sustainability. The urgency of the problem is apparent when
considering the financing gap that is likely to emerge around efforts to meet the 2030 Agenda, as outlined in the previous section.

Moreover, as is also clear from the discussion above, debt sustainability in developing countries is hardly in the hands of the affected sovereigns. In a highly financialized and interdependent global environment, fragility can quickly turn to distress against the backdrop of falling commodity prices and weak growth in developed economies. If monetary policy decisions in advanced economies suddenly drive up borrowing costs, debt positions in emerging markets and other developing countries that previously appeared manageable can quickly become unsustainable. The procyclical nature of capital flows – cheap during a boom and expensive during downturns – is not the only drawback. Once a crisis hits, currency devaluations to improve export prospects simultaneously increase the value of foreign-currency denominated debt. For commodity exporters, the need to meet rising debt servicing requirements also generates pressures to expand production, potentially adding to excess supply and further downward pressures on commodity prices. Unreformed, the current global financial environment leaves little room for countries to determine their own strategies and growth paths. Instead there is an implicit surrender of policy decisions to the logic of financial markets whose image of superiority in determining efficient outcomes has remained intact in some quarters, despite the disastrous GFC.

Consequently, scaling up development finance efforts to meet the SDGs is closely linked to the need to reduce, as much as possible, the exposure of developing countries to external shocks, footloose cross-border capital flows and external debt service burdens. Reforms to the international financial architecture to better manage macroeconomic imbalances and deal with debt distress and possible crises need to be urgently put on the international policy agenda. Some possible reforms are discussed in this section. However, in the absence of an international monetary system supportive of developing countries’ attempts to mobilize development finance, developing countries should also look to regional and South-South financial and economic cooperation and ensure that local, national and regional policy initiatives are connected and coordinated to limit the disruptive influence of global financialization. It is therefore crucial to begin by strengthening domestic public policy spaces and capacities in developing countries to raise domestic public funds and ensuring that both domestic and foreign private capital are reliably channelled into developmental investment projects whose short- to medium-term private profitability is uncertain. The quest is not for just any private capital, but “patient” capital. While this may be a second-best (bottom-up) option to a more sweeping pro-development reform of the international financial system, its strength lies not only in beginning to scale up productive development finance, but also in eventually forcing international economic governance reform back onto the multilateral agenda (Blankenburg, 2019).

1. Revisiting special drawing rights and debt relief programmes

Ideally, a development-friendly international monetary system should ensure that high-productivity surplus economies systematically “recycle” their surpluses to lower-productivity countries by adopting expansionary policies at home to stimulate domestic demand for imports from lower-productivity deficit economies, by investing in these economies and by lending to them on reasonable, or better concessional, terms.

In many ways, this was the ideal pursued by the negotiators of the London Agreement between Germany and its creditors in 1953 which reduced the aggregate debt of Germany substantially and limited the debt servicing requirement to 3 per cent of the value of annual exports (UNCTAD, 2015: 134). While the London Agreement was a debt relief arrangement, the notion that there could be coordination between surplus and deficit countries was implicit in the original conceptions of the Bretton Woods institutions (Kregel, 2018: 89). The wider implication is that such a system would have to sustain significant macroeconomic imbalances that allow domestic development strategies to progress and, at a minimum, to generate the export earnings needed to meet external debt obligations.

When, in the midst of the Second World War, Keynes contemplated ways to rebuild a post-war international monetary system that would enable global economic prosperity and peace, he proposed the introduction of an international clearing union operating an international accounting currency that he called the “bancor” (Keynes, 1973). This proposal focused on two main principles to guide international monetary
cooperation. First, it should respect national policy autonomy and support national growth strategies, in developed and developing economies. Second, it should avoid deflationary biases in the international economy by putting the burden of adjustments to international imbalances on surplus as well as on deficit countries.

The proposal of an international accounting currency (and clearing union) was essential to achieving these goals as it meant that the provision of international liquidity and the management of international imbalances would not remain hostage to the internal constraints and interests of the issuer of an international reserve asset, but would instead be governed by multilateral rules. In Keynes’ words, “the Union can never be in any difficulty as regards the hon-oring of checks drawn upon it. It can make what advances it wishes to any of its members with the assurance that the proceeds can only be transferred to the clearing account of another member. Its sole task is to see that its members keep the rules and that the advances made to each of them are prudent and advisable for the Union as a whole” (Keynes, 1973: 171). The failure to adopt Keynes’ proposal for multilateralism in international monetary affairs and the decision to remain within the confines of a global reserve system has played an important role in steering the international monetary system away from supporting national growth and development strategies to instead prioritize the policy choices of dominant issuers of international reserve currencies.

Expert opinion is divided about the future global robustness of United States dollar hegemony. Empirical views on this matter emphasize the continued large share of dollars in global foreign reserves (see figure 4.11 A), as well as in banks’ foreign-currency assets and liabilities and in shares of world trade invoiced in dollars (Gopinath, 2015). Others consider that multipolar systems of international monetary governance, rather than their dominance by a single lead currency, have been the longer historical rule and will re-emerge (Eichengreen, 2019). An additional and rather different challenge arises from the creation and expansion of private money – or cryptocurrencies – in the international arena, using new technologies (see chap. I: box 1.1).

In any case, available evidence for developing countries would suggest that United States dollar hegemony is well entrenched for now (figure 4.11). As mentioned, the share of the dollar in global allocated foreign-currency reserves has waxed and waned, but it still holds the lion’s share of around 60 per cent of these reserves. It has been on the increase for developing and emerging economies again over recent years (insofar as these data are available; see figure 4.11 A), against a backdrop of overall falling capacities, in developing countries, to use international currency reserves as an “insurance policy” (see figure 4.8). At the same time, developing country PPG long-term external debt has not only been dominated by the dollar, but the trend is rising (figure 4.11 B), and the dollar also,
takes the lead in regard to the rise of shadow-banking in larger developing and emerging economies (figure 4.11 C).

A long-debated and partially operative option to pierce the United States dollar hegemony is to increase the role of so-called special drawing rights (SDRs) in world foreign-currency reserves. SDRs are an international reserve asset that is valued based on a basket of key international currencies and serves as a claim on the reserve currencies of the IMF (D’Arista, 2009; Ocampo, 2011; TDR 2015). SDRs were introduced in the 1960s to cover expected international liquidity shortfalls in United States dollars and in gold. Borrowing limits in SDRs are determined by countries’ SDR-denominated quotas. Following the latest round of quota increases in 2015 and 2016, SDRs currently amount to around $670 billion. One recent proposal (Akiki, 2019) is to regain traction in expanding SDRs by linking these directly to environmental objectives that command a high degree of collective and multilateral support, and specifically to holding global warming at below 1.5°C above pre-industrial levels. Under this proposal, national authorities of participating countries, in cooperation with the IMF, would work out long-term environmental and country-specific adjustment plans, including preservation targets and emission reductions, as well as the required investments and budgets to meet these targets. While some countries may be able to self-finance these plans, an IMF zero-interest loan funding facility would be put into place, in particular for developing countries. Maximum funding capacity would be measured using special environmental drawing rights (SEDRs) that represent an indefinite potential claim on the freely usable currencies for climate finance of the IMF.

This proposal provides a flexible and, in principle, unlimited financing mechanism for long-standing calls, by UNCTAD and others, for a global environmental protection fund that can provide predictable and stable emergency funding without strict policy conditionalities or limiting eligibility criteria. In addition, many poorer developing countries and small island developing states (SIDSs), now regularly exposed to natural disasters related to climate change, will need temporary debt moratoriums and automatic mechanisms to extend such moratoriums on debt servicing to safeguard government expenditure on essential social spending, such as health, education and sanitation, when such events occur. At present, assistance from the international community continues to rely on a combination of short-term aid, longer-term conditionalities of fiscal consolidation and preventative self-insurance schemes against catastrophic risk. This, however, is woefully insufficient to address the systemic impact of recurrent and increasingly frequent climate change-related shocks.

In the immediate aftermath of the earthquake that hit Haiti on 12 January 2010, UNCTAD (2010), alongside other organizations, called for an immediate temporary debt moratorium on debt servicing, to be followed by debt cancellation as quickly as possible. In effect, on this occasion, several of the bilateral creditors of Haiti agreed to a temporary standstill of debt servicing, and the World Bank and the Bolivarian Republic of Venezuela eventually waived the remaining debt. But the more far-reaching call by UNCTAD for a coordinated future approach to disaster management, including a global disaster fund, an automatic mechanism for extending a debt moratorium to countries hit by natural disasters and built-in insurance clauses for debt contracts to cover catastrophic risk, was mostly not heeded. Almost a decade later, the world remains as ill-prepared as ever to address the often-vicious debt cycles of environmentally vulnerable developing countries. Many of the affected countries have complicated histories of external indebtedness, such as for example Mozambique and Zimbabwe, hit in March 2019 by Cyclone Idai. But, more generally, an SDR-based global fund to leverage environmental reserve assets for environmental protection could provide a reliable and stable financing mechanism to also tackle the secondary and tertiary effects of climate change-related shocks on debt sustainability in developing economies. As an UNCTAD, 2010 study shows for 21 large natural disasters that struck LICs between 1980 and 2008, such large-scale shocks can add, on average, 24 percentage points to the debt-to-GDP ratio of affected countries in the three years that follow the event. If the event does not lead to a rapid increase in foreign aid, this figure can reach up to 43 percentage points. (UNCTAD 2010) Poor and even middle-income developing countries hit by natural disasters can still find themselves in a long-term debt trap as the use of public debt and renewed external borrowing to absorb the impact of a natural disaster leads to more burdensome debt servicing and constrains the capacity to invest in long-term climate-change mitigation. With each new disaster, financial vulnerabilities grow and domestic response capacities weaken.
Moreover, and as suggested in section C of this chapter, if the 2030 Agenda is to be met even only for the most basic goals, a global SDG-related concessional lending programme for low- and lower-middle-income developing countries should be considered. One proposal (Munevar, 2019) is to break down such a concessional lending programme into two components: first, a refinancing facility designed to allow participant countries to borrow on concessional terms and progressively repurchase the outstanding stock of public external debt issued in commercial terms over a short period of, say, three years and, second, an additional lending facility designed to cover the external share of gross financing needs of the public sector until 2030. A programme of this type would bring several benefits to participant countries. The reduction in effective interest rates on external debt and extension in maturities would simultaneously improve nominal long-term dynamics and reduce the net present value of debt outstanding. Furthermore, the provision of stable long-term and low-cost funding would allow national authorities to focus their efforts on the effective deployment of resources to accomplish the SDGs.

Ideally, such concessional SDG-related lending could also be financed by leveraging SDRs and expanding these while linking claims on these directly to SDG-related investments, as well as country-specific investment and budgetary plans. In addition, a global (SDG) development fund could be replenished by donor countries paying up to their unfulfilled commitments to the ODA target of 0.7 per cent of gross national income and provide dedicated resources to compensate for what was only partially delivered over past decades. 12 A complementary and more market- and contract-based version of financing mechanisms are debt-swap programmes, such as the ECLAC Climate Resilience Fund debt swap proposal (ECLAC, 2016). In a similar vein, an SDG debt-swap proposal would see the establishment of a special SDG investment fund to support SDG investments and address debt vulnerabilities in developing countries. This fund would require initial contributions from the international community to purchase the share of external public debt held by private creditors over a short period of time, around three years. Beneficiary countries would commit to pay into the SDG investment fund the amount that they would have paid to their former creditors as debt service. Such payments to the SDG investment fund would stretch over a 10-year horizon, over which the underlying liability to the fund would be paid on a rolling basis. The fund would use the payments from beneficiary countries to bolster investment in SDG-related projects while providing technical support and assistance. While welcome, such debt-swap based programmes have a number of drawbacks. They operate on a contract-by-contract basis that is usually slow, costly and subject to partial interests, and country debt would be acquired at times of already impending or unfolding crises when government bonds trade at steep discounts. They also provide no clear longer-term commitment to the fulfilment of collective environmental and developmental goals over time. As Akiki (2019: 18–19) points out, debt-for-nature swaps have been popular, as an instrument of debt relief conditional on environmental conservation, not least because they also allowed private corporate interests, engaging with such initiatives, to largely take control of environmental conservation.

### 2. Strengthening regional monetary cooperation: Regional clearing unions

Whether or not it will be possible to leverage SDRs, rather than less multilateral and more market-based financing mechanisms such as debt-swap programmes, for environmental conservation as well as development remains to be seen. In the meantime, an additional and important option for developing countries is to at least partially escape the United States dollar hegemony by strengthening regional monetary cooperation and marshalling their own financial fire-power to ease the constraints imposed on their development in the current debt-driven and dollar-based financialized global economy. This, it should be noticed, is not about longer-term South–South cooperation to prop up development finance through large-scale lending programmes, such as the Belt-and-Road initiative in China, much as these are both necessary and welcome in view of hesitant, limited and often unpredictable development financing initiatives from developed countries. Rather, such regional monetary cooperation, among developing countries, can complement and support longer-term South–South financial cooperation, if it substantially increases the ability of developing regions to refinance and promote intraregional trade and develop intraregional value chains out of their own pockets. As has been pointed out elsewhere (TDR 2015; Blankenburg, 2019), just as at the international level,
the scope and effectiveness of regional monetary arrangements depends on agreed objectives. These range from simple regional reserve swap and pooling agreements to bridge liquidity constraints when these arise, to the more full-scale development of regional payment systems and internal clearing unions. The latter extend credit to members through the regular offsetting of accumulated (trade-related) debts and credits between them, and thus at least partially replace reliance on external foreign-denominated financial resource and associated exchange-rate volatility with financial resources created in-house. This requires the use of a non-tradable regional unit of account, much like the international accounting currency proposed by Keynes to manage the international monetary system, and that promotes intraregional trade – largely by lowering transaction costs in convertible currencies of such trade, the establishment of automatic credit facilities linked to encouraging intra-Union trade, incentives for regional surplus countries to correct these and, relatedly, strong guarantees against default – while leaving open the door for developed countries to join in by providing preferential access to their markets for developing country industrial exports and through the provision of an agreed percentage of their gross national income as external assistance to developing countries. To ensure that its reserves would always be adequate to meet its liabilities, the Payment Union should be accorded membership status and SDRs at the IMF.¹³

This proposal demonstrates the importance accorded to regional payment systems and clearing mechanisms by developing countries from early on. In the event, it proved too ambitious at the time and instead smaller-scale regional clearing unions and payment arrangements among developing countries developed throughout the 1970s. These, too, eventually faded out or lost importance under growing pressures on developing country central banks to stave off debt crises. In addition, both public and private sectors in developing countries succumbed to the lure of apparently cheap credit available in international financial markets since the late 1980s. As seen, since then the persistence of United States dollar hegemony in a context of continued hyperglobalization, marked by open capital accounts, floating exchange rates and financial deregulation, has played an essential part in
facilitating the emergence of an international monetary system that has favoured short-term financial and corporate interests over developmental ones in systematic fashion.

This also changes the stakes for developing countries in reconsidering expanding regional monetary integration and powering up regional credit creation for regional development to limit the detrimental impact of United States dollar hegemony on their economies. In response to the Asian financial crisis as well as other developing-country crises in the 1990s, multilateral and regional currency swap agreements have already emerged, with the Chiang Mai Initiative Multilateralization (CMIM) being the best known (TDR 2015). The scope for deeper monetary integration, in the form of payment systems and clearing mechanisms, largely depends on the initial trading patterns and positions of prospective member states, as the extent to which intraregional credit creation and clearing can be used to substitute for external financial resources depends on countries’ ability to extend credit.

A brief overview of essential features of the current trading positions for three main developing country trade areas – MERCOSUR (Mercado Común del Sur), ASEAN (Association of Southeast Asian Nations) and SADC (Southern African Development Community) – provides some preliminary insights into the feasibility and potential benefits the use of internal clearing mechanisms might provide. This, first, looks at the share of intraregional commercial trade in member states’ overall commercial trade. The higher the share of intraregional trade, the higher the scope for intraregional monetary arrangements to help expand this. As figure 4.12 shows for three developing country groupings with a history of economic integration in Latin America, Asia and Africa, while this share remains relatively low overall, it has been rising steadily in both ASEAN and SADC, but less so in the case of MERCOSUR.

Second, the net commercial trade balances within country groupings also matter, since the idea of a regional clearing union is precisely to use the extension of trade credits to participant deficit countries to replace covering trade imbalances through compensating external capital inflows. As figure 4.13 highlights, these intraregional dynamics are diverse. For MERCOSUR, Argentina and Brazil were clear net surplus economies capable of providing intraregional credit, at least until the recent Argentine financial crisis in 2018. But since the size of other MERCOSUR countries’ net deficits within the region is relatively small, this limits the role of group-internal clearing even if this still remains relevant. For ASEAN, net intraregional trade balances have clearly
expanded since the mid-2000s. This would suggest that regional clearing could be beneficial, with the possibility of a growing number of deficit countries being provided with funding for their intraregional trade. But the region overall is also a surplus region with the rest of the world, with the exception of the Philippines and Thailand, thus making intraregional clearing less of a priority for most member states. By contrast, SADC presents a more difficult case: While SADC, with the exception of oil-exporting Angola, is a deficit region with the rest of the world, and intraregional clearing to reduce the need to cover trade imbalances through external capital flows and substitute these for the extension of intraregional trade credits would, in principle, be beneficial, the current intraregional trade imbalances through external capital flows and substitute these for the extension of intraregional trade credits would be derived from the use of regional clearing. While some regions (MERCOSUR, ASEAN) could benefit immediately, if to differing degrees, others (SADC) face more formidable obstacles. However, the purpose of such clearing arrangements is of course also to increase intraregional relative to extraregional trade, such that current trade patterns change. This, in turn, also requires political will. For regional clearing unions to function properly in the interest of freeing up own financial resources and policy space to pursue national development strategies, regional interests have to be prioritized, sometimes over immediate national interests, in the understanding that reverse priorities will, ultimately, undermine collective as well as national developmental goals.

Thus, core features of current trading patterns provide a varied picture in regard to the benefits that could be derived from the use of regional clearing. While some regions (MERCOSUR, ASEAN) could benefit immediately, if to differing degrees, others (SADC) face more formidable obstacles. However, the purpose of such clearing arrangements is of course also to increase intraregional relative to extraregional trade, such that current trade patterns change. This, in turn, also requires political will. For regional clearing unions to function properly in the interest of freeing up own financial resources and policy space to pursue national development strategies, regional interests have to be prioritized, sometimes over immediate national interests, in the understanding that reverse priorities will, ultimately, undermine collective as well as national developmental goals.

3. Advancing sovereign debt crisis resolution

In response to rising debt vulnerabilities in developing countries amid fast-changing creditor landscapes and financial innovation in the form of complex new debt instruments, the IMF and the World Bank have recently made coordinated efforts to promote enhanced public debt transparency (IMF and World Bank Group, 2018), in particular in LICs. At the same time, the Institute of International Finance (IIF), representing the global financial industry, has developed Draft Voluntary Principles on Debt Transparency to promote voluntary information disclosure on debt instruments by private creditors (IIF, 2019). Both initiatives have gained traction as part of the G20.

In large part, these initiatives recognize that the availability of high-quality debt data is an indispensable prerequisite for the ability of national governments and the international community to minimize the risk of debt crises and to take timely remedial action when these occur. Beyond this, the new joint IMF–WB “multi-pronged approach [MPA] for addressing emerging debt vulnerabilities” embeds stronger support to strengthen capacities of downstream debt management, such as public debt reporting, recording and monitoring, in a wider surveillance programme that includes improved debt analysis and early warning systems, guidance on macrofiscal policy frameworks and the review of national debt policies by the IFIs (Nishio and Bredenkamp, 2018). While the benefits, to national governments as well as for external reporting to international databases, of more comprehensive, accurate and timely public debt data are uncontroversial, this policy focus is hardly adequate to address the main current causes of developing-country debt crises rooted in their often premature integration into international financial markets and their growing exposure to market risks.

As UNCTAD has long argued (UNCTAD, 2012), transparency, including but not limited to data, is an essential principle for successful debt crisis prevention through responsible sovereign lending and borrowing, alongside other core principles such as impartiality, good faith, legitimacy and sustainability.

While debt crisis prevention is of paramount importance, resolving sovereign external debt crises, when these happen, in ways that facilitate speedy economic recovery and avoid financial crises in the aftermath of de facto default is equally urgent. That the current state of affairs in this regard is unsatisfactory has long been recognized, including by UNCTAD (TDR 2015). Against a backdrop of growing private sector participation in the refinancing of sovereign debt (see section B) an already fragmented non-system to address sovereign default situations has further disintegrated.

With external debt often being the Achilles’ heel of economies facing heightened financial instability, current arrangements for handling sovereign debt problems are fragmented, with different procedures for diverse kinds of external sovereign debt (bilateral, multilateral and debt owed to private creditors)
when difficulties arise. The shift from official to private, and from syndicated banks loans to bond financing (see figures 4.4 and 4.6) over past decades has entailed a significant increase in the complexity of debt restructuring, made even more complex by domestically issued debt held by non-residents that raise complex questions as to whether to differentiate between resident and non-resident holders of local-currency debt in sovereign debt restructurings.

This has, in particular, re-enforced concerns about the “too little, too late” approach to sovereign debt restructurings, by which private creditors and sovereign debtors alike have strong incentives to delay formal default procedures and to minimize restructuring requirements, be this to avoid self-fulfilling prophecies of financial and economic crises in the event of the initiation of formal default procedure or be it to protect creditor interests that, for the most part, will suffer haircuts in the event of such declarations. The result is an inefficient and unbalanced approach to resolving situations of debt distress which also gives rise to asymmetric and procyclical outcomes and is vulnerable to disruption from holdout creditors, thus often imposing very high costs on the countries looking to restructure their debts. As Guzman and Lombardi (2017) report, since 1970 half of sovereign restructuring episodes with private creditors have been followed by another default within a time window of three to seven years, and 60 per cent were followed by further restructuring.

In addition, sovereign debt restructurings have been made more difficult by the inclusion of arbitration clauses for sovereign restructuring disputes in many International Investment Agreements (IIAs), creating unresolved ambiguities between the use of public law – via the International Centre for the Settlement of Investment Disputes (ICSID) – and private law, in national courts designated in sovereign bond contracts to resolve litigation issues (Li, 2018).

Finally, the growing complexity of sovereign debt restructurings has made the provision of advisory and legal services to sovereign borrowers a lucrative and increasingly concentrated business with often costly implications for debtor countries (see box 4.2).

**BOX 4.2 Concentrated, costly and opaque: Sovereign debt restructuring and debt litigation**

The process of sovereign debt restructuring is getting more concentrated, more costly and more cumbersome for sovereign states. Increasing complexity in sovereign debt instruments, a growing diversity of creditors and expected financial rewards have incentivized litigation of sovereign states by creditors – among them even creditor states. Since the Argentine debt crisis of 2001, over half of the recent sovereign debt crises have been litigated in foreign courts (Schumacher et al., 2018). Moreover, for the debtor states, there are difficult decisions to be made about the selection not only of the appropriate law firm to represent it, but also its sovereign adviser.

Sovereign advisory firms are distinct from the law firms representing sovereigns and their creditors in courts. Advisory firms guide the borrower on financial, policy and legal issues of the sovereign debt restructuring but are not involved in litigation per se. Moreover, most governments retain separate advisers on financial and legal matters. Together, these advisers develop and implement the terms and procedures for debt restructuring based on specific circumstances.

Advisory firms are credited with bringing expertise and market awareness in the highly specialized matter of sovereign debt restructuring, where internal governmental skills are lacking. Their professional skills are meant to level the playing field when dealing with creditors who come similarly armed with high-level skills. Moreover, the existing framework for sovereign debt restructuring demands the appointment of external advisers, given that the IMF financing assurance policy sees engagement of legal and financial advisers by a debtor state as one of the relevant factors in the evaluation that a credible process for restructuring is under way and hence the provision of financial support as appropriate (IMF, 2013c: 45).

Sovereign advisory firms have a significant influence on the debt restructuring process – they gather necessary information, make it available to creditors, analyse the information and propose alternative debt restructuring strategies (see Asonuma et al., 2018; Buchheit, 2019). Moreover, it is typically the advisers – together with the IMF – that determine the quantum of necessary debt relief (Abbas et al., 2019). Given their role over the fate of the public finances of a distressed sovereign, there is a marked lack of transparency and public oversight over the role of advisory firms. For instance, there is no way to monitor – or even be aware of – the conflict of interest where advisory firms provide services, even in different cases, to creditors and debtors. A small circle of recurrent players advises states in a debt crisis: 20 of the 25 sovereign debt restructurings with commercial creditors since 2005 were accomplished by just four financial advisory firms. The concentration in the legal
advisory sphere is even more acute, with just one firm as legal adviser in nearly two thirds of all sovereign debt restructurings since 2005 (Smith, 2019).

The market for sovereign debt litigation – at least in the United States – also appears to be highly concentrated in terms of the market share of the top five global law firms. While 70 firms have overcome the supposed barriers to entry such as global presence – and have represented 44 countries since implementation of the Foreign Sovereign Immunities Act of 1976 – only a few law firms dominate the market.

Figure 4.2.1 shows the increasing market concentration in the share of litigation over the past four decades, with a sea change in the 2000s relating to the litigation against Argentina, which involved dozens of lawsuits that were handled predominantly by a single law firm, the current market leader. It appears that the size and publicity of the Argentine litigation produced and reinforced the position of the “go-to” law firms for sovereign debt disputes, resulting in the Herfindahl-Hirshman Index (HHI) for the top five law firms (Herfindahl -5) becoming highly concentrated, with the top five accounting for 87 per cent of the litigations (figure 4.2.2).

The unflinching approach adopted by Argentina in debt renegotiation towards creditors produced a stampede to the United States courts (see figure 4.2.2) and may be a watershed which provided incentives for litigation instead of cooperation. After a lengthy legal battle, which lasted over a decade, Argentina agreed to settle the case with holdout creditors in an offer that distinguished between those creditors that had obtained a pari passu injunction from the New York court and those that did not. The terms for creditors with a pari passu injunction were much more rewarding – one of the creditors received a 392 per cent return on the original value of the bonds. Another legacy of the Argentine saga is that the procedure of class actions in sovereign bond litigation was “fine-tuned” and most likely will be frequently used in future sovereign debt crises. Amassing litigation by retail investors in class actions in this way could have systemic effects on sovereign debt restructuring.

Exposure to foreign governing law and the foreign forum has crucial implications for determining and interpreting contractual relationships on sovereign debt in that they guarantee that a sovereign debtor cannot interfere with rules applicable to creditor-debtor relations. The legal leverage possessed by creditors makes the sovereign debt instruments prone to complex and protracted litigation disturbing the debt restructuring process. The most popular foreign forums for international sovereign debt coincide with the global financial centres of New York and London – which govern approximately 96 per cent of the total outstanding stock of international sovereign bonds, in almost equal shares (IMF, 2015: 3). However, the number of disputes brought in front of English courts is many times lower than in the United States – which apart from reasons specific to the cases, can be explained by the conceptual differences between jurisdictions. While private enforcement
Various attempts have been made to strengthen market-based approaches to debt restructuring and, in particular, to deal with the holdout problems and protect debtors against litigation in market-based restructuring. While these represent a step forward, UNCTAD (2015) has previously argued that they are insufficient to deal with existing debt vulnerabilities, let alone those that could emerge from external borrowing to meet the SDGs. Alternative mechanisms will be needed. One approach is to establish internationally agreed principles that provide for a higher degree of coordination and possibly also centralization than the market-based contractual approach. These would take the form of soft law principles or guidelines, based in international public law, such as the “Basic Principles on Sovereign Debt Restructuring Processes” adopted by the United Nations General Assembly in September 2015 (United Nations General Assembly, 2015). United Nations General Assembly resolutions on external debt and development also have repeatedly called for the consideration of such enhanced approaches to sovereign debt restructuring mechanisms (SDRMs) based on existing frameworks and principles, with the broad participation of creditors and debtors.\(^{16}\) An example of such principles is the UNCTAD road map and guide on sovereign debt workouts (UNCTAD, 2015; see also Guzman and Stiglitz, 2016).

Proponents of such a semi-institutional, general principles–based approach have developed a range of suggestions on how to structure the institutional aspects of promoting general principles or guidelines for sovereign debt restructuring. One approach is for restructuring negotiations to continue to take place in established forums or on an ad hoc basis, but supervised and coordinated by a new independent body, such as a Sovereign Debt Forum (a private organization) or a Debt Workout Institute (endorsed by the United Nations General Assembly).
through a multilateral process). A second, but complementary, approach highlights the usefulness of semi-institutionalizing SDRMs at the level of adjudication or arbitration short of a multilateral treaty. This includes mostly the promotion and use of specific rules and procedures – or applications of the general principles – across ad hoc arbitration processes.

Advocates of multilateral debt workout procedures often draw attention to the asymmetry between strong national bankruptcy laws, as an integral part of a healthy market economy, and the absence of any counterpart to deal with sovereign debt restructuring. UNCTAD was among the first international institutions to propose a more orderly and equitable rules-based framework, drawing on Chapter 11 of the United States Bankruptcy Code.

Given the unique role of sovereign actors with respect to economic, legal and political outcomes, any such framework should meet two objectives. On the one hand, it should help prevent financial meltdown in countries facing difficulties servicing their external obligations, which often results in a loss of market confidence, currency collapse and drastic interest rate hikes, inflicting serious damage on public and private balance sheets and leading to large losses in output and employment and a sharp increase in poverty. On the other hand, it should provide mechanisms to facilitate an equitable restructuring of debt that can no longer be serviced according to the original contract. Meeting these goals implies the application of a few simple principles:

- The enforcement of a temporary standstill, whether debt is public or private, and regardless of whether the servicing difficulties are due to solvency or liquidity problems (a distinction which is not always clear-cut). In order to avoid conflicts of interest, the standstill should be decided unilaterally by the debtor country and sanctioned by an independent panel, rather than by IMF, since the countries affected are among the shareholders of the Fund, which is itself also a creditor. This should provide an automatic stay on creditor litigation for a specified period.
- Standstills should be accompanied by exchange controls, including the suspension of convertibility for foreign-currency deposits and other assets held by residents as well as non-residents.
- Provision of debtor-in-possession financing, automatically granting seniority status to debt contracted after the imposition of the standstill and the generalization of the IMF's current policy on lending into arrears for financing imports and other vital current-account transactions.
- Debt restructuring including rollovers and write-offs, based on negotiations between the debtor and creditors, and facilitated by the introduction of automatic rollover and collective action clauses in debt contracts.

The essential feature shared by all proposals for a statutory approach to sovereign debt restructuring is that legal decision-making in debt restructuring cases would be governed by a body of international law agreed in advance as part of the international debt workout mechanism, and that the core purpose of any sovereign debt restructuring facility or tribunal would be to provide transparent, predictable, fair and effective debt resolution, with its decisions being binding for all parties as well as universally enforceable, that is, regardless of jurisdiction.

E. Conclusions

This chapter has argued that, for debt – whether external or domestic, public or private – to play a forward-looking developmental role, it needs to be an integral part of wider efforts to scale up development finance. This requires a strong focus on channelling debt into supporting productivity-enhancing investment, through more robust domestic financial and banking systems and by strengthening public control over the pace and direction of credit creation. There is, however, no guarantee that debt will play this developmental role.

As section B of this chapter shows, current steep increases in the total debt of both advanced and developing countries are largely led by the rise of private sector debt. Even though this is primarily the case for advanced economies and HICs, this trend has also emerged in some of the poorest developing economies. On available evidence, this proliferation of private debt has not boosted productive investment. At the same time, substantial and rising shares of developing country public debt are now owed to private creditors, including “shadow-banking” actors,
making debt work for development

bringing with them sizeable increases in servicing costs on external public debt, in particular. These trends run counter to debt playing the developmental role it should. Rather, in our hyperglobalized world, the growing global “business of debt” follows the logic of short-term private profitability and risk management rather than wider and longer-term collective economic objectives and the public risk management required to safeguard these.

These trends are of even greater concern because of the unprecedented investment requirements arising from the 2030 Agenda and their likely impact on developing country debt sustainability in the foreseeable future, if “business-as-usual” prevails. Section C of this chapter provides estimates of the impact of required investments to meet only a small but inherently public goods part of this Agenda, on developing country public debt to GDP trajectories under different policy scenarios. The conclusion is that his agenda cannot be met without very substantive increases in external public financial assistance reliably geared towards meeting these developmental goals.

Within the confines of an international monetary system increasingly geared to promoting footloose capital and unduly dependent on the United States dollar as a source of international liquidity, renewed consideration should be given to substantially increasing SDRs as a source of development finance, linking such expansion to core objectives of a Global Green New Deal in which environmental and developmental goals are complementary. In the meantime, alternative but complementary options would mean a substantial and immediate increase in ODA – even if only to make up for earlier and unfulfilled commitments – as well as new debt relief programmes.

Some practicable progress should also be made on extricating developing countries from the increasingly non-transparent and continuously fragmenting market-based, non-binding and decentralized approaches to sovereign debt restructurings. It is telling that, despite long-standing recognition that this current state of affairs is unsatisfactory and despite many substantive reform proposals, neither the current international agenda on financing for development nor the G20 have taken them up. The chapter nevertheless proposes some specific steps that, if agreed and applied, might at least ensure that developing countries can avoid being locked up in a “debtor prison” and keep open the door to further progress in moving towards a rule-based sovereign debt restructuring mechanism that takes on board collective and developmental concerns in a more systematic fashion.

At the same time, developing countries may have to look, more forcefully, to strengthening regional monetary integration as a way to prioritize their own developmental interests. Expanding or introducing intraregional payment schemes and trade-related clearance mechanisms is, in principle, a plausible way to leverage regional credit creation for purposes of promoting intraregional trade and to promote longer-term regional growth and developmental dynamics. What can be difficult to achieve at multilateral levels, may not be any less challenging to achieve at regional levels. But where multilateral governance is disintegrating – and this has been the case for much longer in monetary than trade affairs – the potential benefits of regional arrangements increase considerably.

Notes


2 See, for example, IMF (Krueger, 2002), UNCTAD (TDR 1986; TDR 2001; 2015) and United Nations General Assembly (2015).

3 Almost a fifth (11) of the 57 MICs also received debt relief from these programmes.


6 Improvements until 2012 are depicted by the leftward shift of the distributions for 2000 to those for 2012 and by the fall in the distributions’ median value.

7 The IMF defines the solvency condition for governments such that “the present value (PV) of future primary balances must be greater than or equal to the public debt stock”, while for countries as a whole “the present value of future non-interest current account balances must be greater than or equal to its external debt” (IMF, 2013a: 6).

9 Much of the difference in the evolution of public debt levels between regions can be attributed to the large investment requirements associated with SDGs 1 and 2 (elimination of poverty and zero hunger) in Africa. The Food and Agriculture Organization of the United Nations estimates that countries in Africa would have to invest on average 15.6 per cent of their GDP annually to accomplish just these two SDGs. By comparison, this figure is 0.1 per cent of annual GDP in Latin America and the Caribbean and 1.3 per cent of annual GDP in Asia (FAO et al., 2015).

10 Project-specific aid accounts for over 90 per cent of ODA (UNCTAD, 2017). At present, project-specific aid accounts for over 70 per cent of ODA to least developed countries, compared to budget-supporting ODA, which accounts for less than 10 per cent of ODA (UNCTAD secretariat calculations based on OECD Common Standards Reporting).

11 Under this scheme, international liquidity would be provided through contributions by all participating member states in their national currencies to their accounts at the international clearing union, denominated in the international accounting currency. In addition, economies with persistent current account surpluses would be expected to deposit part of their cumulative surpluses in an account at the international clearing union. The foreign exchange reserves of each member state would remain in their national central bank, but all currency purchases and sales between national central banks would be operating through the international clearing union, that is, through accounts held in the international accounting currency. The system would furthermore run automatic overdraft facilities (relative to the size of an economy’s international trade) and loans to deficit countries would not be conditional on adopting specific policy measures. The international clearing union would intervene only once the borrower’s initial liquidity needs had been met and structural obstacles to repayment became an issue (Keynes, 1973; Skidelsky, 2000).

12 A simple calculation of the last 25 years of OECD Development Assistance Committee member countries missing the target to contributing 0.7 per cent of the gross national income to ODA generates a cumulative total of around $4 trillion (at constant 2017 dollars); part of these “arrears” could be used to capitalize such a fund.

13 For an account of these arrangements, see Kregel (2018).


18 The IMF’s long-standing general policy barring it from providing financing to a country that was in arrears to official bilateral creditors was adjusted in 2015 to accommodate carefully defined specific circumstances, namely cases in which the role of non-Paris Club creditors is dominant and the need to mitigate the increasingly problematic role of hold out creditors. See: https://www.imf.org/en/News/Articles/2015/09/28/04/53/sopol120815a (accessed 4 August 2019).

References


