Chapter V

Realigning the Global Debt Architecture to Work for Developing Countries

Towards a Development-Centred Debt Ecosystem

The aftermath of the global pandemic, marked by successive crises, has underscored the inequalities entrenched in the global financial system. This situation presents a compelling case for a paradigm shift in approaches to sovereign debt workouts. The traditional narrative attributing developing countries' indebtedness to their own mismanagement is losing ground, prompting a reassessment of how nations navigate the complexities of sovereign debt.

The current hierarchical structure of the international financial system is increasingly out of sync with development priorities and marked by resource asymmetries between borrowers and lenders. This, coupled with the vast financing gap for climate-related Sustainable Development Goals, forces many countries to take on more debt, exacerbating the challenges in mitigating climate events and amplifying the burden on developing nations.

Added to this, the continuous servicing of barely affordable debt drains resources from development. Despite more urgent needs provoked by the climate crisis, responses to sovereign debt challenges have been slow and insufficient, emphasizing the pressing need for systemic reform.

To change this dysfunctional debt architecture, a new, development-centred ecosystem is needed. This requires a comprehensive re-evaluation of factors that contribute to unsustainable sovereign debt such as climate change, demographics, health, global economic shifts, rising interest rates, geopolitical realignments, political instability, and the implications of sovereign debt on industrial policies in debtor States. New creative thinking needs to be developed along the entire sovereign debt life cycle. Such a renewed pathway can deliver a more equitable and resilient global financial landscape.

Specific pragmatic policy actions are:

- Increase concessional finance through capitalization of multilateral and regional banks, and issuance of special drawing rights.
- Enhance transparency in financing terms and conditions, using the digitalization of loan contracts to improve accuracy.
- Revise the UNCTAD *Principles for Responsible Sovereign Lending and Borrowing* to motivate and underpin the importance of guiding principles throughout the stages of sovereign debt acquisition.
- Improve debt sustainability analysis and tracking to incorporate consideration of the achievement of the Sustainable Development Goals and empower country negotiators with improved data on their potential for growth and fiscal consolidation.
- Enable countries to utilize innovative financial instruments such as sustainable development bonds and resilience bonds. Develop rules for automatic restructurings and guarantees.
- Enhance resilience during external crises, for example by implementing standstill rules on debtors' obligations in crises, and create a space to enable the avoidance of debt distress.
- Encourage borrowers to share information and experiences, drawing inspiration from private creditor coordination.
- Initiate work on a more robust debt workout mechanism and a global debt authority.

A. INTRODUCTION

The hierarchical and unequal structure of the international financial system has become increasingly disconnected from development priorities. This is reflected in the volatility of external private financing for developing countries, the higher cost of capital faced by these countries, the net negative international financial position of developing countries, the costs and risks associated with being unable to issue an international currency, unequal access to the global financial safety net and the growth of illicit financial outflows. But the clearest measure of the system's shortcomings is arguably its treatment of sovereign debt problems (Panizza, 2022).

If it is true that every crisis reveals an opportunity, the compounding crises since the global pandemic have brought to light inequalities in the global financial system that affect how countries acquire, manage and resolve sovereign debt,[1] especially external debt.

The narrative that unsustainable indebtedness of developing countries is solely a consequence of their own errors has never been less convincing. This awareness creates an opportunity to explore new approaches for bridging the persistent divide between statutory and contractual solutions.

Since the start of the millennium, developing country sovereign debts have piled up faster and become more difficult to manage. By the end of 2022, the stock of developing country sovereign debt had risen to $11.4 trillion, a 15.7 per cent increase since the end of 2019 and the start of the COVID-19 pandemic. The past three years have laid bare that an unforeseen shock can put many countries in a precarious position (chapter II, section D). Added to this, the continual servicing of barely affordable debt places countries under a considerable burden and drains resources from development. On average, at the end of 2022, the debt servicing burden as a share of export revenues for low-income countries was 22.6 per cent and 15.7 per cent for all middle-income and low-income countries.[2] This is clearly unsustainable (United Nations, 2023a).

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The contemporary sovereign debt landscape is characterized by rapid expansion and increasing complexity. It involves a proliferation of public and private lenders, a richer menu of debt instruments and increasing presence of non-resident investors in domestic sovereign markets.

Since the 1990s, changes in the creditor composition of public and publicly guaranteed debt (PPG) have become more diverse, fragmented and complex. These trends were further reinforced after the global financial crisis and subsequent compounding shocks (figure V.1).

As figure V.1 shows, between 2010 and 2021, low-income countries saw a marked shift away from Paris Club bilateral creditors (down to 8 per cent of in 2021 from 13 per cent in 2010) to non-Paris Club official creditors and private creditors. Private creditors' holdings almost doubled to 13 per cent in 2021 (up from 7 per cent in 2010) with bondholders' share reaching 4 per cent (from 0 per cent participation in 2010).

As for lower-middle-income countries, the share of private creditors in PPG debt increased from 24 per cent in 2010 to 41 per cent in 2021, with the bondholders' share doubling from 16 per cent to 32 per cent. This group includes most frontier market economies that lost market access during recent external shocks (see also chapter II, section D). At the same time, the share of official creditors (multilateral and bilateral) decreased from 76 per cent to 59 per cent due to decreases in the shares of multilateral creditors (from 45 per cent to 39 per cent) and mainly, bilateral creditors (from 31 per cent to 20 per cent). For this country group, the decline in the share of non-Paris Club creditors (from 17 per cent to 10 per cent) was greater than in the case of Paris Club creditors (from 14 per cent to 10 per cent).

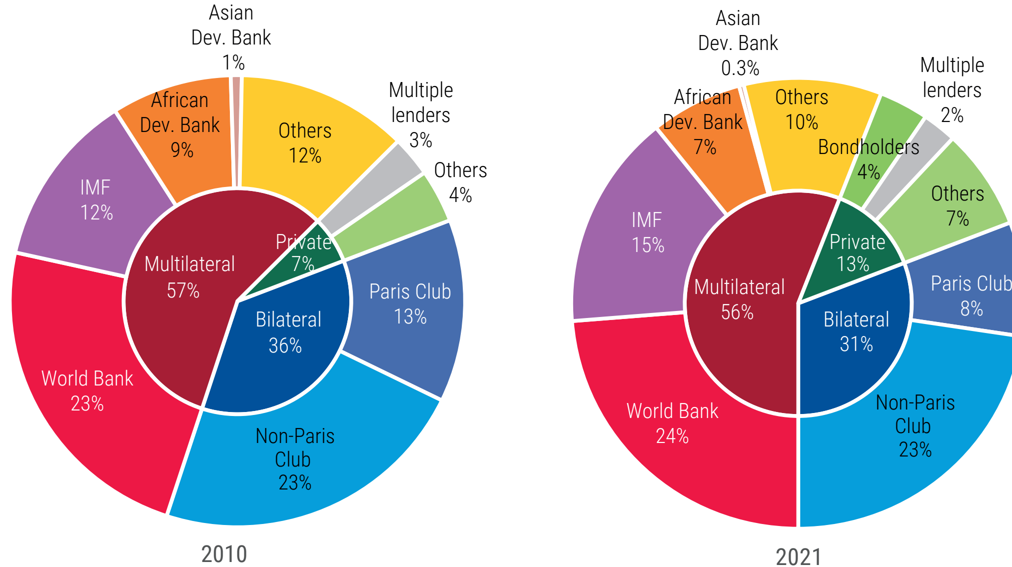
[1] When discussing sovereign debt, the terms "debt workout", "debt restructuring" and "debt resolution" are generally used interchangeably, and can involve suspending debt servicing, extending the maturity of the debt, reducing interest rates or cancelling the debt outright.

[2] Data for 2022 are UNCTAD estimations based on IMF, World Bank and national sources.

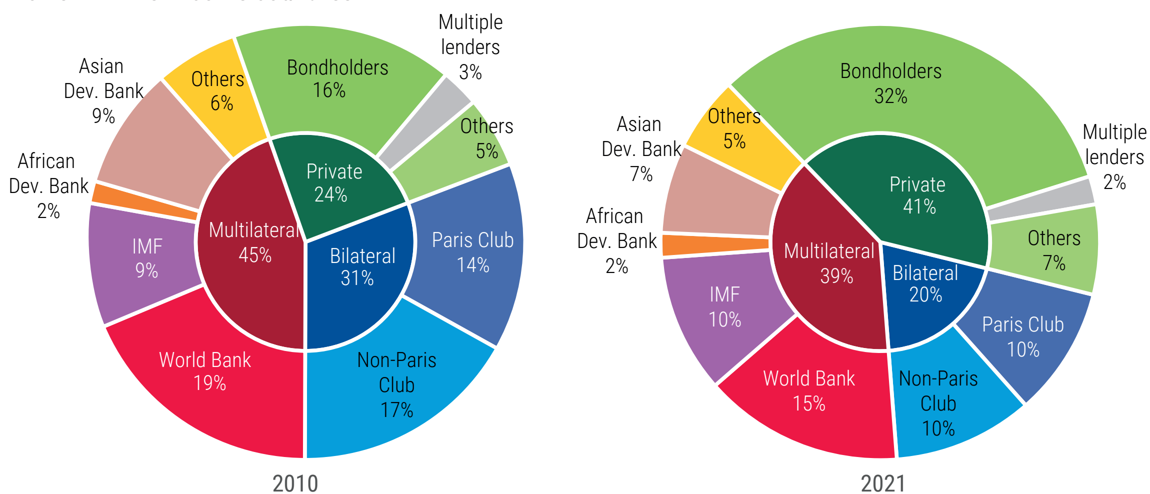
Figure V.1 An evolving debtscape: Growing reliance on private credit

Creditor composition of public and publicly guaranteed debt, groups of low-income and lower-middle-income countries, 2010 and 2021
(Percentage)

A. Low-income countries



B. Lower-middle-income countries



Source: UNCTAD calculations, based on World Bank International Debt Statistics.

This complexity has made the distinction between external and domestic sovereign debt more difficult to navigate. External sovereign debt is defined here as government (and publicly guaranteed) debt (loans and bonds) issued in international financial markets and denominated and settled in foreign currency.[3]

[3] The currency in which debt is denominated and settled affects external sovereign debt sustainability, creating a mismatch between the currency of the debt and the sovereign's tax revenues, which are in the domestic currency. Consequently, such sovereigns are vulnerable to currency depreciations, which are frequent in these countries due to their greater vulnerability to external financial shocks than developed countries (chapter II, section D). Depreciations increase the debt burden in domestic currency and shrink the country's fiscal space. The capacity of States to generate the necessary foreign currency depends on the country's balance of payment performance as influenced by external factors such as capital flow cycles, external demand and the vagaries of international pricing that influence the country's terms of trade (chapter II). The World Bank definition of total external debt shown in the *International Debt Report* publication and *International Debt Statistics* database is the sum of long-term external debt, short-term debt, and IMF credit, representing total debt owed to non-resident creditors and includes that repayable in both foreign and domestic currency.

Up until the 1980s, currency, jurisdiction, and residence criteria tended to coincide as most developing countries' external debt consisted of loans.[4] The lender was a non-resident (international bank) and the loan was issued in a foreign currency under foreign law. Since the early 1990s, the shift in debt instruments from syndicated bank loans to bonds means that bonds issued in domestic currency or under national law may be held by foreign investors. Conversely, residents may hold sovereign bonds issued abroad and denominated in a foreign currency (UNCTAD, 2015). The currency and jurisdiction criteria remain intertwined due to the structural features of the international monetary system; these require a developing country's debt issued in the international financial market to be denominated and settled in international currencies, mainly the dollar, which is at the top of the currency hierarchy (Fritz et al., 2018).

The treatment of sovereign debt challenges has a long history of delivering too little support too late to countries in debt distress. Due to the rise in volumes and complexity, debt restructuring is now even more difficult to coordinate, and the focus has become increasingly short-term. The only new mechanism to help manage debt restructuring in the current environment is the Group of 20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (Common Framework), which was introduced during the COVID-19 pandemic. Its procedures have proved to be laboured, its coverage incomplete and it is insufficiently innovative to be effectual (section B).

"To reform dysfunctional debt architecture, a new ecosystem is needed which places development at its centre."

To reform this dysfunctional debt architecture, a new ecosystem is needed which places development at its centre. A thorough re-evaluation of the factors leading to unsustainable sovereign debt is needed. This would address the contemporary complexities of climate change, demographics and health, along with changes in the global macroeconomic context, a rise in interest rates in developed countries, geo-economic shifts, issues around security and political stability and the implications of sovereign debt regimes on industrial policies in debtor States (Goldmann, 2023). To address these issues, creative thinking is needed regarding the entire life cycle of sovereign debt, including creditor and debtor due diligence; debt transparency; debt sustainability analyses and tracking and debt workout.

"New creative thinking is needed concerning the entire life cycle of sovereign debt, including transparency, debt sustainability tracking, debt resolution and restructuring."

This chapter sets out the sovereign debt life cycle, highlighting current inequalities, inflexibilities and problems as well as possible ways to address these shortcomings. In section B, the regulation of the key system failures is discussed. Section C unpicks the life cycle of sovereign debt and section D presents transformational proposals in four key areas: transparency, sustainability tracking, debt resolution and restructuring. Section E discusses the case for resilience in the debt life cycle and the chapter concludes with recommendations for transformation and the way forward.

B. REGULATING DEBT TO ADDRESS KEY SYSTEM FAILURES?

This section argues that the current situation regarding sovereign debt requires venturing into unexplored or underexplored directions. The opposition between statutory and contractual solutions seems insoluble for addressing contemporary dilemmas. Despite various innovations in sovereign debt over the past decades and

[4] The jurisdiction of debt issuance affects debt sustainability since it defines the rules under which disputes between debtors and creditors are negotiated and the process of debt workout. While external sovereign debt is governed by foreign laws and governments are treated as commercial actors in the international financial system, unlike corporations, sovereigns have no protections provided by bankruptcy laws or codes for efficient debt restructuring. Sovereigns are uniquely exposed to hostile creditor legal actions which can significantly delay the debt workout process (Guzman and Stiglitz, 2016; Buchheit et al., 2018; ESCAP, 2023).

even in the wake of COVID-19, changes have typically been incremental in nature, leaving the main pillars of the system unchanged (Bohoslavsky and Goldmann, 2016).

Since 1990, the regulation of sovereign debt has evolved through four distinct phases. This section outlines these different periods, providing a historical context for the current challenges and arguing for a paradigm shift in approaches to sovereign debt workouts (Gelpern, 2006).

The first of the four phases begins at the end of the Cold War. Around 1990, this period ushered in a new era in regulating debt and development. While the debt crisis that had its roots in the 1980s still persisted, the year 1991 marked the return of capital flows to Latin America (Calvo et al., 1992). The end of the East–West confrontation and impending liberalization of the worldwide economy replaced strategic considerations with market factors as the pertinent drivers of sovereign debt debate. To become independent from development aid and gain market access, highly indebted developing countries received more generous, though still insufficient, debt restructurings supported by governments and international organizations, particularly the Paris Club. This began with Brady bonds and culminated in the Heavily Indebted Poor Countries Initiative (HIPC) and Multilateral Debt Relief Initiative (MDRI). Middle-income countries achieved market access privileges and undertook institutional reforms under the guidance of international financial institutions. Still, adverse events such as the Asian financial crisis exposed the vulnerability of the system and prompted the IMF initiative to establish a statutory sovereign debt restructuring mechanism (Krueger, 2002).

A new phase began around 2000 with a shift to the markets. The IMF sovereign debt restructuring mechanism never materialized. Instead, for a variety of reasons, preference was given to market-based restructuring mechanisms, among them the recalibration of United States foreign policy under the Administration of the country's President at the time. Under the so-called contractual approach, debtor States negotiated a workout with their often-dispersed bondholders. Since the Argentine debt crisis beginning in 2001, Governments have sought to facilitate debt workouts through a series of collective action clauses (CACs), particularly majority voting clauses. This strategy has had some success, although its effectiveness has been limited by the long phase-in of new clauses. This is due to the long maturities of outstanding government bonds and the capacity of creditors to purchase a blocking minority when the price of a debt issue declines in times of crisis. Subsequent generations of collective action clauses sought to remedy these shortcomings. The experience with the Argentina and Greece sovereign debt workouts increased pressure to strengthen contractual frameworks and address collective action problems in sovereign debt workouts. Responding to this, in August 2014, the International Capital Markets Association developed a new model for CACs with aggregation features to make holdouts more difficult. The enhanced CACs include a “single limb” clause under which a single aggregated vote can be taken across all applicable bonds (Chung and Papaioannou, 2020).

The third phase took place in the aftermath of the global financial crisis of 2007–2008 up to recent years. During this time, opposition between the statutory and contractual approaches remained unresolved, despite unsatisfactory results. The global financial crisis triggered a need for debt workouts, including among developed countries. At the same time, creditor litigation became more aggressive and alarmingly successful. Meanwhile, calls for statutory solutions to ensure timely and effective debt restructuring attained only modest success, notably the United Nations General Assembly resolution 69/319 of 10 September 2015 and the 2015 UNCTAD *Roadmap on Sovereign Debt Workouts*. For the most part, the international community engaged in a practice of “muddling through”, combining exchange offers with political pressure and an expansion of financial support instruments, particularly a proliferation of new funding instruments at IMF. Undergirding these efforts was the idea that austerity would re-establish creditor confidence, stabilize the fiscal position and trigger future growth. On the downside, debt workouts continued to cause considerable damage to the economic and social stability of the population in the borrowing country, particularly among less affluent and more vulnerable groups. Human rights challenges to austerity succeeded in only a small number of cases. Some of the more successful cases of debt restructuring, such as in Barbados and Greece, featured the retroactive insertion of collective action clauses into domestic debt (Anthony et al., 2020). Innovations in bond design such as bonds linked to GDP, issued for example by Argentina and Greece, were meant to allow smoother recoveries. However, in the case of Argentina, this resulted in litigation over the method of calculating GDP (*Financial Times*, 2023).

The COVID-19 pandemic and concurrent ecological and geopolitical crises have ushered in a fourth phase of sovereign debt regulation. When the COVID-19 pandemic required the healthcare system to be bolstered in order to overcome an economic crisis, traditional austerity measures of "growing by shrinking" – which have a track record of limited practical success (Blanchard and Leigh, 2013) – lost their theoretical appeal. It became evident that a lack of government investment in healthcare might do more harm than good. Climate change and the need for a transition to clean energy follow a similar pattern, requiring upfront investment to mitigate longer-term consequences.

At the same time, inflationary pressures associated with value chain distortions and energy issues in the wake of the war in Ukraine have created adverse conditions for borrowing countries, putting many at risk of downgrading (Fitch Ratings, 2023). IMF has signed credit agreements with approximately 100 Governments since 2020; 13 countries have since defaulted: Argentina, Belarus, Belize, Chad, Ecuador, Ghana, Lebanon, Malawi, the Russian Federation, Sri Lanka, Suriname, Ukraine and Zambia. In addition, exposure of borrowers to new non-Paris Club creditors calls into question an institutional structure centred on the Paris Club. In this context, the sovereign debt debate has shifted towards global public policy instruments as the elements below suggest:

- The rapid adoption by the Group of 20 of the Debt Service Suspension Initiative (DSSI) for countries eligible for the IMF Poverty Reduction and Growth Trust (PRGT) (May 2020–December 2021), provided a standstill on official bilateral debt payments for 48 of the 73 eligible countries. Of the 73 countries, 23 are low-income countries, 38 are lower-middle-income countries and 12 upper-middle-income countries according to World Bank (2022).
- The succession of the DSSI by the Group of 20 Common Framework for Debt Treatment beyond the DSSI. The Common Framework is criticized for not going far enough, in particular for an ineffective standstill rule requiring consensus, restricting the coverage of eligible countries, and the lack of obligatory private sector participation which allows non-participating creditors to benefit from regained financial strength (Munevar, 2021). So far, only four countries have sought relief under the latter.
- Development of new funding instruments such as the IMF Resilience and Sustainability Trust to allow for re-channelled special drawing rights; or the Next Generation E[uropean] U[nion] (NGEU), an investment and reform policy for the whole of the European Union, which provides opportunities to increase fiscal space and shoulder the rebuilding of the global economy in the wake of the pandemic.
- The rise of complementary new private lending instruments such as sustainability bonds and new restructuring methods, including "debt-for-nature" and "debt-for-climate" swaps.
- The initiatives under way to strengthen domestic law in the situation of harmful creditor action.

Towards resilience

While encouraging, these largely positive developments noted above remain insufficient to redress the deep structural asymmetries intrinsic to the prevailing international financial architecture. These asymmetries not only apply to the uneven access to long-term sustainable development finance, but also to the impact of exogenous shocks through exchange rate fluctuations, which have created a particularly toxic mix for least developed countries (LDCs) (UNCTAD, 2019a).

Some of the abovementioned developments show an increasing focus on resilience in sovereign debt regulation, particularly in relation to ecological and health risks, where "sovereign debt resilience" refers to the ability of a sovereign to avert debt distress in the face of external shocks; with resilience associated with the capacity of a system or a regime to adapt to exposure to stress and rebound to its original shape (Welsh, 2014).

The Secretary-General of the United Nations has called for a reconfiguration of the global financial architecture. This includes the need for sovereign debt restructuring to create the necessary conditions for public and private investments to deliver the Sustainable Development Goals and ensure resilience.

In this time of compounding crises, the existing inadequacies of the global financial architecture in addressing the sustainability of sovereign debt and long-run solvency have been laid bare. Long-run solvency is the condition that net liabilities – a stock, such as external debt – do not grow indefinitely in the long run, relative to a repayment capacity flow, such as export earnings (Domar, 1944). The reconfiguration of sovereign debt workouts needs to address the following resilience challenges, which have fiscal implications:

- **Ecological challenges.** Climate change and its related fiscal implications require the need for substantial private and public investments in new technologies and in infrastructure for adapting, mitigating and facilitating the transition to clean energy while minimizing biodiversity loss, within the context of the inequitable distribution of loss and damage associated with climate change.
- **Social challenges.** Sovereign debt restructuring needs to account for social issues in developing and developed countries, such as growing wealth inequalities in the wake of the shift towards a digital economy and consequent effects on tax revenue and fiscal resilience. Additionally, demographic changes exert an influence on fiscal capacity, and migration poses development risks to the countries of origin and imposes fiscal burdens on receiving countries.
- **Trade challenges.** The current development of the world trade system and its fragmented nature poses challenges due to industrial policies and subsidies that lead to market restrictions. These restrictions have adverse fiscal implications, especially for developing countries.
- **Debt challenges.** Borrowing countries are grappling with increasingly complex debt spaces. Contributing factors include scarcity of resources such as concessional finance and loss of control over value chains, giving rise to new forms of collateralized loans that carry risks for borrowing countries (Chellaney, 2017; Horn et al., 2021; Lippolis and Verhoeven, 2022). Additionally, debt transparency issues have emerged, particularly with the rise of syndicated loans (Gelpern et al., 2022).
- **Political challenges.** The slow – and piecemeal – relief to countries in distress will inevitably lead to political hurdles for Governments seeking debt relief, due to a loss of political capital. Associated security risks may affect countries' fiscal situations either directly or indirectly and compound the difficulty of debt restructuring efforts (e.g. United Kingdom Supreme Court, *The Law Debenture Trust vs Ukraine*, 2023).

Given the structural character of the current difficulties, a continued approach of "muddling through" with regard to sovereign debt is likely to cause significant widespread social and economic problems. A more proactive response is called for concerning every stage of the sovereign debt life cycle.

C. LIFE STAGES OF SOVEREIGN DEBT

The life cycle of sovereign debt is used here as a conceptual device to consider the way in which debt is incurred, how debt instruments are issued, how debt management is structured, how debt sustainability is tracked and the options for debt workout (figures V.2 and V.3).

Sovereign debt can be analysed through a framework comprising the five stages set out below. Challenges and failures can be identified at each stage, calling for improvements for a more robust system. As the stages in the life cycle of sovereign debt are highly interdependent, policy responses that lead to reconfiguration need to address each of them.

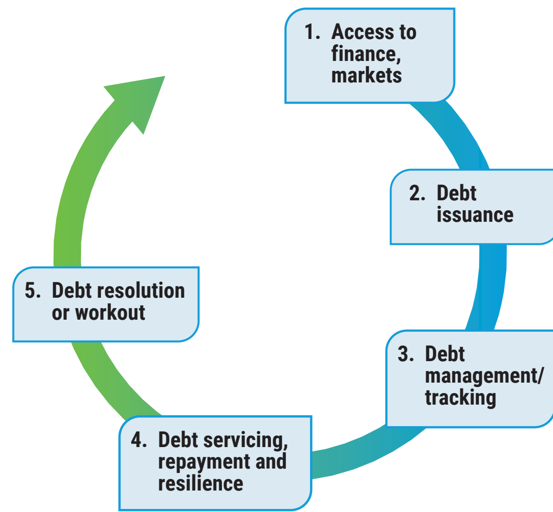
1. **Access to finance and markets.** This critical issue relates to the shortage of both concessional finance and affordable long-term capital. External financial shocks leading to capital outflows may mean countries

face extortionate spreads which imply loss of market access or unexpectedly high borrowing costs, which is further intensified by perceived high risks. These perceptions can be reinforced by benchmark-driven investment strategies and credit rating agencies' evaluations (chapter II).

2. **Debt issuance.** A lack of transparency hinders responsible lending and borrowing. Those that ultimately pay the price – citizens – are often kept in the dark. Contractual and cost terms are obscure, particularly if they contain potentially harmful clauses such as resource-backed collateral. While there have been innovations in related financial instruments (e.g. State-contingent clauses) and enhanced collective action clauses, there is still room for improvement. The UNCTAD *Principles for Responsible Sovereign Lending and Borrowing* (2012) are no longer at the forefront and, while other guidelines have emerged, a global consensus on principles for responsible lending and borrowing remains elusive.[5]

Figure V.2 Unpacking the sovereign debt black box

Life cycle of external sovereign debt expressed as stages



Source: UNCTAD.

3. **Debt management.** While countries have been increasingly empowered to manage their debt (including through the UNCTAD Debt Management Financial Analysis System, DMFAS), technical barriers remain. Countries need to be empowered to track their debt sustainability – including for subnational government and State-owned and parastatal enterprises – to be better able to assess their vulnerabilities and evaluate the debt sustainability analysis required by IMF.

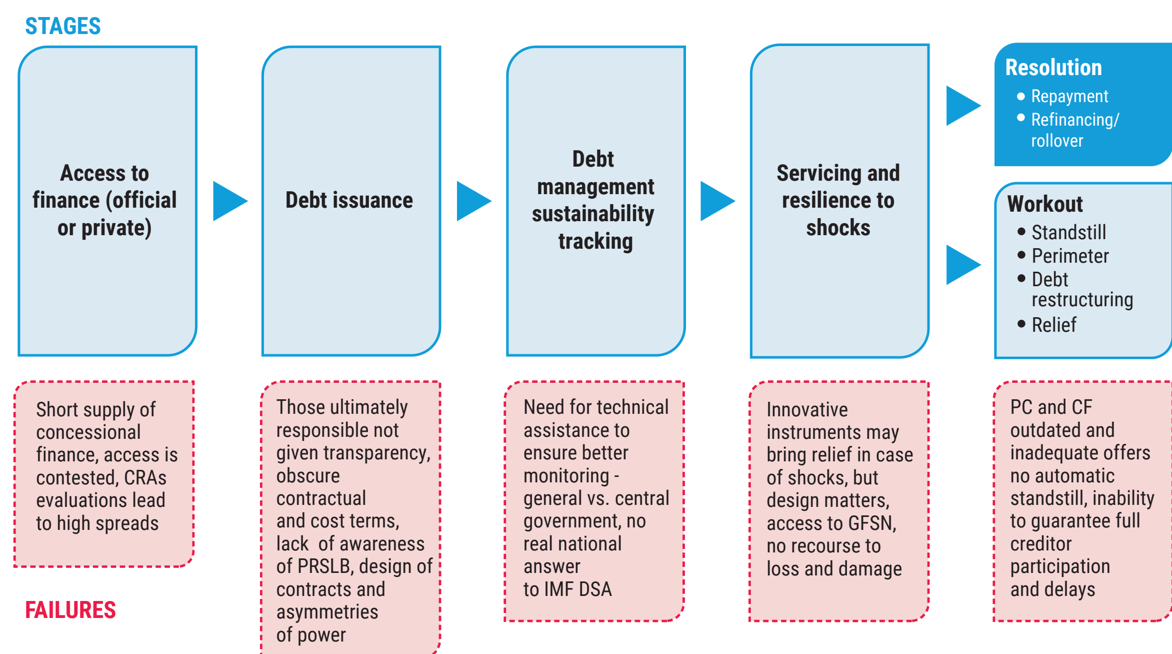
4. **Debt servicing, repayment and resilience.** Ideally, debt servicing should go smoothly but the frequency of external shocks, including those that are climate-related, represents a barrage of externalities that can derail the process. Creating innovative financial instruments can be helpful for managing debt, but even the most effective of tools needs improving to ensure resilience. Limited access to the global financial safety net and the inability to address loss and damage hinders rather than improves resilience (chapter IV).

5. **Debt resolution or workout.** In the best scenario within the life cycle, debt is repaid or easily and affordably rolled over. This is referred to as resolution. If not, the country may have to seek a debt workout which could involve suspending the debt servicing agreement, extending the maturity, reducing interest rates and/or cancelling the debt outright (i.e. a haircut or a reduction in the value of the collateral). However, the institutions and mechanisms dealing with debt workouts have become increasingly disconnected from the realities and complexities of sovereign debt distress. The composition of institutions like the Paris Club are outdated and processes such as the Common Framework are inadequate. The ongoing absence of an automatic standstill mechanism during negotiations, incomplete creditor participation and delays in the process are among the underlying weaknesses.

"The institutions and mechanisms dealing with debt workouts have become increasingly disconnected from the realities and complexities of sovereign debt distress."

[5] Three years after the launch of the UNCTAD *Principles on Responsible Sovereign Borrowing and Lending*, Member States of the United Nations reiterated in the Addis Ababa Action Agenda that maintaining sustainable debt levels is the responsibility of borrowing countries but that lenders also have a responsibility to lend in a way that does not undermine a country's debt sustainability. Since then, other soft law approaches to responsible lending and borrowing have emerged, such as the Group of 20 Operational Guidelines for Sustainable Financing and the Voluntary Principles for Debt Transparency from the Institute of International Finance. None have gained widespread traction.

Figure V.3 Pitfalls along the path: The phases and failures of sovereign debt
Stage analysis of life cycle of sovereign debt



Source: UNCTAD.
Abbreviations: CF, Common Framework; CRAs, Credit Rating Agencies; DSA, Debt Sustainability Analysis; GFSN, Global Financial Safety Net; PC, Paris Club; PRSLB, Principles on Responsible Sovereign Lending and Borrowing.

D. TRANSFORMATIONAL PROPOSALS

This section sets out areas of potential transformation within the sovereign debt life cycle (figure V.4). While each of these proposals may have specific relevance to a particular stage, in all cases the stages and their outcomes are interdependent. The process also contains path dependencies; for example, weak transparency at the "access to finance" stage hinders the entire process.

1. Strengthening transparency across the sovereign debt cycle

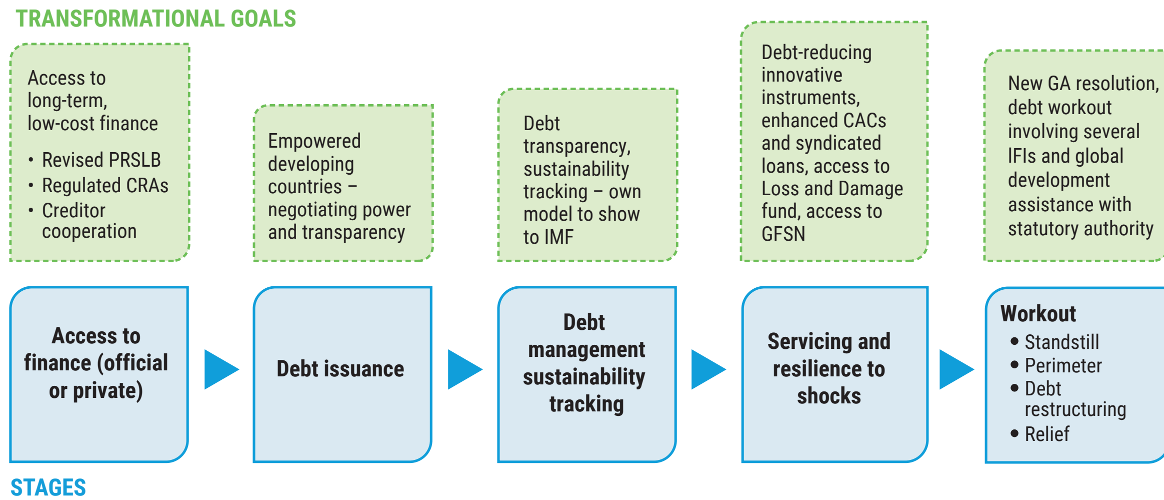
Managing sovereign debt is a complex and intricate process that involves many stakeholders with an evolving interplay of incentives, interests and responsibilities. In this context, transparency is fundamental to every stage of the sovereign borrowing and lending cycle and extends beyond merely recording transactions. Transparency around sovereign debt transactions lies at the heart of the public covenant between Governments and their citizens. It ensures accountability, fosters trust and strengthens public institutions.

From the perspective of public financial management, debt transparency means providing a wide range of information about how public funds are used for development. This includes details of the financial and legal structure of a country's liabilities, the impact of financial needs and obligations on its development prospects as well as loan conditionalities and their relation to domestic policies. Collectively, these elements underpin sovereign debt transactions. Transparency is essential for ensuring legitimacy, accountability and sustainability of debt financing.

Debt transparency is not a static concept. The requirements to achieve transparency change relative to the specific institutional setting of the country and vary with the different stages of the sovereign debt life cycle. The following section provides general recommendations for enhancing transparency at each stage.

Figure V.4 Transformational goals along the sovereign debt life cycle

Aspirations to address the constraints stage by stage



Source: UNCTAD.

Abbreviations: CACs, collective action clauses; CRAs, credit rating agencies; GA, General Assembly; GFSN, global financial safety net; IFIs, international financial institutions; PRSLB, Principles on Responsible Sovereign Lending and Borrowing.

a. Access to finance

The debt challenges of developing countries need to be considered in the context of the difficulties in fully implementing the Addis Ababa Action Agenda on Financing for Development (Inter-Agency Task Force on Financing for Development, 2023). Inequities in the international financial architecture create an explicit resource and information asymmetry between borrowers and lenders. The lack of viable alternatives for securing concessional development financing sets the stage for opaque and expensive sources of debt financing. The presence of confidentiality clauses limiting disclosure by sovereign borrowers and the use of collateralized loans or borrowing on commercial terms that are incompatible with long-term development requirements highlight these power asymmetries. These practices are the result of a system which increases the leverage of agents that can offer otherwise scarce financing, yet frequently at the expense of transparency and inter-creditor equity (Maslen and Aslan, 2022).

"Inequities in the international financial architecture create an explicit resource and information asymmetry between borrowers and lenders."

A global economic system that allows countries to grow while borrowing, in order to develop trading capacities and transform structurally, whilst ensuring a fair international system of taxation would best help reduce the leverage of these agents. This requires greater progress towards a multilayered and resilient structure for development financing. Availability of overlapping and complementary sources of development financing and transparency can counteract questionable practices in sovereign debt markets.

While such improvements are necessary, they will be insufficient to fully achieve debt transparency. The impact of multilateral efforts to strengthen development financing must be mediated by efforts at the national level to ensure that resources are deployed towards the Sustainable Development Goals. Implementing integrated national financing frameworks at the country level can play a key role in developing comprehensive financing strategies that explicitly link sources and uses of financing in a transparent way for all relevant stakeholders (UNDP, 2023).

b. Debt issuance

Existing soft law approaches to promoting debt transparency, including the UNCTAD *Principles for Responsible and Sovereign Lending and Borrowing* and the Institute of International Finance Principles on Debt Transparency, fall in the realm of soft law and self-regulation. Despite some progress, significant gaps remain regarding timely disclosure of financial and legal terms of sovereign debt (United Nations, 2022b). Measures are needed to target the incentives that lead borrowers and lenders to turn to opaque financing mechanisms in ways that are counterproductive.

In the case of borrowers, national legal and regulatory frameworks play a crucial role in improving debt transparency and these efforts should be founded on the notion that transparency around public debt management is a public good (Gelpern, 2018). Legal frameworks for public debt management can help address key problems, including clear authorization mechanisms for the issuance of debt, parliamentary oversight, establishment of requirements for reporting transaction-level data regarding the financial and legal terms of debts and using standardized templates for disclosure (Maslen and Aslan, 2022).

In addition, legislation in lender countries and relevant jurisdictions should limit the recovery of opaque debts to discourage predatory lending practices. Robust debt disclosure requirements as part of public debt authorization frameworks ought to be a necessary condition for enforcing contracts in domestic and foreign courts (Group of 30, 2020). Effective regulation can help improve transparency and prevent harmful practices including collateralization and exploitative sovereign syndicated loans.

"Legislation in lender country jurisdictions should limit the recovery of opaque debts to discourage predatory lending practices."

Financial innovations can be a challenge for effective debt management if not used correctly. Mechanisms such as climate-resilient debt clauses or debt-for-nature swaps can help improve resilience in the aftermath of a climate shock, or used to free up resources for conservation investments, if employed correctly. Full disclosure and transparency is required regarding the contractual terms of such mechanisms to ensure that borrowers and lenders can usefully integrate these tools into their financial assessments.

c. Debt management

Effective debt management is built on transparency and national capacity-building. It should be founded on debt management systems and the capacity to incorporate, analyse and report individual loan transactions. Improvements in debt management can be achieved through an international loans repository (ILR) as further addressed in box V.1. An ILR can improve debt management by digitizing loan transactions, ensuring consistent financial terms and providing reliable statistics.

There is also a need to bolster technical capacity at national levels to assess the financial and legal implications of the existing liability structure. Capacity-building ensures that countries can reduce their reliance on external assessments and enhance their sovereignty over financial operations. UNCTAD is leading in this area through its DMFAS programme. DMFAS has provided technical assistance to 116 institutions in 75 developing countries over 41 years (UNCTAD, 2012; 2022a). The DMFAS programme prioritizes developing and maintaining national capacity to ensure accurate information about public debt to support policy decisions and risk management.

Box V.1 Digitalizing loan transactions through an International Loans Repository

There is a broad consensus among the international financial community on the need to improve public debt transparency. Several initiatives and proposals are being discussed to tackle this, from addressing institutional, governance and capacity gaps in developing countries, confronting adverse incentives among borrowers and creditors to revising cross-country debt databases. The creation of an ILR is one such proposal (Rivetti, 2021).[a] An ILR can be described as a platform that reconciles external sovereign loans and records between borrowers and creditors, improving the accuracy of debt records and limiting operational risk. While enhancing public debt transparency will require a multi-pronged approach, such a repository would bring several benefits.

The problem: Loan data is shared manually

Contrary to debt securities, which are fully digitalized, information related to international loans and associated transactions rely on manually sharing borrower-creditor information. This arrangement leads to data inconsistencies among borrowers and creditors, such as misinterpretation of financial terms and conditions, missing information on transactions or errors in recording information. This then requires resource-intensive reconciliation and creates distrust in the quality and comprehensiveness of the data, which is an obstacle to debt workouts. Moreover, a lack of transparency creates opportunities for fraud and corruption.

Digitalizing international loan data and creating a public ILR could unlock problems related to debt transparency. An ILR could potentially provide a consistent set of all financial terms for each agreement, validate all loan and servicing transactions and present reliable and timely statistics.

Beneficiaries of an International Loans Repository

The ILR would serve borrowers and creditors as well as those using and compiling international debt statistics. Borrowers would be relieved of cumbersome and error-prone debt data recording processes and both creditors and borrowers would benefit from the information sharing it entails. Resource-intensive reporting obligations by borrowers would also be alleviated, facilitating access for all stakeholders in the borrowing country. Creditors would be assured that their debt records and the borrowers' debt records were produced according to international best practices, saving time on reconciliation exercises and possibly enhancing trust in the process. For those compiling international debt statistics, prompt updates to records would reduce costly and time-consuming cross-data checking exercises. Finally, all users of the data would have access to reliable, quasi real-time and verified debt data.

Benefits of an International Loans Repository: security, transparency, validation, automation

The key benefits of an ILR include: i) a secure platform for data exchanges relating to loan transactions, ii) validation of data between borrowers and creditors, iii) automation of borrowers' debt management and reporting systems, iv) enhanced transparency on loan financing conditions, v) promotion of near real-time dissemination of statistics, vi) standardized debt definitions for statistics and debt reporting (IMF, 2023) and vii) assisting borrowers and creditors to move to digital end-to-end processing of loan transactions (Rivetti, 2021).

Ultimately, the ILR may provide an incentive for standardizing and harmonizing international loan agreements. Debt managers in developing countries would benefit from complex financial terms embedded in loan and debt agreements being recorded accurately and automatically, and this data could be automatically fed into their existing debt management systems.

Implementing an international loans repository

The first stage of implementing the ILR would be to define technical specifications, aided by the existing technical working group on improving the World Bank's Debt Reporting System. This working group includes the Commonwealth Secretariat, IMF, UNCTAD and the World Bank. This would follow with a pilot ILR tested with volunteer multilateral development banks, bilateral creditors and interested borrowers.

Since the publication of an initial proposal to create the ILR in October 2021, criticisms of the ILR included the duplication of repositories, technological complexity, it being only a "partial solution", cost, data ownership and authorization for data dissemination.

Addressing concerns

- Duplication of repositories. The role of the ILR is not to duplicate existing databases but to improve data quality and reporting services. Data digitalization would ensure quality and enhance the reporting services offered by existing databases, and feed into existing debt management systems.
- Technological complexity. Borrowers' debt recording and management systems and creditors' loan monitoring systems are based on relational databases that rely on electronic data transmission. An ILR would build on existing systems, making the ILR technically feasible and cost-effective.
- Partial solution. While it is acknowledged that debt transparency requires a multifaceted approach, the ILR addresses a crucial aspect by transitioning from manual information sharing to digitalization.
- Costly. The upfront investment for creating the ILR is necessary yet manageable; and it is estimated that ongoing operational costs would be minimal compared to current practices. These costs need to be considered in relation to the costs currently incurred by borrowers, creditors and international institutions associated with collecting, compiling, reconciling and reporting data.
- Data ownership and authorization. Data handled by the ILR will remain encrypted and owned by data owners, with dissemination rights determined by them, aligning with existing authorization rules.
- Downsides of standardization. While standardized terms for financing instruments can be expected to facilitate debt restructuring, they may reduce policy space for tailor-made debt instruments addressing countries' specific needs. This means retaining some flexibility within the standardized reporting structures.

The creation of an ILR represents a possible step towards improving public debt transparency and streamlining international loan data management. By addressing key challenges and leveraging technological advancements, the ILR offers a valuable solution for borrowers, creditors and data compilers alike, ultimately promoting a more resilient international financial architecture.

[a] Rivetti D (2021), Debt Transparency in Developing Countries, Report No. 165760, World Bank, Washington, D.C.

d. Debt servicing

As debt is repaid, in the event of a shock, national authorities need a clear overview of how various debt instruments and obligations interact during times of crisis, to ensure resilience. This requires ongoing monitoring and modelling of debt dynamics and an understanding of the implications of financial innovations, based on disclosure and transparency.

National authorities also need alternative methodologies to assess their ability to service their debt in a complex world. The IMF–World Bank frameworks to assess debt sustainability are, at their core, risk management tools for creditors. As such, they are ill-suited to provide borrowers with a comprehensive overview of the linkages between debt sustainability and development financing requirements (UNCTAD, 2019b). To address this, UNCTAD has developed the Sustainable Development Finance Assessment (SDFA), which is further addressed in UNCTAD (2022b and 2022d).

The SDFA identifies the development finance needs of a country in order to meet the Sustainable Development Goals, together with pathways to make this compatible with external financial and public debt sustainability (section D.2 and UNCTAD, 2022c).

e. Maturity and debt restructuring

For countries that can repay their debts in a sustainable fashion, debt management offices ought to ensure adequate reporting of relevant payments. Records and assessments of transactions provide useful benchmarks for debt management relating to intermediaries, transactions and borrowing costs.

Countries in debt distress face additional difficulties, as a lack of debt transparency is closely linked to their financial challenges. Debt workouts provide a unique opportunity to improve transparency. The debt treatments from the Group of 20 Common Framework help achieve this by including a requirement for the full disclosure of contractual terms of debt, following a restructuring. Disclosure sets the foundations for improved debt management and equitable treatment of creditors. In the event of additional debt treatments, a mechanism for automatically disclosing debt workout agreements would reduce delays and minimize the risk of incomplete creditor participation and issues relating to comparability of treatment. The United Nations General Assembly has invited relevant international institutions to consider creating a central data registry for debt workouts to compile precisely this type of information (United Nations, 2022c).

In conclusion, transparency is a dynamic principle that evolves through each stage of the sovereign debt life cycle. The pursuit of transparency transcends mere data disclosure. It represents a commitment to building a global financial architecture that is fair and accountable to all. In addition to ongoing work by the DMFAS programme, the UNCTAD *Principles for Responsible Sovereign Lending and Borrowing* mark a milestone in multilateral efforts to improve debt transparency. The growing debt challenges faced by developing countries highlight the need to revisit these Principles and align them with broader development financing needs.

> *"The pursuit of transparency transcends mere data disclosure. It represents a commitment to building a global financial architecture that is fair and accountable to all."*

2. Debt management and debt sustainability analyses and tracking

Debt management offices in developing countries need to urgently strengthen their capacity to evaluate debt sustainability and undertake tracking. They should be able to simulate scenarios and use these as tools to guide economic policies. Policymakers must also enhance their capacity to collaborate effectively with IMF, conducting comprehensive debt sustainability analyses and strengthening their negotiation skills with the organization. Moreover, better integration of debt sustainability tracking – an upstream area of debt management which also includes governance and debt strategy – will benefit the borrower country as well as creditors.[6]

[6] See https://unctad.org/topic/debt-and-finance/dmfas.

In the current context of compounding crises, overlapping debt and climate challenges and mounting obstacles to achieving the Sustainable Development Goals and the Paris Agreement, the SDFA is designed to enable developing countries to track their sustainability progress against their development goals. It is one of several potential country-based tools that could be complementary to the work undertaken by the IMF before, and at the time of, debt distress. The SDFA evaluates a country's development finance needs to achieve climate-resilient, green structural transformation and the most fundamental Sustainable Development Goals while ensuring the sustainability of the external and public sector accounts. The SDFA considers all sources of external financing (foreign direct investment, foreign portfolio investment and external debt) as well as public sector finance (public debt and other public sector liabilities).

The SDFA shows that there are a range of policy options to attain or maintain external financial and public sector financial sustainability while also achieving the Sustainability Development Goals. The SDFA is founded on the assumption that long-run output growth is demand-led and the balance of payment performance is the dominant economic constraint to growth and development. This means that the external sector establishes an upper bound for long-term growth that is usually below full employment. Although, in theory, all countries face this external constraint (Thirlwall, 1979), it is more binding for developing countries due to their external position within the global economy (Prebisch, 1950 and 1959). This position has two interconnected dimensions. First, developing countries typically run trade deficits, reflecting the productive-technological dimension (Porcile, 2021). Second, developing countries do not issue an international reserve currency – a currency widely used in international transactions (predominantly the dollar), which reflects the monetary-financial dimension. The interplay of these two dimensions means that these countries cannot finance their structural balance of payment deficits in their domestic currency. The shortage of foreign currency associated with such deficits eventually leads to constraints on the long-term growth rate.

The SDFA puts the achievement of the Sustainable Development Goals at the centre of the analysis, allowing development ambitions to be explicitly considered within fiscal decision-making. This is contrasted with standard debt sustainability analyses (DSAs) which focus on the ability to repay. The SDFA goes beyond standard debt sustainability analyses to emphasize the broader dimension of external financial and public sector financial sustainability. It also extends Pasinetti's concept (1998) of an "area of sustainability" to external finance, external debt and public sector finance in developing countries.[7] The "area of sustainability" defines a range of values for sustainability indicators that are compatible with external financial and public sector financial sustainability.

The first version of the UNCTAD SDFA (Mark I) only considers the first four Sustainable Development Goals (Goals 1–4: no poverty, no hunger, good access to health services and access to quality education) which are expected to be fully (or largely) met by public sectors given their high, long-term social returns (Schmidt-Traub, 2015).

"The financing gap to achieve climate-related Sustainable Development Goals is enormous, requiring many countries to take on more debt."

The second version (Mark II) is under development and will expand on the first version. Notably, it will estimate the impact on external financial and public sector financial sustainability of meeting the 2030 Agenda and all the Sustainable Development Goals related to climate action (Goal 13 and climate aspects of other Goals). It is well known that developing countries are most affected by climate change and natural disasters that endanger their structural transformation (Intergovernmental Panel on Climate Change, 2023; Wu, 2023). Moreover, these countries are in a more fragile position in terms of productive structure due to their greater dependence on brown sectors and insufficient financial and technological capacity to invest in green industries (UNCTAD, 2021). This means that the financing gap to achieve climate-related Goals through investments in climate adaptation and mitigation is enormous, requiring many countries to take on more debt. At the same

[7] Pasinetti (1998) was a reaction to the "Maastricht criteria" that set targets that the members of the European Union would have to meet to join the future monetary union. The targets were 60 per cent for the public debt-to-GDP ratio, 3 per cent for the fiscal deficit-to-GDP ratio and average inflation of no more than 1.5 percentage points above the rate of the three best-performing member States. He shows that, as the debt and deficit ratios change over time, the relation between them should be considered arbitrary and not fixed thresholds. Thus, different combinations of these two ratios ensure public debt sustainability.

time, the ability of developing countries to address mounting climate challenges is heavily impaired by existing unsustainable debt burdens (section D).

The UNCTAD SDFA Mark II will enable the assessment of a country's financial needs to undertake required investments and achieve a climate-resilient and green structural transformation. The SDFA dashboard allows testing of scenarios for sustainability tracking and assessing how different policy choices affect external public sector positions (Lockwood, 2022). The aim is to update the dashboard for the UNCTAD SDFA Mark II; this would help estimate the impact of climate-related shocks on the funding gap for achieving climate-focussed Goals. In this way, the SDFA will also improve the simultaneous technical evaluation of debt and climate challenges.

3. Debt workout and the global debt authority

Long, drawn-out and ineffective sovereign debt workout mechanisms can lock countries in a vicious cycle. This can cause loss of market access, capital flight, subdued economic activity, financial sector instability and a drying up of foreign direct investment. The consequences have been referred to as "incandescently painful" (Buchheit et al., 2018). The missteps of borrowers or creditors during restructuring can keep a country on the sidelines of the international finance playing field for some time. In particular, inadequate debt relief, overly optimistic projections of future growth, an inability to rally creditors and a lack of capacity to reduce fiscal deficits causes delays, holdouts and risk aversion.

For debt workouts to be transformed in such a way that they contribute to sovereign resilience, multiple innovations both of a private (contractual) and a public (statutory) nature are required. These need to be coordinated rather than played out against each other.

Improved sovereign debt workout requires substantive and institutional changes to the existing framework:

1. An automatic standstill for countries declaring distress, to concentrate the minds of creditors in the workout process. This would prevent holdouts and encourage debtor countries to enter the distress stage before it is too late. Early declaration of distress and early resolution could prevent countries being locked out of markets for a prolonged period. To ensure creditor equity, a standstill might be a useful device to ensure inclusion of private creditors, as would principles on comparability of treatment and rules need to prevent creditors from realizing collateral.
2. A mechanism is needed to determine the perimeter of legitimate debt. This relates to rules regarding unconstitutional debt resulting from corruption, opacity and secrecy, flawed authorization or reckless creditor practices.
3. At the country level, improved debt sustainability analysis needs to be available that reflects the need to achieve the Sustainable Development Goals and climate transition – including related investments and necessary industry policies – and that empowers country negotiators through improved data on their potential for growth and fiscal consolidation. This requires developing countries to have their own models, but it also requires greater transparency of the IMF debt sustainability analysis models and assumptions (and ideally, a willingness from IMF to modify them where necessary).
4. Recourse to regulation of capital flows as part of the ordinary toolkit of developing countries. This would allow monetary policy to be used to not only protect economies when threatened with outflows, but also when large inflows relative to the size of the economy during the expansionary phase of the global financial cycle threaten to create asset bubbles, financial fragility, currency overvaluation and superfluous imports (*Trade and Development Report, 2015*).
5. Improved innovative financial instruments such as debt-for-climate swaps and debt-for-nature swaps that provide mechanisms to enhance fiscal space in countries with sustainable debt – albeit at the margins. The aim is to generate fiscal breathing room through a debt workout to invest in mitigating the effects of climate change or preserving biodiversity. Results have been mixed, and rules that limit creditor control over the investment may be needed so that sovereignty and ownership is assured (Bolton et al., 2022).

6. An institutional framework that fosters resilience. Given the significant current ecological, social and geopolitical challenges, institutions charged with regulating sovereign debt need to bridge differences between constituencies and stakeholders. This speaks in favour of large, universal organizations, including the United Nations. Other actors such as the Group of 20 might play a crucial role, particularly in ensuring the support of a wide range of capital-exporting countries. While any major initiatives for restructuring debt would involve multiple institutions, an institutional "headquarters" with authority over sovereign debt workouts would be advantageous. Thinking about how and where such a technical and neutral Authority should be established needs to begin. It would require dealing with the failures of the system outlined above and obtaining the buy-in of creditors and borrowers alike, while being informed by multilateral institutional views, including of the United Nations (box V.2).
7. Establishment of a borrower's club. Since as early as 1956, official creditors have coordinated their efforts through institutions such as the Paris Club and various private creditor groups also exist (box V.3). Through a borrower's club, debtor countries could discuss technical issues and innovation, such as bond issuance experiences and novel debt instruments for sustainable development, and learn from each other's experiences. Debtor countries with recent experience could advise those facing debt distress on reducing their restructuring costs or building political relations between the debtor countries. This support could lead to a more stable and resilient global financial system, benefiting both borrowers and creditors.

Box V.2 UNCTAD and the evolution of a global debt authority as an institutional mechanism

In April 2020, as the reality of a global pandemic and related shutdown were beginning to be felt across the globe, UNCTAD called for an international developing country authority as part of a series of updates to its *Trade and Development Report* (UNCTAD, 2020). This was the latest in a long history of UNCTAD publications pointing out that since international financial stability and liquidity are global public goods, and the source of debt distress lies partially outside developing countries themselves, an impartial institutionalized mechanism to ensure fair sovereign debt workouts is needed.

In September 1980, the Trade and Development Board of UNCTAD endorsed a set of guiding principles relating to the international management of debt problems for interested developing countries. The guiding principles recognized that any such action should be:

- Expeditious and timely;
- Designed to enhance the development prospects of the debtor country, bearing in mind its socio economic priorities and the internationally agreed objectives for the growth of developing countries;
- Aimed at restoring the debtor's capacity to service its debts in the short- and long-term and should reinforce the developing country's own efforts to strengthen its underlying balance-of-payments situation; and
- Aimed at protecting the interests of debtors and creditors equitably in the context of international economic cooperation.

Lack of movement on this resolution resulted in the *Trade and Development Report 1986* noting that:

> "[The lack of a well-articulated, impartial framework for resolving international debt problems creates a considerable danger […] that international debtors will suffer the worst of both possible worlds […] being judged de facto bankrupt […] largely without the benefits of receiving the financial relief and financial reorganization that would accompany a de jure bankruptcy."

Drawing on Chapter 11 of the United States Bankruptcy Reform Act of 1978, the *Trade and Development Report 1986* set out some of the procedures that could be used in an international bankruptcy framework, including: an automatic stay on creditor claims or judgements to provide the debtor with the space to formulate a reorganization plan; a cessation on interest payments on outstanding debts at the time of a bankruptcy petition; a negotiated plan between debtors and creditors and adopted by a specified percentage of creditors. Later, the *Trade and Development Report 1998* also considered various proposals to establish an international debt facility to advance the restructuring of commercial bank debt to developing countries.

Some of these ideas were revived in the UNCTAD *Roadmap and Guide for Sovereign Debt Workouts* (2015) which recommended the creation of a debt workout institute. The role of this institute would be to facilitate dialogues between the debtor country and all its creditors, as mediator and arbiter, provide technical and logistical support (including a public repository for the complete records of past workouts), to commission debt sustainability analyses and have the capacity to publicly determine the successful conclusion of a restructuring. It was suggested that a more coordinated, multilateral approach in establishing such a body would increase its legitimacy. These features would be fundamental to a global debt authority.

To date, proposals for creating such an institution have failed to gain traction. In part this has much to do with its nature, as its effective operation would amount to a global public good. But debtor countries, which may benefit from such a public good, have to balance defending their interest as individual borrowers and the collective interest in facilitating more efficient and equitable outcomes in the event of a sovereign default. Creditors would also have to be persuaded of the long-term benefits of such an institutional structure.

Establishing new rules and mechanisms for sovereign debt workouts is likely to be fraught with lack of consensus and institutional resistance. The way forward is not simply a legal one; the process is deeply political and will need support from a broad set of member States and actors, including courts and international institutions.

However, pushing towards establishing an authority to deal with global debt could lead to a substantive transformation of the sovereign debt workout regime. Such an Authority would promote and implement the substantive changes listed above. The road towards this aspirational entity could start with small beginnings.

Vision of the global debt authority

Initially, the global debt authority could begin as a coordinating and advisory institution. Instead of being established under a binding treaty with near-universal membership, the authority could be based on a non-binding charter adopted by a smaller group of interested countries. It would initially consist of a small group of permanent staff affiliated with an existing international organization and rely on ad hoc committees of experts.

The initial work of the global debt authority would be identifying tasks, coordinating existing efforts and making recommendations. The ad hoc committees of experts would identify existing issues related to sovereign debt and make recommendations for the authority to provide guidance on soft law, domestic legislation development and contractual approaches. Through the work of these ad hoc committees, the authority would establish its network with experts, international institutions, domestic lawmakers and civil society groups, among others. In terms of collecting sovereign debt workout data, staff of the global debt authority and ad hoc expert committees would develop and maintain databases of previous debt workout agreements, debt sustainability analyses and effective workout communication strategies. In this process, the global debt authority would build its relations with the officials involved in previous debt restructuring from debtor countries, creditor countries and international institutions. From this, the authority could begin its operations and build its network for further development. On this basis, the authority could develop the resources to play a significant role in sovereign debt workouts.

Legal basis of the global debt authority

While some consider it a gold standard to establish an international organization through a multilateral treaty and expand its influence by increasing member States, given the technical nature of the global debt authority and its need for neutrality, it may be both preferable and pragmatic to commence on a non-binding basis and gradually increase its influence through its work. The authority could be established as an autonomous entity, neither borrower or creditor, with the necessary technical personnel by a small group of interested and committed countries. This is rather common, as examples such as International Atomic Energy Agency (IAEA) have shown – which itself emerged from a charter negotiated by 12 countries (Fischer, 1997). Legitimacy and expansion of the global debt authority would arise as a consequence of substantive contribution and recognition, somewhat like the IAEA.

Setting up the global debt authority

The first step towards establishing the authority would be identifying a group of interested States as charter members. The charter member States can negotiate a more comprehensive founding document and more detailed governing structure. The authority would also welcome observer States. A preparatory commission of experts would advise on the drafting of the founding document and lay the groundwork for substantive workstreams and associated networks of actors and organizations. Logistical foundations for the authority would also need to be clarified, including its physical location, initial budget and hiring permanent staff.

To ensure adequate reviews of the global debt authority, regular plenary meetings could be organized with a broader group of stakeholders, with the aim of keeping them informed of activities and hearing their concerns and recommendations.

Box V.3 Private creditor coordination – lessons for borrowers?

Private creditors actively collaborate via established forums such as the Institute of International Finance (IIF), a global association of financial institutions; the London Club, an informal gathering of international commercial banks for workout processes with sovereign debtors; and the International Capital Markets Association (ICMA), an association focused on shaping international capital and securities markets. This type of coordination has become standard practice, with overlaps in private creditor institutional membership.

Through ongoing dialogue, familiarity and cooperation, private creditors can influence the international debt architecture to their benefit and lobby for legislation that aligns with their own interests. Private creditors also have the capacity to draw out the restructuring process. Furthermore, there is a self-reinforcing dynamic at play: coordination enhances the influence of private creditors, cementing their interests, which in turn motivates further coordination.

The current global debt architecture is creditor-centric. Creditor coordination has influenced domestic legislation and promoted contractual tools. Relevant rules in key jurisdictions such as the United Kingdom and New York State, which govern most sovereign debt agreements, favour creditors. For example, in New York State, the existing rules do not impose any restrictions on holdout litigation. Proposals aimed at improving this situation continue to be rejected.[a] There is no legislation in New York State that compels private creditors to participate in international debt initiatives that would benefit sovereign debtors. The recent legislative proposal concerning this received unanimous opposition from private creditors.[b] Another example is the 9 per cent statutory pre-judgement interest rate in New York State law. This represents the annual interest rate applied to the outstanding debt from the time it falls into arrears until the court makes a judgement. It was set in 1981 when the annual inflation rate in the United States was 8.9 per cent and has remained unchanged even though inflation subsequently fell well below this rate for decades, before rising again in 2021.

Contractual clauses tend also to favour creditors. For example, bond contracts and loan agreements typically contain cross-default and acceleration clauses. Cross-default clauses allow all creditors to demand repayment if the borrower formally defaults on one of its debts. Acceleration clauses require the debtor to repay all outstanding bonds earlier than agreed if certain conditions are met (for example, in case of a default with another series of bonds). While such clauses are used to protect creditors' interests and ensure continuity of obligations, they also weaken the position of the sovereign debtor in negotiations and limit their flexibility in handling financial difficulties. For instance, debtor countries can be disincentivized to undertake voluntary rescheduling as this is considered a default under certain loan agreements.

The existing rules in the global debt architecture do not incentivize sustainable financing. Private creditors are not required to provide debt sustainability analyses to justify their lending and risk premiums. By comparison, IMF and the Paris Club have policies outlining that they should respect lending limits according to debt sustainability analyses, even though these rules are sometimes not respected. But there is no equivalent rule in the private sector. This leads to overlending and risk premiums that are disproportionately high. Moreover, despite the substantial risk premiums, in case of default, private creditors often manage to secure full recovery through holdout litigation, even when official creditors have granted debt relief. Private creditors enjoy high returns through unjustifiably high-risk premiums and full recovery at the cost of taxpayers in creditor States that grant debt relief. This gives private creditors incentives to drag out the debt restructuring process, exacerbating the situation for debtor States, as it hinders their ability to restore economic stability and regain market access. Historically, collective action clauses have facilitated some restructuring of private debt, but large creditors may acquire a blocking position. Moreover, they perpetuate dependence on the goodwill of private investors even if urgent public interests are at stake, including climate adjustment measures or essential health care.

How can debtor coordination improve the system?

In contrast to the creditor landscape, there is a substantial lack of coordination between sovereign debtors and room to counterbalance this asymmetry. In the borrowing stage, debtor coordination can promote fair rules and encourage a more balanced international debt architecture, with responsible borrowing and lending. In the restructuring stage, debtor coordination can empower debtor countries to have greater technical capacities, networks and access to information, leading to a more equal footing and less biased outcomes. This can help avoid protracted negotiations and restore debt sustainability and economic recovery.

While there are many benefits for debtor countries to coordinate, there are also disincentives. These include fears of downside risks or being penalized with credit rating downgrades. Furthermore, there is less likelihood of borrowers coordinating than creditors, given that sovereign States typically act alone to initiate debt workouts. While large regional crises can create a temporary common cause, this may unravel quickly – as in the case of the Cartagena Group.[c] While the Group was temporary, there were some gains from coordinating, including an increase in concessional finance, acceptance by creditors of growth-oriented IMF programmes, multi-year rescheduling agreements and increased lending by multilateral banks. Moreover, it is possible that the threat of joint default helped member countries obtain better deals.

[a] While the exceptional Champerty rule in New York State law prohibits third parties from funding a lawsuit in return for a financial interest in the outcome and specifically prohibits acquisition of debt for the purpose of bringing legal action, this is not applied in most sovereign debt disputes. This is because the prohibition only applies in instances where the aggregate purchase price is less than $500,000. See section 489 of the New York Judiciary Law; Elliott Associates, *LP v Banco de la Nacion*, 194 F.3d 363, 368 (2d Cir. 1999)

[b] Assembly Bill A2970 / Senate Bill S4747.

[c] In June 1984, foreign and finance ministers of 11 countries (Argentina, the Plurinational State of Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, the Dominican Republic, Uruguay and the Bolivarian Republic of Venezuela) met in Cartagena, Colombia, and formally established the Group by signing the Cartagena Consensus. By 1986 the Group no longer existed – diverging interests and economic performance of member States, political and ideological differences and the presence or absence of an IMF programme, all eroded their cohesion.

E. RESILIENCE IN THE DEBT LIFE CYCLE

Sovereign debt resilience refers to the ability of a sovereign to avert debt distress in the face of external shocks, through its capacity to adapt to a period of exposure to stress and ensure a rebound in growth and development.

Within the overarching global context of escalating global uncertainty and climate crises, and situated within the conceptual framework of the sovereign debt life cycle, the discussion below considers several crucial elements for a more resilient response to external shocks. These elements include access to national and international buffers, availability of grants and concessional finance and debt relief measures that allow space for recovery.

1. Buffers to support resilience

Data collected just before the COVID-19 crisis in 2020 showed that only one third of American families were ready to cope with a medium-sized shock, with 27 per cent indicating that they would be unable to raise $2,000 to meet an unexpected shock. Another third indicated they found it difficult to make ends meet in a typical month, even without a shock (Deevy and Streeter, 2021). This lack of anticipated household resilience is multidimensional and related to wealth, class and social status, savings and potential sources of liquidity.

Similarly, a sovereign's vulnerability to external shocks can be gauged by its GDP, level of development, foreign currency reserves and its access to global liquidity – for example through a global financial safety net. Typically, developed countries have greater resilience, and it is no surprise that economic recovery after the COVID-19 pandemic revealed considerable inequality gaps within and between countries (United Nations, 2022a).

Accumulation of foreign exchange reserves is a costly national exercise, especially in terms of achieving better returns or investment opportunities foregone. Increasingly, developing countries have relied on reserves as a form of self-insurance, with one measure being the level of reserves compared to short-term debt exposures. In 2022 for example, reserves as a share of short-term debt declined in every developing region, as countries acquired less short-term debt, or used reserves to defend their depreciating currencies (see, for example, General Assembly resolution 78/229).

In turn, the global financial safety net refers to international, regional and bilateral liquidity. Examples include emergency lending from IMF, regional financial arrangements and bilateral currency swap arrangements between central banks. In general, developing countries have diminished access to the global financial safety net relative to developed countries, and those countries without access to a regional financial arrangement are most disadvantaged (Mühlich et al., 2022).

In this context, the August 2021 issuance of special drawing rights to 190 Member States by IMF in response to the COVID-19 pandemic was widely hailed as necessary to boost global resilience. While the special drawing rights mostly accrued to developed countries, developing countries certainly benefited from their issuance (Cashman et al., 2022).

2. Anything but debt?

Additional debt may neither be sustainable nor desirable in the immediate aftermath of a crisis, but unless grants and concessional finance are on offer, this may be the only option. In a context where developing countries typically pay elevated rates to access debt markets anyway (United Nations, 2023b), taking on more debt in these circumstances can come with punitive rates. Borrowing to rebuild after a climate event – for example a hurricane – generally increases in the post-disaster period. At the same time, borrowing costs are also hiked to reflect higher perceived creditor risk (Buhr and Volz, 2018). As the COVID-19 pandemic clearly showed, taking on more debt may be unavoidable. However, a crisis is likely to be accompanied by a slump in government revenue, meaning that social and economic demands soar and compete with debt servicing costs. Resilient recovery in this context is undermined as scarce resources are diverted towards higher debt servicing costs. This increased debt-servicing burden as a proportion of government revenue prevents developing countries from being able to maintain sufficiently elevated levels of public spending on recovery, development objectives and structural transformation.

There is a strong argument for alternatives to debt. More work on alternative sources of finance needs to be done. Insurance, additional grant-based support and far greater access to low-cost, long-term concessional finance can all play a role. The aim is to ensure that lack of debt sustainability and prolonged economic distress does not become the “new normal”.

While intergovernmental risk insurance schemes (such as the Caribbean Catastrophe Risk Insurance Facility) may contribute valuable emergency relief, they require a broad base of countries and institutions to support them.

For countries in or near debt distress, grants enable those whose national laws exempt grants from national primary expenditure growth caps to pursue necessary national development goals. This includes climate action to build their climate resilience (Achampong, 2023).

Regarding more concessional finance, the United Nations Secretary-General set out the *SDG Stimulus to Deliver Agenda 2030,* stating that more concessional finance by multilateral development banks is sorely needed, with calls to multilateral development banks to increase lending from around $100 billion a year to $500 billion per year by 2030 (United Nations, 2023b). Moreover, public development banks can provide finance at lower-than-market rates over and above that provided by the multilateral development banks. A recent counterfactual analysis suggests that the high interest rates which developing countries have faced in past decades has done much to undermine their debt sustainability and resilience (Panizza, 2022).

3. Measures that create respite

In the immediate aftermath of a crisis or shock, affected countries would greatly benefit from a general suspension of debt servicing (both principal and interest) from all creditors. In a similar approach to the Debt Service Suspension Initiative enacted by the Group of 20 as the pandemic hit, rules for this type of blanket standstill or moratorium for a specific period could be agreed by bilateral and multilateral creditors. Progress in this regard is welcomed: the United Kingdom is championing climate-resilient debt clauses (United Kingdom, 2023) and the World Bank announced a comprehensive toolkit to support countries after natural disasters. However, these measures should be considered more widely for international wars, pandemics and other crises.

Such a moratorium, especially if applied to all official and private creditors, could create a space for reassessing a country's debt situation. Ideally, this process would be administered by a neutral body, such as the global debt authority, in conjunction with creditors and the borrowing nation. The greater goal would be to provide an opportunity to reassess the sustainability of sovereign debt, and thus avert debt distress. This would enable countries to continue to build resilience in anticipation of a future shock.

F. RECOMMENDATIONS FOR TRANSFORMING SOVEREIGN DEBT AND A WAY FORWARD

1. Transforming sovereign debt requires increased mobilization of concessional finance, either through greater capitalization of multilateral and regional banks or new issuance of special drawing rights.
2. Greater access to financing should be guided by improved transparency of terms and conditions around how financing is used. Digitalizing loan contracts would significantly improve the automation and accuracy of this information. Rules regarding collateralized sovereign bonds would also protect developing countries.
3. Revising the UNCTAD *Principles for Responsible Sovereign Lending and Borrowing* could create momentum to underpin the importance of guiding principles throughout the stages of sovereign debt acquisition.
4. At the country level, improved debt sustainability analysis and tracking needs to be available, not only to reflect the achievement of the Sustainable Development Goals but also to empower country negotiators with improved data on their potential for growth and fiscal consolidation.
5. Access to a truly global financial safety net would greatly benefit developing countries. While all Member States ultimately have access to conditional financing from IMF, access to central bank swaps in a time of liquidity crunch would help avert crises.
6. To achieve the Sustainable Development Goals, countries need to be able to exploit the innovative financial instruments that best serve their needs. More work needs to be done to empower countries in this regard. Rules are needed regarding sustainable development bonds, resilience bonds and automatic restructurings and guarantees.
7. During a polycrisis, a country's ability to remain resilient while servicing debt is called into question. International and domestic rules for a standstill on debtors' obligations in case of climate, health and other external crises, such as climate-resilient debt clauses and the approach spearheaded by the World Bank, are initial steps that could benefit all sovereign borrowers.
8. In what is an increasingly complex environment, borrowers should draw inspiration from private creditors and cooperate to share information and experiences. Work should begin for a more robust debt workout mechanism and statutory global debt authority. In the process, discussions should take place around creditor treatment and equity and a balancing of borrower and lender rights.

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