United Nations | Committee for Development Policy

2023

# External debt*

## CDP input on the 2023 ECOSOC theme (Accelerating the recovery from the coronavirus disease (COVID-19) and the full implementation of the 2030 Agenda for Sustainable Development at all levels)


### Summary

The Committee discussed the escalating external debt distress and financial constraints faced by many developing countries, particularly in the light of the COVID-19 pandemic, rising interest rates, high food and energy prices and currency depreciation. The Committee stressed the importance of a comprehensive financing strategy to address the large scale of investment needs of developing countries. It also highlighted the need for short-term solutions such as multilateral financing and debt renegotiation to tackle the current debt crisis, while simultaneously establishing long-term solutions to prevent future debt crises. The Committee also called for improvements in the contractual approach with private creditors, including enhanced collective-action clauses and a more predictable framework for debt restructuring. To support vulnerable economies, additional SDR allocations contingent on well-defined economic shocks and re-channelled through multilateral development banks, can play an important role. At the same time, there is a need to efficiently allocate concessional finance for both climate adaptation and mitigation and for developed countries to transfer additional resources to compensate for historical carbon debt to developing nations. Furthermore, the Committee recommended that developing countries also implement preventive measures to strengthen debt management to avoid future debt crises.


### Recommendations

The CDP recommends the Council calls upon Member States and the international community to urgently improve the method, the process and speed of debt relief to developing countries. The process should begin with establishing a country-owned macro-fiscal framework, including an economic recovery strategy and realistic fiscal inputs. Prolonged debt distress harms both the country and the lenders. The debt relief process should be clear and agreed upon, and inclusive of all relevant stakeholders, including the private sector, to build trust and foster creative solutions.

The Committee further recommends that the Council calls for an efficient allocation of different financing sources, including compensation for losses and damages and provision of concessional financing for both climate adaptation and mitigation. This should be in addition to a mechanism for developed countries to transfer resources as payment for historical carbon debt owed to developing countries.

The Committee also recommends the Council to call for adopting preventive actions to avoid future debt crises. Countries should be incentivized to increase their debt management capacity, have full legal and financial details of all their debt, including those of state-owned entities, and regularly interact with their creditors.

* Excerpt from Committee for Development Policy, Report on the twenty-fifth session, See Official Records of the Economic and Social Council, 2023, Supplement No. 13 (E/2023/33)


The Committee for Development Policy (CDP) is a subsidiary advisory body of the United Nations Economic and Social Council (ECOSOC). It provides independent advice on emerging issues that are critical for the implementation of the United Nations development agenda. The CDP is also responsible for recommending which countries should be placed on the United Nations list of least developed countries (LDCs).

The Committee recognizes that the lack of a consensus on key parameters of the framework for sovereign debt restructurings leads to repeated stalemates. The Global Sovereign Debt Roundtable launched this year is a welcome first step towards a more systematic and predictable approach. New statutory bodies such as an independent panel for sovereign debt negotiations and an international bankruptcy court could potentially provide a fair treatment of claims while protecting the sovereignty of debtor countries.

The Committee acknowledges that adopting a statutory mechanism for sovereign debt restructurings may not be feasible in the short-term. Thus, it is important to improve the current contractual approach and increase the use of enhanced collective-action clauses in sovereign bonds, as well as adopt majority-voting provisions in non-bonded debt instruments. Issues related to collateralized debts and the lack of transparency of some commercial and official claims underpins the need for a reinforcement of ongoing debt transparency initiatives.

The Committee recognizes the key role of the Multilateral Development Banks (MDBs) in financing countries' development and emphasizes the need for enhancing MDBs' lending capacity, including the implementation of the recommendations of the G20-mandated Independent Review of MDBs' Capital Adequacy Frameworks and general capital increases where necessary. Re-channelling of Special Drawing Rights (SDRs) and wider use of guarantees as additional tools to fund SDGs or resilience initiatives are encouraged.

## The raw reality of the growing (external) debt crisis: A call to action

The COVID-19 pandemic has inflicted severe economic damage on the developing world, surpassing the impact of the 2008 global financial crisis. Despite a modest recovery in 2021, the situation remains fragile and uneven, as many developing countries continue to struggle with increasing debt levels and a rising cost of borrowing. This precarious financial state has been exacerbated by a series of critical factors, including the rising global interest rates; high food and energy prices prompted by the war in Ukraine; the lingering effect of the Covid-19 pandemic; and a steep depreciation of many emerging and developing economy currencies against the US dollar. Many low-income and emerging market economies are in or at high risk of debt distress, according to the International Monetary Fund (IMF) and the World Bank.

Developing countries face a challenging financial situation that undermines economic recovery and investment in climate resilience. Climate-proofing the economy and public finances is necessary to avoid unsustainable debt burdens and increasing climate vulnerability. LDCs, many of which are in Africa, and the Small Island Developing States (SIDS) have suffered disproportionately from climate change, and they have a legitimate claim to carbon credits due to hindered growth and development caused by resource extraction by advanced economies. It is also necessary to efficiently allocate financing sources, including compensation for losses and damages and concessional financing for adaptation and mitigation projects. Developed countries should also transfer additional resources to compensate for their historical carbon debt owed to developing nations.

To address existing debt difficulties and make necessary investments in climate resilience, a comprehensive debt and financing strategy is required, particularly for poor and vulnerable countries. Additionally, a tailored and comprehensive approach is necessary to address challenges faced by countries with high levels of debt, including liquidity problems, debt-overhang, and debt-as-insurance in climate-vulnerable countries. This includes expanding access to low-cost liquidity facilities and finance and implementing systematic debt-suspension clauses in loan contracts for natural disasters, as pioneered in the Bridgetown Initiative.

The Debt Service Suspension Initiative (DSSI) of the G20 allowed 48 out of the 73 eligible countries to temporarily halt debt service payments to bilateral official creditors. This provided resources that could be used to mitigate the COVID-19 impact. The initiative suspended $12.9 billion in debt-service payments until it expired in December 2021. However, access to financial markets has tightened since then, putting almost half of the 73 eligible countries at risk of debt distress. The G20 and the Paris Club endorsed the Common Framework for Debt Treatments in 2020 to coordinate and provide debt relief to DSSI-eligible countries, but only four countries have applied so far, and progress has been limited. Some middle-income countries have already defaulted or face severe debt distress, while others have restructured their external debts.

Sovereign debt restructuring needs comprehensive reforms, including improvements to the existing "contractual approach" with private creditors, and is criticized for lack of transparency, in particular in non-bond and collateralized debts. Half of emerging and developing countries' sovereign debts lack enhanced collective-action clauses, exacerbating the problem. Urgent attention is needed to reach a consensus on key parameters of the framework, including cut-off dates and comparability of treatment. The Global Sovereign Debt Roundtable is a positive forum but just a first step towards a more predictable approach to debt restructurings. This could involve new statutory bodies such as an independent panel and an international bankruptcy court. To improve debt relief, stakeholders should agree on a process inclusive of the private sector and based on a macro-fiscal framework for a country, fostering trust and creative solutions, including recovery-based instruments.

To tackle the current debt crisis, it is necessary to prioritize short-term solutions such as multilateral financing and temporary mechanisms for debt renegotiation, while also developing long-term comprehensive solutions. Governments would benefit from a time-bound lifeline of multilateral disbursements to facilitate debt renegotiations. Additional SDR allocations contingent on well-defined economic shocks can be an important instrument to assist vulnerable economies, if there is an effective mechanism in place for their distribution and re-channelling, including through MDBs. Developing economies require abundant low-interest, long-term financing from multilateral lenders, and MDBs are critical in financing development. The lending capacity of MDBs should be strengthened through the implementation of G20 recommendations and general capital increases where headroom is limited. Guarantees should be widely used to fund projects towards achieving SDGs or resilience initiatives.

To address the challenges of increasing debt levels, higher interest rates, and constrained access to financing, it is also crucial to take preventive actions to avoid unsustainable debt in the future. This could concretely translate into countries being incentivized to: (i) increase their debt management capacity, including their capacity to monitor its debt sustainability and run their own simulations (ii) having at hand full legal and financial details of all the obligations contracted by the country, including by state-owned entities, and (iii) knowing and regularly interacting with their creditors. In addition, developing and deepening domestic debt markets, attracting foreign investors, and managing and balancing both domestic and external debt are also important for debt sustainability, financial stability and resilience to economic shocks.