United Nations

High-Level Event on Financing for Development in the Era of COVID-19 and Beyond

Convened by Canada, Jamaica and the Secretary-General

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Discussion Notes

1. Global Liquidity and Financial Stability
2. **Debt Vulnerability**
3. Private Sector Creditors Engagement
4. External Finance and Inclusive Growth
5. Illicit Financial Flows
6. Recovering better for Sustainability

Discussion Note

Debt Vulnerability

1. Background

The global health and development emergencies caused by COVID-19 require urgent response and recovery measures for testing, tracing, isolation and treatment, as well as supporting the most vulnerable, securing livelihoods and stimulating the economy. Most developing countries do not have sufficient domestic resources and fiscal space to fund adequate response and recovery measures. International cooperation and external finance to bridge these fiscal gaps are crucial to recover better and prosper together.

As discussed in the Secretary-General's policy brief, *Debt and COVID-19: A global response in solidarity*, COVID-19 and its economic fallout are devastating public balance sheets. Prior to the outbreak of the pandemic, almost half of all least developed and other low-income countries were already at high risk of, or in, debt distress[1]. Debt servicing costs for these countries more than doubled between 2000 and 2019, to 13 per cent of government revenue – and reached over 40 per cent in a quarter of all Small Island Developing States (SIDS). In April 2020, to help increase liquidity to deal with the impacts of the crisis, the G20 agreed to suspend debt service on bilateral official debt to 73 low-income developing countries. The IMF offered further debt service relief to 25 of the poorest countries. The World Bank has been coordinating with regional MDBs to discuss COVID-19 support, joint initiatives, co-financing, and ways to maximize net flows to the poorest countries.

Debt vulnerability does not depend on pre-crisis per capita income levels. Many middle-income countries (MICs), including SIDS, which were not included in the G20 debt standstill, are also vulnerable given high levels of economic informality, inequality, large numbers of multidimensionally poor, and exposure to recurrent climatic and other external shocks. MICs are a heterogeneous group: some continue to enjoy access to private capital markets, while others were already on a trajectory toward default or in default before the crisis. 37 MICs are rated below investment grade by major ratings agencies, with external financing requirements of more than 14 per cent of GDP on average. Six middle-income small island developing States that are not eligible for debt suspension under the G-20 initiative have especially high public debt (61 per cent of GDP on average) and debt service burdens (41 per cent of revenue).

Middle income countries were home to 62% of the world's poor before the crisis. An additional 60 million people, largely in lower-middle countries, will be pushed into extreme poverty by the economic consequences of the COVID-19 crisis. It is crucial to provide adequate support to avoid losing two decades of progress in sustainable development, let alone meet the SDGs by 2030.

[1] As highlighted in the 2020 Financing for Sustainable Development Report.

2. Main challenges

High debt servicing and/or debt distress impede countries' ability to respond to the pandemic and invest in recovery and the SDGs, including making investments to build resilience to more frequent and severe climate impacts. Pragmatic solutions are needed to give countries room to make the policy choices and investments in a COVID response that will also lay foundations to recover better - supporting decent work, gender equality in the economic and social spheres, and inclusive growth that puts people and nature front and centre in the economy for sustainability. The fiscal space to make these important choices and SDG and Paris-compatible investments should not be side-lined through prioritisation of debt servicing in this emergency.

After the initial sudden shock, capital markets have started to mobilize funding to help meet the serious needs of developing countries. However, there is substantial heterogeneity among developing economies in terms of access and pricing beyond normal conditions. This emphasizes the need for shared principles and frameworks for engagement between debtors and creditors. It is also a strong reminder of the need to deal with debt issues on a case-by-case basis, framed in agreed principles.

There are also steep challenges to including multilateral creditors without jeopardizing their AAA credit ratings and their ability to provide fresh financing during the crisis. Such fresh concessional resources are crucial and, to enable them, injections of capital are required for all, including supplemental IDA through an emergency IDA round.

At the same time, any debt relief program will need to avoid a generalized freezing of credit markets, which would penalize developing countries with low debt burdens. Some developing countries are reluctant to seek debt relief under a G-20-backed program out of concern it could harm their credit ratings and future market access.

3. Exploring scenarios and implications

The G20 standstill will free around USD 11 billion until end-2020 and provide breathing space to least developed and other low-income countries. But eligible countries have an additional USD 7 billion in multilateral and USD 13 billion in commercial debt coming due in 2020.[2] In addition, scenarios that assume a gradual reopening of economies expect debt to increase by 13 percentage points of GDP globally, 4 per cent in low-income countries, and 10 per cent in oil producing countries. Such scenarios are now considered the lower bound of the economic fallout.

As a result, even if the standstill is extended to 2021, many countries will not be able to service their debt, fight the pandemic, and invest in recovery. Developing and emerging economies are expected to make debt service payments of $3.9 trillion in 2020[3]. At a minimum, the 34 low-income countries already at

[2] IIF Weekly Insight May 7th, G20 DSSI: What's Owed to Private Creditors?
[3] https://www.brookings.edu/blog/future-development/2020/04/13/what-to-do-about-the-coming-debt-crisis-in-developing-countries/

high risk of or in debt distress at the end of 2019 will require support and very possibly debt relief. Heavily indebted middle-income countries (including vulnerable SIDS) also face impossible choices between fighting the pandemic, investing in recovery, and avoiding costly defaults.

The scenario of a broader standstill that includes multilateral and commercial creditors would free nearly USD 20 billion for LDCs and other low-income countries. Because the standstill is offered on a net-present-value-neutral basis (meaning that creditors will be fully repaid), multilateral creditors should be able to consider participating without significantly impacting their ratings, with support from their shareholders. Similarly, consideration should be given to similar and other options to urgently address debt vulnerability in highly indebted middle-income countries, particularly to fight the pandemic and invest in recovery. Those low and middle-income countries that still have market access could be supported, e.g., with partial guarantees, to help avoid a generalized freeze of capital flows to developing countries. Including debt swaps and debt relief in the scenario would help countries fight the pandemic and invest in a sustainable and resilient recovery and the SDGs.

4. Potential areas of action

- Rapid implementation of the G20 initiative on debt relief and consideration of extension of the current initiative to the end 2021.
- Consider a more comprehensive approach to cover also the middle-income countries in need and involve all creditors.
- Consider the establishment of a Central Credit Facility at Multilateral or Regional Development Banks for drawings to support Covid-19 related expenditures[4] and other alternatives to enhance and preserve access to capital markets.
- Initiate a dialogue among creditors and debtors about options for ensuring debt sustainability, including relief where appropriate, for a sustainable, climate resilient recovery aligned with the SDGs, including regarding commercial external debt issued under foreign laws.
- Consider expanding the Debt Sustainability Analysis (DSA) toolkit to include carbon shadow-pricing, state-contingent vulnerability triggers, and other tools that expand SDG policy space for developing countries.
- Consider mechanisms to address litigation by holdouts, and improve international mechanisms for debt resolution.

[4] This is one of several proposals for discussion. The Central Credit Facility could be funded from reinvestment, by bilateral and commercial creditors, of interest payments on their existing credits due in 2020 plus a modest fund from one or more official sector institutions. See https://cepr.org/sites/default/files/policy_insights/PolicyInsight103.pdf

5. Continued Collaboration

A. By mid- July 2020, at the margins of the High-Level Political Forum

- Discussion of results from debt relief/restructuring initiatives.
- Exploring options to include the rest of the creditors and debtors in need in the standstill.
- Reflection on possible avenues to advance the Secretary-General's Strategy and Roadmap for Financing the 2030 Agenda in support of the process.

B. By mid-September 2020, at the margins of the UN General Assembly

- Reflection on the implementation of the debt sustainability/relief/restructuring initiatives.
- Discussion on options for debt sustainability and relief where appropriate for a sustainable recovery and the SDGs as suggested in Phase 2 of the policy brief of the Secretary-General on Debt and COVID-19.

C. By mid-December 2020

- Stock-taking and placing progress in the context of our common ambition to deliver the 2030 promise—by mobilizing together around the Decade of Action, needed now more than ever to prevent losing decades of progress towards sustainable development.