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Undue High Expectations of the G20 Common Framework: Urgent Need to Reform the International Debt Architecture

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This article stresses how international debt architecture reform requires innovative solutions beyond the G20 Common Framework, and should be addressed at the 4th International Conference on Financing for Development.

Cet article souligne que la réforme de l'architecture de la dette internationale nécessite des solutions innovantes allant au-delà du Cadre commun du G20 et devrait être abordée lors de la quatrième Conférence internationale sur le financement du développement.

Este artículo destaca cómo la reforma de la arquitectura de la deuda internacional requiere soluciones innovadoras más allá del Marco Común del G20, y debería abordarse en la IV Conferencia Internacional sobre Financiación para el Desarrollo.

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Public debt has been increasing fast in developing countries, reaching 30 percent of the global total in 2023 in comparison with 16 percent in 2010.[1] Currently, about 60 percent of low-income countries are facing the challenge of unsustainable debt and are at high risk of debt distress or are already in it.[2] In an environment of slow global economic growth, high real interest rates, and trade fragmentation, the concern about sovereign defaults is real and acute. However, no insolvency or bankruptcy regimes for sovereign debtors exist under which their effective and orderly restructurings can be worked out. The world is facing a "non-system" for sovereign debt restructuring—a longstanding gap in the international debt architecture.

The international community aspires to have a mechanism that can create a pathway toward the quick restorations of the debt sustainability of insolvent sovereign states in a timely, orderly, effective, transparent, and fair manner. However, this has become an even more complex challenge as the world debt landscape has changed with new creditors and alternative debt instruments, making creditor coordination and debt restructuring as a whole even more difficult than before. Attempts to improve the effectiveness of debt workouts have been made over the past decades, with only limited and incremental successes.

During the past three years, the arrangement or mechanism that has been at the center of processing sovereign debt restructuring worldwide is the *G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative*—in short, the Common Framework (CF). When the COVID-19 pandemic led to economic recessions and fast-increasing debt burdens for poor countries, the G20 (Group of Twenty) introduced the time-bound *Debt Service Suspension Initiative (DSSI)* in May 2020 to provide poor countries with a debt-service suspension to redirect financial resources earmarked for debt servicing to fighting the pandemic and safeguarding the lives and livelihoods of their most vulnerable people.

Before the expiry of the DSSI in December 2021, Zambia was in default, and Chad was on the verge of default in late 2020. The Common Framework was jointly established hastily by the G20 and the Paris Club, a group of creditors from developed countries,with the support of the International Monetary Fund (IMF). The CF was an *ad hoc* crisis-time solution to help low-income countries restructure their unsustainable debts and address protracted liquidity problems. Although the exclusion of middle-income countries from the CF has been considered one of its "birth defects", it is still regarded as an important milestone of the international efforts in debt restructuring; it was the first time the Paris Club and non-Paris Club official creditors were brought together in a coordinated process to undertake debt treatments for the low-income countries eligible for the process.

Even though the CF has not introduced reforms to the international debt architecture, there have been unduly high expectations that it will provide a pathway towards the quick restoration of debt sustainability in the countries that have applied for it.

The Paris Club website states that the CF "is a unique mechanism to provide low-income countries (LICs) with orderly and coordinated debt restructurings, with broad creditors' participation."[3] Thus, the participation of private creditors was expected as a given, which turned out to be the contrary.

There has been widespread discontent about the CF's failure to offer outright and deep debt cancelations and write-offs, as well as the exclusion of middle-income economies for which debt-sustainability analyses show distress and looming insolvency. The IMF's managing director also complained that the Common Framework had "yet to deliver on its promise",[4] despite the fact that the CF has not made any splash about its lofty promises and mission statements.

As a matter of fact, the CF did not promise to solve all the obstacles to timely and orderly debt restructuring, including good creditor coordination, private-creditor participation, speedy negotiations, and deep haircuts. It is baffling why, with so little effort made in designing the CF and a lack of concerted political support from various stakeholders, there have been unbelievably high expectations that the CF constitutes a shortcut to closing the gaps of the international debt architecture.

Old wine in a new bottle

The CF is not a new debt-restructuring mechanism; rather, it is an agreement to follow old Paris Club principles, practices, and procedures for debt restructuring presided over by the Paris Club and the IMF. The only fresh aspect is the participation of new non-Paris Club creditors.[5]

The CF's founding document,[6] with the logos of the G20 and the Paris Club, spelled out clearly that the CF would follow the main fundamental principles of the Paris Club—namely, consensus for decision-making, information sharing, comparability of treatment with official bilateral and private creditors, and conditionality. The debt treatments are framed in line with the classic Paris Club debt-rescheduling methods and terms, including the case-by-case approach, and debt-treatment needs are determined by a financing gap (which leads to a restructuring envelope) defined by an IMF-WBG (World Bank Group) Debt Sustainability Analysis (DSA).

The CF's only addition is the notion of "a collective assessment" by participating official creditors as to the debt treatment needed, which means the DSA is the basis for debt treatment, but the views of participating official creditors in debt restructuring would also be considered. The CF inherited the Paris Club's bias against offering debt haircuts or cancelations.[7] The founding document specifically stipulated that the key parameters of debt treatments include "(ii) where applicable, the debt reduction in net present value terms; and (iii) the extension of the duration of the treated claims. In principle, debt treatments will not be conducted in the form of debt write-off or cancellation."[8] Therefore, debt reprofiling is preferred over debt cancelation. Following the Paris Club practice, debt owed to multilateral development banks (MDBs) and the IMF is protected and not brought under debt treatment. The founding document stipulates clearly that the MDBs' joint role is to help meet the longer-term financing needs of developing countries. This signifies that the IMF and MDBs retain their preferred creditor status.

Even though the details of the CF are hazy, the central role of the IMF and the Paris Club in the CF's debt restructuring is crystal clear. The fact that the CF follows well-trodden sequential debt-restructuring processes seals the dominance of the IMF and the Paris Club. Countries applying to the CF must go through the IMF's debt-sustainability analysis and an IMF program involving policy reforms in order to receive IMF financing and the agreed debt treatment by creditors. The IMF's executive board retains discretion over how to judge any breaches of debt-distress thresholds and whether there are country-specific factors not covered by the DSA that contribute to such breaches. This means the IMF decides whether a country that applies to the CF is qualified for debt treatment and also determines the size of the required restructuring envelope. One major reason for debtor countries coming to the CF is to obtain bridge financing from the IMF. Thus, the IMF plays the role of both the creditor of last resort and arbitrator in debt-restructuring processes.

Administratively and technically, the IMF and the Paris Club are also running the CF. The Paris Club is the CF's secretariat. The president of the Paris Club co-chairs the official creditor committee of debt-restructuring cases along with a representative from a non-Paris Club G20 creditor. The IMF does not directly get involved in the negotiations for restructuring the sovereign debt owed to other creditors. Nevertheless, the IMF has never denied its role as lead coordinator and technical advisor for debt-restructuring cases.

New challenges for debt restructuring

When pointing to the CF's failures, the small number of countries that have applied for debt relief under the CF have been frequently mentioned. Indeed, up until now, only four countries have been serviced by the CF. However, many reasons have contributed to the reluctance of countries to declare default and go through debt restructuring, including the slow speed of debt restructuring, insufficient debt relief, painful and ineffective IMF programs, hopes for better economic growth, and acquiring new financing at all costs.

One major new obstacle for insolvent sovereigns to announce default is the changing debt composition of emerging and frontier economies, dominated by rising shares of bond debt. Over the past decade and a half, more than 21 African countries have tapped the international capital market to float sovereign bonds.[9] With this development, the fear of credit-rating downgrades haunts policymakers constantly as increases in borrowing costs and risks of losing market access carry serious consequences.

The experiences of Ethiopia and Ghana were dire, as credit downgrades were fast and sweeping.[10] The countries would try their utmost to defend their market reputations and avoid default as much as possible, even when they had solvency problems. They would rather issue bonds with double-digit interest rates than announce default. The costs of debt default, including the subsequent loss of market access—which can run into a number of years—and higher borrowing costs, can cause serious collateral damage to an economy.[11] Therefore, debt-restructuring requests often come too late, normally when a debtor country has already lost access to capital markets for a year or two. This also explains why only 48 out of 73 DSSI-eligible countries have benefited from DSSI debt relief.

With the fast and significant shift from bank loans to bonds, coordination problems across private creditors have grown in importance. However, the participation of private creditors in debt restructuring at comparable terms with official creditors remains a challenge, as private creditors' participation is voluntary, and no supranational legal mechanism exists to compel their involvement. The Paris Club has no legal means to enforce this obligation, either.[12] Unlike the Brady Bonds episode, the CF has introduced neither carrots nor sticks to seduce or force the private sector to participate. Nor has the CF mobilized strong political and financial support, as the Heavily Indebted Poor Countries (HIPC) Initiative did. The DSSI was unable to secure the participation of any private creditors. So far, the CF has made some progress on this front. But the challenges are still very much there.

Reform of the international debt architecture is urgently needed

The widespread criticisms of the CF and the unprecedented current public debt levels of developing countries clearly show the strong desire for an effective international debt architecture. The current high concentration of countries facing unsustainable debt burdens in the African continent, the slower GDP (gross domestic product) growth, and the fact that debt-servicing costs have crowded out government expenditures on climate change, health, and education also call for urgent reform of the international debt restructuring mechanism.

The CF is a debt restructuring initiative introduced during a time of crisis without introducing mechanisms and policies to address the longstanding structural and systemic problems in undertaking timely, orderly, and fair debt workouts. Nor did it endeavor to design measures to cope with emerging new challenges owing to changing creditor structures and complex new debt instruments. Even though some progress has been made in improving its efficiency, it is far from being an effective mechanism. Therefore, well-thought-out reform of the international debt architecture, including the CF, is required to face the burning challenges of debt vulnerabilities in developing countries.

The 4th International Conference on Financing for Development under the auspices of the United Nations, to be held in Spain in 2025, will be a good opportunity to negotiate and introduce fundamental reforms of the international financial architecture, including the debt architecture.

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