# G20’s Turn to Lead on Debt Relief for a Global Recovery

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The G20 measures in 2020 to support low income countries (LICs) facing unsustainable debt burdens were intended to give nations the space to **mitigate consequences of the virus and rebuild their economies in a manner consistent with development and climate goals**. It has now become acutely apparent that such efforts were incomplete and inadequate. It is paramount that the G20 build on past work on debt relief and supplement it with new thinking and financing. Now that a significant increase in the allocation of Special Drawing Rights was endorsed last week, the G20 needs to build on its debt relief schemes to bring all countries in debt distress and all creditors to the table and to ensure that the recovery is aligned with the world’s broader development and climate goals.

Before COVID-19 started to spread across the world the International Monetary Fund (IMF) had already warned that global debt for both the public and private sectors had reached $188 trillion and that two-fifths of low-income countries were at high risk of, or already in, debt distress. One year later, global debt levels are now $270 trillion and projected to rise; emerging market and developing country debt is upwards of 180 percent of GDP and eight countries have already defaulted. A **debt crisis is unfolding** as the world needs to mobilize an additional 2.2 percent of GDP in resources to meet our climate and development goals.

In the early months of the COVID-19 crisis in 2020, the G20 created a ‘Debt Service Suspension Initiative’ (DSSI) to suspend bilateral official debt payments for six months. **It was soon realized that such an effort was not enough** and the DSSI was extended for six months and complemented with the ‘Common Framework for Debt Treatments Beyond the DSSI’. The ‘Framework’ would grant deeper debt relief and potentially cancellation of bilateral official debt for DSSI countries that are deemed to have unsustainable debts. Last week, the DSSI was further extended until the end of 2021 by the Finance Track under the Italian G20 presidency.

Economic circumstances and poor design have proven the Common Framework to be inadequate as well for at least three reasons. First, like the DSSI, the Framework only pertains to LICs. These nations need relief for sure but **middle-income countries hold the most debt and have been hardest hit by the crisis**. A new UN study estimates that up to 72 countries could experience debt distress moving forward, and 23 of those countries would not currently be eligible for the DSSI. Of the 124 million pushed into extreme poverty in 2020, the World Bank reckons that 8 of 10 were in middle income countries.

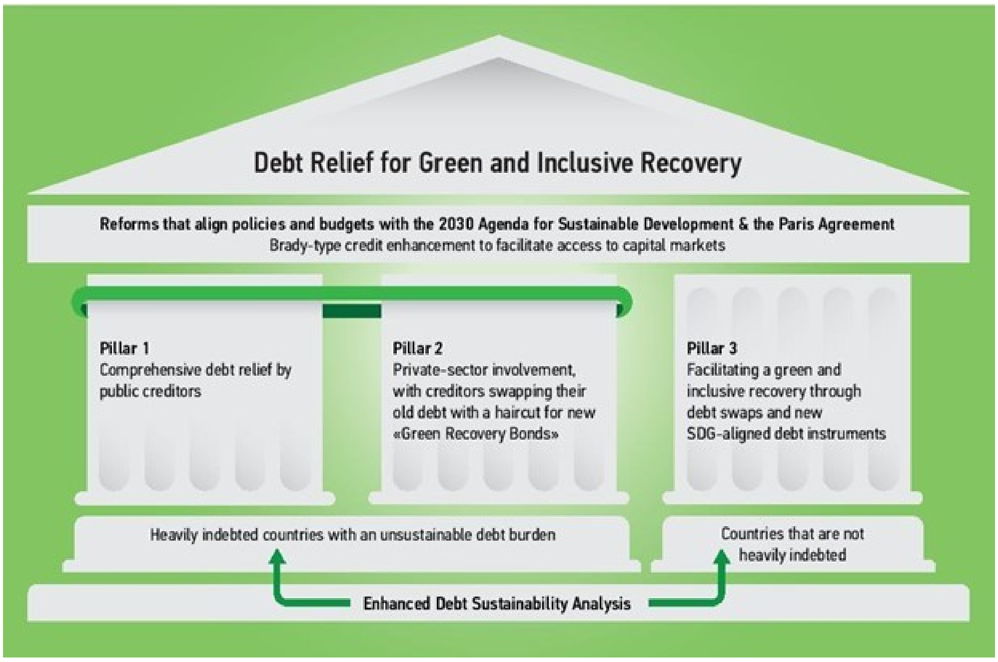
Second, the scheme only pertains to **bilateral official debt, which is only about one-third of the debt burden of emerging market and developing countries**. Of equal magnitude are debts to the private sector and to international institutions such as the World Bank but there is no compulsory participation by these actors.

Third, there is a **lack of incentive to participate due to the fact that credit rating agencies deem participation as a partial default** and thus subsequent credit downgrades could cut off participating countries from credit markets. Indeed, Ethiopia, who along with Chad and Zambia were quick to apply for debt relief under the framework, was downgraded by all three major credit rating agencies for their participation in the framework.

Finally, the **G20 schemes are not linked to inclusive development and climate outcomes**, despite the rhetoric to 'build back better' in a manner that aligns future growth with our global ambitions.

In late 2020 we proposed a more comprehensive debt **relief effort that included all creditors and all countries that face insolvency**. Furthermore, the plan links relief with a green and inclusive recovery. Early in 2021 this approach was endorsed in a letter by 23 former finance ministers and central bank governors.

As shown in the accompanying figure, our proposal has three pillars. The first pillar is **comprehensive debt relief for eligible heavily indebted countries by public creditors** in a manner analogous to, but improving upon, the HIPC Initiative. To safeguard the preferred creditor status of multilateral institutions, their losses could be financed by proceeds from gold sales.




The second pillar is a combination of carrots and sticks that result in compulsory **involvement of private creditors to restructure debt** of heavily indebted countries that receive debt relief from public creditors under pillar one. As a carrot, the plan would include **credit-enhancement instruments through Brady-bond like guarantees**. In exchange, borrowers would commit to dedicate receipts to SDG-aligned spending items or policy commitments such as shifting fossil fuel subsidies toward clean energy and adjustment assistance to ensure that those workers, entrepreneurs, and communities in the fossil fuel sectors are not left behind. Indeed, the IMF's October 2020 World Economic Outlook shows that the world economy would lead to a global recovery in 2021 to 2023 that is close to 2 percentage points of GDP higher if government spending was shifted to green activities than if we used fiscal space to go back to our old ways.

**Of course, a big stick is the threat that private creditors will eventually have to take an even larger haircut than if they acted now. The IMF, United States and the UK can trigger actions to bring the private sector to the table. With support of the G20,** the IMF could condition **that new programs for** heavily **indebted countries be coupled with the restructuring of private**

**sector debt. Moreover,** the United States could issue an executive order to limit the ability of private creditors from holding out on debt restructuring and the UK could re-activate similar measures it had during the HIPC era. Tax incentives could be timed to encourage such private debt relief.

In the third pillar, countries not heavily indebted that have high climate change and development ambitions facing fiscal squeeze under the crisis would be eligible to **swap old debt for new SDG- and climate-aligned debt** with similar credit enhancement schemes as in pillar 2.

The **April 2021 IMF World Economic Outlook warns** that 'divergent recoveries' characterized by large stimulus packages and monetary relief, a faster vaccine roll-out, and the potential of rising interest rates in developed economies is starting to **lead to another bout of capital flight from, and lower private inflows to, emerging market and developing countries**. Associated depreciation in currencies will only balloon already alarming debt levels. Such a scenario will come at a great cost in terms of human suffering and a derailment of our sustainable development goals. It will also put a drag on global growth as more than half the world economy now lies in the developing world. It is time for the G20 to take another step forward on debt relief toward a green and inclusive recovery.