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G20 DEBT-RELIEF INITIATIVES FOR LOW-INCOME
COUNTRIES DURING THE PANDEMIC

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ABSTRACT

The serious economic impact deriving from the COVID-19 pandemic on already ailing low-income countries has prompted the search for support instruments among the international financial community. The official debt moratorium agreed by the G20 for these countries in the spring of 2020 has brought a modest temporary relief to their public finances. However, the agreements reached among official creditors could facilitate consensus on farther-reaching initiatives for the resolution of debt problems in the international sphere. In this connection, the fact that an agreement has been reached by the G20 on a “common framework for debt treatments” is an important precedent for coordination among official creditors. This article puts the debt-relief measures agreed and the challenges associated with their application into context. Their implementation and effectiveness will depend on the degree of coordination achieved in practice by creditor countries.

Keywords: Sovereign debt restructuring, DSSI, Common Framework.

JEL classification: F02, F33, F34, F35.

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Introduction

The official debt standstill for low-income countries agreed in the spring of 2020 by the G20, known as the Debt Service Suspension Initiative (DSSI), has only provided limited temporary relief to the public finances of these countries. However, it is a notable precedent for a durable reform of the international architecture for the resolution of debt problems.

In particular, the extension of the standstill until end-2021 and, above all, the agreement reached by the G20 on the so-called Common Framework for Debt Treatments Beyond the DSSI are important precedents for coordination among official creditors. China's participation in this agreement arouses expectations of a future simplification of the sovereign debt restructuring framework, given that it is the main bilateral creditor of many low-income countries. This article presents an overview of the DSSI and explains the reasons behind its transformation into a "common framework" for debt restructuring.

Background and nature of the initially approved moratorium

In view of the potential damage inflicted by the pandemic on the economy of the world's poorest countries, in April 2020 the G20, at the request of the International Monetary Fund (IMF) and the World Bank, resolved to launch an initiative (the DSSI) to provide temporary bilateral external debt relief to these countries. The initial aim was to swiftly expand their fiscal space and thus strengthen their social and health care capacity. The financial nature of the DSSI was that of an official debt-service moratorium (repayments, interest due and arrears) for debts payable between May and December 2020. The deferral of payments could not exceed four years (including a one-year grace period) and the resulting restructuring had to preserve the net present value of the debt.¹

The scant fiscal capacity and fiscal space in many low-income countries was a source of concern in the international financial community prior to the outbreak of

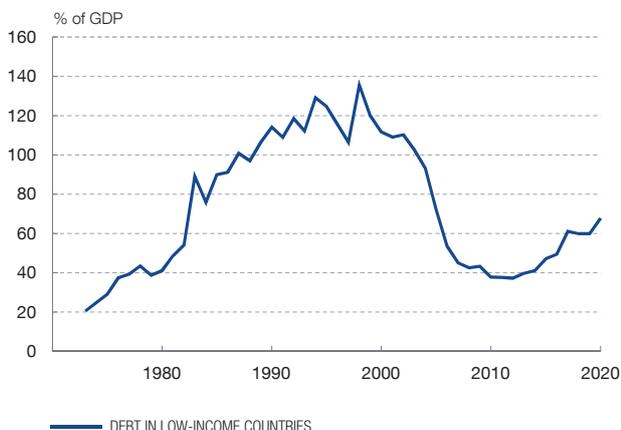
¹ IMF-World Bank (2020).

Chart 1

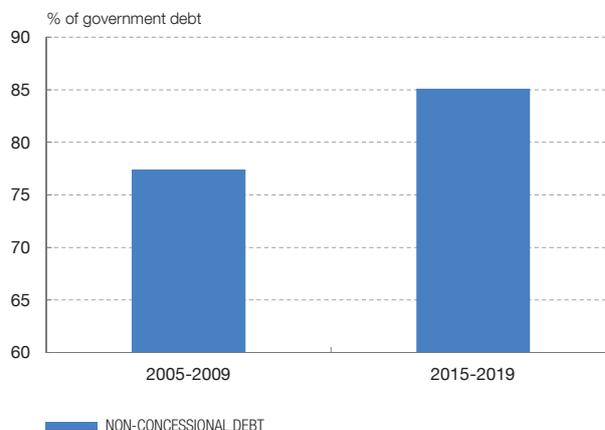
THE DEBT OF LOW-INCOME COUNTRIES WAS ALREADY RISING BEFORE THE PANDEMIC

Since 2010, overborrowing has led to a significant increase in debt, including non-concessional debt, in low-income countries, following the debt relief initiatives of the early 2000s.

1 GOVERNMENT DEBT IN LOW-INCOME COUNTRIES (a)



2 NON-CONCESSIONAL DEBT IN EMERGING MARKET ECONOMIES AND LOW-INCOME COUNTRIES (b)



SOURCES: World Bank and IMF.

a Three-year moving average.

b Non-concessional debt relates to loans not extended on terms substantially more generous than market loans, according to OECD Development Assistance Committee standards. Based on a sample of 120 emerging market economies and low-income countries.



COVID-19. Many of these countries had benefited from significant debt relief over the course of the 2000s under the Highly Indebted Poor Countries (HIPC) initiative.² However, a subsequent rapid process of debt accumulation³ (see Chart 1), whose various drivers are beyond the scope of this article, led these countries to face the pandemic with high debt sustainability⁴ risk profiles (see Chart 2).

The uncertain conditions under which the standstill was agreed at the start of the pandemic led to the proposal of widespread liquidity relief for all of these countries. The need to have more information and to design accurate instruments to address hidden or latent solvency problems implicitly resulted in the initial DSSI only being the first stage of an evolving assistance programme. Also, the fact that it was impossible to involve private creditors in debt relief in a formal and agile manner from the start explains why only debts with official creditors were eligible to benefit from the moratorium. The frequent invitations extended to private creditors to participate were ultimately unsuccessful, reinforcing the arguments in favour of improving the original initiative. For their part, multilateral development banks resolved to provide up to \$75 billion of financing to DSSI eligible countries. However, they did not

2 IMF Policy Paper (2019) and Serra Stecher (2018).

3 For a recent review of debt accumulation processes, see Kose, et al. (2021).

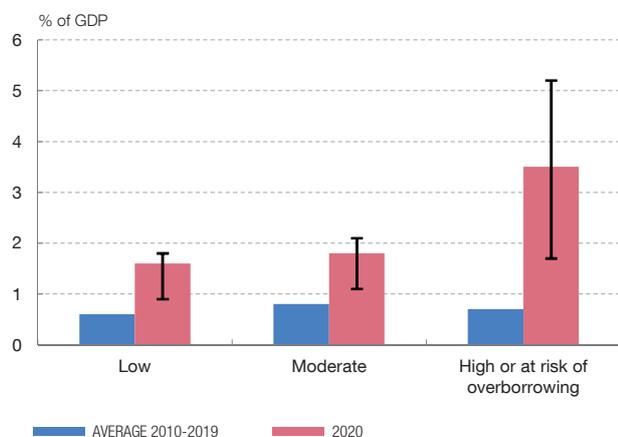
4 IMF (2020).

Chart 2

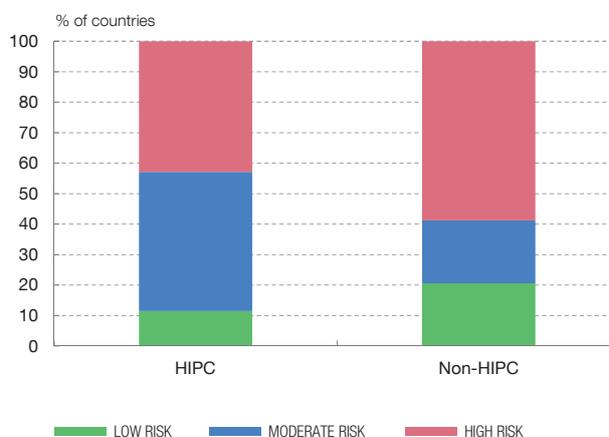
INDICATORS SIGNALLING THE RISK OF OVER-INDEBTEDNESS

Debt service exceeds the historical averages and the percentage of countries at risk of over-indebtedness is very significant.

1 DEBT SERVICE IN LOW-INCOME COUNTRIES BASED ON DEBT LEVEL (a)



2 RISK OF OVER-INDEBTEDNESS IN SELECTED COUNTRIES (b)



SOURCES: IMF and World Bank.

- a The aggregates represent sovereign debt interest and principal maturing in 2020 and 2021 as a percentage of GDP in 2019.
- b HIPC = Heavily Indebted Poor Countries, as defined by the IMF (2020). Non-HIPC = Heavily indebted poor countries not participating in the HIPC initiative. The list can be consulted at <https://data.worldbank.org/country/XE>. The graph is based on a sample of 69 economies for which data were available, as at 30 September 2020. Unsustainability risk is calculated on the basis of the IMF-World Bank debt sustainability framework for low-income countries, which are classified as low-risk, medium-risk, high-risk or in a situation of stress based on debt burden indicators, scenarios and projections.

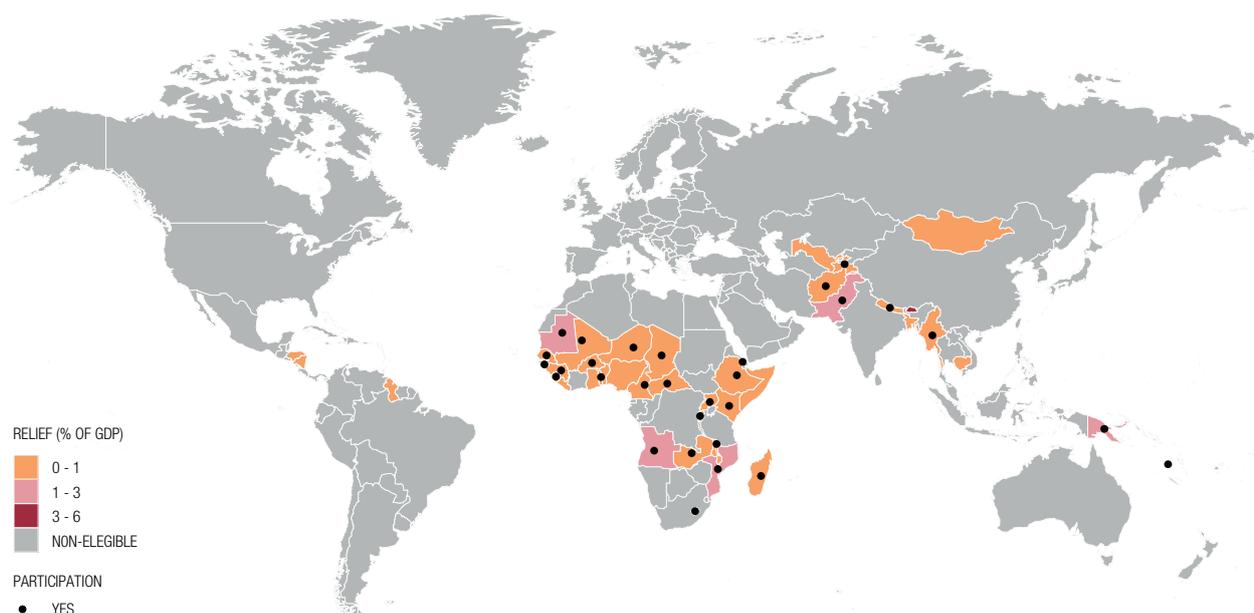


participate in the standstill, since that might have put their credit ratings at risk, and would have raised financing costs.⁵ Consequently, DSSI eligible debt was mainly G20 and Paris Club countries⁶ bilateral or publicly guaranteed debt with eligible countries.

Thus, 73 countries were selected as eligible for the DSSI. The eligibility criteria basically comprised their level of income, based on the threshold set by the International Development Agency (IDA). The only country included in the list whose income level exceeded this threshold was Angola, as it falls in the UN's least developed countries category.⁷ From a geographical standpoint, half of the eligible countries are African (see Chart 3).⁸

- 5 See the public letter sent by the heads of the main multilateral development banks: "Protecting the Poorest Countries: Role of the Multilateral Development Banks in Times of Crisis - Explanatory Note", 7 July 2020.
- 6 In addition to the United Arab Emirates (UAE) and Kuwait.
- 7 The IDA establishes a poverty threshold equivalent to a GNI per capita of less than €1,035 per year in fiscal 2020. Other countries also belonging to this group, such as Eritrea, Sudan, Syria and Zimbabwe, were excluded from the list owing to arrears with the IMF or the World Bank.
- 8 The complete list of these countries can be found in IMF-World Bank (2020). 40% of the 73 countries are fragile or small states according to the IMF's definition. The list also includes eight Central American countries and Caribbean islands, 24 Asian countries and two Middle Eastern and North African countries.

Chart 3

DSSI. MAXIMUM TEMPORALY RELIEF AND PARTICIPATION (2020)

SOURCE: World Bank.

Owing to the urgency of the measure, participation in the moratorium was conceived as an exercisable right at the request of the interested countries and subject to limited conditionality. Specifically, some of the main moratorium eligibility requirements for beneficiary countries are: (1) applying to the IMF (which does not necessarily entail approval) for emergency assistance with no conditionality, or being previously included in an IMF programme; (2) undertaking to use the funds released to cover economic, health or social needs deriving from the pandemic; and (3) undertaking to publish detailed data on the country's debt to facilitate the reconciliation of figures between debtors and creditors.

International financial institutions were to play an important role in supervising the standstill. Specifically, the IMF and the World Bank were to deploy an oversight mechanism to ensure that the funds released would be earmarked for healthcare expenditure. They were also to monitor that eligible countries kept their commitments to not take on non-concessional debt while the initiative was under way, in line with the debt limits policy of the IMF and the World Bank. Finally, the IMF supplemented this debt relief by granting emergency assistance to around 50 low-income countries and by providing relief to 28 low-income countries for debt service owed to the IMF under the Catastrophe Containment and Relief Trust (CCRT), which is funded by other countries' contributions or donations.⁹

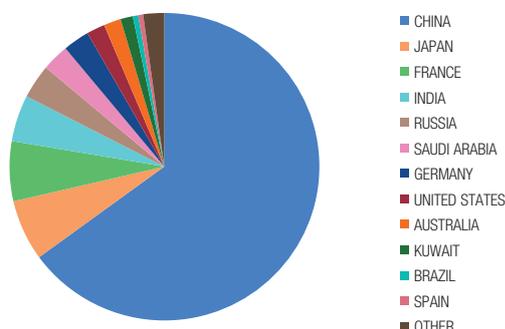
⁹ <https://www.imf.org/en/News/Articles/2021/04/05/pr2199-imf-executive-board-extends-debt-service-relief-28-eligible-lics-october-15-2021>.

Chart 4

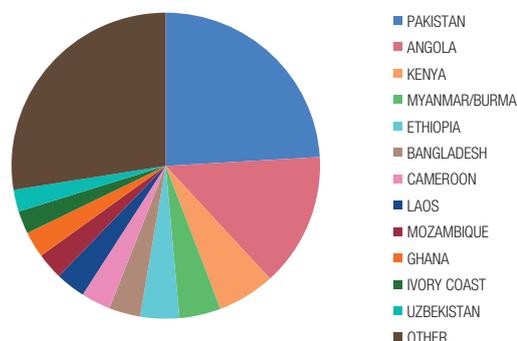
CHINA IS THE MAIN OFFICIAL CREDITOR OF DSSI ELIGIBLE COUNTRIES

The 73 debtor countries are more fragmented, although the debts of Pakistan and Angola stand out in terms of size.

1 MAIN OFFICIAL CREDITORS (a)



2 DSSI ELIGIBLE DEBTOR COUNTRIES (b)



SOURCE: World Bank.

- a Relative exposure of each G20 and Paris Club country to the total debt of DSSI eligible countries.
- b Participation of each country in the total debt of DSSI eligible countries.



Implementation and bifurcation of debt relief

Although the DSSI beneficiary countries have not received differential treatment according to their economic situation, the implementation of the initiative has evidenced the significance of the underlying heterogeneity among these countries. Thus, the balance of immediate benefits and potential costs perceived on the basis of the differing level of sovereign risk, access to international funding markets and the composition of the main creditors (public/private/multilateral) has resulted in only 44 of the 73 eligible countries having decided to participate (see participation indicator in Chart 3). Thus, compared with a potential aggregate (temporary) “saving” of approximately \$12 billion offered by official creditors, according to World Bank estimates, only slightly over \$5 billion of debt relief had materialised at end-2020. Most of this was provided by China, in proportion to the relative magnitude of its bilateral exposure to these countries (see Chart 4).

Analysis of the cases of refusal to participate reveals that a closely related variable was the fear of financial market stigma (as experienced initially by certain countries with greater bond issuance, such as Kenya).¹⁰ In many other cases, failure to participate was linked to the minor benefits of the relief owing to modest debt service amounts in the period concerned (Chart 3 shows the magnitude of potential relief,

10 However, Lang, Mihalyi, and Presbitero (2020) show preliminary evidence of positive effects on the prices of DSSI eligible countries’ sovereign bonds vis-à-vis those issued by non-eligible countries, which they attribute to a liquidity channel, although they note that the result would have been uncertain had the DSSI also been applied to private creditors.

ranging between around 0.1% and -0.3%, in approximately 30 countries). The absence of significant conditionality for participating in the moratorium appeared to minimise any possible stigma effect, a frequent deterrent in IMF adjustment programmes. Also, credit rating agencies expressly rule out requests for debt relief from official creditors as a negative criterion for their rating actions. However, the G20's call on private creditors to contribute to debt relief may have increased the potential costs arising from the risk of losing market access compared with the relatively low effective benefits.¹¹

Similarly, the fact that the debt relief was designed without costs in terms of net present value for creditors also seemed to prompt their voluntary involvement. However, one of the arguments raised by private creditors for not participating in this initiative was the possibility that the support could entail the implicit assumption of some kind of future restructuring.

The adaptation of the G20 standstill beyond end-2020 was, therefore, implicit in the initial response to the pandemic. This flexibility was designed to help address the initial problems of lack of information and heterogeneity in the situation of debtor countries, either through the extension of temporary liquidity relief to those better placed, or through a more substantive treatment of debt for those with solvency problems. This adaptation was also intended to help resolve the problem of an uneven distribution of the debt relief burden between official and private creditors that arose in the initial DSSI phase.

The final work under the Saudi Arabian G20 presidency concluded with the “bifurcation” of the initial DSSI. This entailed, on one hand, a six-month extension¹² of the official debt service deferral for countries that had applied for it and, on the other, the implementation of a “common framework” for restructuring the sovereign debt of countries with deeper debt problems. At the end of the IMF spring meetings in April, 37 countries had requested the DSSI extension until June. At the same time, the G20 agreed on a last further extension of the DSSI until December. The first countries to request debt treatment under the “common framework” were Chad, Ethiopia and Zambia.

The “common framework” for debt restructuring

The new “common framework” is potentially significant for two different, albeit very closely related, reasons. The nexus between them is the use of the Paris Club's methods and procedures. The Paris Club is a group of creditor countries in the orbit

11 Moody's placed five countries (Ethiopia, Pakistan, Cameroon, Senegal and Ivory Coast) on negative outlook between May and June 2020 following their request for moratorium to the G20.

12 A debt deferral extension from four to five years, with a one-year grace period, had previously been agreed.

of the OECD that coordinate their debt relief policies to address liquidity or solvency problems (through debt rescheduling or reduction, as appropriate). This group applies principles such as solidarity, conditionality, treatment on a case-by-case basis or comparability of treatment, which have proved to be fruitful in the more than 50 years of its existence.¹³ Ideally, the pass-through of these principles to the “common framework” context should have an impact both during the current crisis for the DSSI eligible countries, and, more broadly over the long term, if they are finally incorporated into the international financial architecture.

As regards the first reason, against the current backdrop, applying the Paris Club’s comparability of treatment principle would entail private creditors assuming a portion of the burden from the debt treatment that is at least equal to that assumed by the official creditors. While its pass-through to the “common framework” is far from automatic, the strength of the procedures governing the international financial architecture, with the IMF at its apex, ideally provides some guarantees of compliance that the DSSI could not. Specifically, treatment of debt under the “common framework” must be anchored to an IMF programme and a debt sustainability analysis, on which both the necessary restructuring and the financing of the programme depend.

The second reason for the importance attached to the “common framework” is more structural. If the ad hoc application of the Paris Club’s principles is successful, the “common framework” may in practice result in an expansion of the club’s members. Coordination between permanent members and some ad hoc participants, especially China, has been a long-desired goal to strengthen the international debt resolution framework. China’s high relative sway as an official creditor of many low-income countries may always place constraints on the possibility of reaching a broad consensus and, in the absence of such consensus, on the application of the Paris Club’s methods. Indeed, implementation of the first phase of the DSSI brought into relief the curtailing effect of the lack of consensus in certain situations, such as the classification of a development bank’s business as “official” or “commercial” for the purposes of determining whether or not it is required to participate in the debt relief.

In short, the “common framework” emerges as a G20 instrument to afford specific and coordinated treatment to delicate debt situations. Unlike the moratorium, applying this instrument requires a case-by-case analysis that should ultimately result in an IMF programme. Compared with the blanket relief inherent in the DSSI, the advantages of this approach have led the G20 to opt for channelling any debt treatment exclusively through this “common framework” from 2022, irrespective of whether it is liquidity or solvency relief that is provided. In practice, the success of this framework will hinge on the general principles applied providing the debt

13 Pérez de Eulate (2012).

transparency and confidence in its actions that have traditionally underpinned the Paris Club's resilience.

In particular, the success of the “common framework” will depend on its ability to provide without delay the debt relief required for the situation facing each distressed country. In this connection, the G20 agreement establishing this framework expressed a preference for debt rescheduling over notable debt reductions, although it does not rule the latter out. Consequently, the involvement of private creditors would not only be unavoidable, but also more quantitatively demanding and, as a result, potentially more complex. As usual, the ratings agencies will face the uncertainty of interpreting each treatment in their private assessments.¹⁴ In short, the effectiveness of the “common framework” in the near term and its long-term survival will depend on how much it helps reconcile relief and burden-sharing goals via leadership and trust mechanisms.

The end of the DSSI at end-2021, after which case-by-case treatment must be applied, will foreseeably put creditor cohesion to the test. Such treatment tends to result in greater differences in criteria among creditors vis-à-vis burden-sharing where debt reductions are required. Overcoming this test of trust would mean China ultimately becoming, in practice, a member of the Paris Club. However, an alternative scenario, in which creditor cohesion is not solidified or in which debtors refuse to use the “common framework”, may see it dissolve over time. Specifically, the provision of new financial resources at the international level, such as the allocation of special drawing rights announced at the IMF spring meetings, will very likely temper the urgency to use the “common framework” if they are preferentially used to service debt.

Conclusions

Despite the DSSI's modest quantitative results and the uncertainty surrounding the level of success of the “common framework” initiative for debt restructuring, the G20's role in boosting it is unquestionable. Indeed, the G20's response to the COVID-19 crisis is grounds for some hope that multilateral coordination in sovereign debt resolution will improve.

The deployment of the “common framework” will test creditor cohesion, especially from 2022 onwards, when the DSSI moratorium serving as the starting point for the G20's relief measures ceases to be effective. Nevertheless, the first debt restructurings for the most vulnerable countries are expected in 2021, although the allocation of special drawing rights may temper the pace of, and interest in, implementation of this new instrument.

¹⁴ Most of the countries eligible for the DSSI do not have a sovereign rating. Six of the 23 countries that have issued bonds on the market account for 70% of the issues: Pakistan, Kenya, Nigeria, Angola, Ghana and Ivory Coast.

The will to build a consensus on the “common framework” is justified. But cohesion among official creditors, including China, should not be allowed to prevail over the multilateral debt resolution principles that have so far proven key. Further, a consistent application of these principles would prompt the extension of this framework to over-indebted middle-income countries, as advocated by the European Union Member States.

16.6.2021.

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