Addressing the Global Debt Crisis

Briefing for G20 Finance Ministers, September 2024 (updated December 2024)

Oxfam welcomes the G20's attention to the sovereign debt crisis in the Global South, [1] but warns about the risks involved in the G20's approach to resolve it, outlined in more details in the *IMF and World Bank Non-Paper on Actions to Support Countries Faced With Liquidity Challenges*.[2]

We strongly support the approach's aim to significantly increase the net flow of resources to the Global South to back ambitious, country-owned national development and climate strategies. We urge the G20 to adopt several elements of the plan, including increasing bilateral grants, reviewing relevant IMF policies, increasing IMF and multilateral development banks' resources including but not limited to a generous IDA21 replenishment, and redoubling efforts to promote effective and equitable domestic resources mobilization.

We are nevertheless concerned that a critical element is missing in the approach: substantial debt cancellation. Many low-income countries face more than a short-term liquidity crisis. Excessive and sustained debt service forces austerity, exacerbates inequality, and prevents progress on the Sustainable Development Goals. Low-income countries spend more on debt service than on education, health care, and social protection combined.[3] In this context, the plan's approach of doubling down on multilateral lending while incentivizing bilateral and private creditors to maintain positive net debt flows (e.g., by voluntarily rolling over their loans) is very risky for both debtors and creditors. Many things can go wrong. The debt overhang will continue to drag growth prospects. Continued adverse global economic conditions, natural disasters, or ongoing governance weaknesses in debtor countries themselves could hinder economic growth despite the fresh investments. The proposed incentives for bilateral and private creditors to roll over their loans are weak. The plan is politically fraught and operationally complex. There is a high risk that it results in another lost decade of development for low-income countries and in official creditors' taxpayers bailing out private creditors.

Oxfam recommends offering sufficient debt cancellation to low-income countries to bring them down to a moderate risk of debt distress with substantial space to absorb shocks. In the long run, further reforms to the international debt architecture will be needed to prevent repeated cycles of excessive borrowing followed by debt cancellation.

Low-income countries face more than short-term liquidity challenges

The approach is adequate for countries facing financing challenges due to near-term liquidity stress despite their overall debt being sustainable. According to the IMF and World Bank's own analysis, however, very few low-income countries fit that diagnosis: see table below. Only four countries (Comoros, Ethiopia, The Gambia, Tajikistan) subject to the Debt Sustainability Framework for Low-Income Countries (LIC-DSF) breach a liquidity threshold for "high-risk of debt distress" in the medium-term (2025-2029) without also either breaching a solvency threshold or breaching a liquidity threshold in the long term (in 2030 or beyond). When analyzing all low- and middle-income countries for which data is available and including domestic debt service in the analysis, Development Finance International concludes that only two countries fit the diagnosis: Tajikistan and Uzbekistan.[4]

Number of countries breaching IMF/WB thresholds for "high risk of debt distress"

	2020-24	2025+	2025-29	2030+	Never
Liquidity breach	25	21	19	11	39
Solvency breach	26	26	19	18	35
Either	29	33	25	23	30

Source: Oxfam compilation based on https://www.worldbank.org/en/programs/debt-toolkit/dsa
Notes: The table covers the 67 countries subject to the LIC-DSF for which data is available. The solvency row includes both the external and total (external plus domestic) public debt stock indicators (debt stock-to-GDP and debt stock-to-exports ratios). Any country breaching the high-risk threshold for at least one of these indicators in at least one year in the relevant period is counted once. For liquidity, only external debt is included (debt service-to-revenue and debt service-to-exports ratios) because the LIC-DSF does not have thresholds for total debt flow indicators. For some countries, the latest debt sustainability analysis is several years old and projects a high risk of debt distress during a period that is now past (2020-24). Ghana and Zambia are counted only in that period because they have recently received debt relief, such that they will presumably no longer be at high risk in 2025.

We understand that being rated at high risk of debt distress does not necessarily mean that debt is unsustainable. Debt is sustainable for as long as the debtor government and the IMF jointly decide that it is. An investment push by multilateral lenders will allow the IMF to declare debt sustainable in the medium term. But it will deteriorate debt sustainability indicators in the long term. At the end of the day, when the IMF and World Bank rate countries at high risk of debt distress, it is imprudent for all creditors to lend to them, including for multilateral lenders.

The approach offers only weak incentives to bilateral and private creditors

The incentives offered for all creditors to maintain positive net debt flows are weak in the face of mounting debt:

a. *Strengthening the IMF's lending into official arrears policy:* It is welcome, but is only triggered when debtors default. While the shadow of default may increase some bilateral creditors' willingness to voluntarily reschedule their debt, it is unlikely to restore sustained positive debt flows.

b. *Guarantees:* They are tantamount to bailing out the private sector much like giving grants or concessional loans to debtors in the context of negative debt flows from private creditors, which is what the approach seeks to prevent. They are also unsustainable for the many countries that face a protracted debt overhang.

c. *Debt swaps and voluntary present value-neutral reschedulings:* They are useful in some specific circumstances, but not indicated as a tool to return to sustainability.[5] Moreover, the issue of credit rating downgrade that discouraged debtors to seek the private sector's participation in the Debt Service Suspension Initiative has not been resolved.

Oxfam is therefore sceptical that all bilateral and private creditors will reinforce the approach, which will result in multilateral funding bailing out private creditors that have already made profits on their loans, and in taxpayers ultimately footing the bill when multilateral creditors eventually realize that they won't be repaid by countries crushed by debt.

The approach is operationally challenging and politically fraught

The approach represents a new, untested solution involving the coordinated deployment of several complex tools like guarantees and debt swaps. Just as the Common Framework has taken a long time to produce results and still requires improvements, so can this approach. The voluntary approach is likely to make the free rider problem faced by a diverse set of creditors even more problematic than it has proved to be in the Common Framework.

The principle of comparability of treatment of creditors has been the main stumbling block of the Common Framework. While agreements were reached in recent debt restructuring cases, it remains contentious. This approach resets the goal posts with an entirely new yardstick: all creditor classes must keep positive net flows. Paris Club creditors are off the hook as they already provide positive net flows (in part thanks to grants, which is great). The entire debt relief is then expected to come from non-Paris Club and private creditors. They are expected to roll over their loans to countries rated at high risk of debt distress while some bilateral and multilateral creditors have policies that prevent them from lending to such countries because it is too risky.

Resolving the debt crisis requires substantial debt cancellation

The missing element is debt cancellation. It creates a clean slate from which countries can grow. The academic literature indicates that debt cancellation is superior to debt rescheduling in terms of resuming economic growth.[6]

While debt cancellation costs taxpayer money for creditor countries, the G20 approach is to increase the net resources flow to the Global South and part of that can take the form of debt cancellation instead of fresh loans. Cancelling debt service payments is economically equivalent to direct budget aid, and can also be tied to a national development and climate plan.

The advantage of debt cancellation is that enforcement of the comparability of treatment policy can ensure that all creditors participate in the effort. Debt service is stopped during the default period, and reduced afterwards. While private and some bilateral creditors may be reluctant to resume lending afterwards, they don't lend much now anyway, or only at prohibitive interest rates. Experience shows that countries do eventually regain access to private capital markets after debt cancellation, in part thanks to their lower debt stock.

Recommendations

- Donors must increase their grants, support domestic resources mobilization, and reform multilateral development banks to make them more accountable, including by strengthening the IMF's social spending floor policy,[7] ending IMF surcharges, and increasing representation of low- and middle-income countries in their governance.
- The G20 must continue to improve the Common Framework.[8]
- Official creditors must offer substantial debt cancellation to low-income countries to support solid national development and climate plans, sufficient to bring them down to a moderate risk of debt distress with substantial space to absorb shocks, and enforce a similar effort from private creditors.
- The United Nations must launch negotiations of a Framework Convention on Sovereign Debt at the upcoming Financing for Development Conference to address the root causes of debt crises and provide a more balanced approach to debt restructurings.

[1] *"We recognize that market fluctuations, tight financial conditions, and debt vulnerabilities, among others, could be adding near-term pressure on strained public budgets amid increasing financing costs. We believe that country-specific solutions to development financing challenges could be based on combined policy measures that support growth, domestic resource mobilization, capacity building, private capital flows, and targeted concessional financing. In this context, we call on the international community to make efforts to support vulnerable countries facing near-term liquidity challenges whose debt is sustainable. We encourage the IMF and World Bank to continue their work related to feasible options which are country-specific and on a voluntary basis to help those countries and report back to G20 Finance Ministers next year."* Extract from G20 Rio de Janeiro Leaders' Declaration (18 November 2024). https://www.gov.br/planalto/pt-br/media/18-11-2024-declaracao-de-lideres-g20.pdf

[2] International Monetary Fund and World Bank (October 2024) "IMF and World Bank Non-Paper on Actions to Support Countries Faced With Liquidity Challenges". https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099806310222417124/idu1ea1a97dd1cbab141f6187571875332942668

The US and French government circulated a plan *Pathway to Sustainable Growth* in the same vein in the Summer 2024.

Another version of this idea was disseminated by Development Finance Lab, a think tank, earlier in the year: Diwan, Ishac, Martin Guzman, Martin Kessler, Vera Songwe, and Joseph Stiglitz (July 2024) "An Updated Bridge Proposal: Towards a Solution to the Current Sovereign Debt Crises and to Restore Growth", Finance for Development Lab. https://findevlab.org/news_and_event/the-bridge-proposal-a-solution-to-the-current-sovereign-debt-crises/

[3] Martin, Matthew and David Waddock (June 2024) "Resolving the Worst Ever Debt Crisis: Time for an Ambitious initiative?", Norwegian Church Aid.
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[4] Martin et al. (2024), Op.Cit.

[5] International Monetary Fund and World Bank (July 2024) "Debt for Development Swaps: An Approach Framework". https://www.imf.org/en/Publications/Policy-Papers/Issues/2024/08/05/Debt-for-Development-Swaps-An-Approach-Framework-553146

[6] Independent Evaluation Office (2021) "Growth and Adjustment in IMF-Supported Programs", International Monetary Fund. https://ieo.imf.org/en/our-work/Evaluations/Completed/2021-0909-growth-and-adjustment-in-imf-supported-programs
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[7] Oxfam (13 April 2023) "IMF Social Spending Floors" A fig leaf for austerity?". https://policy-practice.oxfam.org/resources/imf-social-spending-floors-a-fig-leaf-for-austerity-621495/

[8] Oxfam (2 April 2024) "Briefing on the Global Sovereign Debt Roundtable".
https://www.oxfam.org/en/research/briefing-global-sovereign-debt-roundtable