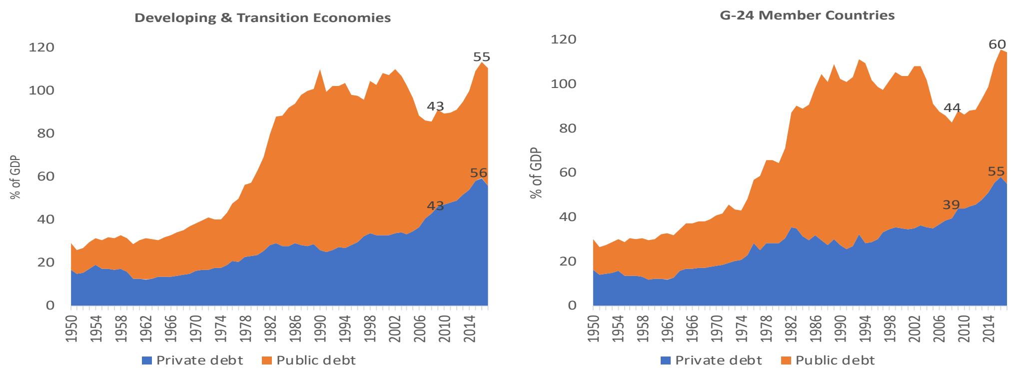
Statement by Dr. Mukhisa Kituyi, Secretary-General of UNCTAD
Provided to the G-24 Finance Ministers and Central Bank Governors' Meeting
Washington DC, 11 April 2019

THE UNFOLDING DEBT CRISIS IN THE DEVELOPING WORLD: RESPONDING TO URGENT CHALLENGES

The developing world is, yet again, in the thralls of a major debt crisis: warning bells have been rung repeatedly by UNCTAD, the IMF and the World Bank over recent years. As chart 1 below shows, levels of indebtedness are at an all-time high, on average, in all developing countries as well as in G-24 member countries.

Chart 1: Private and public debt, 1950-2016 (Percent of GDP)



Source: UNCTAD Secretariat calculations based on IMF Global Debt Database

A common denominator of rising debt vulnerabilities in the developing world is the growing exposure to high-risk international financial markets and complex debt instruments of their public and private sectors, in the context of unprecedented private credit creation over the past three decades, and a global economy running on debt. Other factors, such as growing incidence of natural and climate-change related disasters and volatile commodity prices, add to debt vulnerabilities in the countries affected. The evolving developing country debt crisis is therefore systemic in nature and affects countries in different income categories and with different structural features. From Argentina to Ghana, from Ecuador to Zimbabwe, from Haiti to the Democratic Republic of Congo, developing countries are experiencing debt default, distress or fast-growing financial vulnerabilities.

While improved debt transparency initiatives and international support for capacity-building in developing countries are necessary and welcome, the urgent and systemic nature of unfolding debt crises across the developing world demands additional measures to tackle existing or pending debt distress and sovereign defaults.

From a series of devastating recent hurricane seasons in the Caribbean to Cyclone Idai, which has wreaked destruction on Mozambique and neighbouring Malawi and Zimbabwe, many developing countries are now facing more predictable, frequent and intense natural disasters, almost certainly linked to a changing climate.

The immense human suffering in the immediate aftermath of such events often focuses attention on the need for quick relief and assistance to contain the damage – human and economic - and support reconstruction efforts, including through temporary relief from servicing debt out of limited resources. But such responses by the international community to natural disasters in poor developing countries are wearing thin as such events become almost routine. More importantly, such responses have usually not accounted for the longer-term economic and human consequences of the interplay between debt cycles and environmental devastation.

In the immediate aftermath of the earthquake that hit Haiti on 12 January 2010, UNCTAD, alongside other organisations, called for an immediate temporary debt moratorium on debt servicing, to be followed by debt cancellation as quickly as possible. In effect, on this occasion several of Haiti's bilateral creditors agreed to a temporary standstill of debt servicing, and the World Bank and Venezuela eventually waived remaining debt. But more far-reaching calls for a coordinated future approach to disaster management, including a global disaster fund, an automatic mechanism for extending a debt moratorium to countries hit by natural disasters and built-in insurance clauses for debt contracts to cover catastrophic risk, went largely unheeded.

Almost a decade later, the world remains as ill-prepared as ever to address the debt cycles of environmentally vulnerable developing countries effectively. Both Mozambique and Zimbabwe have complicated histories of external indebtedness. In Mozambique's case, some of its obligations in the form of publicly guaranteed loans to state-owned enterprises are subject to legal disputes. More generally, in the context of unchecked credit creation by private players over recent years, creditor composition and the risk profile of external debt instruments have become highly complex and less transparent.

At the same time, the international community has not provided adequate mechanisms that can tackle the secondary and tertiary effects of climate change-related shocks on debt sustainability in developing economies. As a 2010 UNCTAD study shows for 21 large natural disasters that struck low-income developing countries between 1980 and 2008, such large-scale shocks can add, on average, 24 percentage points to the debt-to-GDP ratio of affected countries in the three years that follow the event. If the event does not lead to a rapid increase in foreign aid, this figure can reach up to 43 percentage points. Poor and even middle-income developing countries hit by natural disasters still find themselves in a long-term debt trap. The use of public debt and renewed external borrowing to absorb the impact of a natural disaster leads to more burdensome debt servicing and constrains the capacity to invest in long-term climate change mitigation. With each new disaster, financial vulnerabilities grow, and domestic response capacities weaken.

At present, assistance from the international community relies on a combination of short-term aid, longer-term conditionalities of fiscal consolidation and preventative self-insurance schemes against catastrophic risk. This, however, is insufficient to address the systemic impact of recurrent and increasingly frequent climate change-related shocks on sustainable development.

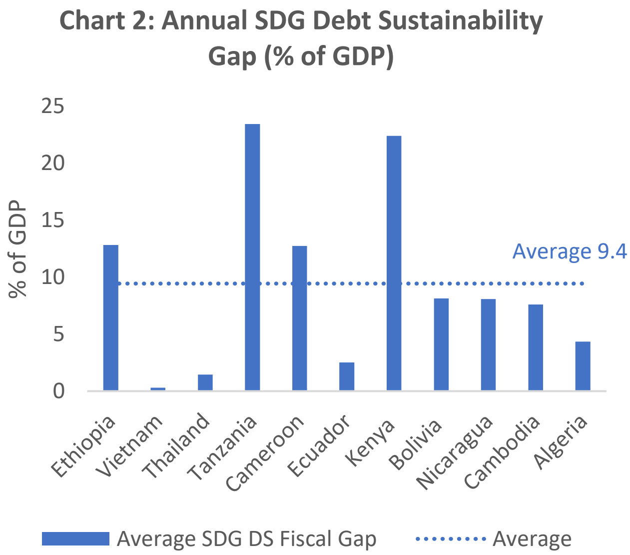
UNCTAD therefore renews its call for an integrated approach to disaster management to avoid recurrent debt crises. This should include the following elements:

- An immediate temporary debt moratorium for developing countries affected by a large-scale natural disaster. Given complex creditor compositions and debt instruments, this will require a concerted effort by multilateral agencies to bring all creditors to the table for this purpose.

- An automatic mechanism to extend a moratorium on debt servicing to safeguard government expenditure on essential social spending, such as health, education and sanitation.

- A global and well-endowed disaster fund that can provide predicable and stable emergency funding without strict policy conditionalities or limiting eligibility criteria, such as those adopted by the Green Climate Fund.

Not all exogenous shocks to developing country debt sustainability take the form of a natural disaster. Shocks propagating through the financialized international economy can be as detrimental to developing country debt sustainability as any hurricane. Many developing countries, including some G-24 members, have recently experienced growing debt and financial distress, arising from volatile and counter-cyclical private capital flows, frequent commodity price shocks, and the lack of reliable long-term development finance to face huge and growing development challenges, not least in view of investment requirements arising from Agenda 2030.



Source: UNCTAD Secretariat calculations based on national data and estimates of SDG investment requirements from various sources.

Chart 2 provides an estimate of additional resources required to achieve the Sustainable Development Goals (SDGs) and maintain long-term debt sustainability for selected developing countries. The country sample includes country groups with different baseline scenarios for the evolution of their public debt until 2030: For the first group (Ethiopia, Vietnam and Thailand), this is set to decrease by 2030 if current macroeconomic dynamics and conservative debt management strategies prevail. For the second group (Tanzania, Cameroon and Ecuador), public debt is estimated to experience a moderate increase of less than 10% of GDP, while for the third group (Kenya, Bolivia, Nicaragua, Cambodia, Algeria) this is expected to increase by more than 10% of GDP. As chart 2 shows, the average fiscal gap for all country categories, if both the SDGs and long-term debt sustainability is to be achieved, amounts to almost 10 percent of GDP.

Clearly, such financing needs cannot be met by improved debt management strategies and domestic resource mobilization alone. Without additional and upfront international support, in the form of increased official development assistance and a coordinated multilateral effort at providing low-cost long-term development finance, developing countries across different income categories face even more serious challenges to their debt sustainability than is already the case for a growing number.

While debt crisis prevention through increased availability of affordable long-term financing options is of paramount importance, resolving sovereign debt crises, when they do happen, in ways that facilitate speedy economic recovery and avoid financial crises in the aftermath of default, is equally urgent.

As is widely recognized, existing processes to deal with sovereign debt crises and their resolution are fragmented, slow and often result in unfair burden sharing and high economic, social and political costs for the sovereign debtor. Incentives, for debtors and creditors alike, are such that delaying any official declaration of insolvency as opposed to illiquidity is paramount: debtor states will be reluctant to declare themselves insolvent for fear of triggering a financial crisis at home. Cooperative creditors will also have an interest to avoid such havoc in order to preserve the market value of their assets. The collectively sub-optimal outcome is "too little, too late". But equally importantly, once sovereign debt restructurings do get under way, the debtor country has to negotiate separately with different types of creditors (bilateral, multilateral, private) for different types of debt contracts (bonds, loans, etc.). Different courts will have different interpretations of the same contractual clause and can impose a wide array of rulings.

UNCTAD has been an active advocate of orderly workout procedures for sovereign debt for decades. It is unfortunate that the political will of the international community to tackle this long-standing challenge is perhaps at its lowest today, at a time when growing debt distress in the developing world puts the implementation of Agenda 2030 in peril.

UNCTAD therefore calls upon the international community to renew efforts to facilitate sovereign debt restructurings and afford debt relief, where required, beyond the advent of natural disasters and in order to support the timely implementation of the Sustainable Development Goals more systematically. Such efforts need not require a fully-fledged regulatory framework for international bankruptcy procedures, but should meet two basic objectives: First, they should help prevent financial meltdown in countries facing difficulties servicing their external obligations. This frequently results in a loss of access to international capital markets, currency collapse and drastic interest rates hikes, inflicting serious damage on public and private balance sheets and leading to large losses in output and employment. Second, they should provide mechanisms to facilitate an equitable restructuring of debt that can no longer be serviced according to the original contract.

Multilateral efforts in this regard should focus on a few basic policies to meet these objectives, including:

- Temporary standstill provision for all debt, whether public or private, and regardless of whether the servicing difficulties are due to solvency or liquidity problems. In order to avoid conflicts of interest, the standstill should be decided unilaterally by the debtor country and sanctioned by an independent panel. Sanction should provide an automatic stay on creditor litigation.

- Standstills should be accompanied by exchange controls, including the suspension of convertibility for foreign currency deposits and other assets held by residents as well as non-residents.

- Provision should be made for debtor-in-possession financing, automatically granting seniority status to debt contracted after the imposition of the standstill.

- Debt restructuring including rollovers and write-offs should take place based on negotiations between the debtor and creditors and facilitated by the introduction of automatic rollover and collective action clauses in debt contracts.