Sovereign Debt: Emerging Issues and Challenges

G24 Webinar, 28 July 2020, 9:00 a.m.–10:30 p.m.

Moderator: Benu Schneider - Introductory remarks

As we are familiar with now, the debt cycle ended last year accompanied by debt distress in many developing countries. This was followed by the outbreak of the COVID-19 pandemic with wide ramifications for the global economy, including a worsening the debt situation in an even larger number of countries. The first international response to this crisis is commendable.

In April the G20 Finance Ministers endorsed the Debt Service Suspension Initiative (DSSI) to grant debt-service suspension on bi-lateral official debt to the poorest countries till the end of this year to help them manage the severe impact of the COVID-19 pandemic.

Since late March 2020, the IMF under its various lending facilities and debt service relief financed by the Catastrophe Containment and Relief Trust (CCRT) is currently making about $250 billion, a quarter of its $1 trillion lending capacity, available to member countries. Thus far total financial assistance for 77 countries amounted to nearly US $ 83 million. (22 July) And only yesterday, the IMF approved its largest emergency assistance of $ 4.3 billion loan to South Africa to combat the impact of the pandemic.

In March this year the drop in oil prices and the impact of the pandemic led to unprecedented debt and equity outflows from emerging markets of around $ 100 billion, much higher than outflows in the 2008 financial crisis. Central Banks in some major economies responded to the situation by making record amounts of liquidity available, such that emerging markets with good fundamentals have been able to access international capital markets averting imminent disaster.

Unfortunately the proposal to enhance SDRs at the IMF was met with resistance.

This first response has provided much needed breathing space. But is it enough? Today's panel is going to look at the emerging scenario and identify some of the challenges and options going forward. For one, debt distress is not just an issue in the poorest countries in the world. Policy actions are needed in other developing and emerging market economies as well.

The DSSI initiative has not met with the support of the private sector and roughly only half of the eligible countries have availed of the facility. The risk of credit rating downgrades is palpable. Some countries have already been downgraded creating the possibility of pro-cyclical effects and some countries have been put on a negative watch. The downgrades are a blunt assessment of the risk of an economy's inability to service its debt; they do not reflect the relative strength and weaknesses of countries. On the other hand, the pessimistic forecasts for the global economy probably necessitates an extension of the standstill arrangement and many countries may require a debt restructuring. and Not to forget that the debt covered by the standstill still has to be repaid.

Private sector involvement is one of the big challenges. The IIF has signaled that debt owed to private creditors, even if only a short-term suspension in debt service payments is needed, will primarily be dealt with on an individual case-by-case basis. There is no incentive or legal structure in place to bring in the private sector to provide relief. And if restructurings are required, experience shows that the processes lead to outcomes that are often "too little too late" and especially problematic pre-default and vulnerable to holdout creditors and litigation.

Unlike previous episodes of debt crises, diversity is a hallmark feature in this crisis, there are new bi-lateral official creditors that are not part of the ad-doc Paris Club arrangement, there are new debtors with institutional capacity constraints, there is a diversity in instruments such as commodity trades. Thus diversity in legal systems, contracts, institutional capacities, and creditors pose a challenge for creditor identification and coordination. The Brady bond deal, which brought an end to the 1980s LA debt crisis, was a solution for an identifiable set of commercial bank creditors, as also the HIPC initiative where the bulk of the debt of poor countries was owed to official Paris Club creditors and the multilateral institutions. The recent push for the inclusion of augmented CACs applies only to one component of debt. Creditor by creditor solutions can create problems of free riding by some. There is also the risk of the official sector bailing out private creditors. How is the international financial system going to handle this diversity?

There is also considerable diversity in the debt composition across countries. Then again some countries had debt problems even before the onset of the COVID-19 crisis, Covid exacerbating their situation; others that became vulnerable because of the COVID crisis and then there are those that are vulnerable to a turnaround in capital flows.

We have received lots of interesting and relevant questions which will be covered in the course of this discussion. We have an excellent panel today with economists, legal experts and representatives of the BWIs to understand where we are now, what the emerging issues are and challenges and some thoughts on how to resolve them.

Let me turn to the panel to lay before us the severity of the problem and how the challenges before us can be tackled.