Development and Change

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Debate

Chronicles of Debt Crises Foretold

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ABSTRACT

The debt crises looming in developing countries are being exacerbated by changing debt composition. Declining net foreign exchange earnings have worsened their predicament. As concessional development finance declined, many governments turned to riskier forms of borrowing from international capital markets. Concerted interest rate hikes are supposed to stem inflation; however, given that prices have mainly risen due to supply chain disruptions caused by war, sanctions and pandemic, interest rate increases are likely to trigger more debt crises, much worse than before. Current discourses, for example about China's 'debt trap' diplomacy, distract from urgently needed international and national measures to avert the looming debt crises.

INTRODUCTION

In the first half of 2022, a perfect storm of inappropriate policies threatened 'stagflation' in the world economy, causing inflation, stagnation and unsustainable debt in developing countries as interest rates rose sharply around the world. Analyses of 159 developing countries by the United Nations Development Programme (UNDP) for the UN High-Level Political Forum on Sustainable Development suggest that food and energy price spikes are devastating households, especially the poor (Molina et al., 2022). The World Bank (2023: xv) warns that '[t]he crisis facing development is intensifying' due to heightened risks of 'long-lasting' global slowdown, 'particularly devastating for many of the poorest economies, where poverty reduction has already ground to a halt'.

Meanwhile, the United Nations Conference on Trade and Development (UNCTAD, 2022) predicts that the ongoing cascade of threats will cause

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severe debt distress in more countries. External indebtedness, UNCTAD cautions, poses important challenges to developing countries, particularly those with floating exchange rates, open capital accounts and ill-considered integration into international financial markets. Developing countries, often borrowing in foreign currencies, are especially vulnerable to external shocks, for example during commodity price slumps. Servicing external debt obligations requires sufficient foreign exchange being generated from exports, remittances, aid, foreign direct investment (FDI), and so on. Drops in any of these major foreign exchange sources can exacerbate debt-servicing difficulties.

Exchange rate volatility also affects the value of export earnings and debt owed externally. The depreciation of developing countries' national currencies against 'hard currencies' may not increase export earnings if export supplies are not sufficiently price elastic. Local currency depreciation also raises import costs and foreign currency denominated debt obligations. Interest rate hikes also increase debt-servicing costs — the major cause of developing countries' debt crises in the 1980s and the protracted slumps that followed, especially in Africa and Latin America.

Developing countries are experiencing capital flight and exchange rate depreciation due to 'keep-up' interest rate hikes by major central banks, with the exception of Japan's; the United States (US) Federal Reserve Bank, the European Central Bank and the Bank of England have led this herd behaviour (Chandrasekhar and Ghosh, 2022). They also face the prospect of reduced export earnings as the world economy slows, even slipping into recession. Meanwhile, international supply disruptions — due to the COVID-19 pandemic, Ukraine war and sanctions — have raised import costs. While these developments are increasingly set to trigger developing country debt crises, their root causes are both deep-seated and long-standing, and still evolving.

Most developing economies face insufficient aid and financial inflows, and limited access to concessional resources from multilateral financial institutions such as the World Bank, International Monetary Fund (IMF) and regional development banks, and bilateral donors. Hence, they have increasingly had to raise funds, including development finance, on onerous commercial terms in international financial markets. This has resulted in major changes in developing countries' external debt composition, especially after the 2007–08 global financial crisis (GFC).

As World Bank data show, low- and middle-income countries (LMICs) have become increasingly indebted to private creditors, especially bondholders. Of the US$ 3.6 trillion in long-term public and publicly guaranteed (PPG) external debt stock at the end of 2021, 61 per cent was owed to private creditors, up from 46 per cent in 2010 (World Bank, 2022). Even in low-income countries (LICs) eligible for concessional World Bank loans through its International Development Association (IDA) arm, the share owed to private creditors rose from 5 per cent in 2010 to 21 per cent in

2021. At the same time, some LMICs have opened their domestic financial markets to non-resident investors, while allowing citizens and firms to borrow from and invest abroad, thus enabling capital flight (UNCTAD, 2020).

While increased access to international financial markets can help capital-scarce countries quickly raise needed funds, it also exposes them to higher risk debt contracts — that is, with shorter maturities and more volatile financing costs — and sudden reversals of private capital flows. Faced with exogenous shocks due to natural disasters, epidemics or geopolitical instability, external debt burdens can quickly become unsustainable. We argue that this toxic mix may well be the recipe for widespread debt crises, likely to be worse than those of the early 1980s as more countries are much more vulnerable due to higher and riskier debt exposures.

We further argue that preventing devastating international debt crises requires urgent measures. The gravity of the situation and extent of the threat demand much more than the G20's Debt Service Suspension Initiative (DSSI) or conforming with the G20's Common Framework for Debt Treatment (CFDT).[1] Although enabling later repayment, DSSI still required payment of accrued interest in the interim. Both G20 initiatives are limited to LICs' official bilateral debt, and do not involve meaningful participation by commercial lenders. In the current situation, 1980s-type debt buybacks and restructuring are unlikely to be enough. This time around, commercial credit is far greater, and both credit and lenders are much more varied, unlike the mainly US and United Kingdom (UK) commercial bank lending of the 1980s.

This article begins with a brief review of key features of developing countries' external debt, followed by a discussion of their heightened debt vulnerability. We then consider the structural causes of Sri Lankan debt distress, which has recently received considerable attention, allegedly due to abusive Chinese debt diplomacy. A closer look at Sri Lanka's official debt composition confirms that the shift in developing countries' debt composition to riskier commercial borrowings, at higher interest rates and with shorter maturities, is a major cause of debt unsustainability. This is exacerbated by falling foreign exchange earnings and rising interest rates.

Sri Lanka's external debt dynamics have changed significantly since the early 2000s. While commercial debt accounted for only 2.5 per cent of its foreign loans in 2004, by the end of 2021, this had risen to almost 60 per cent, with maturities of no more than 10 years. Borrowing from capital markets by issuing sovereign bonds thus ensured that the country's debt was unsustainable. The share of US dollar denominated borrowing in Sri Lanka's total debt stock rose from around 36 per cent in 2012 to over 65 per cent in 2019, while the Chinese renminbi denominated loan share remained

1. Established in May 2020, the DSSI ended in December 2021. Of 73 eligible countries, 48 participated. In April 2021, the G20 developed the CFDT to facilitate LICs' debt restructuring negotiations after the expiry of the DSSI.

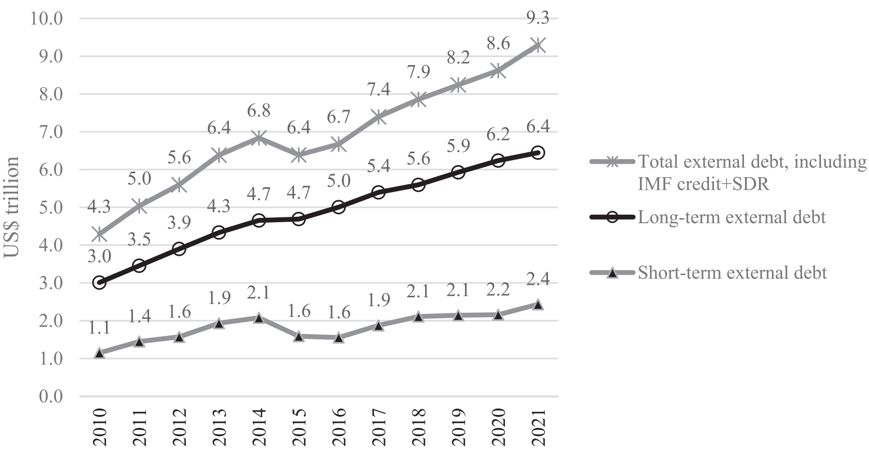
around 2 per cent. Its public debt from China came to around 10 per cent, approximately equivalent to the public debt from the Asian Development Bank (ADB) and World Bank. Thus, politically driven attention to Chinese lending has detracted from urgently needed international and national measures to deal with the looming debt crises.

The subsequent section then discusses various international and national measures that are needed to address the unsustainability of developing countries' debt. International measures include enhanced concessional long-term development financing, meaningful debt relief, improved cooperation to stem illicit fund outflows and harmful tax competition, and greater South–South cooperation. Urgent national measures — such as enhanced domestic resource mobilization and institutional mechanisms enabling increased developmental roles for central banks — can be critical for avoiding excessive reliance on external borrowing.

DEVELOPING COUNTRY EXTERNAL DEBT

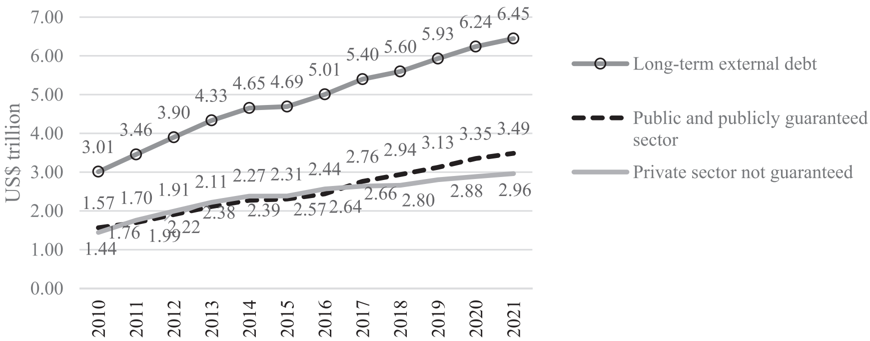
As statistics from the World Bank reveal (World Bank, 2021, 2022), LMICs' external debt stock in 2021 rose by 7.8 per cent to US$ 9.3 trillion from US$ 8.6 trillion in 2020 (see Figure 1a). In many countries, the increase was by double digit percentages. Long-term PPG external debt rose to US$ 3.5 trillion, equivalent to 37 per cent of total external debt stock in 2021. Long-term private non-guaranteed (PNG) debt rose to US$ 3 trillion, accounting for 32 per cent of total external debt stock in 2021 (Figure 1b).

Figure 1a. Developing Countries' External Debt Stocks, 2010–21



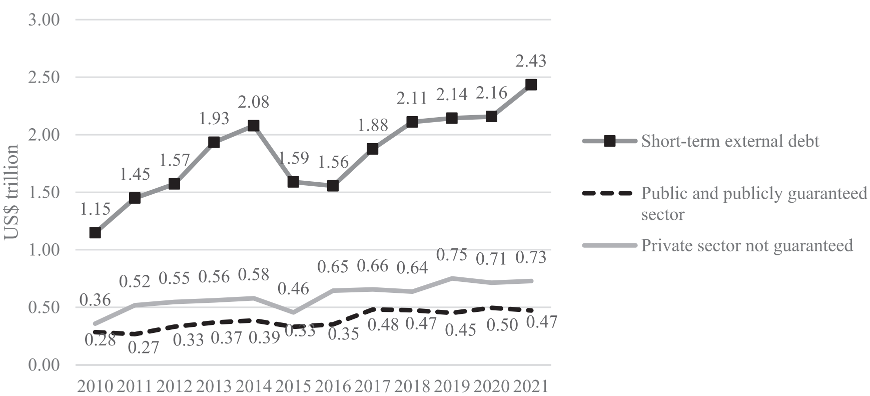
Source: calculated from World Bank (2021, 2022)

Figure 1b. Developing Countries' Long-term Public and Private External Debt Stocks, 2010–21



Source: calculated from World Bank (2021, 2022)

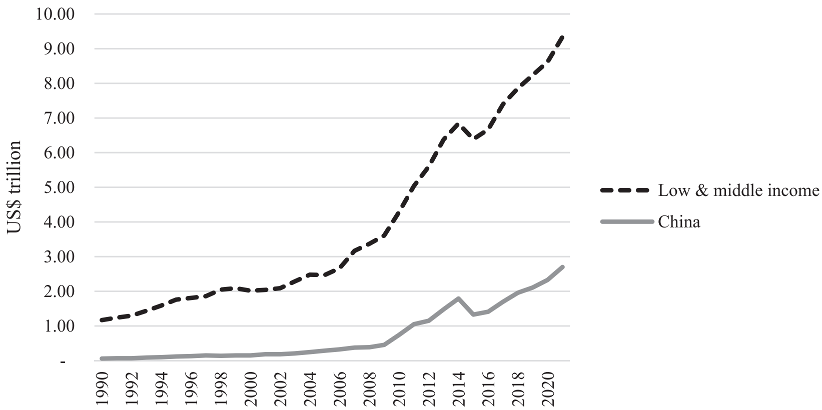
Figure 1c. Developing Countries' Short-term Public and Private External Debt Stocks, 2010–21



Note: Does not include IMF credit lines. *Source*: calculated from World Bank (2021, 2022)

LMICs' short-term external debt rose to US$ 2.4 trillion in 2021, compared to the pre-pandemic average of US$ 1.9 trillion for 2015–19 (Figure 1c). In 2021, while short-term PPG external debt stood at US$ 472.8 billion, short-term PNG external debt was US$ 728.3 billion, about 1.5 times the PPG total. This sharp rise of short-term external debt was probably to fund urgently needed pandemic measures, including the importation of vaccines, personal protective equipment, tests and medicines. The rise of both long- and short-term PNG debt is a worrying trend. It means that governments' contingent liabilities rose significantly as they often had to take over some private sector debt as well. Total long- and short-term publicly guaranteed and non-guaranteed private sector external debt rose from

Figure 1d. Debt Stocks of Low- and Middle-income Countries and China, 1990–2021



Source: World Bank (https://data.worldbank.org/indicator/DT.DOD.DECT.CD?locations=XO-CN, accessed 11 August 2023)

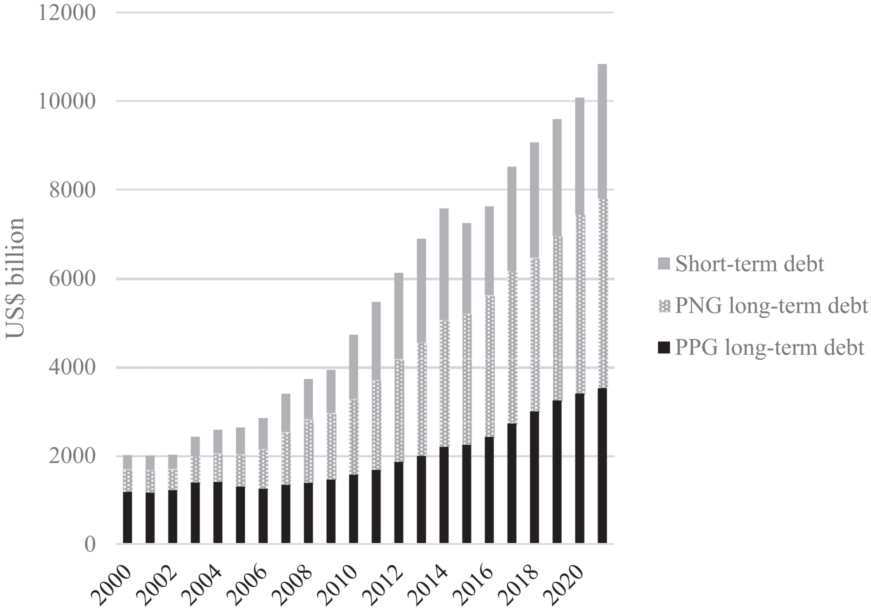
the US$ 3.1 trillion pre-pandemic yearly average for 2015–19 to US$ 3.9 trillion in 2021 (see Figures 1b,c).

China is the largest borrower, accounting for about a quarter of LMICs' external debt stock in 2021, compared to about 13 per cent in 2009. The combined external debt stock of LMICs, excluding China, was US$ 6.6 trillion in 2021, according to World Bank data (Figure 1d).[2] China has also emerged as a major creditor nation; World Bank data show that China greatly increased lending to foreign countries from around 2008 onwards. Total PPG external debt stock owed to China by emerging economies and other developing countries increased from US$ 11 billion in 2007 to US$ 157 billion in 2019. Debt owed to other non-Paris Club government lenders[3] — such as Saudi Arabia, United Arab Emirates, India and Russia — has also risen (World Bank, 2022).

For most countries, rising external indebtedness exceeded the growth of both gross national income (GNI) and exports. Data from World Bank (2022) show the average external debt/GNI ratio in LMICs, excluding China, rose to 42 per cent (29 per cent, including China) in 2020, from 37 per cent (27 per cent, including China) in 2019. Meanwhile, the external debt/exports ratio of LMICs, excluding China, rose to 154 per cent (123 per cent, including China) in 2020 from 126 per cent (106 per cent, including

2. The top 10 borrowers, defined as those with the largest end-2020 external debt stock, were Argentina, Brazil, China, India, Indonesia, Mexico, the Russian Federation, South Africa, Thailand and Turkey (World Bank, 2022).
3. The Paris Club is an informal group of creditor nations whose objective is to find workable solutions to payment problems faced by debtor nations. The Paris Club has 22 permanent members, including most western European nations, the US, UK and Japan.

Figure 2. Developing Countries' External Debt Stocks, 2000–21



Source: UNCTAD (2022)

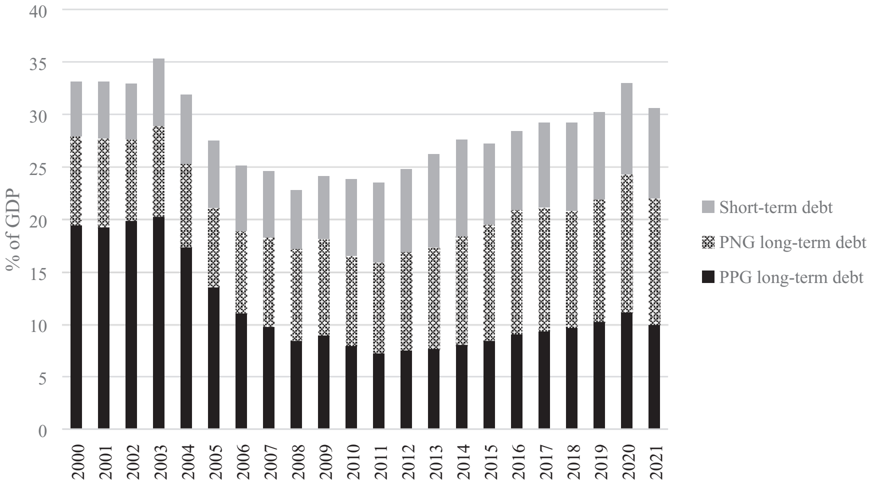
China) in 2019. Thus, the debt of LMICs besides China is worse than the aggregate data suggest. UNCTAD's *SDG Pulse 2022* (UNCTAD, 2022) reveals similar trends (Figure 2). Developing countries' external debt stock reached US$ 11.1 trillion in 2021 — the highest level ever, more than twice the US$ 4.1 trillion in 2009, and more than four times the US$ 2.1 trillion in 2000.

The average external debt/GDP ratio for developing economies, excluding China, reached 45.4 per cent of GDP in 2021, according to UNCTAD (2022) data. Higher growth due to commodity price booms in the early 2000s lowered debt/GDP ratios.[4] However, sluggish growth since the 2007–08 GFC has seen an increase in the average external debt/GDP ratio from 23 per cent in 2008 (the lowest share in the last 20 years) to 31 per cent in 2021 (Figure 3). As already noted, 2020 saw the greatest annual increase in the external debt/GDP ratio since the GFC, in response to the COVID-19 pandemic.

Figure 4 shows changing debt servicing of long-term external PPG debt by various groups of economies. Debt servicing by developing countries shows a trend similar to the debt/GDP ratio. As the debt/GDP ratio declined

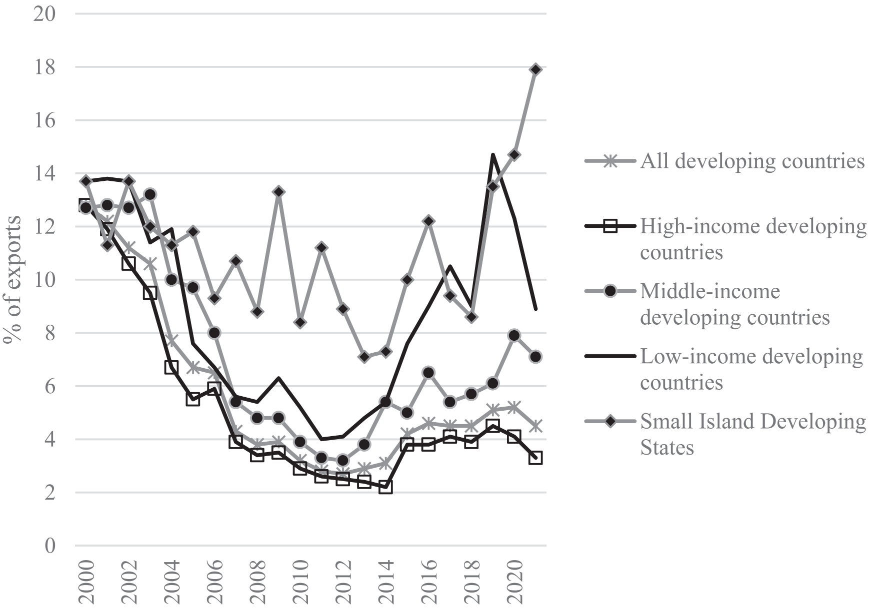
4. Helbling et al. (2008: 10) discuss the commodity price booms of the early 2000s and their impact on growth in developing countries. They note: 'a number of analysts see high commodity prices as an important reason for the buoyant growth in many emerging and developing economies'.

Figure 3. Developing Countries' External Debt Stocks (as % of GDP)



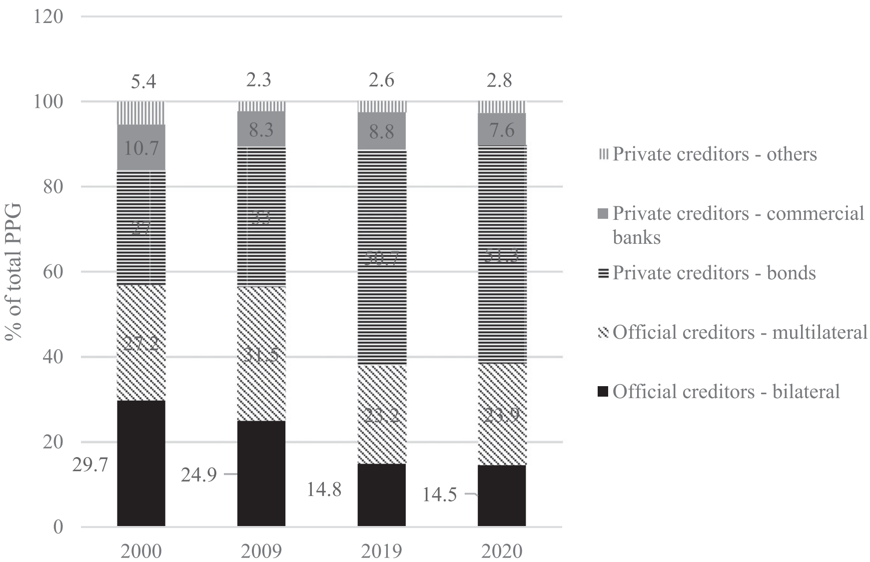
Source: UNCTAD (2022)

Figure 4. Developing Countries' Servicing of Public Sector Long-term External Debt by Country Groups, 2000–20 (% of exports)



Source: UNCTAD (2022)

Figure 5. Developing Countries' Public Sector Long-term External Debt by Creditor, 2000–20 (%)

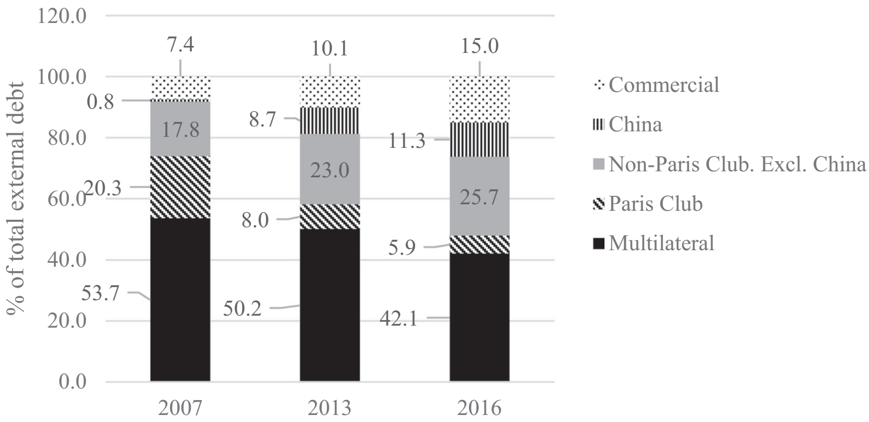


Source: UNCTAD (2022)

during the early 2000s, so did the debt servicing/export ratio; it then rose again after the GFC. Thus, both debt/GDP and debt servicing/export ratios were influenced by commodity prices. Only high-income developing countries have kept the ratio of external long-term PPG debt to export revenue stable in the last decade, at between 2 per cent and 4 per cent, largely due to their greater capacity to issue domestic public debt. Their greater reliance on national currency denominated public debt reduces their vulnerability to exchange rate volatility and foreign currency earnings fluctuations.

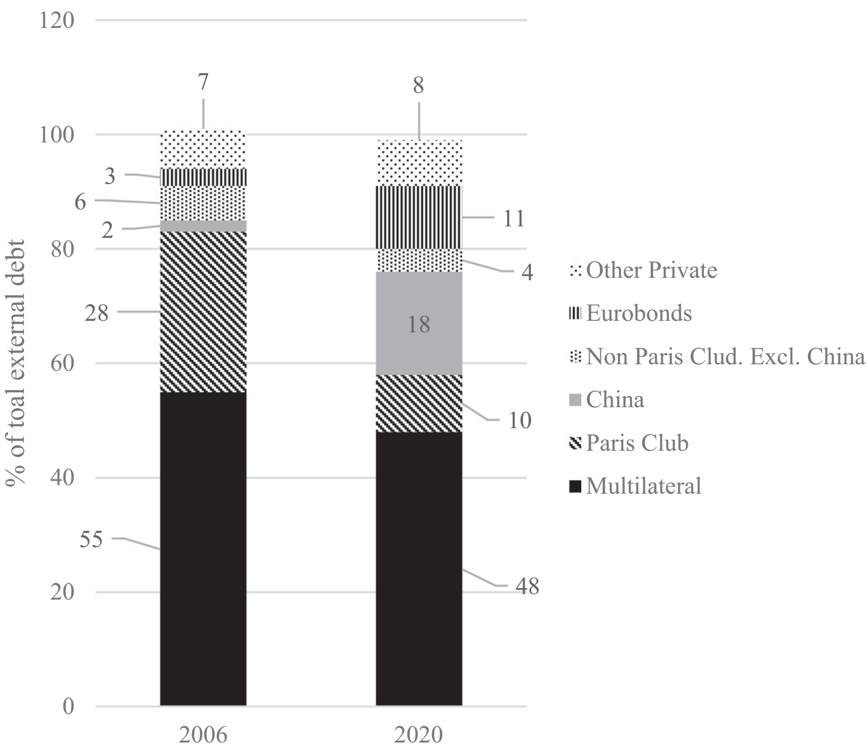
There has been a marked increase in debt-servicing ratios of all country groups by average income levels since 2012. These rose from 3.2 per cent to 7.1 per cent in middle-income countries (MICs) and from 4.1 per cent to 8.9 per cent in LICs between 2012 and 2021 (Figure 4). For LICs, the debt servicing/exports ratios reached their highest level (around 14 per cent) in the early 2000s. In small island developing states, they rose from 7.3 per cent in 2014 to 17.9 per cent in 2021, higher than the early 2000s' level. As these economies borrowed increasingly from international capital markets (see Figures 5 and 6), in the face of commodity price volatility and sluggish economic growth, their debt servicing/exports ratios have also risen since 2012. Higher interest rates and shorter commercial debt maturities, compared to debt from official sources, have also raised debt-servicing costs. World Bank data show the average maturity of IDA-eligible LICs' commercial borrowings is about 10 years compared to around 25 years for official

Figure 6a. Low-income Country Public Sector Debt by Creditor



Source: IMF (2018)

Figure 6b. DSSI Countries' External Debt by Creditor



Source: IMF (2022); World Bank (2022).

loans. IDA-eligible LICs also pay much higher interest rates — on average 5 per cent — for commercial loans, as against around 1.5 per cent for official loans (World Bank, 2022: 13).

Changing Debt Profile

The public–private composition of long-term external debt lenders has changed. The share of PNG debt in overall external debt surpassed the PPG debt from 2008 to 2015, and changed little thereafter (see Figure 2). Figure 5 shows the changing developing country debt profile. PPG external debt owed to private creditors reached 61.6 per cent of overall external debt in 2020, compared to around 20 per cent in the 1970s and 43 per cent in 2000. Public debt from bond markets almost doubled its share of total debt from 27 per cent in 2000 to 51 per cent in 2020. UNCTAD (2022) data show that the share of short-term debt — generally characterized by higher risk profiles — increased from 16 per cent of total external debt in 2000 to a peak of 33 per cent in 2013, falling back to 28 per cent by 2021.

Debt also became more expensive due to changes in the sources from which the money is borrowed. Private commercial creditors charge higher interest rates than public creditors. For example, African governments are paying interest of between 5 and 16 per cent on 10-year government bonds, despite very low, near-zero or negative real interest rates in the US and Europe (Mutize, 2020). Average interest costs on developing countries' external borrowing are three times higher than for developed countries (Spiegel and Schwank, 2022).

Thus, the changing composition of lenders had increased the vulnerability of developing countries' external debt positions even before the COVID-19 pandemic. Public bond finance, the most volatile financing source, has been increasing relative to commercial bank loans and other private credit. This reflects growing international financial market financing of developing country governments' external debt. Such shifts in external debt composition have raised the costs of debt and increased vulnerability to speculation compared to borrowings from bilateral and multilateral official creditors, which are generally more stable and on more favourable terms.

Developing countries' foreign reserves as shares of short-term external debt declined from 2010, with high- and middle-income countries experiencing the sharpest declines (UNCTAD, 2019). Hence, so-called 'self-insurance' has been weakening.[5] LICs tried to rebuild their foreign reserves from 2016, but that trend ended with rising import costs due to

5. Many developing countries accumulated foreign reserves, especially following the 1997–98 Asian financial crisis, to protect themselves (hence, 'self-insurance') in the event of sudden capital flow reversals, by warding off external pressures and currency crises. Reserves are costly to hold, however, because they often yield lower returns than the interest rates charged

COVID-19, the Ukraine war and sanctions. LICs are also highly vulnerable to shocks, especially commodity price volatility.

Low-income Developing Countries

The UN *Financing for Sustainable Development Report 2020* warned that 44 per cent of LICs and least developed countries (LDCs) were at 'high risk of external debt distress or already in debt distress' (UN, 2020: 127). Among LICs, the external debt stock of the 73 poorest countries eligible for the G20's DSSI rose 12 per cent, from US$ 770 billion in 2019 to US$ 860 billion in 2020, and for 17 of them by 20 per cent or more (World Bank, 2021). Debt indicators for DSSI-eligible countries have worsened significantly over the past decade. In 2020, 44 per cent of DSSI-eligible countries had a debt-to-GNI ratio at or below 60 per cent, with 7 per cent exceeding 100 per cent. In 2020, 21 per cent of DSSI-eligible countries had an external debt/exports ratio of over 250 per cent, while about 60 per cent of DSSI countries were at high risk of debt distress in 2021 (Chabert et al., 2022).

In most developing countries, there has been a shift in LIC borrowing away from traditional official creditors. Hence, the share of LIC borrowings from multilateral development banks like the World Bank or from bilateral lending, especially from Paris Club members, has fallen (Figure 6). Data from World Bank (2022) show the share of IDA-eligible LIC debt owed to Paris Club creditors falling to 32 per cent by the end of 2021 (US$ 64.2 billion) from 58 per cent (US$ 48.9 billion) in 2010. Non-Paris Club creditors thus increased their lending from 42 per cent (US$ 35.3 billion) in 2010 to 68 per cent (US$ 138.3 billion) in 2021.

This shift is often presumed to be mainly due to growing Chinese lending, which jumped from under 1 per cent in 2007 to 11.3 per cent of total external debt in 2016 (Figure 6a). Chinese lending to DSSI countries rose from 2 per cent in 2006 to 18 per cent in 2020 (Figure 6b). But loans from China still constitute under a fifth of non-Paris Club credit as there has been increased lending by other such creditors as well.

In sum, developing countries' external debt vulnerability has generally worsened significantly for many reasons. External debt has been rising, especially after 2007–08 and again during the COVID-19 pandemic. Borrowing has become much riskier and more expensive due to greater reliance on international capital markets to finance public debt, including more short-term debt, mostly PNG, involving more contingent liabilities. Slowing economic growth, falling commodity prices, and inadequate debt

on their debt. Such funds could be used more productively instead, for example, for development infrastructure. See Becker et al. (2007).

relief, restructuring and refinancing mechanisms have also exacerbated the looming debt crisis.

WHY AND HOW DID BORROWING RISE?

Increased attention to a variety of development objectives — especially in the eras of the Millennium Development Goals (MDGs) (2001–15) and Sustainable Development Goals (SDGs) (2016–30) — as well as more climate change adaptation and mitigation demands, have greatly increased investment needs. On the eve of the SDGs' adoption in 2015, the Sustainable Development Solutions Network estimated the annual investment gap at US$ 1.4 trillion (Schmidt-Traub, 2015). Meanwhile, UNCTAD (2014) estimated additional investments needed to meet SDG targets at US$ 2.5 trillion annually.

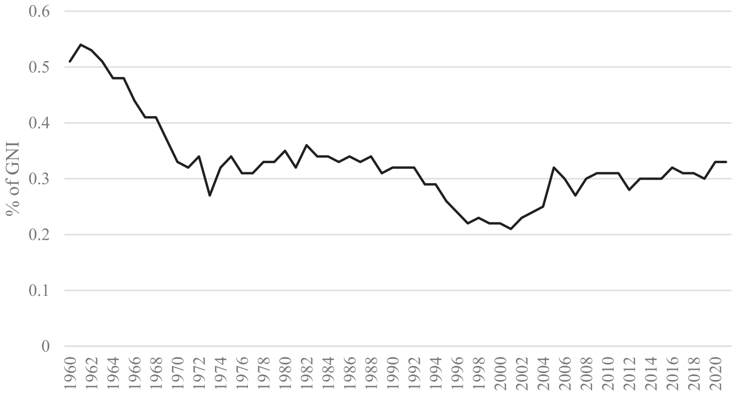
UNCTAD (2021) estimates that annual climate adaptation costs in developing countries could reach US$ 300 billion in 2030 and US$ 500 billion by 2050 as global warming accelerates. On the eve of the 2009 Conference of Parties (COP 15) in Copenhagen, estimates of annual adaptation costs in the world made by the UN Framework Convention on Climate Change (UNFCCC), World Bank, UNDP and Oxfam were similar in orders of magnitude, with much more required in developing countries. But international support to meet these investment needs is not only inadequate, but also declining, marked by broken promises, as donors press for private financing instead of meeting their decades-old commitments to provide 0.7 per cent of their national incomes as official development assistance. The situation is not helped by the absence of any meaningful debt relief and of orderly and equitable sovereign debt restructuring mechanisms.

Credit agencies generally rate developing countries unfavourably, thus requiring them to borrow at higher cost, even in 'normal' times. Such biases make refinancing or restructuring costlier during more difficult times. Unconventional monetary policies in developed countries since the GFC, involving 'quantitative easing', for example, have caused funds to flow to developing economies in search of higher returns. Meanwhile, donor and multilateral development bank (MDB) advice has reduced developing countries' domestic resource mobilization and structural transformation efforts, increasing their vulnerability to external shocks. These pull and push factors are largely responsible for both rising external debt stocks and their increasingly risky composition.

Failed Aid Promises

Over half a century ago, rich nations promised 0.7 per cent of their GNI as development aid, but total official development assistance (ODA) from rich

Figure 7. Official Development Assistance, 1960–2021



Source: OECD 'Official Development Assistance' (www.oecd.org/dac/financing-sustainable-development/development-finance-standards/official-development-assistance.htm)

Organization for Economic Development and Cooperation (OECD) members has not even reached half the promised amount (Figure 7). OXFAM (2020) estimates that 50 years of un-kept promises equated to a US$ 5.7 trillion aid shortfall by 2020.

At their 2005 Gleneagles Summit, G7 leaders pledged to double their ODA by 2010, earmarking US$ 50 billion annually for Africa. But actual aid delivery has fallen woefully short (Elliott, 2011), with little transparent reporting or accountability (Christiansen and Fagan, 2011). Controversies over what climate finance is 'new and additional' to ODA have not been resolved since the 1992 adoption of the UNFCCC at the Rio Earth Summit. The G7 and other OECD countries have also failed to deliver on rich countries' 2009 pledge to give US$ 100 billion annually in climate finance until 2020, and much more thereafter, to help developing countries mitigate and adapt to global warming (Timperley, 2021). The OECD claimed US$ 79.6 billion in climate finance was delivered in 2019, the highest ever. But these OECD estimates are much disputed, for example, for double counting and including non-concessional commercial loans, 'blended finance',[6] 'rolled-over' loans and private finance.

6. The OECD defines 'blended finance' as 'the strategic use of development finance for the mobilisation of additional finance towards sustainable development in developing countries': see www.oecd.org/dac/financing-sustainable-development/blended-finance-principles/ (accessed 9 December 2022). The practice deploys ODA to 'leverage' additional funds from other private or public resources. There is considerable confusion about its meaning, how it works, and how it supposedly fosters development, as well as a significant lack of project data. This arises due to the absence of a common methodology to distinguish and measure 'ODA for blending' and 'mobilized finance'. This can lead to double-counting, and also allows finance to be reported as ODA even if not deployed in a concessional way (Pereira, 2017).

Donors Promote Private Finance

The World Bank and donors claim to be mobilizing private finance for developmental ends, 'converting billions of official assistance to trillions in total financing' (Sebti, 2016). Touted as 'beyond aid', they claim to be leveraging and deploying much more private capital from advanced and major emerging economies to provide the lion's share of development finance (Mawdsley, 2018).[7] Thus, donors and international financial institutions now use scarce official finance to promote public–private partnerships (PPPs) and blended finance. PPPs make dubious contributions to sustainable development outcomes, especially to poverty reduction or the promotion of equity and health.[8] Worse, they impose onerous financial burdens on government budgets, both directly and indirectly. These include explicit contractual obligations to make regular payments such as subsidies to users and service providers. Direct liabilities also emerge with asset amortization when projects are transferred to governments as contracted. Thus, PPPs create long-term obligations similar to debt servicing. Contingent liabilities may also arise from PPP projects due to uncertain additional payment obligations emerging from future developments. Minimum revenue guarantees, exchange rate guarantees and additional charges for specific cost increases are examples of contingent financial obligations that PPPs typically incorporate.

Stuck since 2014 'at about US$20 billion a year … far off the goal of US$100 billion set by the UN in 2015', blended finance is struggling to grow, while effectively transferring risk from the private to the public sector (*The Economist*, 2020). On average, the public sector has contributed 57 per cent of blended finance investments, including 73 per cent in LICs (Attridge and Engen, 2019). In the past, LDCs mainly borrowed on concessional terms from multilateral financiers like the World Bank and IMF and bilaterally from donors. However, such lending comes with stringent conditions, typically for relief and welfare, deterring LDCs from development programmes. Since the GFC, non-concessional loans have grown in significance, with more borrowing from poorly regulated and unaccountable private commercial bond markets.

7. For a discussion on the implications of global capital's influence on the role of the state and development, see Alami et al. (2021).
8. In their analysis of PPPs, Bayliss and Van Waeyenberge (2018) attribute recent official promotion of PPPs to the growing dominance of global finance. Gabor (2021) describes this as part of an 'assertive Wall Street Consensus', criticizing the influence of finance capital on donors and international financial institutions, especially the World Bank and the IMF. PPPs enable states to 'de-risk' private financial investments. This reduces the likelihood of 'green' developmental investments as part of a 'just transition' to low-carbon economies.

Inadequate Debt Relief

IMF debt-service relief for 25 eligible LICs, estimated at US$ 213.5 million, was approved for six months on 13 April 2020, ending in mid-October 2020. However, the World Bank refused to supplement IMF debt-service cancellation for the most vulnerable LICs, arguing that extending 'the moratorium to debt repayments to MDBs … would be harmful to the world's poorest countries'.[9]

The G20's DSSI was supposed to provide some modest relief for debt-servicing obligations of bilateral public debt owed to official creditors by IDA member countries and LDCs eligible for more concessional loans. According to the World Bank, the DSSI suspended US$ 12.9 billion in debt-service payments owed between May 2020 and December 2021, when it came to an end.[10] However, the G20 initiative only deferred countries' long-term PPG external debt-servicing burden briefly, effectively 'kicking the can down the road'. It did not cancel any debt, which still has to be repaid in full during 2022–24, as interest payments due continued to grow.

Unsurprisingly, only 48 of 73 eligible countries requested DSSI relief, underscoring limited interest in the very modest initiative. Private commercial creditors were reluctant to participate, with only one private creditor taking part. This highlights one serious consequence of changing debt composition. Although only a few banks, mainly from the US and UK, were involved in the 1980s' debt crises, it took nearly a decade to arrive at some debt workout mechanism. Now, with so many diverse commercial lenders, quick resolutions of future debt crises are likely to prove almost impossible.

The G20's CFDT has not been a significant improvement over the DSSI it replaced. Predictably, it has not achieved much. As of January 2023, only four countries — Chad, Ethiopia, Zambia and Ghana — had applied for CFDT debt treatment. As Setser (2023) notes, 'so far, the Common Framework hasn't even provided a structure for starting to negotiate financial terms in any of the important test cases — most notably, Zambia'. (See also Brad Setser's critical evaluation of the CFDT in this issue.)

Both DSSI and CFDT are limited to LICs, and do not address the huge debt problems facing many MICs. UNCTAD (2020) estimated that in 2020 and 2021, lower-middle and low-income countries paid between US$ 0.7 trillion and US$ 1.1 trillion to service debt, while upper-middle-income countries paid between US$ 2.0 trillion and US$ 2.3 trillion. The CFDT was

9. The argument being that such an initiative would apparently downgrade the MDBs' credit ratings and hence adversely affect their ability to borrow from financial markets at lower costs. See: www.worldbank.org/en/news/speech/2020/05/28/world-bank-group-president-david-malpass-remarks-at-high-level-event-on-financing-for-development-in-the-era-of-covid-19-and-beyond (accessed 17 May 2023).
10. See: www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative (accessed 8 May 2023).

supposedly designed to address insolvency and protracted liquidity problems on condition that participating countries implement IMF-endorsed 'reform' programmes. But the IMF typically imposes contractionary and often regressive austerity measures as conditions for receiving its financial support or even for endorsing financial support by others. Experience shows IMF conditionalities to be quite onerous, typically not only undermining economic growth, but also adversely impacting the welfare of vulnerable populations. Thus, many countries are suspicious of IMF programmes.

The CFDT has brought newer official creditors — such as China, Saudi Arabia, United Arab Emirates, Kuwait, India and Russia — into a process akin to that used to restructure debt owed to the (mostly OECD) members of the Paris Club. This is significant as non-Paris Club lenders have overtaken traditional Paris Club members in lending to many developing countries. For example, IDA-eligible countries' obligations to non-Paris Club creditors as a share of total obligations to bilateral creditors rose from 42 per cent in 2010 to 68 per cent in 2021 (World Bank, 2022). Both Paris Club and non-Paris Club members agreed to coordinate the provision of debt relief consistent with debtors' capacities to pay while maintaining essential spending needs. But coordinating Paris Club with other creditors, as well as various government institutions and agencies in creditor countries, has not been easy. This has significantly delayed decision making. Also, there is no comprehensive and sustained debt-service payment standstill for the duration of negotiations offering relief to debtors already under stress. The costs of such standstills would also incentivize creditors to accelerate debt restructuring.

The CFDT requires private creditors to participate on comparable terms to overcome collective action problems in debt resolution while ensuring fair burden sharing. However, there is a lack of clarity as to how such 'comparable treatment' is to be effectively enforced, including how IMF debt-servicing arrears policies are to be implemented. Thus, the G20 initiative hardly addresses developing countries' most immediate needs, especially as private creditors have refused to provide relief, instead seeking to maximize returns regardless of circumstances and consequences.

Poor Sovereign Debt Restructuring Mechanisms

Mechanisms for fair and orderly sovereign debt restructuring involving commercial lenders are still lacking, despite repeated appeals, especially since the 1980s' debt crises. Following the 1997–98 Asian financial crises, IMF proposals included standstill provisions comparable to elements of legally prescribed US bankruptcy proceedings (Cui, 1996). When a creditor cannot repay in full, temporary cessation of all payments is followed by an orderly process that works out how much creditors can collectively expect to receive, instead of a disorderly, and ultimately costly, rush to exit. This idea was incorporated into the proposed IMF Sovereign Debt Restructuring Mechanism, 'but did not attract sufficient support from major countries and has not gone forward' (Stevens, 2007), due to opposition from large commercial lenders, mainly from the US.

The lack of a fair and orderly debt restructuring mechanism has added insult to injury. Commercial lenders charge much more, ostensibly to cover higher default risks, but when default happens, they refuse to refinance, restructure or provide relief. Instead, some act opportunistically, for example, holding countries hostage, regardless of consequence, as 'vulture capitalists'. When countries seek emergency credit from the IMF, it often imposes 'one-size-fits-all' austerity measures. In many cases, these impair growth prospects and undermine social stability. It is therefore unsurprising that many countries are reluctant to seek IMF 'help', as a temporary liquidity crisis can deteriorate into a solvency or debt sustainability crisis.

The rise of non-Paris Club bilateral lenders has also compounded the problems of debt-distressed developing countries. There is no common framework that can be applied to restructure sovereign debt owed to non-Paris Club members. Restructuring such debt has to be done on a country-by-country basis, often in an opaque manner. This lacuna has allowed geopolitical considerations to influence the discourse, such as allegations of 'China debt diplomacy'. A recent study by Horn et al. (2023) implies nefarious motives for China's refinancing of debt-distressed countries, with the authors alleging that China participates in international bailout lending to rescue its own banks.

Biased Rating Agencies

Rating agencies are biased against developing countries (*The Economist*, 2017). They often rate developing countries unfavourably, pushing up borrowing costs significantly. They encourage developing countries to borrow from international capital markets by reshaping discourses. Instead of using terms such as 'backward', 'underdeveloped' or 'less developed', new labels such as 'developing', 'emerging markets', 'frontier economies', etc. have been coined to induce foreign portfolio investments and lending. Influenced by interests likely to benefit, rating agencies have encouraged developing countries to float sovereign bonds in international capital markets. By setting explicit criteria, ostensibly to improve a country's ratings, they have successfully induced conformist behaviour among key finance policy makers in countries aspiring for such acknowledgement and status.

Nevertheless, rating agencies are typically quick to downgrade developing countries' credit ratings, but much more circumspect and demanding of those seeking 'upgrading' or improvements in ratings. Downgrading credit ratings when economies are hit by lower commodity prices, natural disasters and epidemics make it costlier and harder to obtain affordable refinancing at times of greatest need, even though their economic fundamentals may otherwise remain unchanged.

The credit rating agency Fitch warned that including MDBs in sovereign debt restructurings under the G20's CFDT, as demanded by China, could weaken MDBs' preferred creditor status unless their shareholders guaranteed full compensation.[11] Such threats by rating agencies — which have conflicts of interest, as they also advise commercial lenders — delayed urgently needed debt relief for LICs.

Developed Country Policy Spillovers

'Unconventional' monetary policies in many developed economies after the GFC — such as 'quantitative easing' (QE),[12] including very low or even negative real interest rates — encouraged fund managers to seek much better returns in developing countries until the US Federal Reserve began raising interest rates in 2022. Many emerging market economies rushed to sell bonds overseas to cope with the COVID-19 pandemic when spending needs suddenly rose, and borrowing costs were relatively low. Now, as other central banks follow the US Federal Reserve in raising interest rates, capital flows are being driven away from emerging markets, leaving them with heavy debts and at greater risk.

Harmful Policy Advice

Policy advice from donors, the IMF and MDBs, including the World Bank, favours market-based private sector solutions regardless of constraint, let alone context. They have opposed proactive industrial policy and structural transformation strategies since the late 1970s. Instead, developing countries have been encouraged to become and remain export-oriented primary commodity or raw material producers, typically with narrow export bases and volatile export earnings.

These institutions have also encouraged tax cuts, with less direct taxation of corporations, especially from abroad, claiming this is necessary to attract FDI. The World Bank promoted such fiscal losses through its ideologically driven, but nonetheless very influential *Doing Business* reports.[13] Such tax

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11. See: www.fitchratings.com/research/sovereigns/chinas-stance-on-multilateral-debt-relief-could-weaken-mdbs-preferred-creditor-status-04-04-2023 (accessed 18 May 2023).
12. Quantitative easing is a monetary policy strategy adopted by central banks. With QE, a central bank purchases securities (bonds) to reduce interest rates, increase money supply and encourage lending to consumers and businesses. The goals are to stimulate economic activity during a financial crisis and to keep credit flowing.
13. The *Doing Business* report was published annually by the World Bank from 2003. The reports came under heavy criticism for methodological flaws and promoting the interests

cuts have largely failed to incentivize FDI, but have reduced government revenue and the ability to service debt and improve government spending. An IMF report to the G20 noted: 'Tax incentives generally rank low in investment climate surveys in low-income countries, and there are many examples in which … investment would have been undertaken even without them. And their fiscal cost can be high, reducing opportunities for much-needed public spending …, or requiring higher taxes on other activities' (IMF, 2017: 3). Furthermore, tax evasion and avoidance by transnational corporations (TNCs) have exacerbated developing countries' revenue losses. TNC tax avoidance costs as much as 5–8 per cent of GDP annually for LMICs like Guyana, Chad, Guinea, Zambia and Pakistan, compared to annual losses of 0.6–1.0 per cent of GDP for higher-income countries like Germany and France (Cobham and Janský, 2018).

Thus, both 'push' and 'pull' factors have increased external borrowing, particularly market finance from commercial lenders. Various compounding factors now threaten to push heavily indebted economies over the edge. Developing countries' financial needs to achieve the SDGs, for climate change adaptation and mitigation, and other objectives, including the priorities of national governments in office, are huge and rising, partly due to the failure to make needed investments earlier. Inadequate and even falling ODA, declining multilateral finance, QE in developed countries, onerous official finance conditionalities, and donor preferences, 'advice' and encouragement ('nudge') have all pushed developing countries to turn to market sources of finance. The lack of reliable and orderly restructuring and refinancing mechanisms, inadequate debt relief, falling export earnings, inadequate government revenue and rising interest rates in developed countries have also exacerbated the situation.

REPLAYING THE 1980s?

Following the 1970s' oil price hikes, US and some other Western banks were flush with liquidity as oil-exporting countries deposited their growing dollar reserves with them. These banks encouraged Latin American and other developing country governments to borrow, offering them relatively low real interest rates in the face of high inflation (Wiegand, 2008). When the US Federal Reserve began raising interest rates from 1979 to check inflation, some other major central banks quickly followed. Thus, borrowing countries' debt-service burdens suddenly rose. The ensuing US recession and world economic slowdown meant falling export revenues for

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of multinational corporations, for example by encouraging corporate tax cuts and diluting labour rights. Critics also found deliberate manipulation of data and political bias. The World Bank was forced to discontinue the *Doing Business* series in 2021; see Richards (2021).

commodity-exporting developing countries, compounding their governments' external debt problems. Debt-distressed countries were forced to seek financial support from the IMF and the World Bank. To qualify, they had to agree to severe austerity measures, market-liberalizing 'structural adjustments' and privatization reforms. These resulted in economic slowdowns and 'lost decades' (of economic stagnation), with declining incomes, de-industrialization and food insecurity (Ocampo, 2014).

As higher food, fertilizer and fuel prices depleted developing countries' foreign exchange reserves, higher interest rates increased their debt burdens. With interest rates rising in developed countries, most developing nations experienced massive capital outflows. Rising import costs and greater capital outflows weakened developing countries' currencies, making debt servicing costlier. Rising US interest rates had the greatest impact on economies with higher debt burdens and volatile export earnings.

In the present context, many vulnerable countries are once again seeking financial help from the IMF, which has reverted to prescribing 'one-size-fits-all' austerity measures, impairing growth and development prospects. Without more predictable and less onerous debt restructuring, and better debt relief, temporary liquidity crises are more likely to turn into solvency or even debt-sustainability crises. Although recent developments have some parallels with the 'stagflation' of the late 1970s and early 1980s, however, there are significant differences.

First, the current sovereign external debt crisis is likely to be much deeper and wider as debt has increased in almost all regions of the world. A World Bank report (Kose et al., 2020) noted that with the latest wave of debt accumulation since 2010, world borrowings have grown to an all-time high. While debt in LICs rose significantly, the debt build-up was generally faster in emerging market and other developing economies. Second, debt vulnerability is much greater this time round due to increased commercial borrowings by both public and private sectors. Worse, developing country governments are often forced to take over private sector debt at times of crises, even when not publicly guaranteed.[14] Third, in the external debt crises of the 1980s, the US was more directly involved in rescue efforts as the largest creditors were US commercial banks.[15] Thus, averting default

14. See Shadlen (2003) for useful comparisons.
15. US, British and Canadian banks held about 36 per cent, 12 per cent and 9 per cent, respectively, of total Latin American debt in 1984, according to *World Financial Markets*, July 1985, from the Morgan Guarantee Trust Co. (no longer widely available, but see also Jayanti, 1991). According to Sachs and Huizinga (1987), at the end of 1986, the exposure of the nine largest US banks in the four most indebted Latin American countries — Argentina, Brazil, Mexico and Venezuela — accounted for US$ 41 billion, or 45 per cent of total US bank exposure. The top nine banks accounted for 65 per cent of US banks' total exposure in Latin America. Loans to foreign public sectors accounted for about two-thirds of US bank lending to developing countries. Latin America accounted for about US$ 200 billion in outstanding bank debt, of which about US$ 75 billion was owed to US banks, US$ 30

was deemed necessary to avoid a US banking crisis, although it came at high cost (Ocampo, 2014). Such considerations are not currently significant enough for the US to proactively avert impending developing country debt crises.

Although supply-side disruptions had contributed to inflationary pressures — especially since the pandemic — the Ukraine war and US-led economic sanctions against Russia have worsened inflation. While prices have continued to rise all over the world, US inflation has not been accelerating since mid-2022. Hence, while the stagflation threat has receded, the threat of protracted economic slowdowns remains (World Bank, 2023). Ideologically driven interest rate hikes now threaten continued stagnation, likely to be exacerbated by debt crises of potentially larger proportions than in the 1980s.

SRI LANKA

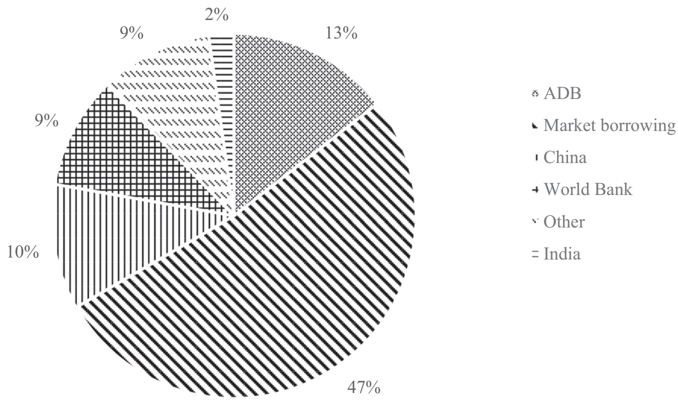
Sri Lanka's recent experience may well anticipate the looming debt crises of developing countries in general. The threat is mainly due to their changed external debt composition, with much riskier commercial borrowings and shorter loan maturities. A toxic mix of falling foreign currency earnings, higher import costs, 'external' impacts from policy actions in advanced countries — particularly concerted interest rate hikes — as well as domestic policy abuse and errors has triggered Sri Lanka's debt distress.

Increased Commercial Borrowings

By the end of April 2021, Sri Lanka had US$ 35.1 billion in outstanding government external debt. Borrowings from the ADB, China and the World Bank accounted for approximately 10 per cent each, with other bilateral lenders, including India, making up over half of the island nation's total debt. Capital market borrowings comprised 47 per cent of Sri Lankan public external debt in 2021, and have become the main cause of debt unsustainability (Figure 8a). About 60 per cent of government external borrowing has been for periods of less than 10 years (Figure 8b). The share of US dollar denominated debt in the total debt stock increased from around 36 per cent in 2012 to over 65 per cent in 2019, while the share of Chinese renminbi denominated loans remained around 2 per cent. Interestingly,

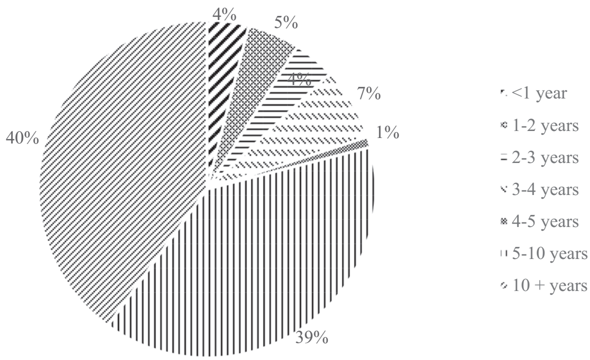
billion to Japanese banks, US$ 40 billion to UK banks, with the remaining US$ 55 billion shared by German, French, Canadian, Swiss and other banks.

Figure 8a. Sri Lanka's External Debt Composition, end April 2021



Source: Sri Lanka Department of External Resources, 'Foreign Debt Summary' (www.erd.gov.lk/index.php?option=com_content&view=article&id=102&Itemid=308&lang=en, accessed 18 January 2023)

Figure 8b. Sri Lanka's External Debt Maturities, end April 2021



Source: Sri Lanka Department of External Resources, 'Foreign Debt Summary' (www.erd.gov.lk/index.php?option=com_content&view=article&id=102&Itemid=308&lang=en, accessed 18 January 2023)

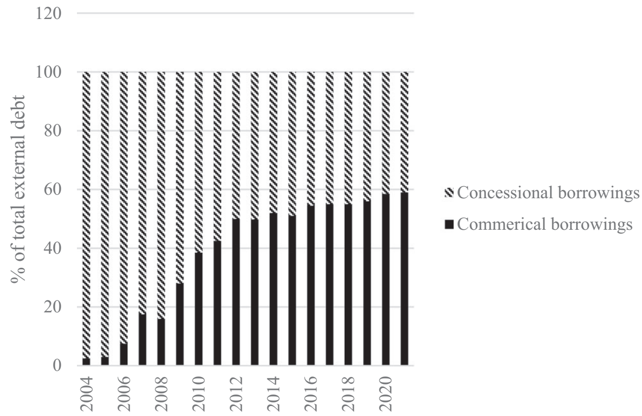
the share of 'cost-free' IMF Special Drawing Rights (SDRs) allocations declined by half from around 28 per cent to 14 per cent.[16]

Middle-income Country Curse

The World Bank elevated Sri Lanka to the status of lower-middle-income country in 1997. Its classification of countries by average national income

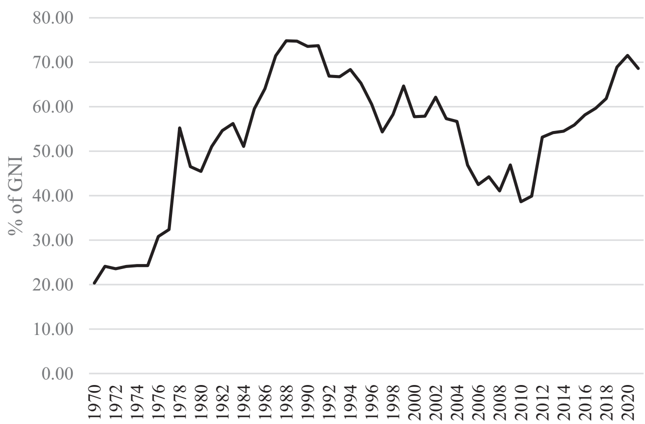
16. Sri Lanka Department of External Resources, 'Foreign Debt Summary': www.erd.gov.lk/index.php?option=com_content&view=article&id=102&Itemid=308&lang=en (accessed 18 January 2023).

Figure 8c. Sri Lanka's Commercial Borrowing, 2004–21



Source: Sri Lanka Department of External Resources, 'Foreign Debt Summary' (www.erd.gov.lk/index.php?option=com_content&view=article&id=102&Itemid=308&lang=en, accessed 18 January 2023)

Figure 8d. Sri Lanka's Debt/GNI Ratio, 1970–2020



Source: World Bank (https://data.worldbank.org/indicator/DT.DOD.DECT.GN.ZS, accessed 11 August 2023)

differs from the UN's definition of LDCs based on a broader set of criteria to reflect a country's economic structural characteristics. World Bank categories determine a country's eligibility to access concessional loans. Thus, the elevation of Sri Lanka to MIC status meant it had to borrow increasingly at non-concessional rates. A decade later, in 2007, Sri Lanka issued its first international sovereign bond for US$ 500 million.

Since then, Sri Lanka's external debt dynamics have changed significantly. In 2004, commercial debt accounted for only 2.5 per cent of its foreign loans, but by the end of 2021, almost 60 per cent of the country's external debt consisted of commercial borrowings (Figure 8c), mostly sovereign debt bonds sold internationally. External borrowings among developing countries generally rose in the new century, especially with QE. A growing proportion of this debt has been from international capital markets. Sri Lankan external borrowings had risen rapidly from the mid-1970s, peaking at around 75 per cent of its GNI in 1989, before declining steadily to 38.7 per cent of GNI in 2010 (Figure 8d). The current crisis began in 2019 when its external debt/GNI ratio reached 69 per cent of GNI — although this was still less than in the 1980s.

Before Sri Lanka became a MIC in 1997, most of its foreign debt consisted of concessionary loans — mostly from multilateral and bilateral development agencies such as the World Bank, ADB and Japan International Cooperation Agency — with long payback periods (25–40 years), generous grace periods, and low interest rates (some even under 1 per cent). However, its recent foreign debt has been quite different, with close to 60 per cent of external borrowings coming from commercial sources, with much shorter repayment periods and higher interest rates. Such external borrowings carry additional risks due to falling export earnings and remittance inflows, declining tourist numbers, exchange rate depreciations and interest rate hikes internationally.

Thus, the current Sri Lankan debt crisis is primarily due to borrowing from international capital markets at commercial rates with short maturities, as exports and FDI inflows declined. Sri Lanka's export/GDP ratio declined continuously from around 39 per cent in 2000 to 19.6 per cent in 2010, taking a big hit during the pandemic to drop to 16.6 per cent in 2020. Since 2000, FDI inflows into Sri Lanka fluctuated between 1.1 per cent and 1.8 per cent of GDP, before falling to 0.5 per cent in 2020. The situation has been made worse by falling government revenues: the government reduced tax rates and greatly raised the minimum income tax threshold, but tax cuts failed to spur investment and growth, as promised by advocates of the fiscal reform. Falling revenue forced the government to borrow even more, at increasingly higher rates, due to its deteriorating credit ratings.

POPULAR WESTERN MEDIA NARRATIVES

Most discussion of developing country debt ignores its primary causes, focusing instead on related issues such as corruption and poor governance. Sometimes, discussion has also been clouded by geopolitical discourses and considerations, as implied by popular terms in media coverage such as 'China debt trap diplomacy'.

Corruption and politically motivated populist policies have undoubtedly contributed to debt crises, including in Sri Lanka. However, poor governance may be only the tip of the iceberg, concealing far more important issues.

Poor debt management, inefficient tax policies, as well as weaknesses in implementation and enforcement, may be among the other causes. Furthermore, government loans have often been used for consumption, rather than productive investments. Donors and MDBs also need to provide better technical assistance to help developing countries improve debt deployment and management. 'External shocks' such as falling commodity prices (since 2011) or 'natural disasters', exacerbated by climate change-related weather phenomena including droughts, storms and floods, can make things worse. Economic structural problems, such as limited diversification, may result in economies becoming more vulnerable to demand and price fluctuations. As the analysis above has shown, the external debt situation has changed significantly with new creditors, and therefore, altered debt composition. Developing countries have substantially increased their market borrowings on more onerous conditions, including higher interest rates, shorter maturities, and reduced prospects for refinancing or restructuring.

In terms of China's involvement as an increasingly important creditor, the World Bank (2022) estimates that LMICs' combined debt to China was US$ 170 billion at the end of 2020 — more than three times its 2011 level. By way of comparison, LMIC debt obligations at the end of 2020 amounted to US$ 204 billion to the World Bank's International Bank for Reconstruction and Development and US$ 177 billion to its International Development Association. LMICs' Chinese debt constituted less than 20 per cent of total borrowings in most cases, and less than 15 per cent for all LICs (see Figure 6 above).

China extends four main types of loans to LMICs, on both concessionary and non-concessionary terms (World Bank, 2022). These are: (1) concessional loans extended by the government of China at very low interest rates, or even interest-free; (2) concessional loans by the Export-Import Bank of China; (3) the largest category, non-concessional loans extended by policy banks, for example, the China Development Bank and the Agricultural Development Bank of China, which are denominated in US dollars with market interest rates and medium-term maturities; and (4) loans from Chinese commercial banks and suppliers insured by China's official export credit agency, SINOSURE. Thus, Chinese loans are quite diverse, with only a small share involving commercial conditions (ibid.).

Western observers, including the IMF and World Bank, accuse Chinese lenders of lacking transparency (Bretton Woods Committee, 2022). However, independent studies have debunked the China 'debt trap' narrative. For example, a Chatham House report (Jones and Hameiri, 2020) found that Sri Lanka's undeniable debt distress was mainly due to excessive borrowing from Western-dominated capital markets — not Chinese banks. As the US Federal Reserve began tapering its QE programme, Sri Lankan borrowing costs have risen. Another Chatham House study, of Chinese loans in Africa (Vines et al., 2022), notes that although China became a major creditor of many African nations from the start of the 21st century, the scale of its lending had decreased by 2016. New Chinese loans to African governments dropped from a peak of US$ 28.4 billion in 2016 to US$ 8.2 billion in 2019, and to just US$ 1.9 billion in 2020. Vines et al. argue that China's economic needs, rather than foreign policy or military objectives, have been the main driver of Chinese lending. They conclude that the economic fallout from the COVID-19 pandemic and Russia's invasion of Ukraine, including the sharp rise in interest rates, has undermined the ability of many African nations to service their sovereign debt. They expect China's future state-backed lending to decline, but also to be better coordinated among Chinese lending institutions with greater concern for debt sustainability.

A Lowy Institute study (Rajah et al., 2019) came to similar conclusions regarding China's lending to South Pacific island states: 'Our analysis, however, finds a nuanced picture. The evidence to date suggests China has not been engaged in deliberate "debt trap" diplomacy in the Pacific' (ibid.: 1). China announced that it was 'forgiving' 23 interest-free loans to 17 African countries (Monteiro and Hancock, 2022). A study by the Washington-based Center for Global Development (Gelpern et al., 2022) claims that Chinese contracts include 'unusual confidentiality clauses', but do not promise collective debt restructuring. Also, their debt cancellation-related clauses would allegedly allow China to 'influence debtors' domestic and foreign policies' (ibid.: 1).

It has been estimated that 26 per cent of total debt-service payments by 68 DSSI countries in 2022 went to China, compared to 17 per cent to bondholders and 9 per cent to the World Bank-IDA (Yue and Nedopil, 2022). By the end of 2020, China had deferred payments of US$ 2.1 billion to address DSSI countries' debt, compared to US$ 2.5 billion deferred by Paris Club members. China promised to redistribute US$ 10 billion of its US$ 38.2 billion worth (26 per cent) of newly issued IMF SDRs to African countries. By comparison, other G20 countries — such as France, Italy, the US and the UK — committed about 20 per cent of their SDRs for redistribution to emerging market economies (ibid.). Of the LICs that sought DSSI relief, China contributed to 63 per cent of debt-service suspensions, despite holding only 30 per cent of debt claims, with 23 countries (including 16 in Africa) benefiting from China's G20 DSSI relief (Brautigam and Huang, 2023).

China has also been criticized for insisting on the participation of the IMF, World Bank and other MDBs in debt relief; allegedly, it has done so to evade demands by the US and IMF for China to provide more debt relief (Lynch, 2023). However, China's insistence on MDB participation is not only not new, but is also supported by others (Kebret and Ryder, 2023), including many African countries. For example, South African President Cyril Ramaphosa, speaking on behalf of the African Union in 2020, had urged MDBs to join the DSSI (Fabricius, 2020).[17] At the Global Sovereign Debt Roundtable during the 2023 Spring meetings of the IMF and the World Bank, China agreed to drop its earlier demand that the MDBs share losses as part of LIC debt restructuring, provided the World Bank uses its IDA fund to offer more concessional lending and even grants to the poorest indebted nations.

Clearly, discourses such as China's alleged 'debt-trap diplomacy' or 'debt relief reluctance', lack of 'good governance' and debt buyback proposals using donor, IMF or multilateral development bank financial resources detract from urgently needed measures to avert and alleviate debt distress.

PREVENTING AND MITIGATING DEBT CRISES

Possible international and domestic measures to address the structural causes of the looming debt crises need to be considered. With more debt, especially commercial borrowings, and higher interest rates, developing countries' public debt burdens are likely to worsen further, due to the pandemic, war, sanctions and policy-induced recessions. Hence, appeals for urgent debt standstills, cancellations and restructuring are understandable. However, as noted by UN-DESA (2020): 'Addressing sovereign debt distress is a long-standing challenge. While there is no shortage of policy ideas, progress in addressing the challenge has remained piecemeal, with little appetite among key actors'. Distractions like proposals to use IMF and donor resources for debt buybacks have not helped. Bond buybacks are no panacea, and do not necessarily help debtor countries (Bulow and Rogoff, 1988; Sachs, 1988). Furthermore, private bond markets have changed significantly since the 1980s, with more varied and powerful private creditors than US commercial banks. Prospects for comprehensive debt buybacks, involving all creditors, are much more difficult to achieve now as lenders are more heterogeneous.

Despite such difficulties, bond buybacks on terms much more favourable to indebted countries could be part of possible debt restructuring options, even though, in recent history, only one sovereign debt buyback — Ecuador's in 2008–09 — has been widely acknowledged as helping the debtor country (Feibelman, 2017). Argentina's recent debt restructuring initiative may also be positive for the republic (Hoyos, 2020; Silva et al., 2022). The two cases of Ecuador and Argentina may well be the exceptions proving the rule. They were led by the governments themselves, on their own terms and with some of their own resources, to use opportunities

17. South African Government, 'President Cyril Ramaphosa: Handover Ceremony of the AfCFTA Secretariat'. Press Release 20 August 2020. See: www.gov.za/speeches/president-cyril-ramaphosa-handover-ceremony-afcfta-secretariat-20-aug-2020-0000 (accessed 9 May 2023).

presented by international developments for comprehensive debt restructuring. No donor country consortium or multilateral financial institutions were involved in underwriting these restructurings. Such underwriting could have led to moral hazard by encouraging holdouts: if creditors think more money may be available, they are more likely to keep bargaining to get as much as possible. Debtor countries may thus end up paying much more. Such institutionalized approaches also encourage trading in risky sovereign bonds offering high returns. Private investment funds may buy such bonds if they expect to sell them off profitably. They can still make money, even when such bonds are heavily discounted due to high interest rates.

There is an urgent need for money to roll out adequate and inclusive relief and transformative recovery packages to protect development gains. Most debt restructuring is 'messy' and time consuming. Using IMF or donor money for bond buybacks, as advocated by Stiglitz and Rashid (2020) — instead of directly providing urgently needed funds — is unlikely to be the best way to deploy scarce funds in dire circumstances. Reflecting on the 1980s' Latin American debt crises, Ocampo (2014: 111) emphasized, 'international financial institutions should never be used to support the interests of creditor countries'. The situation is even worse if such arrangements involve private creditors.

International Measures

Preventing debt crises sustainably would require bolder and much more adequate international measures, and earnest donor commitments to meet their aid obligations, including their more recent climate finance promises. MDBs should also significantly increase concessional development financing so that countries are not compelled to borrow from international capital markets. Effective steps are urgently needed to facilitate SDR use for development finance, which has been proposed ever since the SDRs' inception.[18] A new SDR allocation was agreed on 2 August 2021, over a year after it was first proposed by the IMF Managing Director but blocked

18. In 1965, an UNCTAD group of experts argued that SDRs should be allocated to meet the development finance needs of newly independent countries. But when SDRs were first issued in 1970, they were allocated in proportion to members' quotas. In 1971, the US unilaterally revoked its Bretton Woods commitment to fixed gold convertibility of the US dollar. In 1972–73, developing countries proposed 'the link' envisaging a deal in which (mainly European) developed countries would get a reformed international monetary system with the SDR serving as international reserve currency — as the US dollar had in the defunct Bretton Woods system — thus eliminating the US dollar's 'exorbitant privilege'. In return for their support, developing countries would receive most of the next SDR allocation. In the end, a second SDR allocation went ahead without honouring the promised bias, with developing countries told their proposal may be considered in the future. Predictably, nothing has happened since. Support for issuing SDRs for development finance resurfaced in discussions to finance the MDGs after the 1997–98 Asian financial crisis, but again, noth-

by the Trump Administration.[19] Although representing the largest amount ever, the SDR issue was insufficient, and circumscribed by the requirements of avoiding securing US Congressional approval. The IMF had estimated at least US$ 2.5 trillion of financing was needed by developing countries, while *The Financial Times* (2020) believed SDR 1 trillion (US$ 1.37 trillion) was needed to help poorer countries. But only about SDR 456 billion (equivalent to approximately US$ 651 billion) could be approved by the new US administration. Washington has effective veto power in IMF governance, but can only approve a limited amount without US Congressional approval. SDR allocations are largely made according to IMF 'quotas', broadly reflecting members' relative economic size and openness, meaning developing economies receive little. However, unused SDRs can be re-assigned, for instance to designated MDBs and the IMF itself.

Meaningful international cooperation is also needed to prevent TNCs' tax evasion and avoidance. Developing countries' reliance on corporate income tax is higher than in OECD member countries: for example, the share of corporate tax in total revenue is 58 per cent in India, 66 per cent in Malaysia, and 52 per cent in Indonesia, compared to 9 per cent in France and the UK (OECD, 2021). Hence, developing countries' tax revenues continue to suffer much more from tax base erosion and profit shifting (BEPS) activities by TNCs. The current OECD 'Inclusive Framework' to address the issue is stacked against LMICs (McCarthy, 2022). Although called 'inclusive' and indeed including 48 LMICs that are not members of the OECD or G20, LMIC voices are rarely heard, seriously undermining the framework's legitimacy (Chowdhury and Jomo, 2019b). Thus, *The Economist* (2021) doubts whether LMICs will benefit much from the BEPS deal based on a minimum tax rate of 15 per cent for large TNCs as dictated by the G7 of most powerful developed countries.

While donors and MDBs must stop encouraging harmful tax competition, LMICs should be at the table as equals when international tax rules are designed (Chowdhury and Jomo, 2019a). Developing countries have long argued for a leading role for the UN, where they expect an equal say on international tax matters. UN members finally resolved to begin talks on international tax cooperation in November 2022. However, developing countries fear that the approval of the OECD's Inclusive Framework to design and implement a BEPS deal will shape any future UN agreement and block challenges to it, as 'delegates speaking for America and the EU warned that it would "undermine" the progress made by the OECD' (*The Economist*, 2022).

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ing happened. In 2009, following the GFC, 250 billion SDRs were issued, but they were allocated according to members' quotas.

19. The proposal was opposed by the Trump Administration because it would also benefit countries disliked by the US, the largest IMF shareholder (Reuters, 2020).

At the same time, effective actions are needed to implement the UN General Assembly's 2014 landmark resolution to establish a multilateral framework for sovereign debt restructuring. The resolution contains nine core principles for countries undertaking sovereign debt restructuring: sovereignty, good faith, transparency, impartiality, equitable treatment, sovereign immunity, legitimacy, sustainability and majority restructuring. The emergence of non-Paris Club countries as major bilateral lenders has been important for growing South–South cooperation. There is now greater reliance on financial cooperation between low- and middle-income countries. Therefore, there is a greater need to develop a common debt sustainability and restructuring framework including non-Paris Club lenders.

Meanwhile, the UN Security Council could pass a new resolution, under Chapter VII of the UN Charter, calling for standstills, for 6–12 months, on debt-service payments for countries requesting exceptional IMF support. Such a resolution would allow time for negotiations between governments and private creditors without the threat of litigation by those insisting on holding out. Debt-distressed countries can also cite Security Council Resolution 1483 — which granted a 'debt-shield' preventing commercial creditors from suing the Iraqi government to collect on sovereign debt — as a precedent to provide more breathing space to settle commercial debt in a much more considered manner (Kharas, 2020).

Domestic Measures

Appropriate domestic measures are also important. Developing countries need to strengthen their resource mobilization efforts, particularly to secure more tax revenue, and especially from direct taxation, which is generally more progressive than indirect taxation. They must avoid harmful tax competition, and carefully analyse the costs and benefits of offering 'tax breaks', for example to TNCs.

Central banks must become much more developmental, by boosting economic growth, promoting employment, and promoting needed and desired investments, as well as addressing balance-of-payments problems and maintaining price stability. Multiple objectives will require more coordination and joint efforts with fiscal authorities, planning ministries and regulatory agencies. Effective fiscal–monetary policy coordination needs appropriate enabling arrangements. Laurens and de la Piedra (1998) of the IMF showed that, 'neither legal independence of central bank nor a balanced budget clause or a rule-based monetary policy framework … are enough to ensure effective monetary and fiscal policy coordination' (ibid.: 29). Appropriate design of fiscal and monetary policies is also critical for supporting dynamic structural transformation, including greening the economy and expanding productive capacity. Without effective linkages between macroeconomic policies and sectoral strategies, central bank financing may spill over into balance-of-payments problems, causing inflation. Macro-prudential regulations can help avoid possible adverse impacts of monetary financing on exchange rates and capital flows.

Poorly accountable governments often take advantage of real, exaggerated and imagined crises to pursue macroeconomic policies for regime survival, often also benefiting cronies and financial supporters. There are no alternatives to ensuring state-owned enterprise efficiency, necessary public investments and project financial viability. Undoubtedly, much better governance, transparency and accountability are needed to minimize both immediate and longer-term harm due to 'leakages' and abuses associated with increased government borrowing and spending. Citizens and their political representatives must develop more effective means to 'discipline' policy making and implementation. This will help ensure public support to create fiscal space for responsible counter-cyclical and development spending. Finally, both borrowers and lenders must behave responsibly, and rigorously check the financial viability of project proposals and implementation. Democratic oversight is essential to ensure much greater borrowing for productive investment, particularly to enhance productive, including export, capabilities.

CONCLUDING REMARKS

Debt has been rising worldwide since 2010 following the GFC, reaching historical highs before the COVID-19 pandemic. As the World Bank has acknowledged, emerging market and other developing economies saw rapid debt build-ups, rising by 54 percentage points to 170 per cent of GDP in 2018 (Kose et al., 2020). Debt has also risen in LICs to 67 per cent of GDP (US$ 268 billion) in 2018, up from 48 per cent (around US$ 137 billion) in 2010, after a steep fall during 2000–10. Assessing macroeconomic developments and prospects in LICs, the IMF (2018) raised concerns that rising debt levels had increased associated vulnerabilities in many countries. Some 40 per cent of LICs, up from 21 per cent in 2013, were facing significant debt-related challenges. Meanwhile, countries at high risk of debt distress faced tight fiscal constraints and limited borrowing space.

The COVID-19 pandemic exacerbated the debt situation as countries responded with unprecedented fiscal and monetary measures for relief and recovery. It has greatly increased the list of developing economies in debt distress. While crises were already imminent for some, exceptionally low QE interest rates before 2022 had provided breathing space to many. The situation has changed dramatically with the rapid, sequenced interest rate hikes to stem rising inflation. But the recent inflation is due to pandemic, Ukraine war and sanctions-induced supply disruptions. Pent-up demand has often surged as pandemic responses changed. The situation has not been helped by rich nations refusing to provide meaningful and adequate debt relief. For example, the World Bank refused to emulate, let alone complement, the IMF's debt relief initiatives for LICs in pandemic debt distress.

While interest rate hikes and consequent economic slowdowns have undoubtedly been important proximate triggers, one major cause of developing country debt distress lies in their changing external debt composition. In the preceding decade, they have taken much riskier commercial borrowings at higher interest rates with shorter maturities, with less refinancing or restructuring options. This shift has accelerated since the GFC, due to broken aid promises, declining concessional finance, and donor and MDB pressure to leverage private finance to meet increasing emergency, development and other financing needs.

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