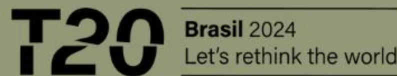
T20 Policy Brief



Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Navigating Global Debt Challenges through G20: Brazil's Role in a Shaping a Just Order with a Rights Based Approach

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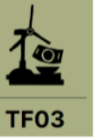
Abstract

Despite contemporary global challenges, the G20 remains uniquely positioned to shape solutions for globally important issues including sovereign debt restructuring. Debt issues are complex, stemming from domestic factors such as corruption and capacity deficiencies, and exacerbated by external factors like increasing interest rates, unfavorable terms of trade, and general slowdown in the global economy, etc. As per the International Institute of Finance, global debt has surged to $307 trillion. In the wake of the Pandemic, the G20 had initiated the Debt Service Suspension Initiative (DSSI) in 2020 for temporary relief and followed with the Common Framework for Debt Treatments. The framework intends to bring together large creditors like China and the Paris Club to negotiate plans for debt restructuring. This policy brief seeks to map the constraints faced by indebted nations and delineates a committed and pragmatic pathway to enable Brazil to build global consensus on alleviating debt distress for the world's poor. The brief proposes strategies to remove systemic constraints that inhibit prompt and efficient debt restructuring. The brief recognizes the crucial role of the IFIs and proposes a balanced model to spare the poor from crushing austerity while enhancing debt servicing capacity of debtor nations. Besides, the policy brief advocates for a 'rights-based approach' to frame debt relief beyond pure economics.

Keywords: Global Debt, G20, Common Framework, Human Rights



Diagnosis of the Issue

Since its elevation to the leader's level in 2008, the G20 has matured from being a crisis manager to a powerful body for addressing various global economic challenges, deriving legitimacy from its ability to muster unprecedented political will and financial muscle to deliver globally necessitated public goods (GPGs). The performance-based legitimacy of

G20 is also crucial given that non-G20 countries i.e. Global Governance Group (3G)[1] have been critical of the restricted membership of G20. Therefore, it becomes necessary for the G20 to address issues (i.e. debt distress) that are predominantly priority concerns of the non-G20 states.

The Covid-19 pandemic pushed the G20 to establish the DSSI in May 2020 to help debt-distressed low-income countries protect the vulnerable sections of their society. Its temporary aim was to enable nations to fulfill their urgent liquidity requirements by encouraging redirection of resources towards social, health and economic spending (World Bank 2022). Thus, it was never supposed to address the root cause of the debt crisis. However, with the participation of only 48 out of 73 eligible countries, the

[1] The 3G comprises of the following members: Bahamas, Bahrain, Barbados, Botswana, Brunei Darussalam, Chile, Costa Rica, Finland, Guatemala, Jamaica, Kuwait, Liechtenstein, Luxembourg, Malaysia, Monaco, Montenegro, New Zealand, Panama, Peru, Philippines, Qatar, Rwanda, San Marino, Senegal, Singapore, Slovenia, Switzerland, the United Arab Emirates, Uruguay and Vietnam. The grouping aims to enhance the representation and interests of its members in the G20 led global governance process.

initiative's overall impact on debt relief has been limited. Today, many countries[2] totter on the brink of sovereign default (Mukhopadhyay 2022, IMF 2021).

Given the ballooning global debt problem, the G20, with a prior endorsement from the Paris Club, unveiled the vision of a Common Framework (CF) based on key principles of 'comparability of treatment', 'effective creditor coordination'[3] and 'case by case approach' to offer timely, orderly debt treatment. The CF intends to provide restructuring if the debt is unsustainable while reprofiling or rescheduling would be a preferred solution if the problem is a liquidity crunch (IMF 2021).

Chad was the first to enter negotiations under CF, resulting in the debt restructuring agreement in November 2022. Nonetheless, the arrangement has been criticized for not reducing Chad's debt burden and instead intensifying its dependence on oil revenues.

Glencore, the private creditor holding one-third of Chad's total debt, was criticized for delaying the process for nearly two years (Bretton Woods Project 2022).

Another major problem with CF is that it excludes low-middle-income (LMICs) and middle-income countries (MICs) like Sri Lanka from the scheme. The pandemic has created a new pool of vulnerable sections in MICs that are still under recovery (Shivamurthy 2023). This cross-country pool of poor demands a transition in debt relief programs from a nation-focused to a poverty-focused approach, because a nation centric approach runs the risk of excluding poor within LMICs and MICs since the country as a whole may not qualify for debt treatment under CF or similar mechanisms.

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[2] Some prominent names include Argentina, El Salvador, Ecuador, Ukraine, Tunisia, Egypt, Kenya, Ethiopia, Nigeria, Pakistan etc.

[3] Including Paris Club, Official Bilateral Creditors and Private Creditors.

Debt-stricken states also face a dilemma given the powerful influence of market dynamics. Countries like Senegal, Kenya, Rwanda, Benin and Pakistan have been reluctant in participating in CF, or negotiating with private creditors owing to fears of negative market sentiments or sovereign ratings downgrades. Likewise, driven by the fear of reputational loss, Vanuatu withdrew its request from DSSI. While signing up for CF in 2021, Ethiopia pitched for equal burden sharing among official bilateral lenders but sought to exclude private creditors from the relief package (Cassimon et al 2023). Bringing private lenders to the bargaining table still remains a huge task.

It is worth noting that debt distress is a fundamental problem and threatens realization of SDGs. The 2024 G20 Brazilian Presidency has prioritized poverty alleviation, social inclusion, and sustainable development as core agenda items intricately linked to debt. Approximately 18 states are experiencing the combined problem of debt distress with famine. At the most fundamental level, the global debt crisis reflects the unequal nature of the global order. The developing world is in dire need of finance to achieve their development goals sustainably. Still, they are also the ones who are disproportionately at risk from climate-induced disasters, a problem to which they hardly contributed (Zucker-Marques and Espinosa 2024). For the 2024 G20 Summit, President Lula has therefore pitched that any effective solution must entail combining social, economic and environmental sustainability..

Recommendations

1. **Proactive restructuring:** Proactive restructuring is crucial because delays invariably lead to massive socio-economic costs as evidenced in Latin America and Africa. The recent Zambian example demonstrates how a $6.3 billion treatment deal in 2023 led to massive socio-economic costs because of a delayed restructuring process. The G20 can propose a framework for early detection and pre-emptive debt restructuring. To build political support for the proposal, UNCTAD's 'Principles for Responsible Sovereign Lending and Borrowing' published in 2012 can be referenced. These principles advocated for debt restructuring that is efficient, timely, orderly, and fair for nations experiencing financial distress (Gelpern 2012).

2. **Objective restructuring:** A key bottleneck preventing global consensus in resolving the debt negotiations is to decide 'whether' and 'when' a nation requires debt treatment. Lukkezen and Romagosa (2014) have proposed a two-pronged mechanism to speed up decision-making on debt restructuring. The first involves scrutinizing 'debt indicators' that credibly hint at a nation's trajectory towards vulnerable debt. These indicators are multidimensional having fiscal, external and banking dimensions. The fiscal aspect is measured by the fluctuations in interest and growth rates as well as the anticipated policy response to these fluctuations. The external dimension is captured by the abrupt halts in foreign currency inflows, such as capital investments, remittances and exports. It may also include an international political/geopolitical crisis. The banking aspect aims to study the banking sector stress that may lead to crises, obliging states to intervene. The second component of this mechanism is the 'unexpected negative shock 'or negative externality capable of triggering a default (Lukkezen and Romagosa 2014).

These components indicate latent possibility of default. G20 can recommend adoption and institutionalization of some of these criteria in G20's finance track.

3. **Bridging China-Paris Club divide:** China's major concern has been 'fair burden sharing,' demonstrated by President Xi's meetings with major debtor states like Venezuela and Zambia *during* the 2023 G20 summit. The Paris Club on the other hand has insisted on a multilateral approach through CF. Brazil and India can help find the 'common minimum ground' between China and the Paris Club to facilitate acceptable haircuts and restructuring.

4. **Rights-based approach:** The Human Rights Watch (HRW) has criticized the majority of the pandemic-induced IMF loans during 2020-2023 that were austerity-laden and deepened inequality and social exclusion. As a champion of causes such as "Responsibility while Protecting (RwP)," Brazil should flag debt distress as an HR concern. A collaborative enterprise with like-minded countries and organizations may prove vital here. It also gels with the current High Commissioner for Human Rights (OHCHR), Volker Turk's idea of a 'human rights economy' and the former UN Independent Expert Cephas Lumina's work on the necessity of trade-off between debt servicing and basic human needs (Lumina 2018: 289, OHCHR 2023).

5. **Soft law:** Given the austerity pain faced by the world's poor, the UNHRC has issued 'guideline principles' for lenders and debtors. These include adhering to strict criteria, mitigating negative effects on rights, and publishing HR impact assessment reports (Stauffer 2023). The HR impact assessment should be made a core agenda item

in the G20's Sherpa Track discussions and the details thereof should be made public domain for analysis by different stakeholders.

6. **Categorisation approach:** Based on country-specific debt sustainability analysis (DSA), the CF operates on the 'case by case' approach on deciding whether an economy needs restructuring (IMF 2021). This approach is sluggish and prolongs the suffering of the poor. Positioned between the extremes of a universal, one-size-fits-all approach and a case-by-case method, the G20 should recommend a categorization strategy, to grouped countries on the common treatment they require, identified through technical assessments. This approach would expedite decision-making and empower debt-distressed nations to negotiate on better terms by pooling their otherwise limited bargaining power.

One such category can be 'conflict ridden states' whose failure may present regional and oftentimes, global security risks. It directly flows from the IMF's assessment that, "fiscal measures that place a disproportionate burden of adjustment on vulnerable people risk creating unrest in fragile and 'conflict-ridden' states….. and could trigger a move from fragility to failure" (IMF 2022). G20 must work closely with the IMF in monitoring such states and their debt profile, and trigger timely actions before they turn unserviceable.

7. **Overhauling pro-poor benefit processes:** The need to ring-fence the poor and vulnerable sections of populations in debt-stricken countries can hardly be overemphasized. It is imperative, therefore, for the debt relief measures and programs to achieve two goals simultaneously. First, the austerity measures and other economic conditionalities must be designed to ensure that the prevailing means-testing cash transfer

schemes are protected and not resource-starved. Second, measures to strengthen the processes of benefit transfers need to be enshrined in debt relief/adjustment conditions and flagged as an important progress evaluation element. This is because very often, cash transfer schemes in low-income countries are rendered wasteful and leak-prone because of corruption, mistrust, and statistical errors, leading to money vanishing from the system and not reaching the needy. Overhauling the benefit-transferring processes would save precious exchequers' dollars while ensuring that the money spent actually reaches the poor, thus increasing economic activity in the system. It will simultaneously insulate the vulnerable sections of the population from the strenuousness of economic adjustments necessitated by structural adjustment measures.

8. **Deleveraging:** Deleveraging involves financing without incurring debt through two avenues: grants and equity. Under this, multilateral creditors can convert loans into grants, while private debt holders would swap debt for shares in privatized state-owned enterprises; thus, new financing would be either grants or equity. Deleveraging anticipates short-to-medium-term stress but long-term recovery (Tata 2023). Collaborating with the IMF, the G20 finance track could identify sectors for a deleveraging cycle, easing public debt, boosting investor confidence, and unlocking economic potential.

9. **Reforming the raters:** The G20 should propose a pausing of country ratings during crises like COVID-19 or natural disasters as they impinge on the genuine efforts made by countries to ameliorate the socio-economic distress (Li 2021). The G20 can facilitate consensus making on the 'time-period' during which the credit rating agencies may refrain from assessing the defaulters.

Scenario of Outcomes

The recommendations made above advocate a three-pronged strategy for easing the debt burden of poor countries. These relate to early detection of stress and prompt response mechanisms, humane focus, and enhancing the debt repayment ability of debtor countries.

There are, however, several challenges in introducing and implementing these recommendations. The biggest contradiction is the moral dilemma of incentivizing bad behavior of the relief recipient governments. The donors face a stark choice of whether to punish the bad behavior of countries or bail them out. This dilemma is accentuated by the suffering of the poor who suffer most despite having no say in debt-generating policymaking.

This brings to focus the questions of conditionalities, jurisdiction, and interference. It is widely realized that debt relief needs to be accompanied by pre-relief policy-related conditionalities and effective monitoring with defined goalposts. These measures, however, restrict the policy maneuverability of target countries' governments and are oftentimes construed as interference, reducing the acceptability and the implementability of relief, as was evidenced during the financial crisis of the late 1990s in East Asia where IMF conditionalities were seen as villains. It is in this regard that packaging the relief program with reasonable decision-making autonomy for national governments, joint monitoring of progress, and capacity building becomes necessary.

The countries needing debt relief are a diversified lot, each displaying a different socio-economic problems and requiring country specific programs. However, such a high country specificity increases the time required for program creation through separate technical negotiations. To address the problem, a categorization approach should be

adopted that assigns countries to respective risk categories, inviting automated response triggers. Countries with extreme requirements and/ or afflictions may receive immediate response from donors. Essentially, a judicious trade-off between speedy relief programs and necessary specificity is required.

Lastly, restructuring needs acceptance among stakeholders. Whether it is IFIs, donor countries, or private loan-giving organizations, each is accountable to different entities and stakeholders. Therefore, greatest care is required to create satisfactory trade-offs. In an environment infested with wars and conflicts on the one hand, and the rise of populism on the other, it is hard to sell the idea of debt relief for foreign countries to voters, politicians, and profit-maximizing shareholders.

What still tilts the balance in favor of creating and implementing a humane, effective, and monitorable debt relief is the cost of balking. As has been seen in the last couple of decades, debt disasters and insolvent, bankrupt economies lead to social upheavals, spilling over borders. A significant part of the contemporary refugee problems are rooted in economic destitution. No problem is strictly national in the present interconnected world. As such, it is in every nation's interest to ensure that all constituents of the global economy function well and are not ailed by debt-related problems. G20, because of its political and financial wherewithal and technical expertise is uniquely positioned to steward the debt-related deliberations.

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