PERSPECTIVE

ECONOMY AND FINANCE

NO MORE LOANS?

How Creditors Torpedo Debt Relief Initiatives

Kristina Rehbein and Jürgen Kaiser
October 2021

The debt relief initiatives established in the context of the COVID-19 crisis threaten to fail because poorer countries are reluctant to participate.

One reason for this is the claim made primarily by private creditors that the beneficiaries of debt relief exclude themselves long-term from the capital market.

However, more important than any short-term downgrade of participating countries is the question whether the debt relief goes far enough to facilitate an economic restart.

FRIEDRICH EBERT STIFTUNG

NO MORE LOANS?

How Creditors Torpedo Debt Relief Initiatives

The take up of G20 debt relief initiatives to tackle the economic consequences of the COVID-19 crisis has been reluctant. Private creditors have warned countries seeking to participate that in doing so they risk long-term exclusion from the capital market. In turn, that has persuaded some of the countries eligible for the Debt Service Suspension Initiative (DSSI) to maintain their payments to private creditors even though the International Monetary Fund has long concluded that their total debt burden is unsustainable. However, the threat scenario propagated by creditors

is baseless. It cannot be proven logically or empirically. Historically, participation in debt relief initiatives has led, after a short transitional period in which borrowing has been sourced primarily from the public sector, in the majority of cases, to the countries concerned gaining initial or improved access to the capital markets. Writing off unsustainable old debts ultimately increases the likelihood that each new financing will repaid. For debt distressed countries it is therefore never advisable to continue paying beyond their capacity. For the debtor, an economic restart is only

possible without oppressive old debts. For creditors, it offers, in addition, the chance that the remaining debts will be serviced reliably – not least because the country concerned, following the debt relief, is now attractive for new investors. Consequently, in the current situation, debtor countries should insist on a timely and comprehensive implementation of debt relief. The G20 is called on to take political and legal measures to strengthen the position of debtor countries in their dealings with uncooperative creditors.

For further information on this topic:
www.fes.de/themenportal-die-welt-gerecht-gestalten/weltwirtschaft-und-unternehmensverantwortung

FRIEDRICH EBERT STIFTUNG

ECONOMY AND FINANCE

NO MORE LOANS?

How Creditors Torpedo Debt Relief Initiatives

In April 2020, the G20 countries established the Debt Service Suspension Initiative (DSSI),[1, 2] offering 73 of the poorest countries the opportunity to suspend for a limited period their debt service payments to the G20 and all the members of the Paris Club. This was intended to help them in tackling the pandemic and its consequences. In addition, in November 2020, the G20 established a common framework[3] to allow the same group of countries to negotiate debt restructuring in a timely manner should they be unable to resume their debt servicing. This is the first debt relief initiative to address an entire group of countries since the multilateral HIPC (Heavily Indebted Poor Countries) Initiative of the late 1990s. Following the debt relief achieved under the HIPC Initiative, creditors and international financial institutions considered sovereign debt crises to have been overcome once and for all, meaning that serious political discussions on reforms in this area have not taken place. In this sense, the DSSI and the G20 Common Framework are an admission that debt management as it existed before the pandemic is not capable of providing suitable long-term answers to the debt problems of the Global South.

However, both initiatives have fallen short of their potential effectiveness. Some countries have actively refrained from participating in debt relief. One of the reasons is the signal that participation in debt relief would result in a downgrade of a country's rating on international capital markets, increasing the cost of future borrowing.[4] Not least for this reason, of the 73 countries eligible for the DSSI, as yet only 47 have participated.[5] Also the principle of comparability of treatment for all creditors in debt restructuring called for by the G20 under its Common Framework[6] – which is central to a comprehensive solution – has come under pressure. Ethiopia is one of the three countries that has so far requested a restructuring under the Common Framework. Out of concern for its future access to capital markets, the country has already signalised that it wants to avoid any greater losses for its private creditors.

This analysis examines how plausible it is that participation in debt relief does in fact lead to an increase in borrowing costs. Consideration is given to the challenges facing critically indebted countries and to the individual arguments against debt relief. Furthermore, a critical assessment is made of the motives of the actors involved and recommendations are offered as to how debtor countries can escape the dilemma between necessary debt relief and the risk of increased borrowing costs.

1 THE CURRENT CHALLENGE FACING POOR COUNTRIES – BETWEEN DEBT RELIEF AND THE THREAT OF LOSING CAPITAL MARKET ACCESS

The G20 recognised that debt relief was a suitable tool for assisting countries that in the early phase of the pandemic did not have sufficient financial resources to pursue an effective crisis management and support their economy. With the debt service suspension, the time-consuming acquisition of new funds from donors can be avoided. Instead, hard currency stocks already held by the countries concerned are repurposed. A more efficient route to establishing fiscal scope does not exist.

---

1 This analysis builds on the following publication of 28.9.2020: *Debt relief? Thanks, but no thanks!* (https://www.ips-journal.eu/topics/foreign-and-security-policy/debt-relief-thanks-but-no-thanks-4671/).

2 The debt moratorium provides for a net present value neutral deferral of debt servicing payments for 2020 and 2021 until the period 2023 to 2027. Its objective is to provide poorer countries with additional fiscal scope to overcome the consequences of COVID-19. The initiative has been extended twice; now set to expire at the end of 2021.

3 *Common Framework for Debt Treatment beyond the DSSI*. See G20 (2020): Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting Final Statement, 13.11.2020 (https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/world/G7-G20/G20-Documents/2020-11-13-extraordinary-g20f-mcbg-statement-of-november-13.pdf%3F__blob%3Dpublication-File%26v%3D6).

4 See, for example, Olivares-Caminal, R. (2020): Africa needs to be wary of the unintended consequences with a moratorium on its debt, *Quartz Africa*, 11.5.2020 (https://qz.com/africa/1855578/africa-needs-to-be-wary-of-consequences-of-debt-moratorium/).

5 See World Bank: COVID-19: Debt Service Suspension Initiative (https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative last accessed on 4.6.2021).

6 What has been agreed is the deferral of debt service payments for a limited period in relation only to public creditors which are members of the G20 or the Paris Club. However, from the outset, this group has called for comparability of treatment for private creditors; it has, however, not implemented any measures to compel participation.

However, if such a moratorium is not implemented comprehensively, there is a danger that this fiscal scope is not used as intended to finance measures for tackling the crisis but to maintain debt service payments to creditors not participating in the debt treatment. Had the public creditors not provided debt relief, these non-participating creditors could, quite possibly, have been hit by disorderly defaults because debtor countries no longer had the resources for regular debt servicing following the pandemic-related downturn in their economies. This is the position in which primarily private foreign banks and private holders of government bonds now find themselves, following the concessions made by the public sector.

In fact, since the establishment of the DSSI in April 2020 not one single moratorium has been granted by the private sector for any of the countries eligible for the DSSI.[7] When establishing the Common Framework in November 2020, the G20 argued that if debt rescheduling negotiations are carried out correctly, insisting on comparability of treatment, the private sector can and indeed must be included.[8] Under the comparability of treatment clause included in the debt rescheduling agreements between debtors and the participating G20 governments, debtors are required to seek from all creditors that are not members of G20 or the Paris Club – in other words mostly from private creditors – debt treatments that are (at least) as favourable. How debtors are expected to convince private creditors to make concessions of that kind in the absence of proper legal means and contrary to the terms of existing debt agreements – on this the G20 and Paris Club are silent. Furthermore, the Common Framework does not establish any instruments to assist debtors in pushing for comparability of treatment.[9] This explains the call by the African Development Bank, made in the March 2021 edition of its *African Economic Outlook*, for more stringent comparability of treatment clauses, requiring also the G20 governments to ensure the participation of the private sector.[10]

As there are no binding instruments with which to compel private sector participation, under earlier Paris Club debt relief agreements, from which this principle of comparability of treatment originates, the policy was implemented in different ways. After 2010 it appears generally to have functioned, but also in this period evidently some private creditors continued simply to hold their debts, even if they were no longer being serviced. It would seem that they hoped to collect the old debts in full (together with penalty and default interest where applicable) when the debtor had recovered economically or to sell them, albeit at a deep discount, to a vulture fund.[11]

In the context of the COVID-19 crisis and the initiatives established by the G20, private creditors built up an effective threat scenario to deter countries from taking advantage of debt relief measures requiring private sector participation. In the media reporting on the DSSI, their non-participation was increasingly justified: Time and again bankers and fund managers were quoted as saying that debt relief could increase the cost of future borrowing and hence, ultimately, was contrary to the interests of debtor countries.[12] From the outset of the initiative, rating agencies were quick to spread this message, also repeated by finance ministers of the beneficiary countries, justifying their decision to refrain from taking up the G20 offer.[13] Even the spokesperson for the public creditors assembled in the Paris Club, which had previously appealed to the private sector to participate, finally succumbed to this logic. On 25 June 2020, at the close of a G20 Working Group meeting,[14] the Vice-Chairman of the Paris Club, Guillaume Chabert, announced that the fact that 41 countries had applied for the moratorium was due in part to the clarification that private sector participation was no longer a requirement.

2 ARGUMENTS AGAINST DEBT RELIEF AND THEIR PLAUSIBILITY

The most far-reaching claim, advanced in the opening phase of the DSSI, was that mere participation in the debt moratorium offered by third parties (as the public creditors in the G20 and Paris Club are seen from the perspective of private creditors) would negatively impact on future capital

7 In an interview with erlassjahr.de, State Secretary Wolfgang Schmidt indicated that, according to official sources, the German Federal Government has always pressed in the G20 context for private sector participation in debt relief. See: *Schulden mit noch mehr Schulden bekämpfen? Ein Gespräch mit Wolfgang Schmidt und Patricia Miranda*, erlassjahr.de/Misereor: Schuldenreport 2021.

8 See comments made by the Chief Economist at the German Federal Ministry of Finance in the Online Expert Discussion: *Debt Relief as response to the corona-induced recession*, 25.9.2020 (https://www.youtube.com/watch?v=pWcJ9atl8Uk&t=806s).

9 Fitch approvingly emphasised that private sector participation is not mandatory under the Common Framework. See Fitch Ratings (2021): *G20 Common Framework and Private-Sector Debt Restructuring*, p. 3.

10 See https://www.afdb.org/en/documents/african-economic-outlook-2021, from page 84.

11 Vulture fund is a disparaging term used for investment or hedge funds that specialise in buying the government debt of distressed countries at a discount during a crisis which they seek to collect in full through the courts. The amount claimed often exceeds many times the price paid. The business model does not consider the implications for the debtor. The term vulture fund reflects the behaviour of vultures which circle patiently before swooping to take advantage of the weakness of their victim.

12 Most recent statements by private sector representatives include those made in April 2021 at the World Bank / IMF Spring Meeting (see, for example, statements made by Julie Monaco from Citi at the virtual World Bank event *Rethinking Debt: Financing the Future Amid Crisis*, https://live.worldbank.org/rethinking-debt-financing-the-future) and at the *UN Financing for Development Forum* (see the statements made by Clay Lowery from the Institute of International Finance in the panel discussion: Strengthening private creditor and credit rating agencies contribution to pandemic response and recovery, 14.4.2021).

13 See Gakweli, M. (2020): Kenya refrains from G20 Debt Relief Initiative, *The Kenyan Wall Street*, 16.5.2020 (https://kenyanwallstreet.com/kenya-refrains-from-g20-debt-relief-initiative/).

14 See G20 (2020): G20 International Financial Architecture Working Group Meeting – Press Release (http://www.publicnow.com/view/B3B830A5D0E1BE795FDE16A4C6EB635D3CE266C3).

market access.[15] The background for this was, amongst other things, the appeal – albeit not binding – by the G20 to private creditors also to participate. In truth, the argument is not sound, not even from the perspective of the private sector, as concessions made by third parties increase, by their very nature, the probability that the debts owed to private creditors will be repaid.

The position is similar with regard to the threat of negative consequences in the event that a debtor country takes advantage of genuine debt relief (and not simply a deferral of debt service payments) granted by public creditors, as is offered under the Common Framework.[16]

More plausible, at least ostensibly, is the argument that participation in a moratorium that includes private creditors could endanger future capital market access. If a credit transaction is understood as a »favour between friends«, this line of argument is comprehensible. However, it ignores the fact that the moratorium is net present value neutral. This means that the unpaid instalments also attract interest at the rate originally agreed; in other words, de facto, the creditor places the instalments that have been deferred on deposit on the same conditions on which, entirely voluntarily, it granted the original loan. As funds borrowed on the capital market are, as a rule, the most expensive form of government borrowing, this can hardly constitute a bad deal for creditors. The argument is only meaningful where creditors must assume that a country's participation in the moratorium will increase its risk of debt distress and, as a consequence, they must fear greater losses, for example, because the moratorium causes the debt burden to rise in the medium term. For that reason, some experts advise combining debt moratoria with the additional possibility of debt relief (which, in principle, is what is offered under the G20 Common Framework).[17] However, this argument does not appear yet to have troubled private creditors in the public debate.

If private creditors are forced, however, to participate in genuine debt relief, they do, in fact, suffer a real loss. Their participation is more clearly required by the G20 under the Common Framework than under the DSSI. To what extent participation in actual debt restructuring may or indeed must lead to penalties on the debtor in relation to future borrowing depends in the first instance on several factors. If the write-down is only limited, the creditor may not even suffer a loss, but simply earns less on the loan.[18] If the write-down is more significant, a genuine loss materialises. However, this must not be measured simply in terms of the original repayment expectations but also by reference to the book value at which investors (must) record loans in their books. Where a bank, for example, holds loans on its books to the notorious non-payer Zimbabwe, it is required under accounting rules already to reduce their book value and, in certain circumstances, to make (tax-deductible) provisions for the loans. If the loss actually materialises, the book value and actual value tend to converge. In relation to private debtors, banks and investors must carry out write-downs of this kind on a day-to-day basis. In themselves, they do not constitute any reason to exclude the company concerned from future borrowing if, following successful business restructuring, it can present a convincing business plan.

In addition, the arguments mentioned are undermined by the following misinterpretation. To be able to threaten the debtor, the individual creditor must act as if there was only one bank (as in the board game Monopoly) with no competition between investors. However, this is clearly not the case. Even if a former creditor withdrew from one of the beneficiary countries following a write-down of debt under the HIPC Initiative, there were enough others willing to grant new loans, given that the borrower had become virtually debt-free as result of the initiative. After all, following the cancellation of the debt, the country's future economic prospects were now extremely attractive.[19] In general, arguments against debt relief rest on the popular assumption that, if comprehensive (and orderly) debt restructuring were easier, it would greatly encourage governments in the Global South to become irresponsible and profligate. Following this, creditors are forced to increase the costs of borrowing. The establishment of debt relief initiatives or rules to improve the effectiveness and efficiency of debt restructuring negotiations would allow debtor countries to achieve debt cancellation more easily. This would remove the incentive for responsible budget management (the moral hazard argument). A further underlying assumption is that anyone whose debts must in some way be cancelled will be regarded from then on as a »bad debtor« and will be granted new loans, if at all, only at a greater cost (higher interest rate) and on provision of security. This argument has considerable public impact, since in the private context where loans are often a favour between friends for someone who has got into difficulties this chain of effects is undeniably convincing and common practice. However, it overlooks important dif-

15 See the reactions of private sector actors as compiled by White & Case (2020): The G20 Debt Service Suspension Initiative – Reaction from Key Market Participants, 8.6.2020 (https://www.whitecase.com/publications/alert/g20-debt-service-suspension-initiative-reaction-key-market-participants) or reported in Jones, M. and Arnold, T. (2020): Private creditors push back against blanket debt relief for Africa, *Reuters*, 15.5.2020 (https://www.reuters.com/article/us-health-coronavirus-africa-creditors-idUKKBN22R1QX).

16 See, for example, the view of investment manager Kevin Daly cited in Jones, M. and Strohecker, K. (2021): Analysis: Is the 'free ride' over for poor countries' bondholders?, *Reuters*, 2.2.2021 (https://www.reuters.com/article/ethiopia-debt-g20-analysis-int-idUSKBN2A22J8), and, similarly, Jones, M. (2021): Ethiopia's debt relief request to put other DSSI nations under scrutiny, *Reuters*, 1.2.2021 (https://www.reuters.com/article/ethiopia-debt-morganstanley-idUSL8N2K72Y5).

17 See Hatchondo, J. C. et al. (2020): Sovereign Debt Standstills, IMF Working Paper WP/20/290, for example, pp. 2–3.

18 As happened in the case of the seemingly deep write-down on Argentine bonds in 2020. Under the repayment scheme agreed in the restructuring, bond holders still made a profit on their initial loans, albeit the profit was somewhat reduced.

19 This applies not only to the competition between private creditors. Following the major write-down of loans granted by »traditional western« creditors to HIPCs, China has been highly pro-active in providing vast resources to cover the borrowing needs of numerous countries considered relevant to its global strategy.

ferences between a loan given as a favour between friends and the provision of credit to poor countries.

- Countries, in the same way as companies, borrow primarily to finance investments, from which the necessary funds are generated to service the debt. That is normally not the case where loans are given privately as a favour between friends; in that situation, it is hoped that the debtor's future regular income will be sufficient to service the repayment of the present loan.

- The creditor's motivation has nothing to do with friendship. Rather, the creditor makes an investment in order to generate an income from the interest payments. As to whether that is actually likely to materialise, the repayment history of the debtor country is only one of many factors taken into consideration. What matters above all is the debtor's future repayment capacity. However, past debt relief not only does not impair this but may indeed improve or establish the repayment capacity in the first place.[20] Even loans provided in the framework of development cooperation are better not regarded as favours between friends since, in addition to improving the borrower's position, they facilitate a multitude of interests on the part of creditors, from employment for experts and advisors in the domestic »development industry« and the opening up of markets for domestic exporters to the furthering of geostrategic interests. If a debtor does not repay such loans for a period, this does not automatically imply disqualification from further financing.

A further argument against debt relief, more implied than explicitly formulated, is that if the debtor simply continues to pay, they will retain, notwithstanding the deteriorating economic situation, access to the capital market. In this vein, during the pandemic, debtors experienced neither debt relief nor bridging finance from their private creditors.[21]

However, in fact, when it comes to a debtor's repayment capacity, rating agencies as well as individual investors focus primarily on the debtor's actual economic and fiscal situation – which is entirely logical. Thus, what is decisive for the deterioration in access to capital market financing or its complete loss (for example, as a result of a downgrade in rating) is simply the question whether debt relief, where this is necessary, is also sufficient to restore the debtor's economic capacity. Fitch Ratings clarified in a non-public document that following a debt restructuring the rating of a debtor country is naturally adjusted to reflect its creditworthiness (and thus the future risk of debt distress).[22] Were the Common Framework to exclude categorically the cancellation of debt and to permit only relief in terms of debt service payments, in other words, were sufficient improvement in the debt situation of critically indebted countries not achieved, because the debt restructuring does not go far enough, the creditworthiness (and correspondingly the rating) of the countries concerned would not improve. In turn, this would jeopardise future capital market access.[23] Systematic research into previous global debt crises, for example, following World War I and in emerging markets between 1978 and 2010, confirms the, as such, plausible assumption. It was not excessively deep debt relief that resulted in higher costs for the different parties in the past but restructuring that was too timid, that was intended to hurt the creditors as little as possible. Only with substantial debt cancellations were countries able to return to a sustainable growth path and thus restored to a position in which they could reliably service the remaining debt owed to their creditors.[24]

Nevertheless, the political debate is dominated by a desire to hurt the creditors as little as possible.[25]This also explains the threat to the debtor countries not to request comprehensive restructuring negotiations.

3 THE EFFECTS OF DEBT RELIEF ON CAPITAL MARKET ACCESS – HISTORICAL EVIDENCE

The experiences to date of countries participating in the DSSI are by no means as clear-cut as the supposed relationship between debt relief and capital market access would suggest. In April 2021 Pakistan and the Maldives, both participants in the DSSI, were successful in issuing new bonds. For these they paid up to 10.3 per cent. On the other hand, Ghana which refrained from DSSI participation achieved a new placement at a price considerably below that at 7.3 per cent (even if that interest rate is still high). Laos, another country which has refrained from DSSI participation despite its high debt burden, had to abandon a bond placement as not enough buyers could be found.[26] There is much to

---

20 A good example is provided by the countries (37 so far) which participated in the multilateral HIPC Initiative launched in the late 1990s, as a result of which they gained access for the first time to the international capital market, something that had previously not been possible.

21 See, for example, the remark made by Kevin Daly, Senior Investment Manager at Aberdeen Asset Management, speaking on behalf of the creditor group: »We expressed our desire to support African countries address liquidity pressures that have arisen due to the crisis, and by ensuring they remain current on their Eurobonds, we believe financing opportunities will materialize soon.« in: Africa's debt load forces negotiations, with China at the center, 19.5.2020 (https://www.clbrief.com/africas-debt-load-forces-negotiations-with-china-at-the-center/). Moritz Krämer describes this as a strategy of »doing nothing«; see Krämer, M. (2020): Bondholders need to forgive some African debt, *Financial Times*, 26.8.2020.

22 Fitch Ratings (2021): *G20 Common Framework and Private-Sector Debt Restructuring*, p. 5.

23 Ibid.

24 See, for example, Reinhart, C. M. and Trebesch, C. (2015): Sovereign Debt Relief and its Aftermath, Harvard Kennedy School Faculty Research Working Paper Series RWP15-028.

25 For example, in a conversation between the IMF's European executive directors and European civil society in the context of the World Bank / IMF Spring Meeting on 7.4.2021, the view was expressed that in the case of debt relief the bar must not be set too high so as not to frighten off creditors.

26 Compare Arnold, T. and Jones, M. (2021): Poorest countries will follow a tricky path back to debt markets, *Reuters*, 1.4.2021 (https://www.reuters.com/article/emerging-debt-eurobonds-idAFL8N2LU1H4).

suggest that capital market access depends primarily on a country's macroeconomic fundamentals, including the state of the economy and its future economic prospects, and not on whether it participates in debt relief.

Systematic research and experience from previous debt crises confirm this.

- Before the debt relief granted under the HIPC Initiative, since 1996, practically none of the countries eligible for the initiative had access to the private capital market; and where such access existed, it was exorbitantly expensive.[27] By the end of 2020, of the 37 countries that have benefited from the initiative to date, 14 have been successful in placing bonds on the international capital market.[28]

- Argentina is almost the epitome of a »bad debtor«. It was the country for whose debt restructuring the Paris Club was founded in 1956. Since then, Argentina has had to suspend payments to its creditors on no less than ten occasions. From the perspective of this paper, what is interesting, however, is not the suspension of payments but the speed at which creditors, after each write-down of debt, were queuing once again to grant the country new loans.

- At the global level, research by Andritzky and Schumacher who have investigated the long-term earnings of investors affected by debt restructuring losses in comparison with those not affected shows that even following seemingly drastic debt restructuring investors were able to achieve positive returns. And these were even higher than those achieved in risk-free bonds such as German government bonds.[29] In their latest research, using an updated dataset, they show that participation in debt restructuring is not an act of charity but is clearly in the interest of investors themselves and their long-term investment strategies.[30] Hence, they have called for better rules to facilitate debt restructuring process.

- Lang, Mihalyi and Presbitero observed for the initial DSSI implementation period between April and September 2020 not an increase but, rather, a decline in bond spreads for the participating countries in comparison with those not participating in the DSSI.[31] This is confirmed by other research.[32]

NO NEW ARGUMENT: FROM THE SOVEREIGN DEBT RESTRUCTURING MECHANISM TO COLLECTIVE ACTION CLAUSES

The argument that debt relief leads to a country's long-term exclusion from the capital market is not limited to the dispute surrounding the DSSI and the Common Framework. The argument has flared on almost every occasion a systematic improvement to debt restructuring processes has been attempted (see the moral hazard argument mentioned in section 2). Historically, debtor countries often did not take the decision to support reforms in relation debt relief on the basis of whether such reforms would result in fairer and more effective outcomes to debt restructuring negotiations. Or on the basis of whether these are appropriate to sufficiently stabilise their economies in the event of a crisis. What was decisive when deciding whether to support reforms to debt restructuring was how private investors would view such support and whether they would react by increasing the cost of borrowing. For this reason, the 1930s proposal for a comprehensive statutory framework for debt restructuring drawn up by Mexico and discussed at the Pan American Conference in Montevideo failed to gain support.

Also, in relation to creditor-led processes the narrative of capital market exclusion has been deployed as an instrument in the debate. This was the case, for example, in relation to the Sovereign Debt Restructuring Mechanism (SDRM), by which, in 2002-03, the International Monetary Fund attempted to establish under its own auspices a global framework for sovereign bankruptcy.

Shortly beforehand an article had appeared in *Euromoney* criticising the operations of the Paris Club. Under the provocative heading »Gulag-sur-Seine«, the author criticised the fact that in implementation of its comparability of treatment policy the public sector was wrongfully coercing well-meaning private funders of poorer countries to write off their debts to those countries. This was something investors would never have agreed to voluntarily. An attempt was made, at least indirectly, to suggest solidarity with debtor countries, also supposedly deprived of their autonomy by the process, by raising the difficulties they faced on the capital markets following a debt restructuring imposed in Paris.[33]

More recently, the motif has emerged in discussions surrounding the introduction and later the improvement of collective action clauses (CACs), which, following the failure of the SDRM, have been touted on all sides as the panacea against future debt crises. CACs allow a majority of creditors to negotiate debt restructuring measures with a debtor country to which also a non-consenting minority of the sub-

27 Some of the countries benefiting from the DSSI, above all in Africa, had lost access to the capital market long ago (or had never had access).

28 See Munevar, D. (2021): *Sleep now in the fire: Sovereign Bonds and the Covid-19 Debt Crisis*, EURODAD 2021.

29 See Andritzky, J. and Schumacher, J. (2019): Long Term Returns in Sovereign Bond Markets, IMF Working Paper WP/19/138.

30 See Andritzky, J. and Schumacher, J. (2021): Bond returns in sovereign debt crises: The investor's perspective, 18.1.2021 (https://voxeu.org/article/bond-returns-sovereign-debt-crises-investors-perspective).

31 See Lang, V., Mihalyi, D. and Presbitero, A. (2020): Borrowing costs after debt relief, 14.10.2020 (https://voxeu.org/article/borrowing-costs-after-debt-relief).

32 See IMF (2021): Has the DSSI helped lower Sovereign Spreads of Eligible Participating Countries?, IMF Special Series on COVID-19, Washington, DC, forthcoming in IMF (2021): Regional Economic Outlook Sub-Saharan Africa: Navigating a Long Pandemic.

33 See Caplen, B. (2000): Paris Club comes under attack, *Euromoney*, Issue No 377, pp. 56-61, specific passage is on p. 60.

scribers for that particular bond or a whole series of bonds is bound. Various research papers – most recently by Chung and Papaioannou (2020)[34] on bond yield spreads between 1996 and 2020 – show that here too there is no connection between the introduction of improved debt restructuring rules and the interest premium on bonds. Here, too, the cost of borrowing has tended to fall, which in the authors' view is connected to the benefits of having an orderly process in the event of a crisis.

4 HOW GOVERNMENTS OF HIGHLY INDEBTED COUNTRIES CAN ESCAPE THE DILEMMA

The above analysis has clearly shown how barely tenable the constant discourse of creditors is when they claim that moratoria, debt restructuring and debt write-offs are harmful to debtors.

At the same time, it is true that the big three rating agencies have downgraded countries participating in the DSSI. However, that should be interpreted less as meaning that the countries concerned are excluded in the long-term from the capital market. Barely any of the countries concerned needs, and has the capacity, in the short-term to obtain new financing on the capital market. Rather, in order to satisfy the preponderance of their external funding needs, the majority of them are reliant on public funds from multilateral or bilateral sources. However, naturally, these (limited) funding sources are not impaired if a country participates in a debt relief initiative of the G20 and the Paris Club. In addition, many of the African countries eligible for the DSSI have no longer had access to the capital market, in any event, for nearly one year.

Rather, the downgrade by the agencies constitutes a snapshot, which influences the secondary market more so than the primary market. However, secondary market trading in bonds of countries whose creditworthiness has already been rated as speculative or in (partial) default takes place, in any case, only to a very limited extent.

What is decisive for renewed or improved access to capital market financing is the speed at which a country can regain a mid-range rating. And that in turn depends, above all, on whether the debt restructuring goes far enough to offer medium-term growth perspectives. If that is the case, countries will be rated eligible for the capital market.[35]

Not least the ongoing global low interest rate environment means that a possible exclusion from the capital markets will not last. Investors who have difficulties to find investment opportunities in developed countries with which they can cover their capital costs are greedy for interest rates at over five per cent which poorer countries (must) offer. Irrespective of whether a country had a credit rating that was good or bad, or even had no credit rating at all, in the years following the global financial crisis, again and again, bonds issued by poorer countries were clearly oversubscribed – in other words, the demand for the bond issue exceeded the supply.

4.1 What does that mean for countries which must decide whether to participate in the DSSI and the Common Framework?

Countries should not hesitate to participate in debt relief initiatives and to actively request negotiations for such relief. A downgrade constitutes a snapshot, from which countries should seek to move forward as soon as possible, by means of the DSSI moratorium, genuine debt relief under the Common Framework and domestic reforms, whose implementation is, in any event, urgently needed.

Under no circumstances should debtors (and creditors) delay the inevitable. The top priority should be to stabilise the health, social and economic situation as soon as possible and in the broadest possible terms. It would be very serious were a crisis to persist, constantly prolonged by attempts to achieve a stabilisation of that kind while maintaining the short-term profit expectations of creditors.

4.2 What does that mean for G20 governments whose initiatives are threatened with failure?

The G20 governments have together with the debtor country a common interest which must be defended against those creditors who prove uncooperative. Therefore, the G20 should make use of all legal and political instruments to strengthen the position of debtor countries in their confrontation with private creditors. Instead of capitulating without a fight to the intimidation attempts of private creditors or worse supporting these, they should develop, before their own domestic courts, a credible threat scenario, threatening to support debtor countries that are unwilling to pay. This deters uncooperative creditors from taking legal action if the debtor defaults.

---

34 See Chung, K. and Papaioannou, M. (2020): Do Enhanced Collective Action Clauses Affect Sovereign Borrowing Costs?, IMF Working Paper WP/20/162.

35 See Fitch Ratings (2021): *G20 Common Framework and Private-Sector Debt Restructuring*, p. 5.

ABOUT THE AUTHORS

Kristina Rehbein is political coordinator of erlassjahr.de.

Jürgen Kaiser is the political advisor to erlassjahr.de.

IMPRINT

Friedrich-Ebert-Stiftung e.V. | Godesberger Allee 149 | 53175 Bonn | Germany

E-Mail:
info@fes.de

Register no.: VR2392
Bonn Register of Associations
Bonn Local Court

President: Martin Schulz
Secretary General: Dr Sabine Fandrych

Responsible for content:
Annette Schlicht

Contact / Order:
Christiane.Heun@fes.de

Translation: Dr. Paul Skidmore
Design: Ludger Stallmeister

© 2021

The views expressed in this publication are not necessarily those of the Friedrich-Ebert-Stiftung. Commercial use of media published by the Friedrich-Ebert-Stiftung (FES) is not permitted without the written consent of the FES. Publications by the Friedrich-Ebert-Stiftung may not be used for electioneering purposes.

GLOBAL AND EUROPEAN POLITICS

The Department of Global and European Policy provides advice on key European and international policy issues to policymakers, trade unions and civil society organizations in Germany, Brussels and at the UN offices in Geneva and New York. We identify areas of transformation, formulate concrete alternatives and support our partners in forging alliances to implement them. In doing so, we reflect on national as well as European and international policy. The 2030 Agenda for Sustainable Development with its far-reaching political claim to promote a social-ecological transformation provides a clear orienting framework for pursuing our work.

Coordinator responsible for the publication:
Annette Schlicht, annette.schlicht@fes.de

This publication is printed on paper from sustainable forestry.

ISBN: 978-3-98628-018-5