

DEBT

Paper Outline:

1. Background (Significance of Addis for debt issues)
2. Overview of UN and EU commitments on debt issues
3. Narrative position for discussion
4. Recommendations on debt issues for Addis for discussion

1. Background

With regard to debt issues, the Third Financing for Development Conference outcomes will be greatly influenced by the UN General Assembly's negotiations leading to a multilateral legal framework for sovereign debt restructuring which take place in parallel to the FfD process. The text of the framework is supposed to be adopted by September 2015, it is obvious that the Addis Summit in June will be an important milestone in this process.

Two critical gaps of the current sovereign debt regime - firstly the lack of a fair and transparent process to deal with sovereign debt crises and secondly the regulation of vulture funds (financial market actors that buy debt claims against distressed countries at highly concessional rates only to sue these countries) - are expected to be addressed in this process.

While the IMF's debt sustainability analyses show that developing country debt distress levels are overall low, the most recent MDG 8 Gap Task Force report¹ warned that aggregate data mask the extent to which some developing countries remain critically indebted or are at significant risk of debt distress. (p47). Moreover, the IMF's methodology only assesses the risk that a debtor could default, it does not assess the opportunity costs for poor nations when scarce public resources are used for debt service instead of financing development and poverty eradication.²

Recognition at the second FfD Conference (Doha, 2008) of developing countries' need to maintain debt sustainability while at the same raise finance to fulfil development commitments has not been translated into stepped up public finance commitments : ODA commitments remain unfulfilled, finance commitments for climate change mitigation and to cover the increasing costs of biodiversity loss and climate-change related shocks also remain unfulfilled and the future of international public finance commitments as a whole remains a big question mark. Because grant-financing is not coming forward, many developing countries are increasingly relying on private borrowing. An increasing number of countries- including several low-income sub-Saharan African countries- have begun to issue sovereign bonds on international capital markets. All in all, the debt of developing countries has an increasingly risky profile and is becoming more expensive, as private creditors replace concessional loans.³

As pointed out the MDG 8 Gap Task Force Report, the increased use of non-concessional loans by some countries that are dependent on a few volatile commodity exports increases their debt vulnerability. According to a recent IMF survey, debt levels in a third of the Low Income Developing Countries are high and/or have increased significantly in recent years, undoing the debt relief success of

¹ MDG Gap Task Force Report 2014. Millennium Development Goal 8, The State of the Global Partnership for Development,

http://www.un.org/en/development/desa/policy/mdg_gap/mdg_gap2014/2014GAP_FULL_EN.pdf

² Eurodad/Erlassjahr (2006): To repay or to develop?, p. 26-28;

http://eurodad.org/uploadedfiles/whats_new/reports/eurodad%20debtsustainabilityhandbook.pdf

³ Eurodad (2013): The new debt vulnerabilities. Ten reasons why the debt crisis is not over.

<http://eurodad.org/files/pdf/528109fd22bc3.pdf>

the HIPC Initiatives.⁴ Another debt-related risk is that of market volatility especially when foreign investors begin to speculate on local currency movements and short term interest. Thirdly, countries are facing increasing debt risks through contingent liabilities associated with high borrowing of public enterprises, State guarantees and public-private partnerships and through the banking system.

The Addis FfD Conference will have to address to changing nature of public borrowing and their associated public costs and development risks. Beyond recognizing that countries at risk of debt distress will need support to raise finance to fulfill commitments in the new Post-2015 agenda, the current debt management regime will need to be addressed and commitment made to ensure that countries' human rights and other obligations (environmental, climate...) weigh upon decisions regarding financing, debt restructuring and the pace of policy reform.

The Addis Conference is also an opportunity to call for further endorsements and promote the implementation of the UNCTAD principles on responsible lending and borrowing. A substantial share of developing country debt origins from irresponsible lending by bilateral creditors, including the Europeans. Strict adherence to responsible financing principles can prevent the creation of future illegitimate debt that results from irresponsible lending and borrowing. Other European creditors should follow the example of Norway and conduct debt audits to scrutinize outstanding debt along responsible financing standards. Illegitimate debt must be cancelled.

EU Position:

- On Debt work-out mechanism:

In an important development, EU member states did not vote on the recent UN GA resolution on a debt restructuring process as a bloc. Most of the EU abstained from the vote (Italy, holding the EU presidency, reported to the UN General Assembly that the reason for abstaining was procedural- that the resolution had been tabled too quickly-rather than substantive) and only Germany, UK, Ireland, Finland, Czech Republic and Hungary voted against. Norway and Switzerland also abstained

- On Debt Sustainability:

The EU strongly supports the WB-IMF Debt Sustainability Framework as an effective instrument to promote developing country debt sustainability. Recent treatment of EU countries debt crises (Greece, Ireland, Portugal, Spain) reveals that the EU prioritises countries' debt sustainability over upholding their social and human rights obligations and other international commitments (including development commitments).

- On Responsible Lending and Borrowing

The EU has never publicly recognised or welcomed the UNCTAD principles on responsible lending and borrowings. So far Germany and Italy are the only EU member states that have endorsed the principles. Norway is the only other European country that has endorsed the principles, and conducted a debt audit using the principles as an assessment tool.

- On Debt Cancellation:

Committed to fulfil its commitments under HIPC and MDRI. (But HIPC and MDRI expired, no further debtor country can qualify to benefit from HIPC/MDRI)

⁴ IMF (2014): Macroeconomic Developments in Low Income Developing Countries; <http://www.imf.org/external/np/pp/eng/2014/091814.pdf>

2. Commitments made per issue

Debt work-out mechanisms

Monterrey Consensus 2002	Doha FfD Declaration 2008	UN Financial and Economic Crisis Outcome 2009	Rio+20 Outcome: Future We Want, 2012	Other: UN GA Resolution 68/304 ⁵ Sept. 2014	EU Position
<p>Welcome consideration of an international debt workout mechanism, in the appropriate forums, that will engage debtors and creditors to come together to restructure unsustainable debts in a timely and efficient manner. Adoption of such a mechanism should not preclude emergency financing in times of crisis. (para 60. p.19)</p>	<p>We will consider ways to explore enhanced approaches to sovereign debt restructuring mechanisms based on existing frameworks and principles, with broad creditors' and debtors' participation and ensuring comparable burden-sharing among creditors, with an important role for the Bretton Woods institutions. (Para 67, p25)</p>	<p>We will also explore enhanced approaches to the restructuring of sovereign debt based on existing frameworks and principles, broad creditors' and debtors' participation and comparable burden-sharing among creditors. We will also explore the need and feasibility of a more structured framework for international cooperation in this area. (Para 34, p 10)</p>	<p><i>We further recognize the need to assist developing countries in ensuring long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate. (para 263, p. 50)</i></p>	<p>Decides to elaborate and adopt through a process of intergovernmental negotiations, as a matter of priority during its sixty-ninth session, a multilateral legal framework for sovereign debt restructuring processes (para 5, p 4)</p> <p>Also decides to define the modalities for the intergovernmental negotiations and the adoption of the text of the multilateral legal framework at the main part of its sixty-ninth session, before the end of 2014 (para 6, p4)</p>	<p>The EU also confirmed that it 'supports discussions, if relevant, on enhanced forms of sovereign debt restructuring mechanisms, based on existing frameworks and principles, including the Paris Club, with a broad creditors' and debtors participation and ensuring comparable burden sharing among creditors with a central role for the Bretton Woods Institutions in the debate (Council Conclusions 18 May 2009 para 12)</p> <p>The EU will promote the participation of non-Paris Club members in debt-workout settlements, and Member States that have not yet done so will take action to restrict litigation against developing countries by distressed-debt funds (Council Conclusions of 15 Oct. 2012 para 3)</p>

⁵ Towards the establishment of a multilateral legal framework of sovereign debt restructuring processes

Debt sustainability

Monterrey Consensus 2002	Doha FfD Declaration 2008	UN Financial and Economic Crisis Outcome 2009	Rio+20 Outcome: Future We Want, 2012	Other: UN GA Resolution 68/304 Sept. 2014	EU Position
<p>We welcome initiatives that have been undertaken to reduce outstanding indebtedness and invite further national and international measures in that regard, including, as appropriate, debt cancellation and other arrangements. (para 48, p.17)</p>	<p>Given the imperative of maintaining debt sustainability and the external financing requirements for meeting development goals, particularly in least developed countries and low-income countries facing increased risks of debt distress, bilateral donors and multilateral financial institutions should seek to increasingly provide grants and concessional loans as the preferred modalities of their financial support instruments to ensure debt sustainability.(Para 66, p25)</p> <p>In debt renegotiations, we stress the need for full involvement of debtors as well as creditors and the importance of taking into account debtors' national policies and strategies linked to attaining the internationally agreed development goals, including the Millennium Development Goals. (Para 63, p24)</p>	<p>Donors and multilateral financial institutions should also increasingly consider providing grants and concessional loans as the preferred modalities of their financial support instruments to ensure debt sustainability. (Para 34, p 10)</p>	<p>We recognize that ongoing serious global financial and economic challenges carry the possibility of undoing years of hard work and gains made in relation to the debt of developing countries. We further recognize the need to assist developing countries in ensuring long-term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate. (para 263, p. 50)</p>	<p>Calls upon all Member States and the United Nations system, and invites the Bretton Woods institutions and the private sector, to take appropriate measures and actions for the implementation of the commitments, agreements and decisions of the major United Nations conferences and summits, in particular those related to the question of the external debt sustainability of developing countries (para 3, p4)</p>	<p>The EU is committed to supporting debt sustainability in developing countries, in line with the 2001 Doha Declaration (EU Accountability Report, 2.2. p50)</p> <p>The EU (...) values the Evian approach as an appropriate flexible tool to ensure debt sustainability (Council Conclusions of 18 May 2009 para 12)</p> <p>The EU will continue to deliver on debt relief commitments to support the sustainability of public finances in developing countries, participate in international initiatives such as the WB/IMF Debt sustainability framework (Council Conclusions of 15 October 2012, Para 3)</p>

Debtor and Creditor Responsibility

Monterrey Consensus 2002	Doha FfD Declaration 2008	UN Financial and Economic Crisis Outcome 2009	Rio+20 Outcome: Future We Want, 2012	Other: UN GA Resolution 68/304 Sept. 2014	EU Position
Debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations. (Monterrey Consensus, para 47, p.16)	We will intensify our efforts to prevent debt crises by enhancing international financial mechanisms for crisis prevention and resolution, in cooperation with the private sector, and by finding solutions that are transparent and agreeable to all.(...) These include the need (...) to strengthen transparency and accountability among all parties; to promote responsible borrowing and lending practices (...)(Para 61, p 24)	(...) stress the responsibility of all debtors and creditors on the issue of debt sustainability (Para 34, p 10)		Stressing the importance of the Principles on Promoting Responsible Sovereign Lending and Borrowing issued by the United Nations Conference on Trade and Development on 4 May 2011, which aim to reduce the prevalence of sovereign debt crises, prevent unsustainable debt situations, maintain steady economic growth and help achieve the Millennium Development Goals, encouraging to that end responsible sovereign borrowing, (Recitals, p.3)	The EU will continue to (...) promote responsible lending practices. (EU Council Conclusions of 15 May 2012 para 3)

Debt Cancellation

Monterrey Consensus 2002	Doha FfD Declaration 2008	UN Financial and Economic Crisis Outcome 2009	Rio+20 Outcome: Future We Want, 2012	Other: UN GA Resolution 68/304 Sept. 2014
(...)Debt relief measures should, where appropriate, be pursued vigorously and expeditiously, including within the Paris and London Clubs and other relevant forums (...) we welcome initiatives that have been undertaken to reduce outstanding indebtedness and invite further national and international measures in that regard, including, as appropriate, debt cancellation and other arrangements. (para 48, p.17)	We recognize that the current global financial and economic crises carry the possibility of undoing years of hard work and gains made in relation to the debt of developing countries. The situation demands the implementation of existing and any future bold and encompassing initiatives and mechanisms to resolve the current debt problems of developing countries, particularly for	We call upon States to redouble efforts to honour their commitments regarding debt relief (Para 34, p 10)	We recognize that ongoing serious global financial and economic challenges carry the possibility of undoing years of hard work and gains made in relation to the debt of developing countries. We further recognize the need to assist developing countries in ensuring long-term debt	Stressing the importance of developing countries, on a case by case basis, of debt relief, including debt cancellation, as appropriate, and debt restructuring as debt crisis prevention and management tools, (Recitals, p2)

	<p>Africa and the least developed countries, in an effective and equitable manner, including through debt cancellation. (para 56, p 23) We recall our encouragement to donor countries to take steps to ensure that resources provided for debt relief do not detract from ODA resources intended to be available for developing countries (para 57, p23)</p>		<p>sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate. (para 263, p. 50)</p>	
--	---	--	---	--

3. Narrative Position (for discussion)

International Financial Institutions and sovereign creditors have put in place two debt relief initiatives: HIPC (Highly Indebted Poor Country) and MDRI (Multilateral Debt Relief Initiative) that they claimed offered a 'lasting exit' to the debt crisis (G8 Communiqué, 1998). Alongside these initiatives the new debt sustainability framework was put in place to prevent low-income countries from incurring excessive borrowing again and a specific programme for middle-income developing countries within the framework of the Paris Club of creditors.

A historical review of mechanisms to deal with sovereign debt reveals many problems:

- Debt restructuring mechanisms are dominated by creditors who are also interested parties, thus undermining impartiality and sometimes resulting in politically biased decisions often coupled with harmful policy conditionality.
- The process and outcome of the deliberations within such mechanisms are not transparent and highly unpredictable. The ad hoc nature of the process lengthens the process thus making it costly for both creditors and debtors.
- The mechanisms completely ignore the principle of creditor co-responsibility. In many cases, countries continue to serve debt contracted by oppressive or corrupt regimes or for irrelevant or even damaging and overpriced projects. A report has documented instances of donor countries lending to regimes they knew to be corrupt or repressive in order to buy political allegiance or to secure access to natural resources (Eurodad et al 2007). Yet it is only the debtor who is made responsible for the consequences.
- Financial considerations are often the only considerations in dealing with debt distress, obligations of a government to fulfill its human rights obligations and commitments to its people and the environment are seldom taken into account.
- The lack of a formal procedure to ensure fair burden sharing between creditors and debtors and assess the validity of claims, current procedures fail to discipline lenders and prevent them from irresponsible lending in the future.

As observed by the 2012 MDG 8 Gap Report: *“Lessons from the European crisis reiterate lessons from emerging market debt crises, as well as from the entire history of sovereign debt crises. One of those recent lessons from Europe is that ad hoc political processes for debt workouts do not necessarily lead to timely, effective or fair burden-sharing after debt crises occur.”*⁶ As the HIPC and MDRI debt relief have now expired, the FfD Conference in Addis offers the opportunity to create a new debt workout mechanism that overcomes the problems mentioned above and is fit to tackle the challenges posed by the new debt and development finance landscape. Developing countries at the United Nations are calling for an ‘effective, equitable, durable, independent and development-friendly debt restructuring and international debt resolution mechanism’, and in September 2014 mandated the UN General Assembly to create such a debt restructuring framework. European CSOs have called on the EU to support this process.⁷

The policy consequence of the debt sustainability framework for poor countries was to assess the risk whether their debt level could lead to a default, and limit their ability to borrow if this risk is considered high. In the face of continuing limitations on concessional financing, however, it simply limited their access to new financing for development, even in emergency situations such as natural disasters or pandemics (such as recently Ebola). In addition to this, low-income countries with a Fund supported programme are subject to conditionality related to the level of borrowing (IMF 2006a, para. 25/26). Developing countries demand that the IFIs do not restrict their ‘fiscal space’ and that

⁶ MDG Gap Task Force Report 2012. Millennium Development Goal 8, The Global Partnership for Development: Making Rhetoric a Reality,

www.un.org/millenniumgoals/2012_Gap_Report/MDG_2012Gap_Task_Force_report.pdf.

⁷ Cf. European CSO letter; <http://www.eurodad.org/files/pdf/540fec218c433.pdf>

conditionality attached to new finance does not undermine their 'policy space' to choose their own development path.

4. Policy Recommendations for discussion

Debt Workout Mechanisms

- The Addis Outcome document must commit all UN Member States and the IFIs to contribute constructively to the multilateral legal framework for sovereign debt restructuring processes developed through the intergovernmental process mandated to create such a text by UN General Assembly Resolution 68/304 of 17 September 2014. The EU position for Addis must commit the EU to engage constructively in this process and undertake to fully support its implementation, also engaging to do everything in its ability to ensure that all other stakeholders (institutional and private) recognise the legal text and support its implementation.

-Civil society should be strongly involved in the design and implementation of debt restructuring processes. They should be given the right to be heard and give evidence.

Debt Sustainability

-Reform debt sustainability frameworks and analysis to take countries development needs into account, including the financial costs to grapple with climate-change shocks and invest in climate adaptation and mitigation. Governments' financial needs to fulfil their human rights and other obligations must take priority, while debt service obligations are a secondary and residual claim on the public budgets.

-International institutions should improve the collection of debt data, its timeliness and coverage, and reconciliation between creditor and debtor reporting systems to enhance the capability to monitor debt sustainability and respond to early warning signals.

Creditor and Borrower Responsibility

-Governments, international financial institutions and the private sector should endorse and implement the UNCTAD principles on responsible and lending.

-Steps to take forward the principles should be agreed at Addis or as a minimum, a commitment to implement and be held to account against the principles should be included in the Addis outcome⁸

Debt cancellation

-Recognise the importance of national debt audits to determine the legitimacy of claims especially where there is evidence or suspicion of debts linked to corruption, irresponsibility and undemocratic conduct which by definition would be illegitimate.

-Recognise countries that have cancelled illegitimate debt and call for all creditors to cancel debt determined to be illegitimate after national debt audits.

⁸ Members of the session should discuss if they go the moderate way (implement UNCTAD principles) or the more ambitious (develop UNCTAD principles further. In our submission to the ICESDF, we asked for the latter.