HIGHLIGHTS from Special Focus:
Resolving High Debt after the Pandemic: Lessons from Past Episodes of Debt Relief

Key Points

- *Global debt levels have surged as a result of the pandemic. In 2020 total global debt reached 263 percent of GDP, its highest level in half a century. Many countries, especially low-income countries, are now in debt distress or at high risk of debt distress.*
- *The G20 Common Framework for providing debt relief is the latest in a long line of coordinated initiatives aimed at providing debt relief. These include the Paris Club, the Brady Plan, and the Heavily Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative.*
- *The lessons from these initiatives highlight the challenges to providing comprehensive debt relief. As the Framework continues to evolve, its structure could be improved to increase its effectiveness and avoid the shortcomings faced by earlier initiatives.*

Sharp rise in debt on top of existing surge. In 2020, total global debt rose by 30 percentage points of GDP, to 263 percent of GDP—the largest single-year increase since at least 1970. The buildup has been broad based, with rapid growth in both government and private debt; advanced-economy and emerging market and developing economies (EMDEs) debt; and external and domestic debt. This recent increase has come on the heels of a decade of rising debt in EMDEs. As a result, debt vulnerabilities have risen: more than one-half of low-income countries are in debt distress or at high risk of debt distress; some countries have already defaulted on their debt; and debt restructurings have been completed in some, or are underway in others.

Lessons from previous debt relief initiatives. There are several examples of debt relief frameworks that have attempted to resolve unsustainable debt over the past 70 years. These have included the Multilateral Debt Relief Initiative (MDRI) from 2005; the Heavily Indebted Poor Countries (HIPC) Initiative from 1996; the Brady Plan from 1989; and the Paris Club which was established in 1956. In these initiatives, debt relief was granted to a number of debtor countries on common principles. They were typically preceded by a series of less ambitious, unsuccessful debt relief efforts. Once debt relief was agreed, however, it was substantial—the net present value of debt was reduced by 37 percent, on average, under the Brady Plan and around 60 percent under HIPC/MDRI—although it typically took several years before debt relief was provided.

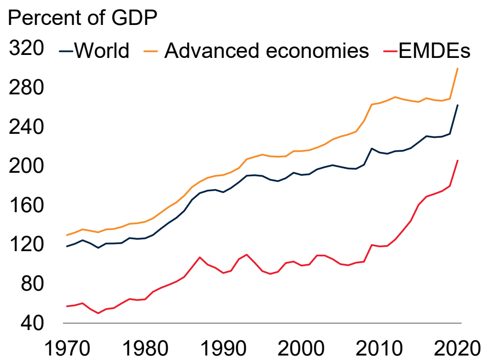
G20 common framework in comparison. The G20 Common Framework provides a forum for DSSI-eligible countries with unsustainable debt to seek debt relief. The Framework primarily envisions debt relief in the form of maturity extensions and interest rate reductions rather than face value reductions, although it reserves the option to cancel or write off debts for the most difficult cases. To the extent that it focuses primarily on the former, it will bear most similarity to debt reschedulings that occurred in the 1980s (the early agreements of the Paris Club and the Baker Plan). These provided debt service relief without lasting face value reductions of debt, and they were followed by either outright debt default or more wide-ranging debt relief initiatives.

Policy implications: room for improvement. As the Framework continues to evolve, its structure could be improved to increase its effectiveness. The Framework could provide faster debt relief, formalize implementation processes, and find ways to encourage private sector participation. In addition, where debt is unsustainable, creditors and debtors should aim for comprehensive debt relief, including face value debt reductions.

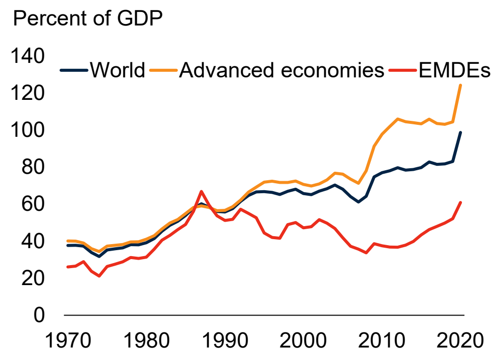
Figure 1. Debt risks and debt relief

The COVID-19 pandemic resulted in a surge in debt levels, both in advanced economies and in emerging market and developing economies (EMDEs). Government debt increased sharply amid fiscal stimulus and declining revenues, in the sharpest one-year increase on record. There have been several examples of debt relief provided to countries under umbrella frameworks. These include the Paris Club group of official creditors, which have provided substantive debt relief and restructuring to many countries on a case-by-case basis. The Brady Plan and HIPC/MDRI provided significant debt stock reductions to many countries within an umbrella framework, even if agreed on case-by-case basis.

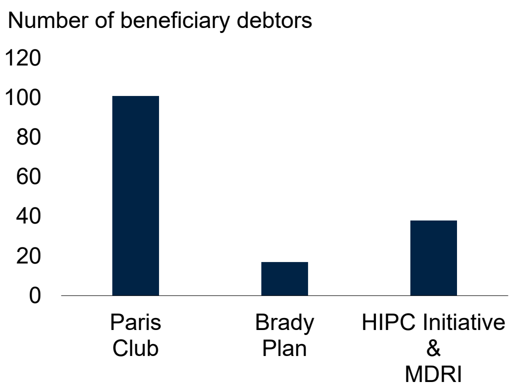
A. Total debt



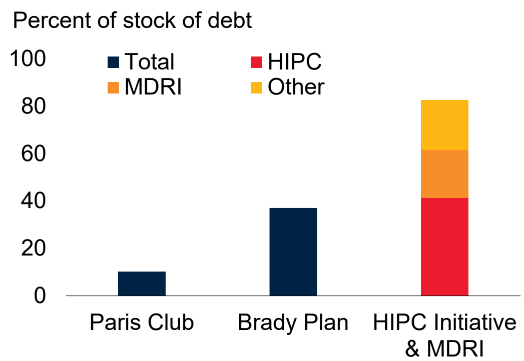
B. Government debt



C. Number of debtor countries included in umbrella initiatives



D. Debt relief granted under initiatives



Source: Arslanalp and Henry (2005); Cheng, Diaz-Cassou, and Erce (2019); Gamara, Pollock, and Braga (2009); IMF; Kose et al. (2017, 2021); World Bank.

A. Data are available until 2020 for up to 191 countries. Nominal GDP weighted averages.

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C.D. HIPC = Heavily Indebted Poor Countries; MDRI = Multilateral Debt Relief Initiative.

D. Stock of debt refers to stock of eligible debt treated by the Paris Club or eligible for restructuring under the Brady Plan, and total stock of debt for the HIPC countries which received HIPC/MDRI debt relief. Paris Club includes 188 restructuring episodes and excludes debt restructuring under the "Classic" terms which did not offer debt relief, and the HIPC episodes taken from Cheng, Diaz-Cassou, and Erce (2019). Brady Plan includes 16 Brady Plan deals, taken from Arslanalp and Henry (2005). For HIPC/MDRI debt relief is split into debt relief under the HIPC Initiative (which includes debt relief provided by the Paris Club), MDRI (provided which includes debt relief on debt held by the multilateral institutions) and "Other" which refers to traditional debt relief outside of HIPC/MDRI.