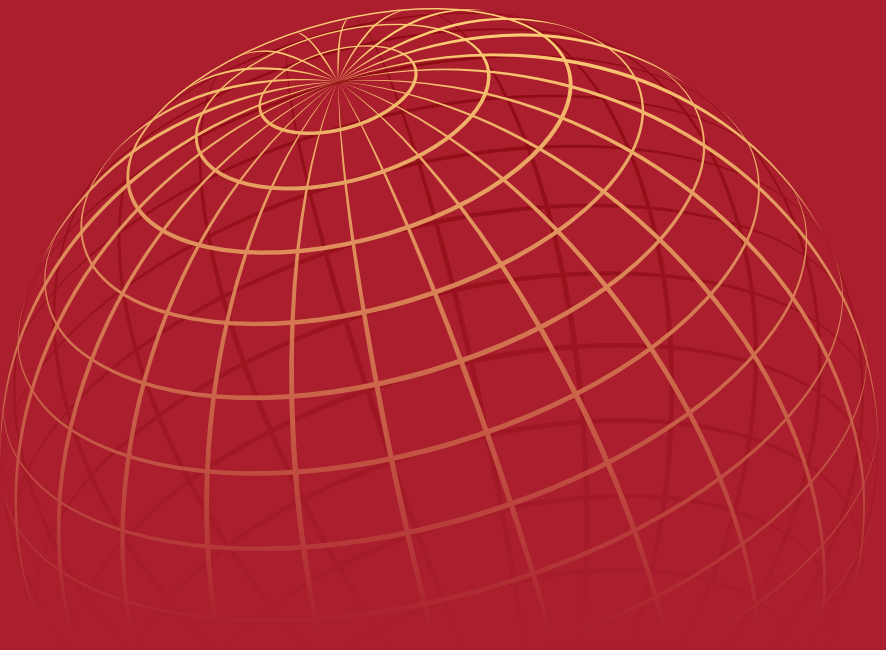


SPECIAL FOCUS

RESOLVING HIGH DEBT AFTER THE PANDEMIC

Lessons from Past Episodes of Debt Relief

In the pandemic-induced global recession of 2020, global debt levels surged. The rise in debt has led to several countries initiating debt restructurings, while many others are in or at high risk of debt distress and may also eventually need debt relief. Historically, several umbrella frameworks coordinated debt relief to multiple debtor countries from multiple creditors on common principles. They offered substantial—but protracted—debt stock reductions that were typically preceded by a series of less ambitious debt relief efforts. The G20 Common Framework provides a structure to initiate debt restructuring for low-income IDA eligible countries, but largely avoids the issue of outright debt reductions. Future umbrella frameworks for debt restructuring will face greater challenges than those in the past due to a more fragmented creditor base.

Introduction

As a result of the COVID-19 pandemic, global debt levels have surged. In 2020 total global debt reached 263 percent of GDP, its highest level in half a century. 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 (Kose, Nagle et al. 2021a).

The rise in government debt in EMDEs is of particular concern. In these economies, government debt rose by 9 percentage points to 63 percent of GDP in 2020, the fastest one-year increase in the past three decades. Contingent government liabilities are likely to have risen because of loans and loan guarantees to corporates, while debt incurred by state-owned enterprises will also have increased (Melecky 2021).

This recent debt increase has come on the heels of a decade of rising debt in EMDEs amid slowing growth (Kose, Nagle, et al. 2021b; figure SF.1). 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.

Following an urgent call by WBG President David Malpass and IMF Managing Director Kristalina Georgieva for a debt moratorium to help countries cope with the COVID-19 pandemic, the G20 announced the Debt Service Suspension Initiative (DSSI). The DSSI offered debt payment suspension on official sector debts for the poorest countries to create fiscal space to increase social, health or economic spending in response to the crisis but did not reduce debt stocks or require private sector participation. In November 2020, the G20 announced the "Common Framework" which would provide a forum for DSSI-eligible countries to seek debt relief if their debt is considered unsustainable by the IMF and the World Bank (G20 2020).

The Framework primarily envisions debt relief in the form of maturity extensions and interest rate reductions rather than face value reductions. It reserves the option to cancel or write off debts, however, for the "most difficult cases", determined by the WBG-IMF Debt Sustainability Analysis and the participating official creditors' collective assessment. The Framework is now being operationalized and refined, in part in the context of three countries—Chad, Ethiopia, and Zambia—that have sought debt relief under the Framework.

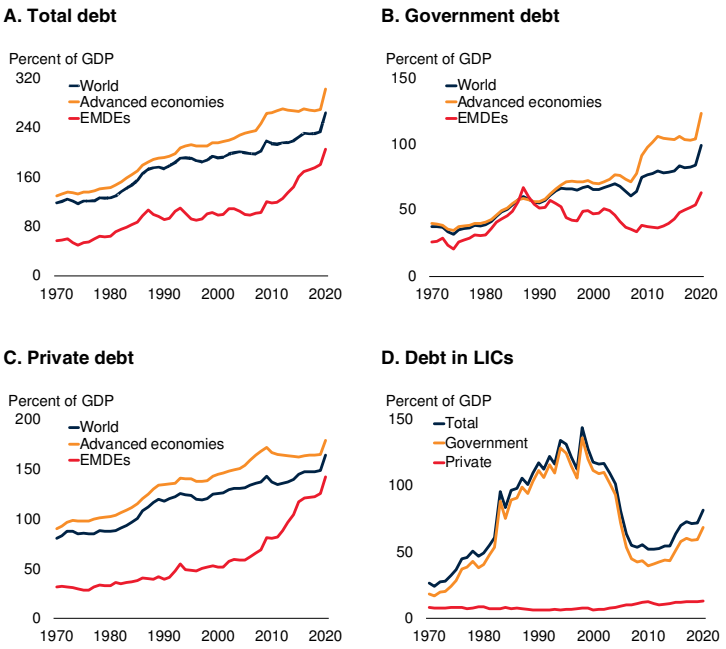
The Framework includes both Paris Club members and non-Paris Club G20 members, including China. Consistent with previous debt relief initiatives, the Framework requires debtor countries to seek comparable debt relief from their other official bilateral creditors and from private creditors on at least as favorable terms as from their official sector creditors. At present, however, the framework does not have a clear methodology to assess comparability of treatment. It also currently lacks a mechanism to incentivize private sector participation.

The Common Framework is the latest example of an umbrella initiative to resolve debt distress. Restructuring of sovereign debt has often taken

Note: This Special Focus was prepared by Peter Nagle.

FIGURE SF.1 Debt

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. Private debt jumped as corporates borrowed heavily, facilitated by government loans and loan guarantee programs. Government debt in LICs also saw a significant increase, although there was little increase in private sector debt, in part due to less developed financial markets.



Sources: Kose et al. (2017, 2021); World Bank.
A. Data are available until 2020 for up to 191 countries. Nominal GDP-weighted averages.
B. Data are available until 2020 for 191 countries. Nominal GDP-weighted averages.
C. Data are available until 2019 for 184 countries. Nominal GDP-weighted averages.
D. Data are available until 2020 for 26 LICs. Nominal GDP-weighted averages.

place under umbrella initiatives that coordinated multiple creditor and debtor countries within common frameworks. 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 several debtor countries on common principles, even if sometimes negotiated on a case-by-case basis. These facilities generally aimed to overcome information asymmetries and lack of transparency by coordinating creditors.

More broadly, the number of countries in or at high risk of debt distress, alongside current historically large debt levels, warrants an examination of lessons from past efforts to lower debt. Against this backdrop, this Special Focus examines the following questions:

- What lessons do historical umbrella initiatives offer for debt resolution now?
- How does the Common Framework compare to these historical initiatives?

This Special Focus is the first analysis to compare and draw lessons from all previous umbrella initiatives for debt reduction over the past seven decades. While several studies have examined one or two of these in depth, no study has yet brought them together to distill lessons and patterns from all of them.[1] Second, this Focus is the first to compare the past agreements with the Common Framework. Two recent studies have considered lessons from either the Brady Plan or the Paris Club and HIPC Initiative, but not all prior initiatives (Essers and Cassimon 2021; Truman 2021).

Findings. This Special Focus offers the following findings.

- *Debt restructuring frameworks.* Historical umbrella frameworks for debt relief included the Paris Club founded in 1956; the Brady Plan launched in 1989; and the HIPC Initiative and MDRI of 1996 and 2005, respectively. In these initiatives, debt relief was granted by multiple creditors (including in the private sector) to multiple debtor countries on common principles, even if sometimes negotiated on a case-by-case basis. These

[1] Das, Papaioannou, and Trebesch (2012) provide data and stylized facts for debt restructurings from 1950-2010, and include all the umbrella initiatives discussed here. However, while they provide data on the HIPC initiative and MDRI, they do not discuss the initiatives in detail. Callaghy (2002) and Easterly (2002), examine the history and evolution of Paris Club restructurings up to and including HIPC; Cheng, Diaz-Cassou, and Erce (2019), and Ferry and Raffinot (2019) consider Paris Club restructuring including HIPC and MDRI; Barkbu, Eichengreen and Mody (2012) consider official sector debt relief, but primarily focus on official financing and not Paris Club operations; Reinhart and Trebesch (2016) compare episodes during the 1930s (official relief for European nations) and the 1990s (private relief for Latin American countries via the Brady Plan).

initiatives shared several commonalities: substantial—but protracted—debt stock reduction and being preceded by a series of less ambitious debt relief efforts.

- *Common framework.* The Common Framework shares some of the features of the precursors of past umbrella debt restructuring frameworks in that it primarily envisions debt relief in the form of maturity extensions and interest rate reductions instead of face value reductions, although it recognizes that in the most difficult cases debt write-offs may be needed. In addition, future debt restructurings will face greater challenges than those in the past due to a more fragmented creditor base which poses larger difficulties in coordinating and negotiating debt relief efforts.

Lessons from past debt resolutions

The elevated risk of debt distress faced by many countries, alongside the broader risks presented by current historically large debt levels, warrant an examination of how large debt stocks in the past were reduced, both in conventional and unconventional ways. All forms of debt reduction were economically costly or politically challenging. Where debt proved unsustainable, debt default or debt restructuring and relief were necessary. Over the past seventy years several umbrella initiatives have coordinated debt relief among a large number of creditors and multiple debtors.

Past debt resolution

Historically, large debt-to-GDP ratios have been unwound in both conventional ways and unconventional ways (Reinhart, Reinhart, and Rogoff 2015, Kose, Ohnsorge, et al. 2021).

- *Conventional ways.* These include generating higher growth, fiscal consolidation, privatization of government assets, and wealth taxation.

- *Unconventional ways.* These included default, debt restructuring (both on external and on domestic debt), inflation, and financial repression—often in combination.

The appropriate mix of these approaches depends on country circumstances and on the type of debt. Overall, however, none of these approaches are straightforward (Kose, Ohnsorge, et al. 2021).

Where debt becomes unsustainable, countries have few options, particularly if it is external debt. In these instances, countries must resort to either debt default (and a loss of market access) or seek debt relief or restructuring. The COVID-19 pandemic has already seen several countries initiate debt restructuring, and more are in debt distress or at high risk of debt distress. The G20 Common Framework provides an umbrella facility for providing debt relief via maturity extensions and interest rate reductions. It is the latest in a long line of previous initiatives to provide debt relief to countries with unsustainable debt.

Past umbrella facilities for debt relief

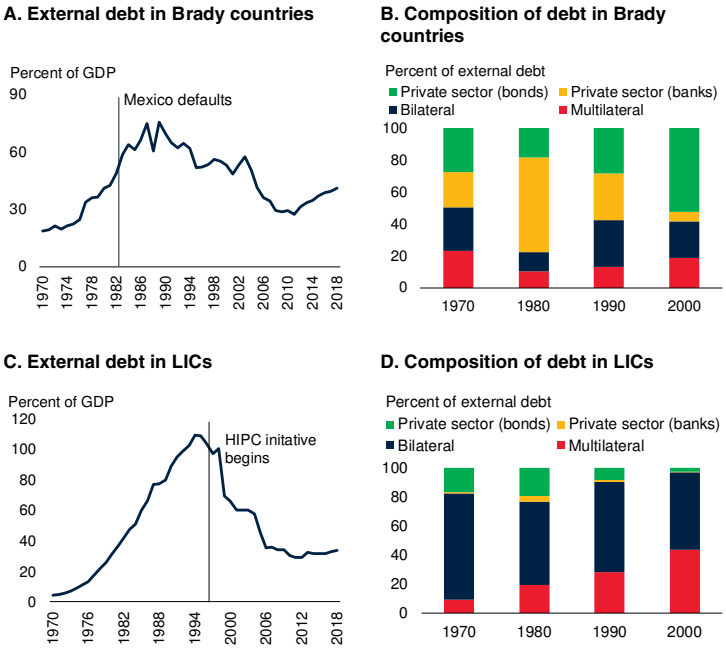
Historical umbrella frameworks for debt relief included the Paris Club founded in 1956; the Brady Plan of 1989; and the HIPC Initiative and MDRI of 1996 and 2005, respectively.[2] In these initiatives, debt relief was granted to a number of debtor countries on common principles. A common set of principles, enhanced by coordinated data gathering, was intended to address the information asymmetries and coordination problems between multiple creditors with various debt instruments that can hinder restructuring agreements (Eichengreen and Mody 2003; Truman 2002). Although the three frameworks are discussed separately in this section, they were interlinked, with the Paris Club being heavily involved in most debt restructuring negotiations.

Paris Club. Established in 1956 to resolve the debt of Argentina to official creditors, the Paris

[2] Other historical examples of debt relief include the Hoover moratorium in 1931 and the London debt agreement in 1956. The London Club has also been an important framework under which private sector creditors have negotiated debt relief.

FIGURE SF.2 Debt increases and composition before and after the Brady Plan and HIPC/MDRI

Prior to the Brady Plan and HIPC/MDRI, debt levels rose sharply in affected countries, notably LAC for the Brady Plan. Over time, debt relief in the form of maturity extensions and interest rate reductions simply resulted in a growing share of debt owed to the official and multilateral sectors.



Sources: Haver Analytics; World Bank.
Note: HIPC = Heavily Indebted Poor Countries; MDRI = Multilateral Debt Relief Initiative.
A.B. Brady countries includes 17 countries that negotiated a Brady Plan.
A.C. Long-term external debt only. Mexico defaulted in 1982, HIPC initiative began in 1996.

Club has become the coordinating forum for restructuring sovereign debt to official bilateral creditors.[3] Debt restructurings initially often provided limited relief, with a preference for rescheduling debt payments rather than outright debt reductions, such that between 1970-89, roughly four agreements were needed, on average, among the 47 debtor countries which required debt rescheduling, and nearly one-third had more than four agreements (Trebesch, Papaioannou, and Das 2010).

Over time, the Paris Club shifted its provision of debt relief from rescheduling toward outright debt reductions, in recognition that many of the countries in difficulty faced solvency issues, rather than liquidity issues.[4] The amount of debt relief gradually increased with different "menus" starting with the "Toronto" terms in 1988 which offered debt reduction of up to 33 percent, and reaching 80 and 90 percent with the "Lyon" and "Cologne" terms, which were linked to the HIPC Initiative (Callaghy 2002). In 2003, the "Evian" terms were developed, with the aim of broadening the group of countries eligible for debt restructuring to include non-HIPC countries.[5]

By end-2020, the Paris Club had restructured the debt of 101 debtor countries in more than 470 agreements (Paris Club 2021). The average debt reduction of agreements before HIPC was 10 percent, while under the HIPC Initiative it rose to 65 percent, in part reflecting the greater debt burdens facing the HIPC countries (Cheng, Diaz-Cassou, and Erce 2019).

Debt restructurings typically required the debtor country to have a program with the IMF under which it would commit to economic reforms to help return the country to solvency. In addition, Paris Club debt relief typically required comparability in treatment from private sector creditors. Assessing comparability of treatment frequently proved challenging, however, given difficulties in making a direct comparison between different types of debt treatments. For commercial banks negotiations with private-sector creditors regarding debt relief and new lending were coordinated under the framework of the London Club (Rieffel 1985). There is no equivalent framework for nonbank private creditors, although the IMF has often played a coordinating role.

Brady Plan. The Brady Plan was implemented in 1989 to resolve unsustainable sovereign debt in mostly Latin American countries to primarily U.S.-based private financial institutions that had lent heavily to governments during the 1970s and

[3] Although still a strictly informal group, the Paris Club now includes 22 permanent creditor countries and more than a dozen ad hoc creditor countries that have joined discussions on a case-by-case basis. Paris Club debt relief is usually contingent on a country having an economic reform programs with the IMF and World Bank.

[4] The terminology used among the sovereign debt restructuring community also evolved over time, reflecting these developments (Buccheit 1992).

[5] Under the Evian framework, middle income countries can seek debt relief on a case-by-case basis, based on a joint IMF-World Bank debt sustainability analysis.

early 1980s (Kose, Nagle et al. 2021b; figure SF.2).[6] In part, the Plan was motivated by U.S. financial stability concerns (Clark 1993). The Brady Plan offered net present value debt reductions of 37 percent of the eligible debt stock, on average, of 17 debtor countries to more than 100 private sector creditors (Cruces and Trebesch 2013; Reinhart and Trebesch 2016). Creditors had three options to provide debt relief under the plan; issuing discount bonds with a haircut of 35 percent, par bonds which kept their face value but had interest rate reductions and maturity extensions, or an option to issue new lending to countries.

Private sector participation was incentivized by the collateralization of the Brady bonds with U.S. treasuries, paid for by the debtor country, but financed with loans from the IMF and World Bank (as a result, the net reduction in debt was lower than the reduction in debt to private creditors would imply). Regulatory authorities in creditor countries also made tax and regulatory changes to incentivize banks to participate in debt relief, such as changing write-down and provision rules around the new bonds (Stiftung 2021).

The introduction of the IMF's lending into arrears (LIA) policy in 1989 also incentivized better creditor coordination. Under LIA the IMF could lend to a country that was in arrears on financing from private creditors, so long as the debtor was negotiating with its creditors in good faith. Previously a private creditor could hold up IMF financing by refusing to restructure its claim. Multilateral institutions also oversaw countries' adjustment programs and continued lending to countries where needed.

While the Brady Plan offered significant debt reductions, it was formulated well after the initial episodes of debt distress, with the Latin America debt crisis starting in 1982. Its predecessors included multiple Paris Club debt restructuring via maturity extensions and interest rate reductions, as well as the Baker Plan in 1985. The Baker plan differed from the early Paris Club agreements in that it recognized debt burdens were a long-term issue that would take time to resolve (Cline 1989). However, it rejected outright debt forgiveness, and instead focused on cash flow relief and the provision of new lending, conditional on market-oriented reforms designed to return countries to growth (Reinhart 2021).

The Baker plan proved unsuccessful, primarily because it failed to recognize that countries were insolvent and would not be able to grow their way out of debt (Reinhart and Trebesch 2016). The plan also failed to encourage additional lending from the private sector. A compounding factor was overoptimistic growth expectations, which underestimated countries' near-term financing needs and overestimated their capacity to repay debt (Boughton 2001).

HIPC Initiative and MDRI. In 1996, the HIPC Initiative was launched to resolve the protracted sovereign debt overhang in predominately low-income countries, mostly in Sub-Saharan Africa.[7] The Initiative determined the amount of debt relief that would be needed to enable a country's permanent exit from unsustainable debt. Debt relief was provided when the country met key structural and social development reforms. Importantly, debt owed to multilateral creditors, primarily the IMF and World Bank, was eligible for debt relief—prior to this, multilateral debt was exempt from debt restructuring. In addition to debt relief from the Paris Club and multilateral institutions, Other creditors—smaller institutions, non-Paris Club official bilateral creditors, and commercial creditors—were also expected to provide debt relief.

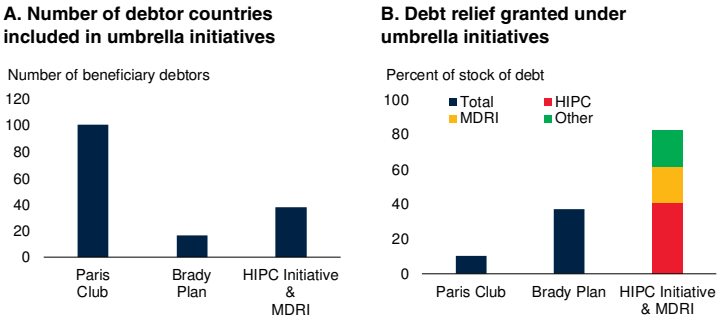
Concerns about the slow provision of debt relief under HIPC led to the creation of the enhanced HIPC Initiative in 1999, which aimed to accelerate the provision of debt relief (most creditors subsequently wrote off the remainder). The enhanced HIPC Initiative also increased the conditionality of debt relief, with a greater focus on poverty reduction, with countries required to

[6] Several countries outside of LAC also issued Brady bonds, including in ECA, EAP, MNA, and SSA.

[7] As of March 2021, the Initiative had coordinated and provided sovereign debt relief for 38 low-income debtor countries by a large number of official and multilateral creditors (World Bank 2021a).

FIGURE SF.3 Umbrella debt restructuring frameworks

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.



Sources: Arslanalp and Henry (2005); Cheng, Diaz-Cassou, and Erce (2019); Cruces and Trebesch (2013); Gamara, Pollock, and Braga (2009); IMF (2019); World Bank.
A.B. HIPC = Heavily Indebted Poor Countries; MDRI = Multilateral Debt Relief Initiative.
B. 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 17 Brady Plan deals, taken from Cruces and Trebesch (2013). For HIPC/MDRI debt relief is split into debt relief under the HIPC Initiative (which includes debt relief provided by the Paris Club), MDRI (which includes debt relief on debt held by the multilateral institutions) and "Other" which refers to traditional debt relief outside of HIPC/MDRI.

spend fiscal savings from debt relief on increases in poverty-reducing programs, such as health and education. This was supplemented in 2005 by the MDRI, which offered full debt relief on multilateral debt from four lending institutions (World Bank, International Monetary Fund, Inter-American Development Bank, and African Development Bank) to HIPC-eligible countries.[8]

On average, it took 3.5 years from the decision to grant debt relief (decision point) to the actual delivery of debt relief (completion point) but in one-fifth of countries it took five years or more. While the process has been protracted, debt relief has been substantial: debt reductions have been estimated to average about 60 percent of the eligible debt stock, with additional relief offered on maturities, grace periods, and interest rates (Gamarra, Pollock, and Braga 2009; IMF 2021b).

[8] The MDRI has been estimated to have reduced the stock of eligible debt by almost 50 percent below levels after HIPC debt relief in participating countries (Gamarra, Pollock, and Braga 2009; IMF 2019).

Non-Paris Club bilateral creditors as a whole have delivered around 51 percent of their share of HIPC Initiative debt relief, but about one third of these creditors have not delivered any relief at all (IMF 2021). Private sector participation was facilitated by the IDA Debt Reduction Facility in countries with large commercial debt. Overall, the HIPC Initiative and MDRI appear to have allowed beneficiary countries to raise investment and social spending, although impacts on growth are less certain (Cassimon et al. 2015; Ferry and Raffinot 2019; World Bank 2019a). However, by 2013 debt levels had started rising once again in many of the countries that received debt relief under the HIPC initiative and MDRI. By 2019 around half of IDA-eligible countries were in debt distress or at high risk of debt distress (World Bank 2021a). This increase in debt vulnerability was attributed to weaknesses in fiscal frameworks, weak debt transparency, and a changing composition of debt toward more expensive and riskier sources of financing (World Bank 2019a).

Commonalities among past umbrella frameworks for debt relief

These initiatives established common principles to resolve the debt of multiple debtors to multiple creditors, and shared some commonalities: substantial, but often protracted debt stock reductions, broad participation, and being preceded by a series of less ambitious debt relief efforts.

Following failed attempts. Several of the significant coordinated debt stock relief initiatives were preceded by failed efforts to provide debt flow relief for servicing unsustainable debt. Paris Club agreements were initially only partial and focused on debt service relief before a comprehensive settlement was reached; the Brady Plan in 1989-94 and HIPC and MDRI in 1996 and 2005 were preceded by repeated Paris Club reschedulings in the 1980s as well as the Baker Plan (Guinnane 2015; Reinhart and Trebesch 2016). This frequently reflected an aversion of creditors to recognize losses, as well as a tendency to treat debt issues as a liquidity problem, rather than a solvency problem. In part, this was caused by unrealistic growth forecasts which over-

estimated countries' abilities to service debt (Reinhart 2021). As a result of this process, there was a tendency for debt to migrate from private sector creditors to the official sector (Figure SF.2)

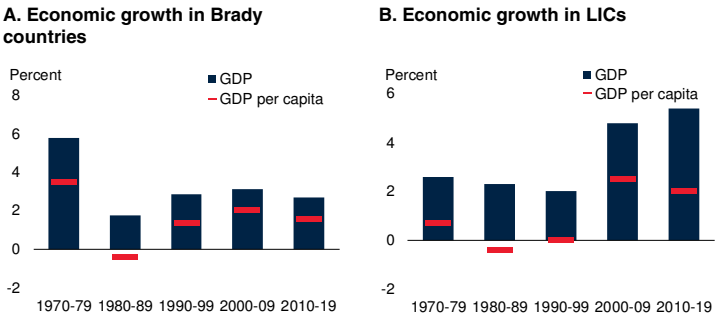
Substantial reductions in debt. All of these umbrella initiatives offered substantial debt stock reduction and were typically designed to resolve debt overhangs after long periods of debt distress and clear evidence of debt being unsustainable (figure SF.3). Except for the Brady Plan, where creditors were private financial institutions, the initiatives coordinated debt relief among official creditors (although with the private sector frequently involved in debt restructurings, often coordinated through the London Club). Even under the Brady Plan, countries were often still dependent on loans from Paris Club members, while multilateral institutions were also heavily involved, including through overseeing countries adjustment programs and providing credit enhancements for the newly issued Brady bonds.

Protracted processes. Debt relief under these initiatives was protracted, for different reasons including inefficient or slow negotiation, political instability, and overoptimistic expectations for growth and fiscal balances (Von Luckner et al. 2021). For example, countries were still negotiating deals under the Brady Plan five years after its launch; under the HIPC Initiative, it took an average of 3.5 years for debtor countries to be granted debt reduction. Other initiatives, especially Paris Club reschedulings, often had to be repeated multiple times to achieve sustainable debt levels (Reinhart and Trebesch 2016). Empirical analysis of past measures of debt relief has shown that preemptive debt restructurings have generally been associated with better macroeconomic outcomes rather than restructurings that occur after a default has occurred (Asonuma and Trebesch 2016; Asonuma et al. 2020).

Lost decade of growth. Lengthy debt crises result in deadweight economic losses (Sturzenegger and Zettelmeyer 2006). The delay in resolving unsustainable debt had severe economic consequences for the Brady countries and the HIPC countries (figure SF.4). The Brady countries, notably LAC, suffered a "lost decade" of growth, with GDP per capita only recovering to its precrisis level by 1993, while growth was anemic in other regions including sub-Saharan Africa and the Middle East and North Africa. Growth strengthened following debt relief but remained well below its precrisis rates.

FIGURE SF.4 Economic growth before and after debt relief

The debt crises lead to a lost decade of growth in the countries which had a Brady plan, and two decades of negative GDP per capita growth in LICs. After debt relief, growth in the Brady countries recovered but at a slower rate than before the crisis. Among LICs, growth rebounded strongly in the 2000s, aided by the prolonged commodity price boom.



Sources: Haver Analytics; World Bank.
A. Brady countries include 17 countries that negotiated a Brady Plan.

Among LICs, GDP per capita fell by an average of 0.2 percent per year between 1980-99, due to weak economic growth and high population growth. In the decade after debt relief GDP per capita growth in the LICs of 2001 averaged 2.9 percent a year between 2001 and 2011. Almost half of LICs in 2001 had graduated to middle-income country status by 2017, and about one-third of these had received debt relief (World Bank 2019b). Besides debt relief, other factors contributed to these developments, including robust global growth in the period before the global financial crisis, the prolonged commodity price boom over the 2000s, and a reduction in conflict and violence in LICs (Essl et al. 2019).

Differences among past umbrella frameworks for debt relief

While broadly similar in approach, the frameworks also differed by their structure, private sector participation, and availability to debtor countries.

Framework and conditionality. The frameworks had different approaches to the provision of and conditionality for debt relief. The Paris Club framework had a prescriptive transaction form which gradually evolved. Similarly, the Brady Plan had a transaction form, under which private sector creditors could choose from a menu of options as to how they would grant debt relief. In contrast, the HIPC Initiative and MDRI were highly standardized programs with uniform requirements and terms, and were outcome-based—in particular, they had the aim of ensuring that no poor country faced a debt burden it could not manage, but also linked debt relief to the implementation of structural reforms and national-determined poverty reduction strategies, that required increased spending on poverty-reducing programs such as health and education. The three frameworks had certain degrees of conditionality, such as the need for IMF and World Bank programs, commitment to economic and social reforms, and seeking private sector participation in the provision of debt relief (whether direct or indirect).

Creditor participation. While all plans involved multiple creditors, the types of creditors varied. Paris Club reschedulings involved bilateral debt to official creditors, with multilateral debt not included due to its preferred creditor status. The Brady Plan directly addressed private sector debt only (in the form of syndicated loans from commercial banks). It did not address bilateral lending, although throughout the period countries that issued Brady Bonds were also able to benefit from lending from multilaterals and Paris Club debt reschedulings (Clark 1993). In contrast, the HIPC Initiative was the first time that the debt problems of a limited group of countries were addressed in a comprehensive manner by offering debt relief on eligible debt held by multilateral, bilateral, and commercial creditors. However, commercial debt only accounted for a small share of HIPC-eligible countries' debt, with most countries having minimal commercial debt.

Private sector incentives. The Brady Plan incentivized private sector participation by collateralizing debt, enhanced by changes to tax and regulatory laws in creditor countries, and changes to the IMF's lending policies. In contrast, Paris Club agreements required countries to seek comparable treatment from private sector creditors, and private sector participation in HIPC/MDRI was assumed, but on a voluntary basis. In practice, ensuring private sector participation in these agreements was difficult, given limited tools to incentivize creditors. For the HIPC Initiative, this has been compounded by litigation against debtor countries by some commercial creditors (World Bank 2019a). The World Bank's Debt Reduction Facility has been the primary method of fostering commercial creditors' participation in the HIPC Initiative, by providing grant funding to eligible governments to buy back—at a deep discount—debts owed to external commercial creditors.

The IMF's lending into arrears (LIA) and lending into official arrears (LIOA) policies are also designed to help incentivize private sector participation by providing debtor countries with greater bargaining power. LIA and LIOA enabled debtors to continue accessing liquidity and loans from the IMF while negotiating with creditors.

Debtor participation limits. The number of countries which were eligible for participation in the different initiatives has also varied, reflecting the permanent nature of the Paris Club framework and the temporary nature of other initiatives. The Paris Club has negotiated debt treatments in the form of debt rescheduling for over 100 countries. In contrast, the HIPC Initiative and MDRI were more restrictive and were based on eligibility criteria, with 38 countries benefiting so far. The Brady Plan was negotiated on a case-by-case basis, with 17 countries issuing Brady bonds, less than the number of countries who were in debt distress in the 1980s. Participation in initiatives was also restricted by eligibility criteria to avoid issues posed by moral hazard, as well as to prevent negative contagion to similar debtors.

Changes in debt resolution and the emergence of collective action clauses

Need for a debt restructuring mechanism. The conversion of syndicated loans into bonds under the Brady plan of the late 1980s ended the

dominance of foreign banks in external financing of EMDEs. When EMDEs returned to credit markets in the 1990s, they did so mainly through bond markets rather than commercial banks, which led to a more diffuse creditor base. This made any potential debt restructuring harder to coordinate. The majority of bonds at the time had a unanimous consent clause, that is, any restructuring required the agreement of all bondholders, regardless of how small individual holdings were (Häseler 2009). This was problematic for several reasons, ranging from the practical issue of locating all bondholders to a free-rider problem, as individual creditors had an incentive to hold out in the hope that restructuring by others would allow the debtor to continue to pay the free-riders. While collective action problems were also an issue for debt held by commercial banks, these creditors were typically not as numerous, diverse, or anonymous as bondholders.

Alternative resolution strategies. In 2002, the IMF proposed the creation of a formal resolution framework, the "Sovereign Debt Restructuring Mechanism" (IMF 2002). However, the framework failed to receive sufficient support from IMF member countries, some of which had a preference for a market-based solution (Bedford, Penalver and Salmon 2005).

This resulted in a growing interest in the introduction of collective action clauses (CACs) in loan contracts to reduce the cost of debt resolution.[9] CACs would enable debt restructuring to take place with the consent of a majority or super-majority of bondholders (typically two-thirds to three-quarters), reducing the likelihood of restructurings being delayed by creditors.

While CACs had been used in debt contracts agreed under English law for many years, they were rarely used for debt issued under New York law (Drage and Hovaguimian 2004). The broader use of CACs had been promoted in academic circles since 1995. However, they were unpopular among some creditors, who worried that they would create a bad incentive for debtors by making restructuring easier, thus making defaults more likely (Eichengreen and Portes 1995). As a result, sovereign borrowers did not include them in debt issuance, given fears they would not be able to find buyers for their bonds (Häseler 2009).

In 2003, Mexico was the first EMDE to issue a bond under New York law containing a CAC, and was shortly followed by Korea, Brazil, and South Africa. CACs quickly became routine for most sovereign debt issuance, with the share of new issuance covered by CACs rising from less than 10 percent in 2000-02 to more than 90 percent in 2004-06 (Bradley, Fox, and Gulati 2008). Several studies, both theoretical and empirical, have shown that the use of CACs leads to better outcomes for both creditors and debtors.[10] By removing the likelihood of holdout creditors, CACs should accelerate restructuring processes. In turn, that could result in faster resolutions of debt, and quicker returns to economic growth, by reducing debt overhangs.

While CACs now cover most new issuance of sovereign debt, a legacy stock of debt without enhanced CACs remains—about 50 percent of outstanding international debt does not include enhanced CACs—limiting their effectiveness in any future debt restructuring (IMF 2020). One policy proposal to alleviate this issue would be the creation of an aggregated collective action clause, which would apply to debt and debt-equivalent instruments, would cover all official sector and private sector creditors, and would apply both to outstanding debt and new debt going forward. This would sharply reduce the likelihood of holdout creditors and facilitate debt restructuring, but still be conditional on acceptance by a majority of creditors.

The Common Framework in historical comparison

The Common Framework. In November 2020 the G20 announced a Common Framework for providing support to DSSI-eligible countries

[9] For a discussion of these issues, see Eichengreen and Mody (2000); Eichengreen, Kletzer, and Mody (2003); Haldane and Kruger (2001); and Sturzenegger and Zettelmeyer (2007).

[10] For details, see Eichengreen, Kletzer, and Mody (2003); Weinschelbaum and Wynne (2005); Ghosal and Thampanishvong (2007).

facing unsustainable debt levels and with large protracted debt service needs. The Common Framework offers a structure for guiding agreements on debt treatments for eligible countries, with agreements negotiated on a case-by-case basis. The Framework includes both Paris Club members and non-Paris Club G20 members, including China, but excludes debt to multilaterals (IMF and World Bank 2021). The Framework applies to all DSSI-eligible countries, however, this excludes many middle-income debtor countries that have also seen sharp increases in debt because of the COVID-19 pandemic.

The initiative primarily focuses on providing debt service relief through maturity extensions and interest rate reductions (this is a notable difference with the DSSI which only provided maturity extensions). The framework recognizes that in some instances this may still not be sufficient, and in exceptional circumstances outright debt stock reductions may be needed, subject to a Debt Sustainability Analysis by the IMF and World Bank and the participating official creditors' collective assessment.

Any debt treatment is coordinated among bilateral creditors and requires that the debtor seeks comparable debt relief from private creditors, although the Framework does not, at present, have a clear methodology on how the assessment of comparable treatment is supposed to be carried out. It also does not currently provide a mechanism to induce private sector participation (G20 2020, IMF and World Bank 2021).

Similarities with past umbrella initiatives. To the extent that the Common Framework focuses primarily on debt relief by maturity extensions and interest rate reductions, it will bear most similarity to the debt reschedulings that occurred in the 1980s (the early agreements of the Paris Club and the Baker Plan).[11] These initiatives 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 with debt write-offs. The option to cancel or write off debts in the most difficult cases, subject to a debt sustainability analysis, bears similarities to the Paris Club's more recent "Evian" approach to debt relief, although the Evian approach is available to a broader range of countries beyond IDA countries.

The Common Framework differs from the Brady Plan as it does not provide detail on private sector participation or contain incentives to encourage private sector participation. It also differs from HIPC/MDRI in that it veers away from providing deep face value haircuts.

Old and new challenges. The Common Framework faces numerous challenges faced by earlier initiatives, such as the reluctance of creditors to grant substantial debt relief quickly, a lack of mechanisms to enforce private sector participation, and uncertainty about the ability or willingness of borrowing countries to commit to credible multi-year action plans. The Common Framework also faces new challenges, notably the increasingly complex nature of the creditor base which increases the difficulties of coordinating and negotiating among creditors (Essers and Cassimon 2021). In addition, the debt structure of EMDEs and LICs has changed substantially (Kose, Ohnsorge, and Sugawara 2021).

Whereas the creditor base at the time of the Paris Club and HIPC was predominately multilateral, Paris Club bilateral, and commercial bank creditors, today it includes a broader range of creditors with diverse motivations, which reduces the influence of traditional lenders in sovereign debt restructuring (Gelpern 2016). The importance of bilateral non-Paris Club lenders has increased significantly, and China is now the largest official creditor to developing countries (Horn, Reinhart, and Trebesch 2020; G30 2021). Among LICs in particular, the share of non-concessional debt has risen significantly. Publicly owned policy institutions like China Development Bank and KfW also blur the line between private and public sector creditors.

[11] In contrast, the DSSI, as a debt standstill, bears the most similarities to the Hoover Moratorium of 1931. This initiative provided a one-year debt standstill by the United States to debtor countries on their war debt incurred during World War I. The DSSI was intended to provide fiscal space to countries for spending on social, health or economic spending; in this regard it bears some similarities to HIPC and MDRI which mandated that debt relief be spent on poverty-reducing expenditure such as education and healthcare.

The growing number of private creditors and range of financial instruments further complicates debt resolution (Kose, Nagle, et al. 2021b). Ensuring the participation of the private sector, a prerequisite for any deal, could prove particularly challenging and may only be achieved through the use of incentives. While the Institute for International Finance published its guidelines for creditor participation in restructuring, no private sector creditors provided similar debt relief under DSSI (IIF 2020). Private sector creditors have also become increasingly litigious, which could further delay debt restructuring (Gelpern 2016; Schumacher, Trebesch, and Enderlein 2018).

The migration of debt from private sector creditors to official sector creditors is an additional concern in this regard. If official bilateral creditors provide maturity rate extensions and interest rate reductions but private sector creditors do not provide comparable treatment, it could result in a migration of debt to the official sector, as occurred during the first wave of debt in the 1980s. If debt subsequently had to be written down, it could result in the official sector being exposed to a greater share of losses.

Debt transparency. The growing diversity of creditors and complexity of debt instruments has been associated with greater uncertainty about the level and composition of debt, as not all creditors are bound by a single set of reporting standards and loan terms are often confidential. This raises the risk that public sector debt is higher in some EMDEs than reported. This risk is compounded by indirect and hidden debt, especially debt incurred by state-owned enterprises and public-private partnerships (Melecky 2021). Debt-like instruments, such as long-term bilateral deposits and central bank "swap lines, are sometimes used as multi-year funding sources and can also further obscure the true level of indebtedness. Any debt relief measure will also need to apply to debt-equivalent instruments.

A lack of clarity about commitments is a major challenge to debt sustainability analysis, and also encumbers debt restructuring negotiations as creditors may be reluctant to provide debt relief until a country's true debt stock is known (Friedrich-Ebert-Stiftung and Consensus Building Institute 2021; World Bank, 2021i). Debt sustainability can be further undermined by policies that impose strict nondisclosure clauses on government borrowers, require major liens and collateralization, and place guaranteed debt repayments in SOEs (G30 2021).

Implications for future debt reduction and resolution

The sharp rise in debt levels and fall in growth resulting from the COVID-19 pandemic has exacerbated existing debt vulnerabilities. In addition, the economic recovery in EMDEs and LICs is vulnerable to several factors including the ongoing COVID-19 pandemic and the scarcity of vaccines, as well as inflation pressures, energy shortages and a breakdown of the supply chain (chapter 1). More broadly, long-term potential growth has been declining in EMDEs for many years (World Bank 2020).

As a result, several countries are already in debt distress and additional episodes of distress are to be expected in both LICs and EMDEs. It is likely that further debt relief will be needed if growth remains subdued and the global community will need to stand ready to provide this in an equitable but efficient way. The consequences of inaction to address debt challenges point to the urgency to act on the parts of both national policymakers and the global community (Kose, Nagle, et al. 2021a).

The G20 Common Framework is a welcome development in this regard, particularly as it brings both Paris Club creditors and major non-Paris Club official creditors together. The lessons from past debt relief initiatives, however, highlight the challenges to providing timely, comprehensive debt relief. As the Framework continues to evolve, however, its structure could be improved to increase its effectiveness and avoid the shortcomings faced by earlier initiatives and their predecessors.

For countries facing large debt servicing needs, maturity extensions may be sufficient to address debt concerns, although the Framework needs to provide faster debt relief to be effective—the first country that requested treatment under the Framework made the request in January 2021 and

the process has yet to be completed. Measures to formalize the implementation process with a clear timeline and transparent rules could help reduce the time taken to provide debt relief. The provision of a debt service standstill to a country seeking debt relief would also provide temporary assistance while a deal is being negotiated and would incentivize creditors to reach a deal.

Where debt sustainability analyses show that countries are facing a solvency issue rather than a liquidity issue, debt stock reductions will be needed.[12] The evidence from past debt relief initiatives suggests that when debt is unsustainable, creditors and debtors should aim for comprehensive debt relief, including face value debt reductions. A comprehensive solution to debt relief frequently occurred many years after the initial default, and was preceded by unsuccessful episodes of restructuring via maturity extensions and interest rate reductions. In addition, at present many middle-income countries that also face very high levels of debt are not eligible for debt relief under the Framework, which limits its potential to resolve unsustainable debt globally.

The lack of measures to encourage private sector participation may limit the effectiveness of any negotiated agreement and raises the risk of a migration of private sector debt to official creditors. In the past, credit enhancements were one tool used to encourage private creditor participation in restructuring (Friedrich-Ebert-Stiftung and Consensus Building Institute 2021). However, this could require significant financial resources from the entities funding credit enhancements, and in a systemic crisis may still not be sufficient.

The Framework could also be strengthened by the enactment of statutory or legal measures to inhibit preferential recoveries by private sector creditors that are subject to comparable treatment requirements. Aggregate collective action clauses could also help accelerate private sector participation by reducing the likelihood of creditor hold-outs. Clarifying the methodology of how to assess different types of debt relief from private creditors would also help assess private sector comparability and could encourage creditor participation.

For debtor countries, implementing policies to strengthen fiscal frameworks and increase debt transparency could facilitate and accelerate the provision of debt relief. Stronger fiscal frameworks could help alleviate concerns among creditors that debtor countries which receive debt relief today will borrow unsustainably again in the future (World Bank 2019a). More broadly, improved debt transparency is associated with lower borrowing costs and improves debt management practices (Kubota and Zeufack 2020). Creditors can also help in this regard by refraining from confidentiality clauses, allowing borrowers to publish detailed information, and themselves disseminating data on their lending.

[12] Debt sustainability analyses, particularly for LICs, also need to take into account long-term debt dynamics.

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