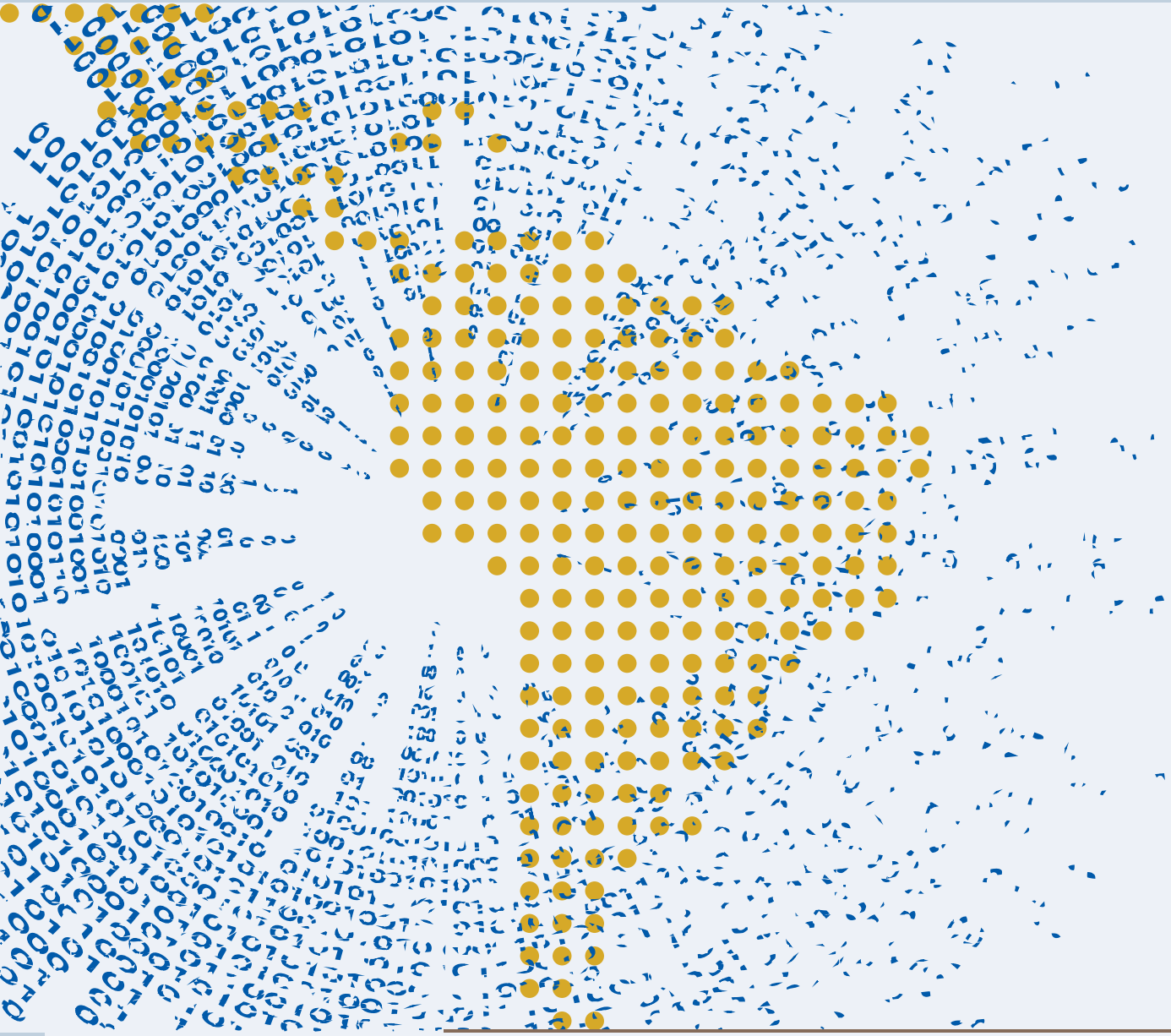

Public debt and development distress in Latin America and the Caribbean

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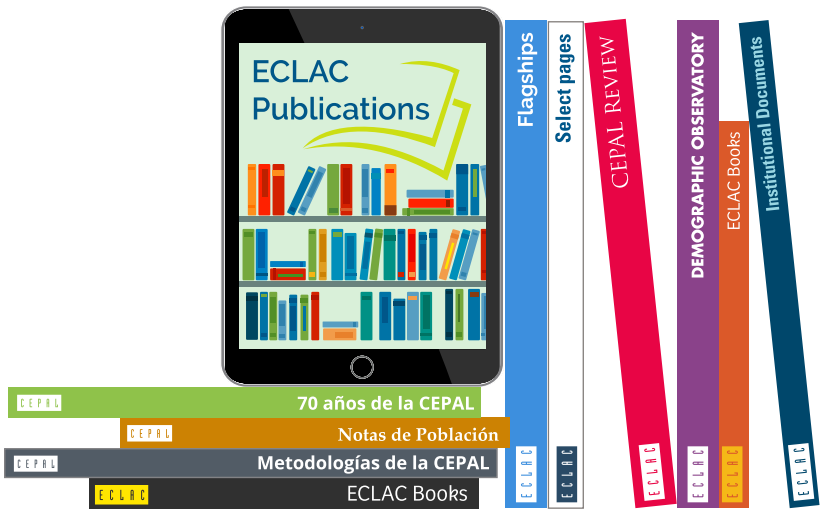

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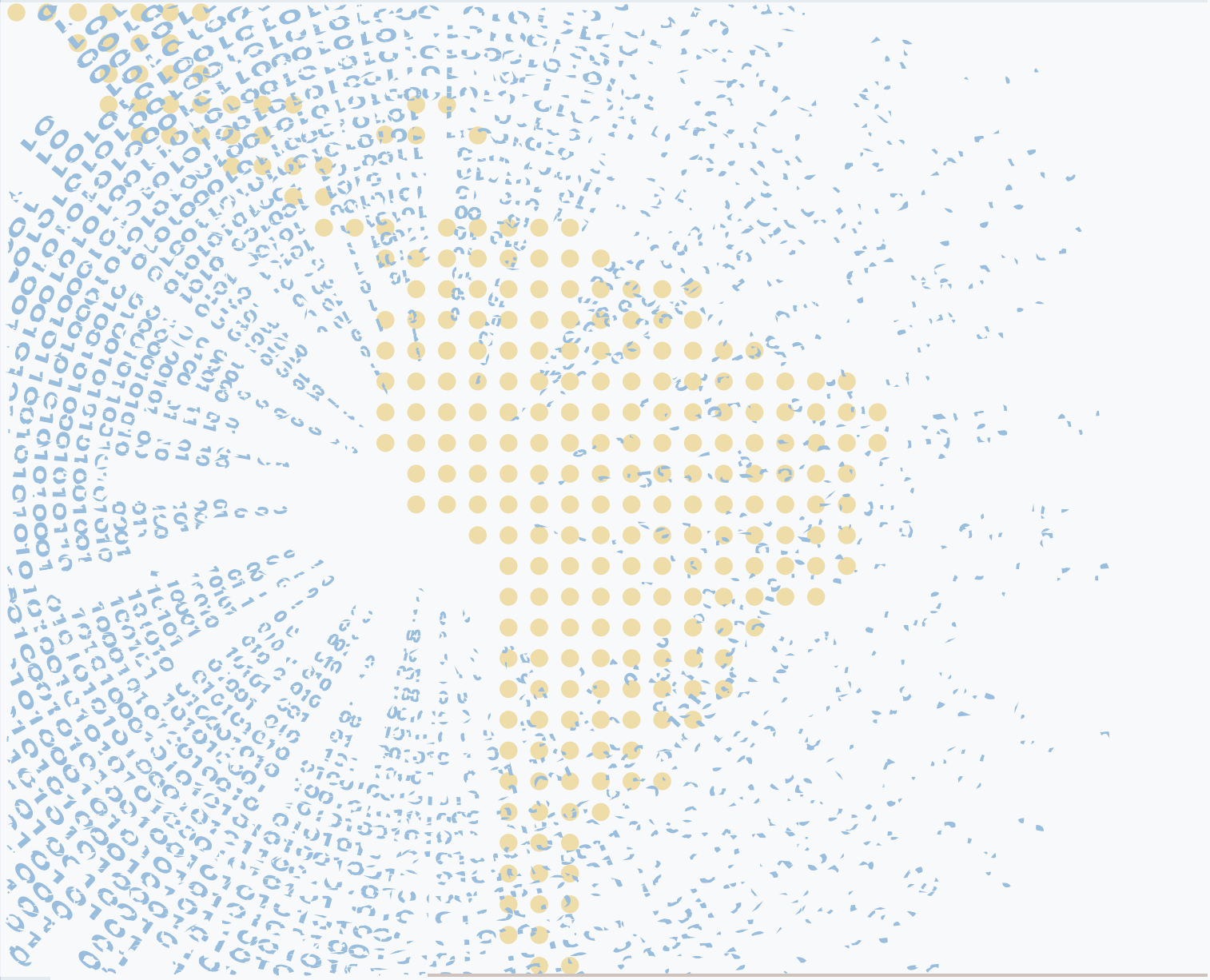

Public debt and development distress in Latin America and the Caribbean

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The decision of the Secretary-General deriving from the Executive Committee meeting of 22 December 2022 (Decision 2022/45) requested the Economic Commission for Latin America and the Caribbean (ECLAC), with support from the Department of Economic and Social Affairs and the United Nations Conference on Trade and Development (UNCTAD), to produce a report on the debt situation in Latin America and the Caribbean and its implications for fiscal space and countries' access to financial markets. This report was prepared under the supervision of José Manuel Salazar-Xirinachs, Executive Secretary of ECLAC, and coordinated by Daniel Titelman, Chief of the Economic Development Division of ECLAC. It incorporates input from Michael Hanni, Noel Pérez Benítez, Esteban Pérez Caldentey, Ramón Pineda Salazar and Cecilia Vera of ECLAC, from Danyira Pérez, Oliver Schwank, Shari Spiegel and Sebastián Vergara of the Department of Economic and Social Affairs, and from Penelope Hawkins, Richard Kozul-Wright and Daniel Munevar of UNCTAD. Vianka Aliaga, Claudio Aravena, Pablo Carvallo, Sandra Galaz, Ivonne González and Patricia Weng of ECLAC provided research support.

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Foreword

Weakening economic activity, rising interest rates in the main developed economies, the resulting reduction in capital flows to emerging markets and heightened exchange-rate volatility have significantly pushed up financial costs and limited access to international financial markets for emerging and developing economies. This has compromised public finance sustainability and increased concerns surrounding the sustainability of public debt in emerging markets and developing economies, including those of Latin America and the Caribbean.

In response to this situation, the Secretary-General of the United Nations has put forward various initiatives to promote reform of the international financial architecture. One of these is the SDG Stimulus proposal, which aims to support developing countries in opening up pathways towards delivery on the Sustainable Development Goals (SDGs).

As part of these initiatives, this document analyses the constraints on growth and development generated by high levels of public debt and its implications in terms of the fiscal space available to the Latin American and Caribbean countries. The rising cost of debt service, especially interest payments, forces countries to mobilize increasing amounts of public resources to keep their debt sustainable. This effort generates a vicious circle because it forces countries to make sacrifices to the public investment and social spending that are required to support inclusive and sustainable growth, which would not only stabilize the debt trajectory, but also underpin progress towards delivery of the SDGs and the productive transformation that the economies of the region need.

When the debt service climbs to unsustainable levels, the situation becomes a debt crisis. As economic history has shown over and again, debt crises, debt distress or high debt service have profound developmental consequences and lasting effects on growth, investment, poverty and inequality.

High levels of public debt in developing regions, including in Latin America and the Caribbean, together with adverse global macrofinancial conditions, lend urgency to the need to mobilize financing and transform the international sovereign debt architecture in order to offer countries options that are consistent with inclusive and sustainable development.

In line with the proposals of the United Nations, this document calls for a new consensus on the treatment of sovereign debt —including new debt resolution mechanisms that provide for broad participation of stakeholders, as well as a registry of debt data for greater transparency— and the creation of a global sovereign debt authority to support effective, efficient and equitable debt restructuring for all countries.

José Manuel Salazar-Xirinachs
Executive Secretary
Economic Commission for
Latin America and the Caribbean (ECLAC)

Executive summary

The current unfavourable global macrofinancial context has given rise to public debt sustainability concerns in emerging markets and developing economies, including in Latin America and the Caribbean. Weakening global economic activity, lower international trade volumes, high inflation and volatility in financial and commodity markets are increasingly undercutting economic prospects for developing regions, making it more difficult to fulfil the Sustainable Development Goals (SDGs). Restrictive monetary policies among the principal central banks in developed economies, falling capital flows to emerging markets and exchange rate volatility are raising financial costs and threatening to limit access to international financial markets for some countries.

In Latin America and the Caribbean, adverse external conditions threaten to worsen the low economic growth experienced in the past decade. ECLAC projects that growth between 2014 and 2023 will average 0.8%, a rate lower than that seen in the "lost decade" of the debt crisis in the 1980s, when economic activity expanded by 2.0% per year on average. Policy space for monetary and fiscal interventions to support aggregate demand is exceptionally tight. Management of public debt is becoming more complicated, with higher interest rates and sovereign risk increasing the cost of new debt issuance and the rollover of maturing public debt.

Public debt levels were on the rise in Latin America and the Caribbean before the exceptionally large increases caused by the coronavirus disease (COVID-19) pandemic. As with other emerging and developing regions, countries in Latin America and the Caribbean were strongly affected by the deterioration in global macroeconomic fundamentals in the years leading up to the crisis. Public revenues stagnated and were insufficient to support public spending, leading to persistent and elevated fiscal deficits and a concomitant increase in the debt stock. The COVID-19 pandemic aggravated this trend, as countries implemented unprecedented support packages that were funded in many cases by debt issuance and emergency financing from international financial institutions.

The vulnerabilities associated with high public debt in the region are heightened by its composition. For several countries in the region, public debt is largely held by non-residents in foreign currencies. In South America, this has coincided with a structural shift in the creditor base, with private bondholders emerging as the single most important creditor. Multilateral and bilateral lenders, by contrast, are the principal holders of the external debt of Caribbean countries. Despite relatively favourable sovereign debt amortization profiles, significant short-term debt rollover requirements expose countries to market volatility, especially as interest rates rise.

Unfavourable debt dynamics are expected to persist, further reducing fiscal space. Weak growth, higher interest rates and the risk of currency depreciation will intensify the upward trend in debt levels. The interest rate-growth differential, the principal driver of automatic debt dynamics, deteriorated over the past decade as economic growth progressively decelerated and effective interest rates remained high. The pass-through of exchange rate volatility to debt dynamics may also intensify, but there is considerable uncertainty about the direction of currency movements.

History suggests that countries have undergone development distress when similar macrofinancial and debt conditions coincide. Rising debt service, especially in the form of interest payments, requires countries to mobilize ever greater public resources to ensure debt sustainability. When public revenues are stagnant, or if there are considerable barriers to increasing the tax take, countries face painful trade-offs, sacrificing social spending and investment to meet their debt service needs, including those necessary to advance towards the SDGs, and place their debt on a sustainable trajectory. When these trade-offs are no longer viable and meeting debt service requirements becomes untenable, a debt crisis is the likely outcome. As seen repeatedly throughout economic history, the development implications of these crises are profound, with long-lasting impacts on growth, investment, poverty and inequality. Even if the point of debt crisis is not reached, a situation of elevated debt service and distress may last for years and leave serious economic and social scars.

Countries face critical trade-offs between debt service and pursuing development objectives. Higher debt has led to a stepwise increase in interest payments in the region, the magnitude of which varies across countries. Debt service-related development distress is apparent in Latin America and the Caribbean. Interest payments are higher than central government social expenditure in health, education and social protection in several countries. Weak macroeconomic growth hindered the increase in the overall tax take, limiting the availability of resources to accommodate development needs and debt service. As a result, some countries in the region allocate an increasing share of their tax revenues to interest payment obligations. Higher interest payments are increasingly depleting domestic resources available for public investment and social spending.

Debt crises provoke long-lasting development distress. Debt stress episodes in the region have been followed by severe and protracted contractions in investment, economic activity (GDP) and consumption, in addition to deterioration in labour markets and increases in poverty rates. The debt crisis of the 1980s was the most severe of these episodes, resulting in economic scars that persist to this day. Investment, relative to output, has been consistently lower since the debt stress episode of the 1980s, compared to the situation prior to the crisis. Likewise, economic growth has not regained the same level of momentum. Unemployment and poverty caused by the crisis also proved to be persistent, returning to the levels seen before the debt stress episode decades after its onset.

High public debt levels across developing regions and unfavourable global macrofinancial conditions increase the urgency to transform the international sovereign debt architecture to provide solutions that are aligned with sustainable development. The United Nations can play a central role in building a new consensus on debt resolution that includes the broad participation of all relevant creditor and debtor stakeholders, and a publicly accessible registry of debt data to address transparency gaps. In addition, a global sovereign debt authority should be established to support effective, efficient and equitable debt restructuring, along with supporting sound sovereign debt markets.

Middle-income countries should have access to all debt relief and restructuring initiatives, which should be regulated by the financing needs of countries rather than by income per capita. Debt reduction initiatives should not be "one size fits all", but rather tailored to countries' economic vulnerabilities and debt profiles. Such initiatives should also institutionalize the structural features of the middle-income countries that are highly vulnerable to natural disasters and external shocks.

The United Nations, through its SDG Stimulus proposal, calls for the design of a new international financial architecture that can deliver sustainable development for all countries while addressing immediate needs. This can be achieved through a substantive increase of at least US$ 500 billion per year in financing for sustainable development. In addition, it puts forward an agenda to: (i) tackle the high cost of debt and rising risks of debt distress, including by converting short-term high-interest borrowing into long-term (more than 30 year) debt at lower interest rates; (ii) massively scale up affordable long-term financing for development, especially through strengthening and improving the terms of lending for multilateral development banks (MDBs), and by aligning all financing flows with the SDGs, and (iii) expand contingency financing to countries in need, including by integrating state-contingent and disaster clauses into all lending, and exploring how special drawing rights (SDRs) can finance climate mitigation and be automatically issued in times of crisis.

I. A stormy macrofinancial context has thrust debt sustainability concerns to the fore

Global macroeconomic conditions are weak and unstable with implications for growth and social conditions in emerging markets and developing economies. The outlook continues to deteriorate as global economic activity is expected to slow in 2023. After expanding by approximately 3.4% in 2022, global output is expected to grow by only 2.8% in 2023 (see table 1). This is very low by historical standards, as the average global growth rate was 3.7% between 2010 and 2019. Global growth trends in 2023 will be uneven across regions, with developed countries expected to register little growth (1.3%), while developing economies are projected to maintain a rate of growth similar to that of the previous year. However, within the developing world there are also stark differences, with deceleration in most regions being offset by a rebound in China. Weak economic growth is expected to continue in the short run, hindering the ongoing recovery from the COVID-19 crisis. For emerging markets and developing economies, output levels by the end of 2024 are expected to be 6 percentage points below what was forecast on the eve of the pandemic (World Bank, 2023).

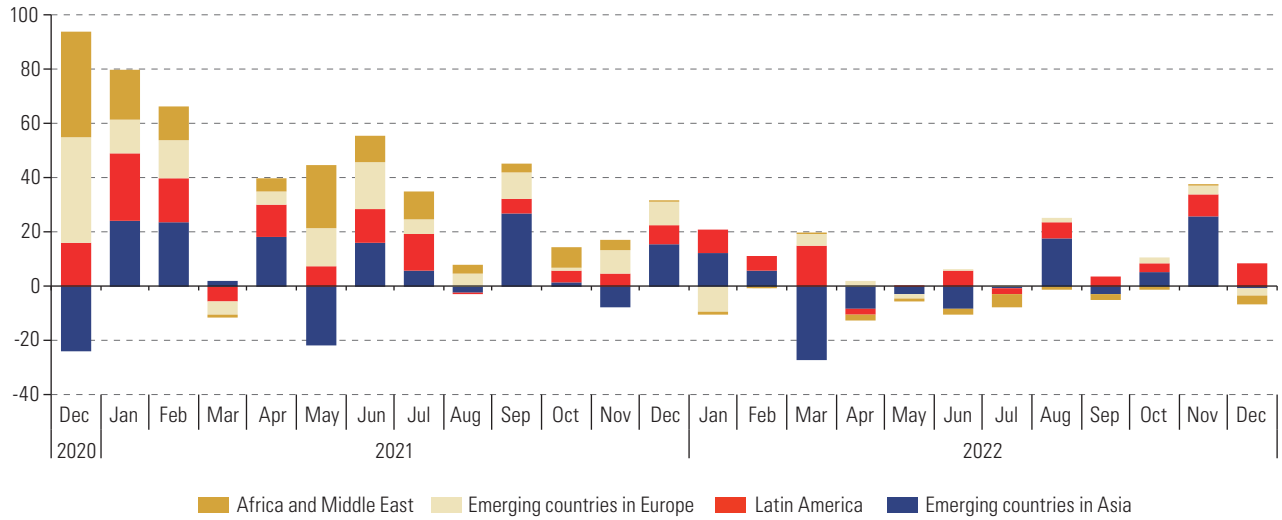
Table 1
Selected regions and countries: GDP growth rate, 2021, 2022 and forecast for 2023
(Percentages)

	2021	2022	2023
World	**6.3**	**3.4**	**2.8**
Advanced economies	**5.4**	**2.7**	**1.3**
United States	5.9	2.1	1.6
Japan	2.1	1.1	1.3
United Kingdom	7.6	4.0	-0.3
European Union	5.6	3.7	0.8
Emerging and developing economies	**6.9**	**4.0**	**3.9**
Emerging and developing Asia	**7.5**	**4.4**	**5.3**
China	8.5	3.0	5.2
India	9.1	6.8	5.9
Emerging and developing Europe	**7.3**	**0.8**	**1.2**
Russian Federation	5.6	-2.1	0.7
Middle East and Central Asia	4.6	5.3	2.9
Sub-Saharan Africa	4.8	3.9	3.6

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook: A Rocky Recovery*, Washington, D.C., April 2023.

Monetary policy in developed economies has become increasingly restrictive as countries tackle high inflation, affecting capital flows to emerging markets and developing economies. Conditions in international financial markets have tightened considerably, owing to the most synchronized monetary policy tightening in decades and continued uncertainty stemming from the conflict in Ukraine. Dampened risk appetite and interest rate hikes by the Federal Reserve System of the United States led to a strengthening of the dollar and a large decrease in financial flows towards emerging markets and developing regions. Net non-resident portfolio flows towards emerging markets fell by 85% in 2022, compared with the previous year, with flows towards Latin America and the Caribbean declining by 41% (see figure 1). In equity markets, global stock indices posted their biggest yearly decline in 2022 since the 2008 global financial crisis (a 20% decrease in 2022 versus 42% in 2008), and at mid-April, they remained below the levels seen before the start of the conflict in Ukraine, both in developed economies and in emerging economies (12% and 19% lower, respectively).

Figure 1
Net portfolio capital flows to emerging markets, December 2020–December 2022
(Billions of dollars)



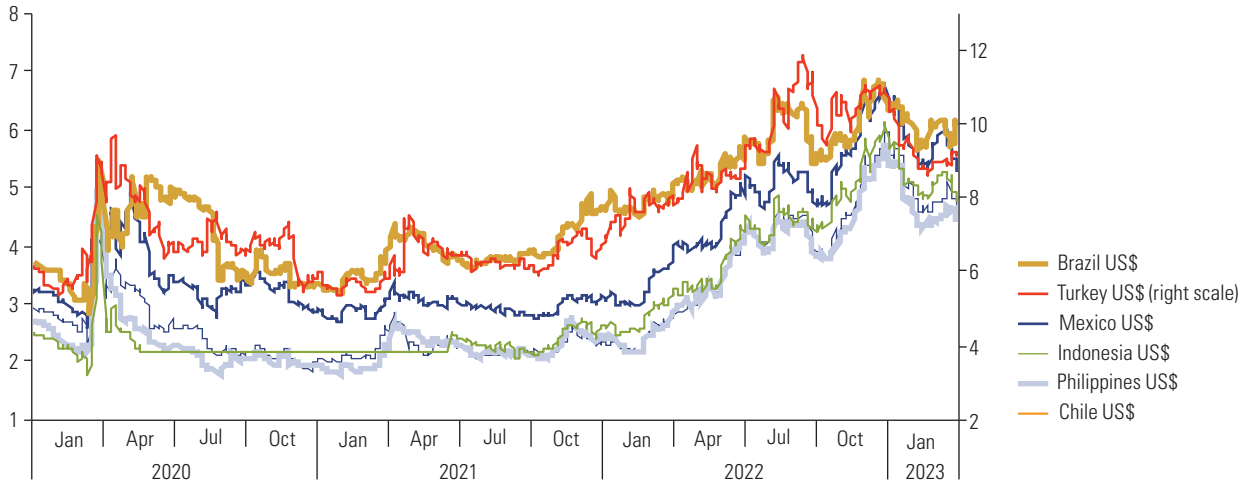
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of data from the Institute of International Finance (IIF).

Borrowing costs for sovereign debt are on the rise. In fixed-income markets, yields for the sovereign long-term bonds of countries which are considered risk-free benchmarks, such as the United States and Germany, climbed sharply as inflation surged and monetary policy tightened. Access to global liquidity is reaching an inflection point, even for investment grade-rated emerging and developing economies. Higher bond yields in developed economies and diminished risk appetite have led to higher borrowing costs, with yields rising in tandem with United States Treasury bond yields (see figure 2). Apart from higher borrowing costs, emerging markets are facing tougher conditions for issuing new debt in international markets. In 2022, nearly 30% of sovereign bonds issued had a maturity under seven years, the highest share in over a decade (IMF, 2022). For non-investment grade sovereigns, access is likely to narrow considerably, with borrowing conditions becoming increasingly prohibitive in terms of coupons and maturities.

Figure 2
United States, Germany and selected emerging and developing economies: sovereign bond yields, January 2020–January 2023
(10-year dollar bond yields in percentages)

A. United States and Germany

B. Selected emerging and developing economies



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of figures from Bloomberg.

For Latin America and the Caribbean, the current global macroeconomic environment threatens to aggravate existing economic underperformance. Economic activity is projected to expand by just 1.2% in 2023, among the lowest rates of all developing regions, down sharply from 6.7% in 2021 in the direct aftermath of the pandemic and from 3.8% in 2022. The current trajectory suggests that the region is returning to the meagre economic growth rates registered prior to the COVID-19 crisis. Economic growth in the 2014–2023 period will average 0.8%, which will be lower than that of the "lost decade" of the debt crisis in the 1980s (2.0% annual average). Potential output growth has dwindled, stymied by chronically low levels of public and private investment. Latin America and the Caribbean is the region with the lowest levels of public investment in the world. Limited public and private investment have left the region with a rapidly depreciating capital stock that is insufficient to build dynamic economies that create good jobs and are resilient to climate change. Falling domestic and global demand, coupled with the rising costs of capital, will further weaken short- and medium-term growth.

Monetary and fiscal policy space is exceptionally tight in the region. A rapid increase in consumer prices in 2021 worldwide and in the region led policymakers to adopt an increasingly restrictive monetary policy stance, a trend that continued unabated in 2022 (ECLAC, 2022a). Monetary policy rates rose sharply in most countries that maintain an inflation target, rising by 500 basis points or more between 2021 and the end of 2022 in five countries: Chile, Colombia, Costa Rica, Peru and Uruguay. Lending rates registered a stepwise increase, depressing real domestic credit to the private sector, which has not recovered since the pandemic. Higher interest rates also reverberated in public sector financing, especially in countries with significant short-term domestic debt, such as Brazil. Tighter financial conditions, both internationally and domestically, led countries to place greater emphasis on efforts to reduce fiscal deficits. Fiscal measures featured prominently in the public policies adopted in 2022 to offset the impact of rising prices (for example fuel and transportation subsidies) but were largely contained by cuts in other expenditure areas (such as social transfers that had increased sharply during the period of pandemic shock and lockdowns).

Public debt rose sharply in the decade prior to the COVID-19 pandemic, and that trend was aggravated by record fiscal deficits in 2020. The unprecedented but necessary fiscal response to the pandemic, accompanied by a sharp decline in public revenues, drove general government gross public debt in Latin America and the Caribbean to 77.4% of GDP in 2020, up from 67.9% of GDP in 2019. Public debt in Latin America has been trending higher since 2010, reflecting the impact of a cyclical downturn in growth, the end of the commodity supercycle and the persistence of elevated fiscal deficits. While the average debt level receded in 2022, reaching 56.3% of GDP, it remains well above the levels last seen two decades ago when the region was exiting a series of profound financial crises. In the Caribbean, public debt was at a high level

prior to the crisis, explaining the efforts of countries in the subregion to generate sizeable primary surpluses to achieve debt sustainability. However, the COVID-19 pandemic has significantly increased the debt burden in the Caribbean, for which the debt-to-GDP ratio rose by 20.1 percentage points in 2020 to reach 93.2% of GDP, before falling to 83.1% of GDP in 2022.

History suggests that countries have undergone development distress when similar macrofinancial and debt conditions coincide. Rising debt service, especially in the form of interest payments, requires countries to mobilize ever greater public resources to ensure debt sustainability. When public revenues are stagnant, or if there are considerable barriers to increasing the tax take, countries face painful trade-offs, sacrificing social spending and investment to meet their debt service needs (including those necessary to advance towards the SDGs) and to place their debt on a sustainable trajectory. When these trade-offs are no longer viable and meeting debt service requirements becomes untenable, a debt crisis is the most likely outcome. As seen repeatedly throughout economic history, the development implications of these crises are profound, with long-lasting impacts on growth, investment, poverty and inequality. Even if the point of debt crisis is not reached, a situation of elevated debt service and distress can last for years and leave serious economic and social scars.

Previous waves of debt accumulation and debt distress were initiated by periods of low or falling global interest rates and major changes in innovation in financial markets. In general, those conditions enabled many previously credit-constrained borrowers to access international financial markets and therefore to accumulate debt (Kose and others, 2021). From the point of view of these authors, a new wave of debt started in 2010, after the global financial crisis and in the aftermath of the European debt crisis, and they underscore that this wave exhibits the largest, fastest and most broad-based increase in debt in emerging markets and developing economies in the past 50 years.

If the latest wave of debt accumulation follows the historical pattern of its predecessors, it could result in a widespread financial crisis. There are significant similarities with previous episodes (Kose and others, 2021). Interest rates in advanced economies have been very low since the global financial crisis and until the first half of 2022. Innovation in financial markets such as the significant growth of regional banks, the expansion of shadow banking and larger appetite for local currency bonds, together with a long period of non-conventional monetary policy, have contributed to the increase in borrowing in international markets. But the rise in inflation rates has driven a change in the orientation of monetary policy and, as a result, interest rates have been raised by central banks around the world.

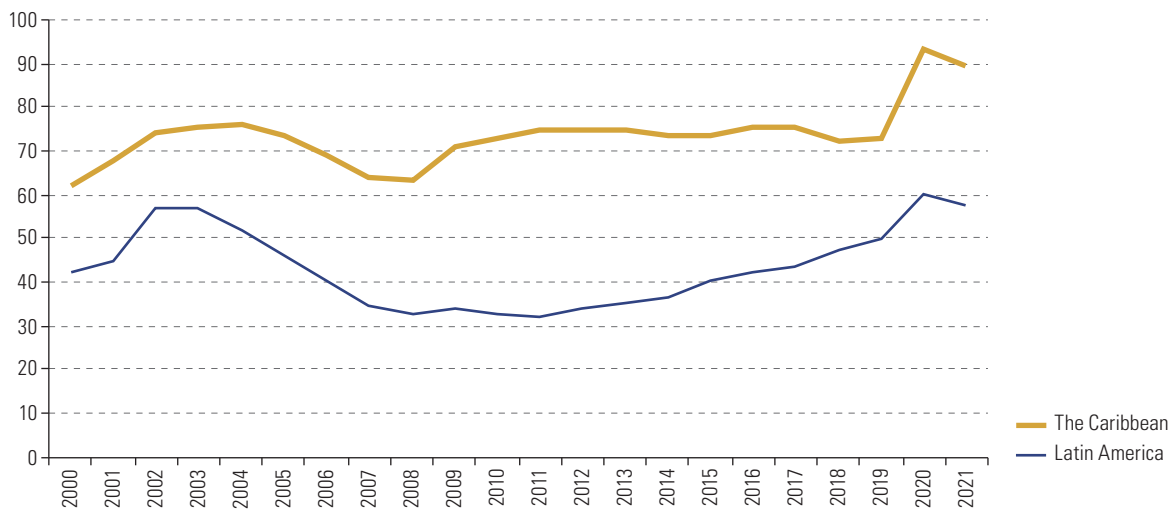
Historically, the combination of these factors with an outlook for low economic growth tend to end with debt stress episodes, in which many countries must restructure their debt to avoid default. These episodes usually imply painful debt distress involving large and protracted reductions in investment, GDP and consumption in emerging and developing economies, including in Latin America and the Caribbean.

II. Public debt in Latin America and the Caribbean

A. Public debt levels were trending upwards before the shock resulting from the COVID-19 crisis

Public debt levels in Latin America and the Caribbean rose in the decade prior to the COVID-19 pandemic, after which they increased sharply. The end of the commodity supercycle and a cyclical slowdown in economic growth, combined with elevated and persistent fiscal deficits, resulted in a steady increase in public debt levels in Latin America in the decade leading up to the COVID-19 pandemic (see figure 3). General government gross public debt in Latin America rose from a low of 32.4% of GDP in 2011 to 49.7% of GDP in 2019. Debt levels increased sharply in 2020 —reaching 60.3% of GDP— as countries took unprecedented steps to strengthen public health systems, support families and protect the productive structure, leading to record fiscal deficits (ECLAC, 2020). In the Caribbean, public debt levels prior to the crisis were high, between 70% and 80% of GDP. However, this relative stability deteriorated in 2020 as a result of the COVID-19 pandemic, with public debt rising by 20.1 percentage points of GDP on average in the Caribbean, roughly double the increase observed in Latin America (10.6 percentage points of GDP). These trends are not unique to Latin America and the Caribbean and are replicated across emerging markets and developing economies, representing a systemic concern (see box 1).

Figure 3
Latin America and the Caribbean: general government gross public debt, 2000–2021
(Percentages of GDP)



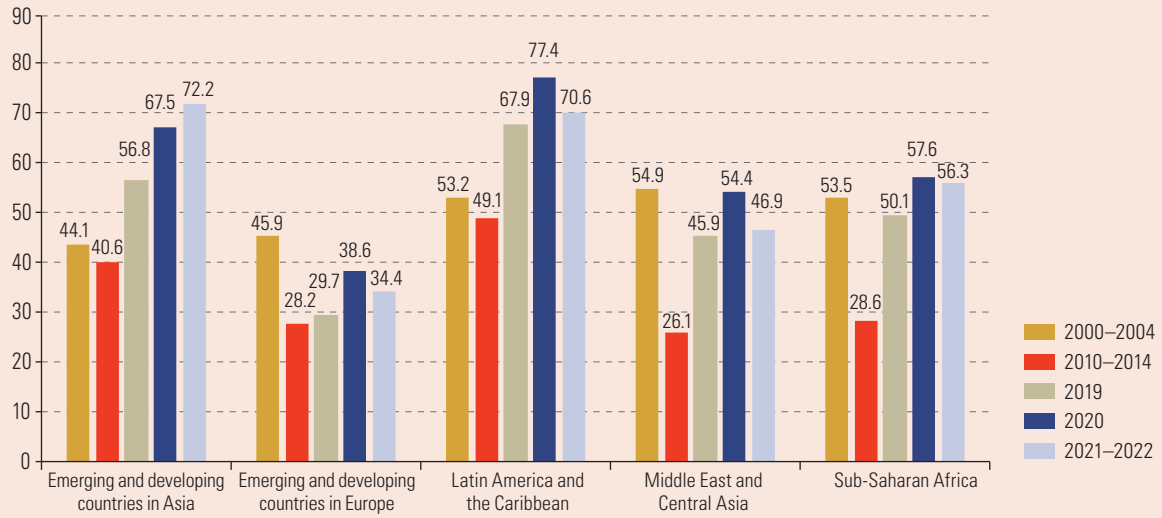
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook: Countering the Cost-of-Living Crisis*, Washington, D.C., October 2022; for Uruguay: P. Mauro and others, "A modern history of fiscal prudence and profligacy", *IMF Working Papers*, No. 13/5, IMF, 2013.
Note: Simple averages. Excludes Aruba and the Bolivarian Republic of Venezuela.

Box 1

Elevated public debt levels: a systemic concern for emerging markets and developing economies

Public debt levels rose progressively in most emerging and developing regions in the decade leading up to the COVID-19 pandemic in 2020. Weak global macroeconomic fundamentals and adverse price shocks for non-renewable natural resources, especially the collapse in crude oil prices between 2014 and 2015, reverberated in these economies, leading in some cases to the creation of persistent and elevated fiscal deficits. By 2019, general government gross public debt reached levels well above the 2010–2014 average in emerging and developing countries in Asia (16.2 percentage points of GDP), Latin America and the Caribbean (18.8 percentage points of GDP), the Middle East and Central Asia (19.8 percentage points of GDP) and Sub-Saharan Africa (21.5 percentage points of GDP) (see figure). The shock to public finances resulting from the COVID-19 crisis aggravated this trend, resulting in a sharp increase in public debt. While the public debt-to-GDP ratio trended lower in 2021 and 2022, owing mainly to the rapid recovery in nominal output, debt levels remain high, well above those registered in the aftermath of various economic and financial crises that hit emerging and developing regions in the late 1990s and early 2000s.

Selected emerging and developing regions: general government gross public debt, 2000–2022
(Percentages of GDP)

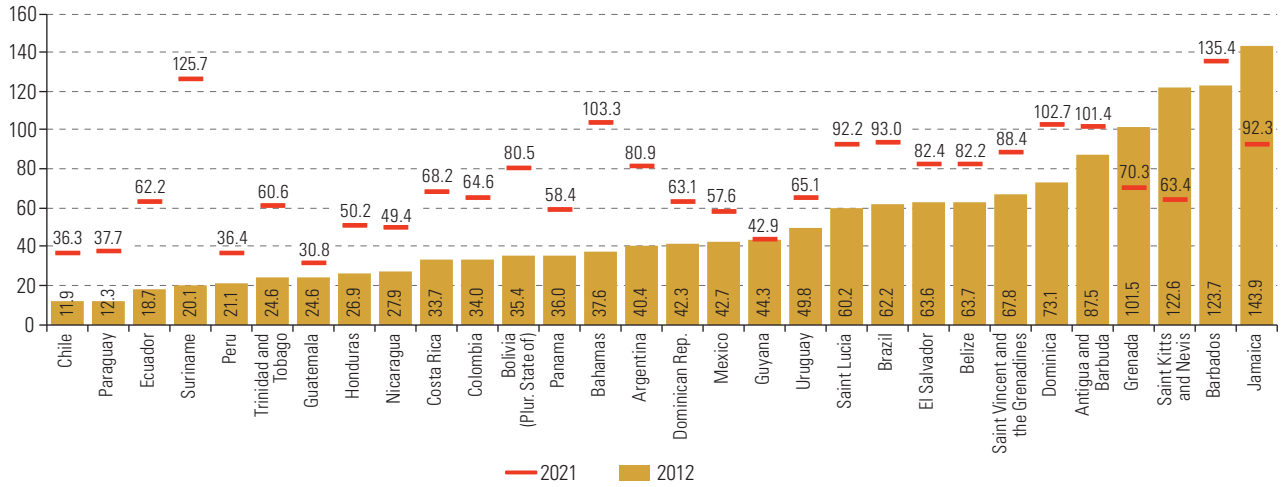


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook: Countering the Cost-of-Living Crisis*, Washington, D.C., October 2022.
Note: Country groupings are based on those presented by IMF in the World Economic Outlook.

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

The regional trend towards higher public debt levels was replicated in most countries in the region in the past decade. This pattern was widespread, and by 2021, 21 countries out of 30 had general government gross public debt equivalent to 60% of GDP or more (compared to 11 in 2012). Of these, 13 (compared to 5 in 2012) registered a level of indebtedness of 80% of GDP or more (see figure 4). The largest increases over the period 2012–2021 were observed in Argentina (40.5 percentage points of GDP), the Bahamas (65.7 percentage points of GDP), Ecuador (43.5 percentage points of GDP), the Plurinational State of Bolivia (45.1 percentage points of GDP) and Suriname (105.6 percentage points of GDP). In contrast to the general trend in the region, public debt levels fell in Grenada, Guyana, Jamaica and Saint Kitts and Nevis. The declines in Jamaica and Saint Kitts and Nevis were particularly significant, higher than 50 percentage points of GDP, as both countries implemented agreements with the International Monetary Fund (IMF).

Figure 4
Latin America and the Caribbean (30 countries): general government gross public debt, 2012 and 2021
(Percentages of GDP)

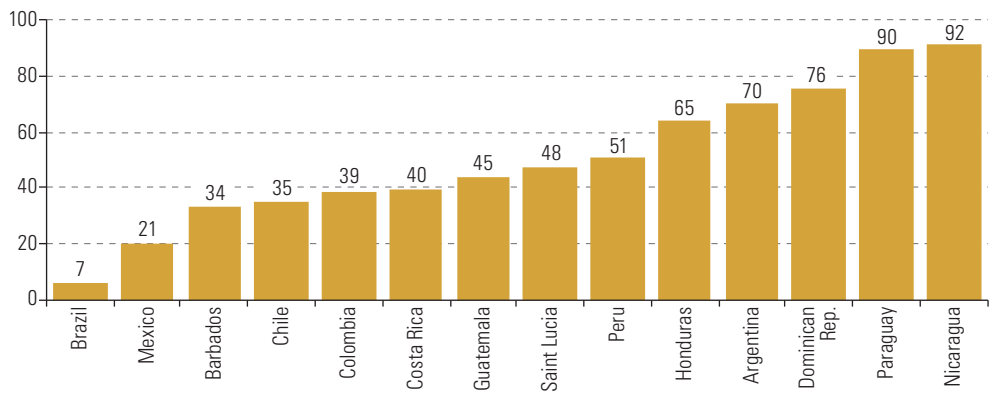


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook: Countering the Cost-of-Living Crisis*, Washington, D.C., October 2022.

B. Public debt composition indicates potential vulnerabilities to macrofinancial shocks

Foreign currency-denominated public debt is significant in some countries, increasing the exposure to currency shifts. The relative share of gross general government debt denominated in foreign currency, principally United States dollars, is high in the region, above IMF early warning benchmarks for vulnerability, which range from 20% to 60% in most countries (see figure 5). While foreign currency debt is normally related to external debt, some countries in the region also issue domestic debt in dollars. For countries with sizeable foreign currency debt stocks, debt service has the potential to rise significantly in national currency terms, creating tremendous pressure to mobilize additional resources or cut public spending to meet obligations. Currency depreciations in the region in 2021 highlight the magnitude of these shocks. That year, the national currencies of several countries depreciated heavily against the dollar, including those of Argentina (38%), Suriname (35%), Haiti (30%), Chile (15%) and Colombia (14%). However, in the case of Chile, the overall debt-to-GDP ratio is low, limiting the magnitude of exchange-rate shocks to debt service.

Figure 5
Latin America and the Caribbean (14 countries): ratio of general government gross public debt in foreign currency to total general government gross public debt, 2021
(Percentages)

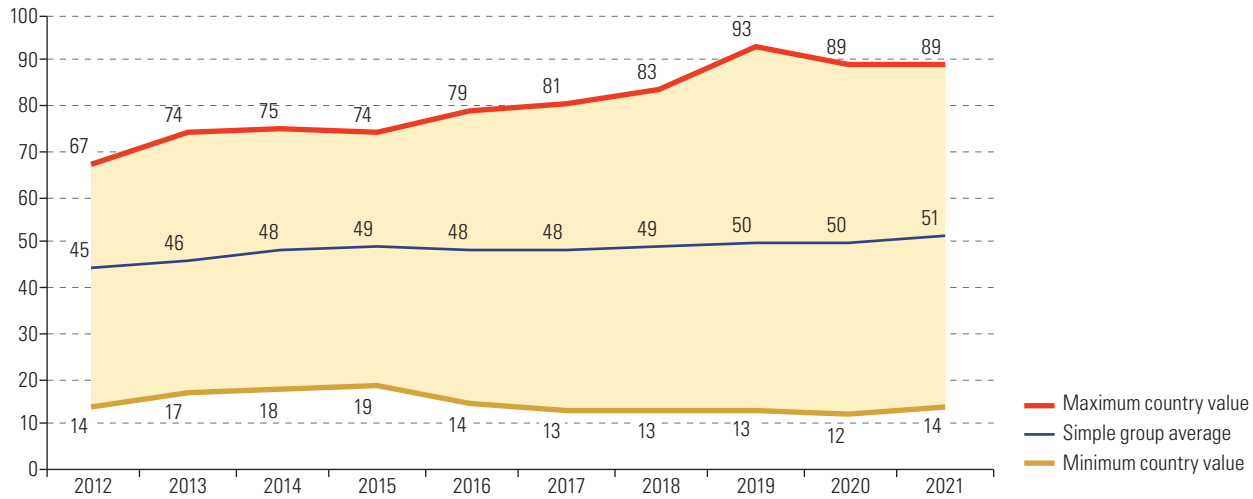


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "A Cross-Country Database of Fiscal Space" [online] http://www.worldbank.org/en/research/brief/fiscal-space.

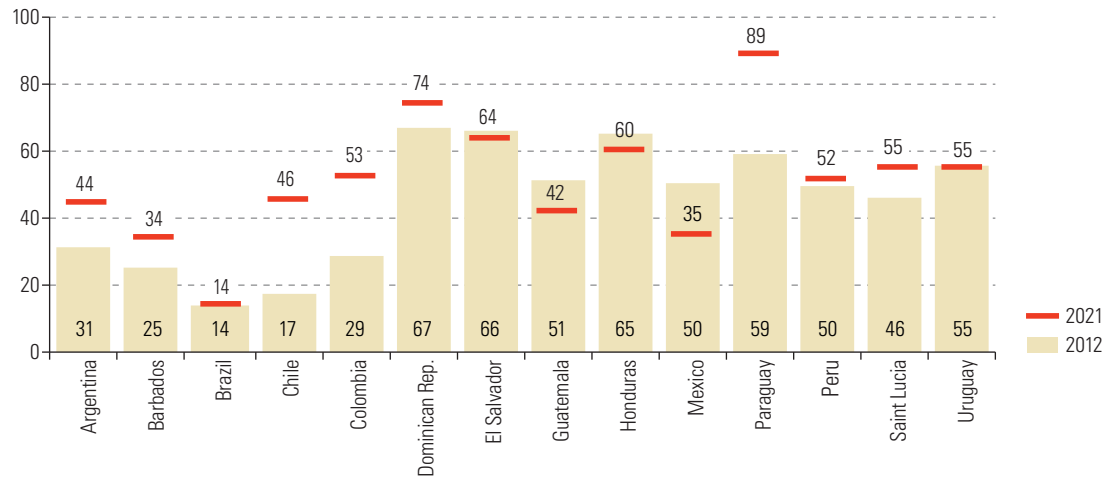
External debt is an increasingly important source of financing for government operations in some countries of the region. The share of general government gross public debt held by non-resident creditors has increased in the past decade, from an average of 45% in 2012 to 51% in 2021 for a sample of countries in the region (see figure 6). This increase in the group average belies a more complex series of movements at the country level. External debt, as a share of total general government gross public debt, rose sharply over the period in Chile (by 29 percentage points), Colombia (24 percentage points) and Paraguay (30 percentage points). All three countries actively borrowed on international financial markets during the period. Other countries that also made extensive use of international bond markets, such as Peru, registered little change, as domestic debt issuance also rose. By contrast, the share of public debt held by non-residents declined markedly in Guatemala (by 9 percentage points) and Mexico (15 percentage points). These overall trends notwithstanding, the share of non-resident creditors in most countries in the region are above IMF early warning vulnerability benchmarks (within a band of 20% to 60%). In this respect, the Dominican Republic and Paraguay stand out, with a non-resident share of 74% and 89%, respectively.

Figure 6
Latin America and the Caribbean (14 countries): ratio of non-resident held general government gross public debt to total general government gross public debt, 2012–2021
(Percentages)

A. Latin America and the Caribbean, 2012–2021



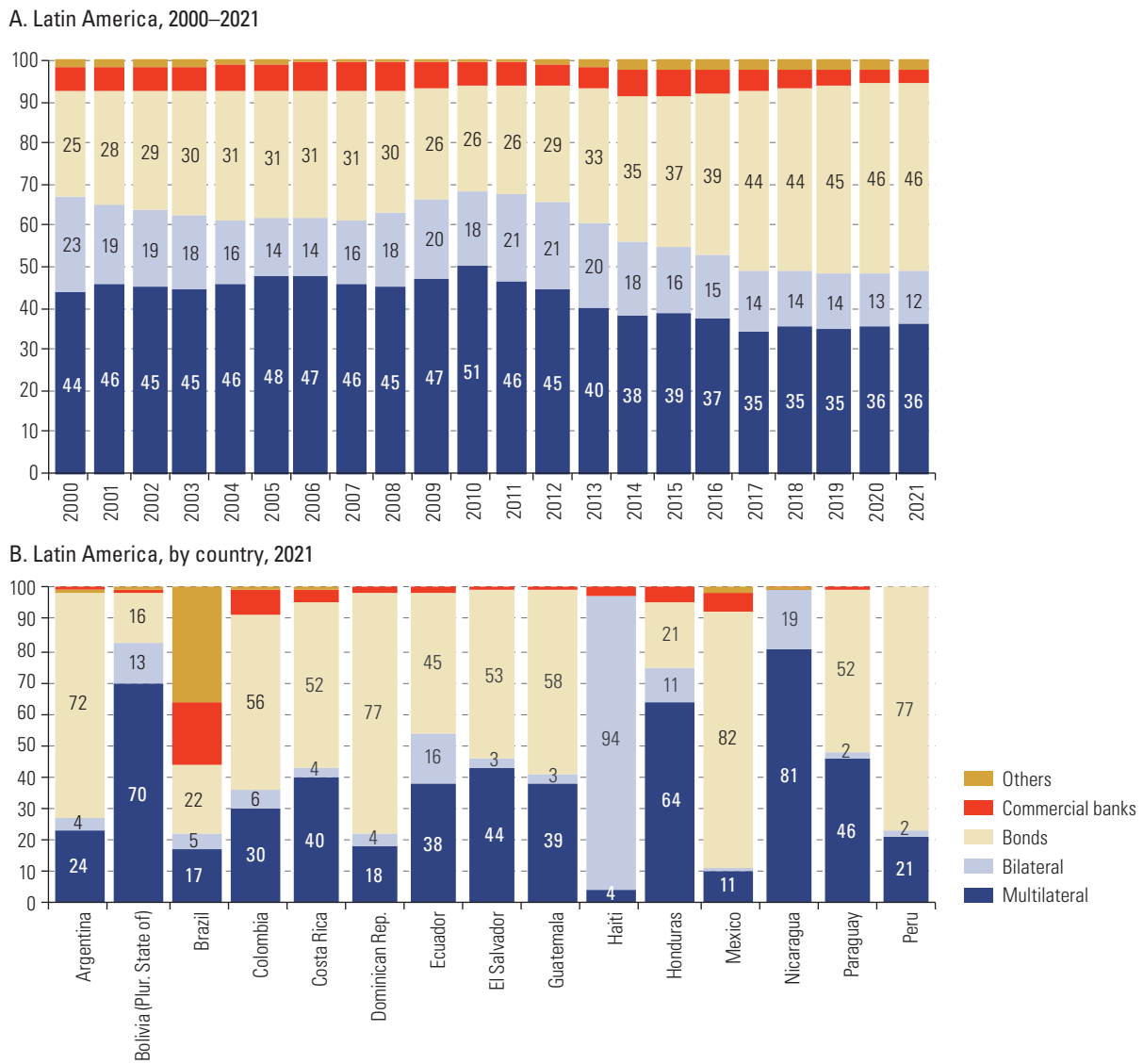
B. Latin America and the Caribbean, by country, 2012 and 2021



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "A Cross-Country Database of Fiscal Space" [online] http://www.worldbank.org/en/research/brief/fiscal-space.

Private investors are the single most important external creditor for Latin American governments. The composition of Latin America's creditors has undergone a profound shift in the last decade. The dominance of multilateral and bilateral lenders rapidly eroded in the 2010s, as external public debt became increasingly concentrated in the hands of bondholders (see figure 7). The share of multilateral and bilateral creditors fell from a high of 69% in 2010 —in the aftermath of the global economic and financial crisis of 2008–2009— to 48% in 2021. Notably, the share of multilateral and bilateral debt did not increase, on average, during the COVID-19 pandemic. The relatively greater importance of bondholders is apparent in many countries, making up more than half of total public external debt in Argentina, Colombia, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Mexico, Paraguay and Peru. Multilateral and bilateral lenders remain significant creditors for countries with limited access to international financial markets, such as the Plurinational State of Bolivia, Haiti, Honduras and Nicaragua.

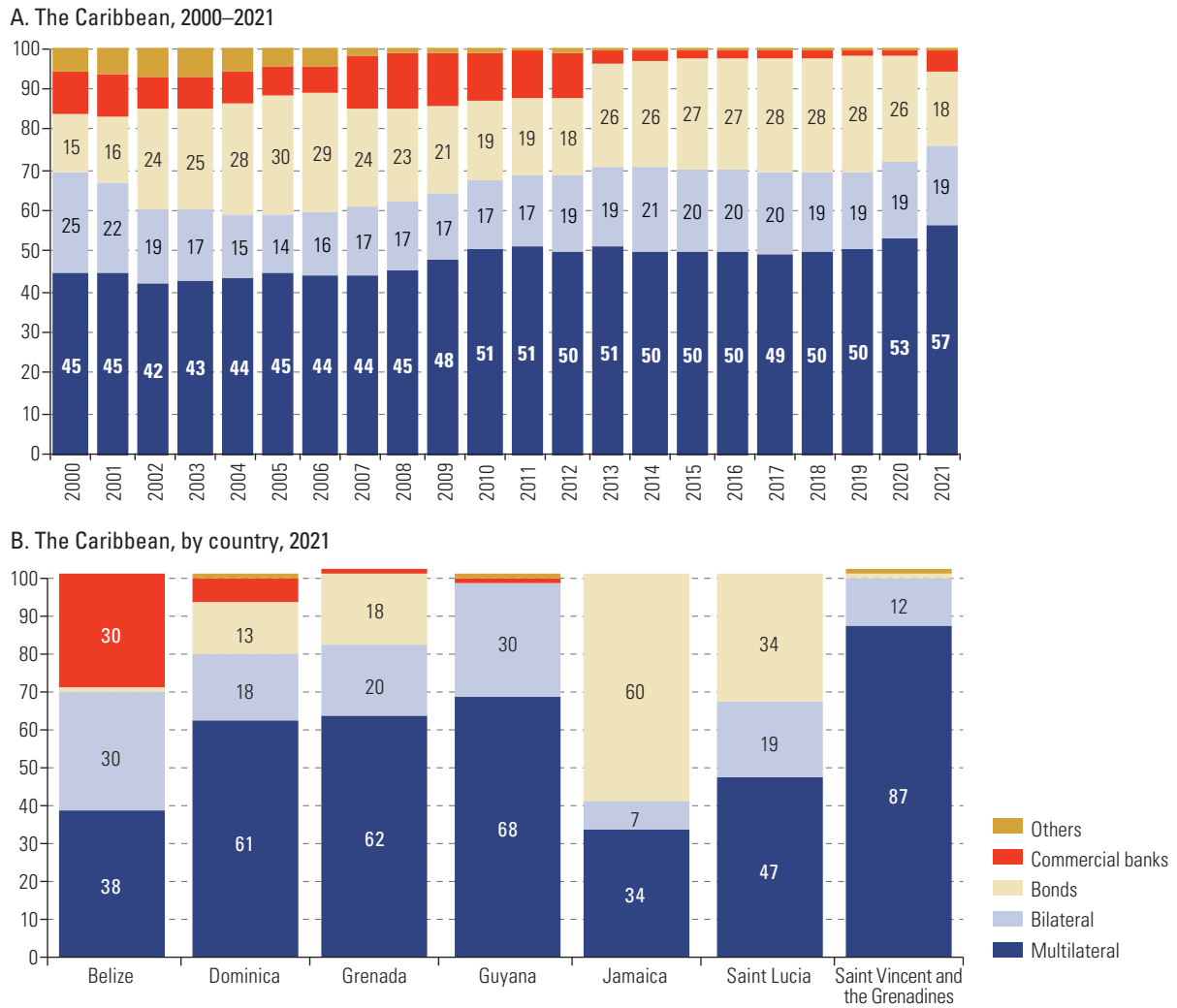
Figure 7
Latin America (15 countries): public and publicly guaranteed external debt, by type of creditor, 2000–2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "International Debt Statistics (IDS)" [online] https://www.worldbank.org/en/programs/debt-statistics/ids.
Note: Simple averages.

Multilateral and bilateral lenders are the dominant external creditors for Caribbean countries. Official creditors account for most public external debt, representing 76% of the total in 2021 (see figure 8). In contrast to the trend observed in Latin America, in the Caribbean, the importance of official creditors increased in the aftermath of the global economic and financial crisis of 2008–2009, after which it stabilized at a significantly higher level than that seen prior to the crisis. The COVID-19 pandemic reinforced the role of multilateral lenders, whose share in total public external debt rose on average, from 50% in 2019 to 57% in 2021. Despite these general trends, the situation varies from one country to the next. While official creditors account for almost the entirety of public external debt in Guyana and Saint Vincent and the Grenadines, private bondholders are significant in Jamaica. By contrast, commercial financial institutions are important external creditors for Belize, accounting for roughly 30% of the outstanding public external debt stock. This relatively large share is due to the outcome of external debt restructuring in 2021 as part of a debt-for-nature conservation swap supported by The Nature Conservancy (TNC) (Central Bank of Belize, 2021). TNC issued an international blue bond, the proceeds of which were lent to Belize through a financial special purpose entity in the form of a "blue loan". The loan allowed the country to subsequently purchase, redeem and cancel its external public debt held by private bondholders.[1]

Figure 8
The Caribbean (7 countries): public and publicly guaranteed external debt, by type of creditor, 2000–2021
(Percentages)



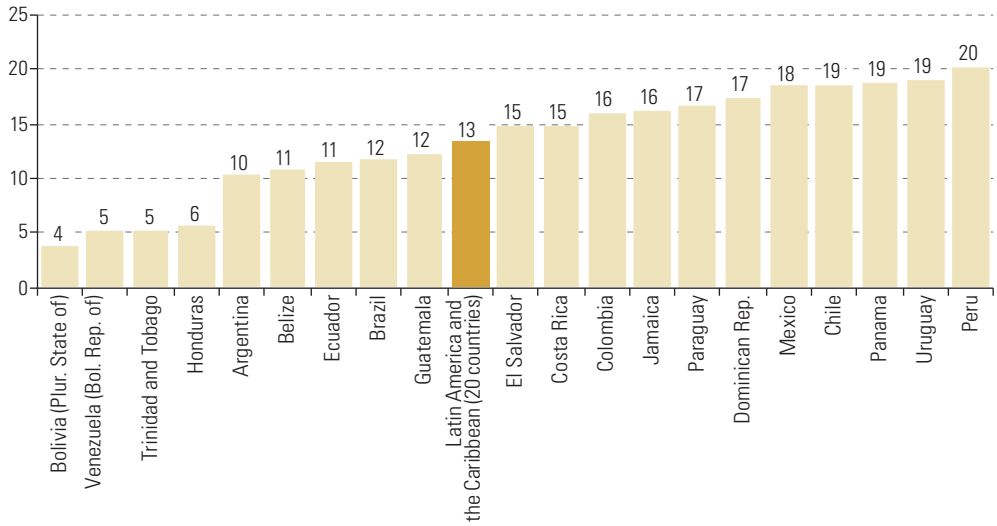
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "International Debt Statistics (IDS)" [online] https://www.worldbank.org/en/programs/debt-statistics/ids.
Note: Simple averages.

[1] The effective principal haircut obtained as a result of the restructuring reduced total public sector debt by 10% of GDP (Central Bank of Belize, 2021).

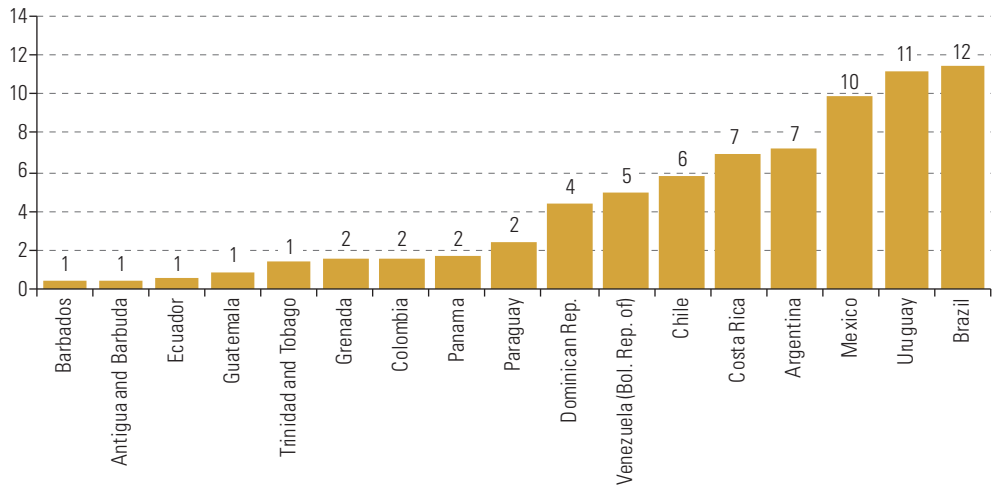
Despite relatively favourable sovereign debt amortization profiles, significant short-term debt rollover requirements expose countries to market volatility. Most countries in the region have debt amortization profiles that average 10 years or more, and are as high as 20 years in the case of Peru (see figure 9). However, there is a significant gap between countries on either side of the regional average. The average maturity of sovereign debt in the Plurinational State of Bolivia, Honduras, Trinidad and Tobago and the Bolivarian Republic of Venezuela was well below average in 2021. For these countries, the need to rapidly roll over public debt heightens their exposure to shifts in financial market conditions, principally moves in interest rates. By contrast, for countries with longer amortization profiles, with a large share of fixed interest rate coupons, this process is less pronounced. However, long average amortization profiles are not in themselves a buffer against external shocks. Countries with a significant volume of debt coming due in the short run also face a pass-through of prevailing financial market conditions to their balance sheet. For example, Brazil, Mexico and Uruguay faced amortizations of 10% of GDP in 2022.

Figure 9
Latin America and the Caribbean: average sovereign debt maturity and central government debt maturing in 12 months or less, 2021
(Years and percentages of GDP)

A. Average sovereign debt maturity
(Years)



B. Central government debt maturing in 12 months or less, 2021
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "A Cross-Country Database of Fiscal Space" [online] http://www.worldbank.org/en/research/brief/fiscal-space.

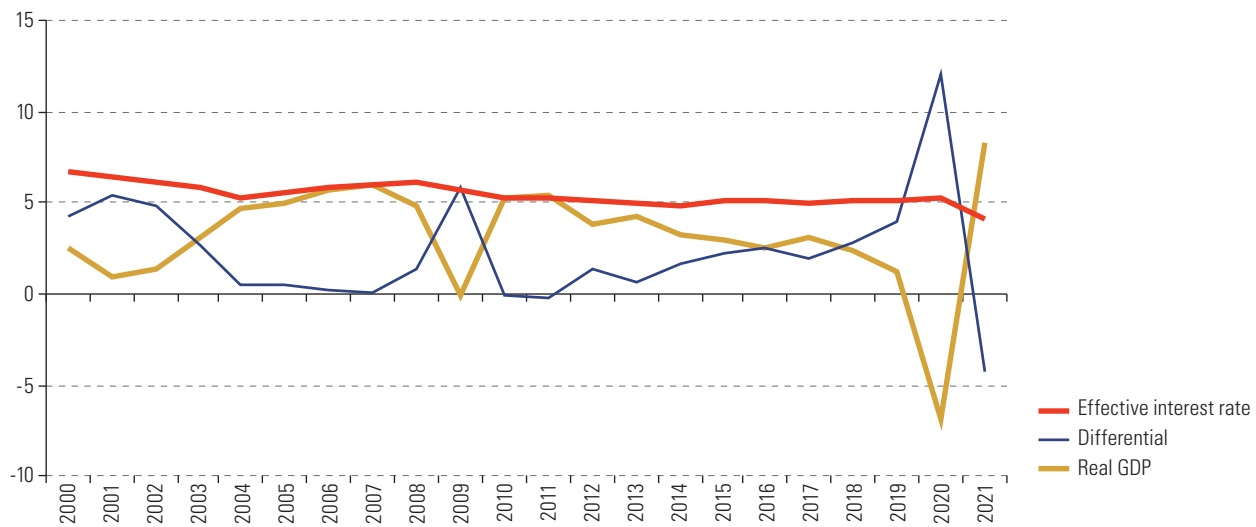
C. Debt dynamics may become more difficult to manage owing to deteriorating macrofinancial conditions

Weak growth, higher interest rates and the risk of currency depreciation will intensify unfavourable debt dynamics. Public debt sustainability and public debt dynamics are traditionally analysed using an equation that describes the factors that influence changes in debt levels. In its most basic form, this framework describes debt dynamics as the interaction of the prior period's debt stock, the differential between the effective interest paid on public debt and the rate of economic growth, the effect of variations in the exchange rate on foreign currency debt and the primary fiscal balance. Most of these factors are effectively exogenous to the policymaking process, with the primary balance typically being the only variable that provides policymakers with active leverage on debt dynamics. Proactive management of public debt liabilities, such as reprofiling the existing stock or efforts to modify its composition, can limit the potential vulnerabilities to shocks to these exogenous factors. However, such measures are not always viable, especially when financial market conditions, both international and domestic, are unfavourable.

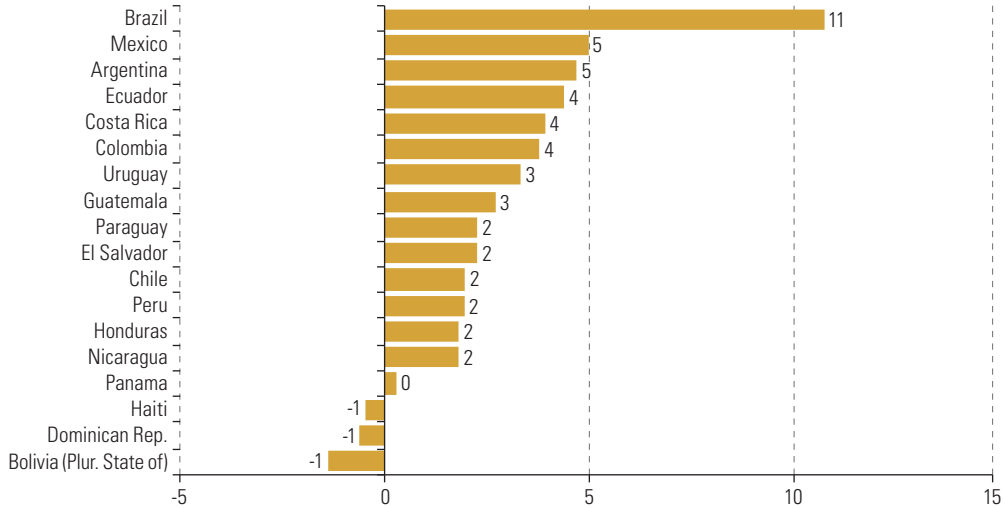
The interest rate-growth differential, the principal driver of debt dynamics, has deteriorated in Latin America over the past decade. Excluding the volatility associated with the COVID-19 pandemic in 2020 and the subsequent rebound in economic growth in 2021, the contribution of this differential to the increase in public debt rose from 2011 onward (see figure 10). The increase in the interest rate-growth differential was driven entirely by the deceleration in economic growth, as the effective interest rate remained essentially unchanged over the period. This trend is expected to persist after 2021, as economic growth lost momentum in 2022 and is projected to slow further in 2023. Even in the absence of interest rate shocks, the interest rate-growth differential will continue to be a significant contributor to debt dynamics in the coming period. However, its role in debt dynamics at the country level varies significantly, mainly reflecting differences in the effective interest rates of each country.

Figure 10
Latin America: effective interest rate and economic growth differential, 2000–2021
(Percentage points)

A. Latin America, 2000–2021



B. Latin America, differential by country, 2015–2019 average



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of CEPALSTAT [online database] https://statistics.cepal.org/portal/cepalstat/index.html?lang=en; and P. Mauro and others, "A modern history of fiscal prudence and profligacy", *IMF Working Papers*, No. 13/5, Washington, D.C., International Monetary Fund (IMF), 2013.

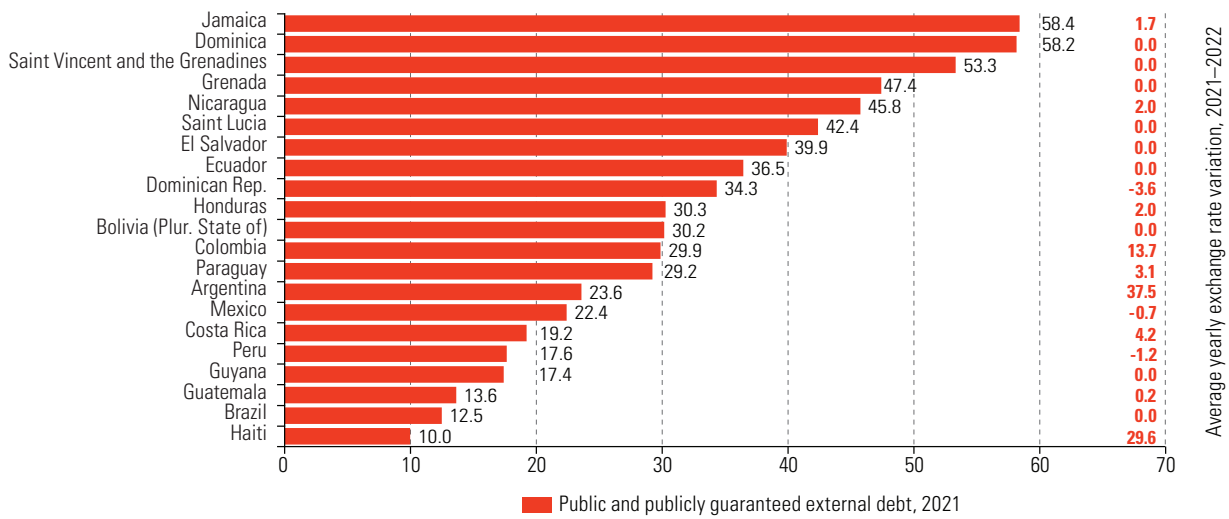
Note: Simple averages. Effective interest rates are derived from dividing interest payments by the debt stock at the end of the previous year.

The potential pass-through of exchange rate volatility to debt dynamics is pronounced in some countries in the region. External debt stocks, primarily denominated in foreign currencies, are significant across countries in the region (see figure 11). Nevertheless, the contribution of variations in the exchange rate to debt dynamics varies widely across the region. Many of the countries with the largest levels of public external debt, relative to output, maintain a fixed or managed exchange rate. This is the case of the economies of the Eastern Caribbean Currency Union (ECCU) —which includes Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, Saint Kitts and Nevis, Saint Lucia and Saint Vincent and the Grenadines— where the exchange rate has remained fixed since 1976. However, several countries experienced significant depreciations in 2022 with implications for debt dynamics, including Argentina, Colombia and Haiti. For countries that maintain a floating exchange rate regime, the pass-through of deteriorating macrofinancial conditions is potentially high.

Figure 11

Latin America (21 countries): public and publicly guaranteed external debt, 2021, and exchange rate variation, 2021–2022

(Percentages of GDP and percentages)

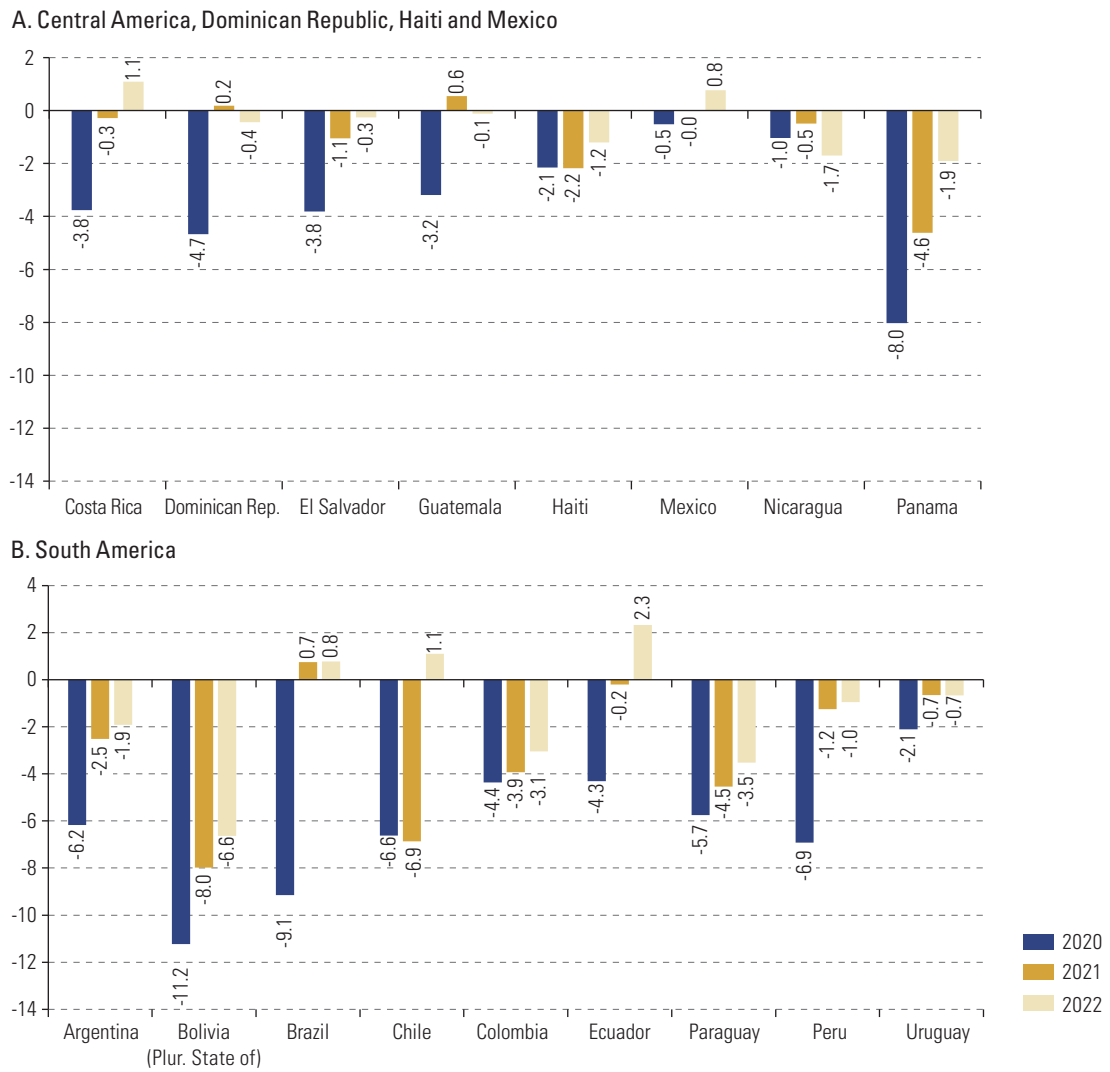


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of World Bank, "International Debt Statistics (IDS)" [online] https://www.worldbank.org/en/programs/debt-statistics/ids and International Monetary Fund (IMF), "International Financial Statistics (IFS)" [online] https://data.imf.org/?sk=4c514d48-b6ba-49ed-8ab9-52b0c1a0179b.

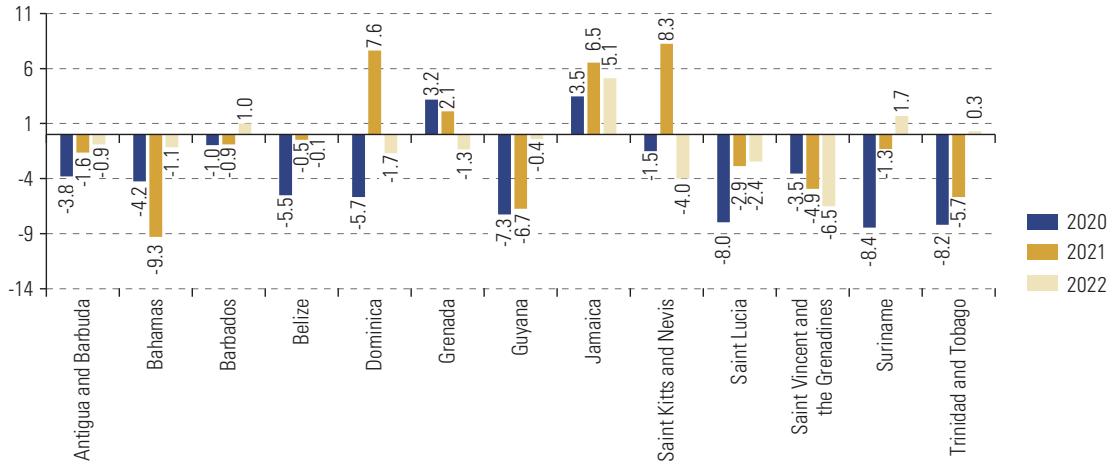
Note: A negative figure for exchange rate variation denotes appreciation.

Primary deficits were closed rapidly in the aftermath of the COVID-19 pandemic as emergency programmes expired, but further reductions will require difficult decisions about public investment and social spending. Faced with the increase in public debt levels caused by the COVID-19 pandemic, coupled with the deterioration in the underlying factors of debt dynamics, policymakers in the region have come under increasing pressure to place public debt on a sustainable trajectory. The primary balance, the principal lever available to policymakers to shape debt dynamics, registered significant improvements in 2021 after reflecting record deficits in many countries in 2020 (see figure 12). A further reduction in primary deficits and the generation of primary surpluses in some countries are expected for 2022. In many cases, these changes reflect the programmed withdrawal of COVID-19-related emergency measures, coupled with a stronger-than-expected rebound in tax revenues. However, improving primary balances going forward will create significant policy challenges, including the need to generate additional public revenues and the management of public spending to achieve social and investment goals. These improvements will occur against the backdrop of a projected return to slow economic growth, suggesting that debt pressures will result in a procyclical fiscal policy that could hinder sustainable development in the region.

Figure 12
Latin America and the Caribbean (30 countries): general government primary balance, 2020, 2021 and 2022
(Percentages of GDP)



C. The Caribbean



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of International Monetary Fund (IMF), *World Economic Outlook: Countering the Cost-of-Living Crisis*, Washington, D.C., October 2022.

III. Debt-related development distress

Countries face potential development distress when tackling debt service requirements in an unfavourable macrofinancial and growth environment. External macrofinancial shocks reverberate strongly in the domestic economies of developing countries. Disruptions to economic growth, trade and financial flows can inhibit a country's ability to meet its debt service obligations. Faced with such an environment, policymakers must navigate a series of trade-offs between meeting debt service obligations and pursuing the needed development policies. These trade-offs can be mitigated to the extent that additional resources can be mobilized, but countries are often forced to countenance potentially painful reductions in public spending when there are significant obstacles to raising the tax take. This process is not necessarily abrupt; countries often undergo a prolonged period of fiscal adjustment. The foregone social spending and public investment can undercut potential economic growth and disrupt the development process, which, in turn, can further reduce the ability of a country to meet its debt service obligations.

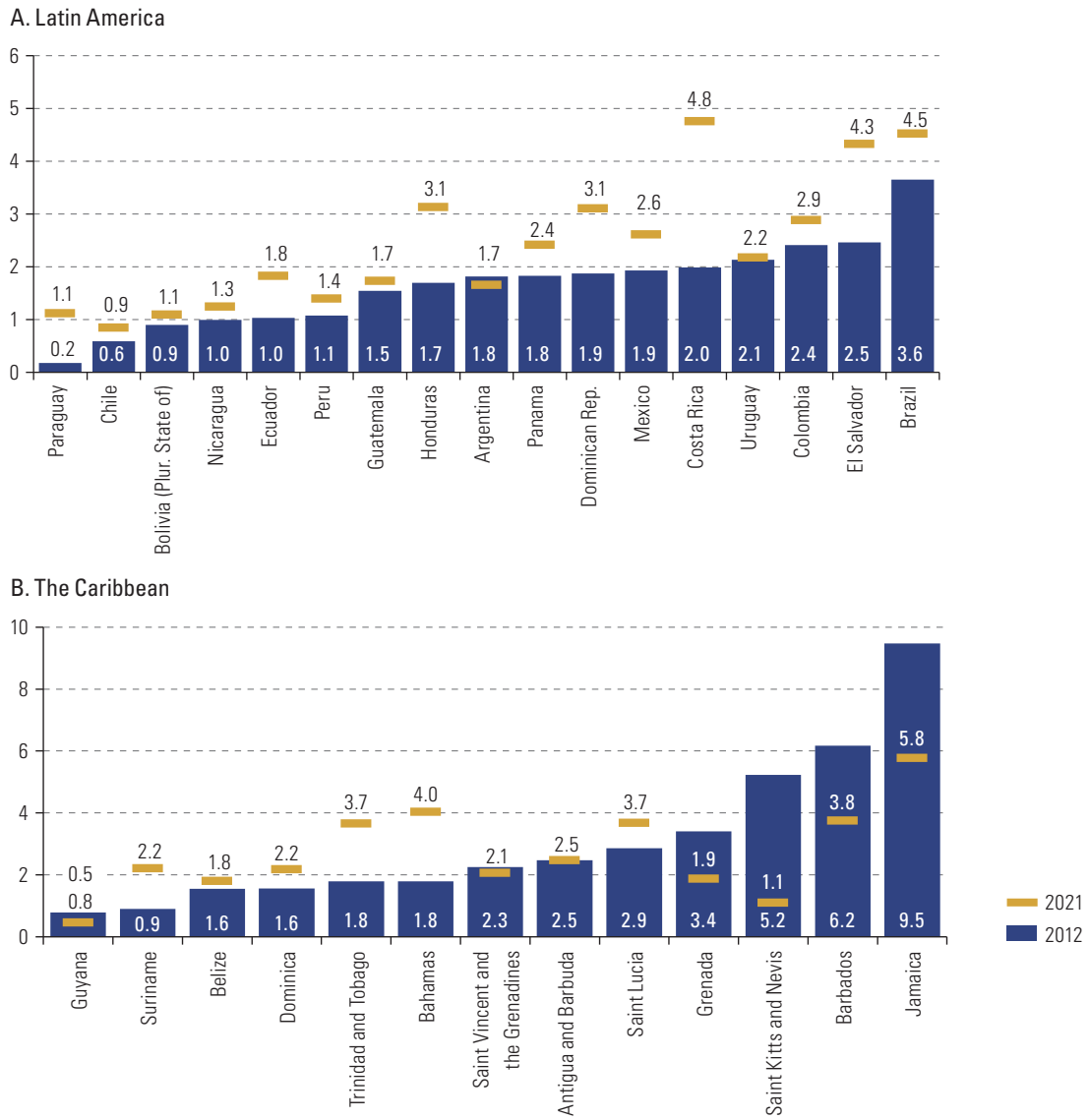
Debt crises often cause significant development distress. Episodes of debt crisis generate severe economic and social costs, with long-lasting effects that include sizeable and protracted losses in economic output, investment and consumption. Countries undergoing episodes of debt stress also face rising poverty, inequality and unemployment, among other social impacts. As no appropriate mechanism exists for debt restructuring and relief, resolving these episodes has traditionally been a protracted process, intensifying the adverse effect on development.

A. Countries face critical trade-offs between servicing debt and pursuing development objectives

Higher debt has led to a stepwise increase in interest payments in the region, the magnitude of which varies significantly across countries. The steady rise in public debt levels in Latin America and the Caribbean has led to a concomitant increase in interest payments. Increases in public debt levels of 20 to 30 percentage points of GDP between 2012 and 2021, depending on the country, led to a generalized but varying increase in interest payments (see figure 13). Interest payments rose sharply in Costa Rica (2.8 percentage points of GDP), the Bahamas (2.2 percentage points), El Salvador (1.9 percentage points) and Trinidad and Tobago (1.9 percentage points), but increased little in Chile (0.3 percentage points) and Peru (0.3 percentage points), despite their government gross public debt widening significantly over the period (see figure 4). This significantly elevated the debt service effort for the whole region: countries such as Costa Rica, Brazil and El Salvador were paying interest on their debt equivalent to 4.5% or more of GDP, while six countries (Colombia, the Dominican Republic, Honduras, Mexico, Panama and Uruguay) were paying the equivalent of between and 2% and 4%.

Trends in interest payments at the country level were shaped not only by higher debt levels but also by differences in the composition of creditors and by the prevailing financial conditions for debt issuance in international and domestic markets. The effective interest rates floated on bond markets for sovereign debt are high in several countries that have recorded large increases in interest outlays, such as Brazil, Costa Rica and El Salvador. By contrast, in the case of Chile and Peru, both countries have issued bonds on international markets under favourable conditions, including during the COVID-19 pandemic, reflecting their investment-grade sovereign credit rating. Trends at the country level were also shaped by the results of various debt restructuring exercises, which reduced interest payments through a combination of cuts to the outstanding principal and lower average interest rates (see box 2).

Figure 13
Latin America and the Caribbean (30 countries): central government interest payments, 2012 and 2021
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean, 2022. Executive summary* (LC/PUB.2022/19), Santiago, 2022.

Box 2

Latin America and the Caribbean: recent examples of debt restructuring and their impact on debt service

In recent years, high debt servicing costs and debt sustainability concerns have prompted several countries to pursue debt restructuring negotiations with their creditors. The successful completion of these exercises in some countries has resulted in an improved amortization profile, lower effective interest rates, and —in some cases— a reduction in the outstanding principal. Some interest payment savings were significant and created additional fiscal space for countries facing difficult macrofinancial conditions and high public debt levels.

In 2020, Argentina concluded debt restructuring with its private creditors on debt instruments issued under foreign and local law. The country will realize savings of US$ 42 billion between 2020 and 2024, owing primarily to the reduction in the average interest rate (from 7% to 3% for debt under foreign law and from 7.6% to 2.8% for debt under national law) (Ministry of Economy of Argentina, 2021). Central government interest payments in Argentina fell from 4.3% of GDP in 2019 to 2.3% of GDP in 2020 —owing in part to delayed payment of interest obligations— and then to 1.7% in 2021. Argentina subsequently reached an additional deal in 2022 with the Paris Club, covering US$ 1.97 billion.

Similarly, Ecuador successfully restructured global bonds valued at US$ 17.4 billion in 2020, resulting in an 8.9% cut to the capital outstanding, a reduction in the weighted average interest rate from 9.2% to 5.3%, and a significant extension of the amortization profile, from an average of 6.1 years to 12 years (Ministry of Economy and Finance of Ecuador, 2021). Significantly, debt service for the period 2020–2024 fell from US$ 12 billion to US$ 1.4 billion. As a result of the deal, central government interest payments fell from 3.3% of GDP in 2020 to 1.8% of GDP in 2021. In 2022, Ecuador obtained US$ 1.4 billion in debt relief following debt restructuring with a series of Chinese banks.

In 2021, Belize successfully restructured its external debt with private creditors through a debt-for-nature conservation swap in partnership with The Nature Conservancy (TNC) (Central Bank of Belize, 2021). Under the negotiated deal, the country liquidated its 2034 bond in United States dollars, with a 45.5% reduction in the outstanding principal. The cash tender was financed by funds from a "blue bond" issued by TNC. The proceeds of the bond were subsequently lent to the country through a special-purpose entity in the form of a "blue loan". As a result of the restructuring, the country's external public debt fell by 17.1 GDP percentage points. Interest payments on external debt declined from 65 million Belize dollars (1.6% of GDP) in 2020 to 33.9 million Belize dollars (0.7% of GDP) in 2021, mainly thanks to the restructuring.

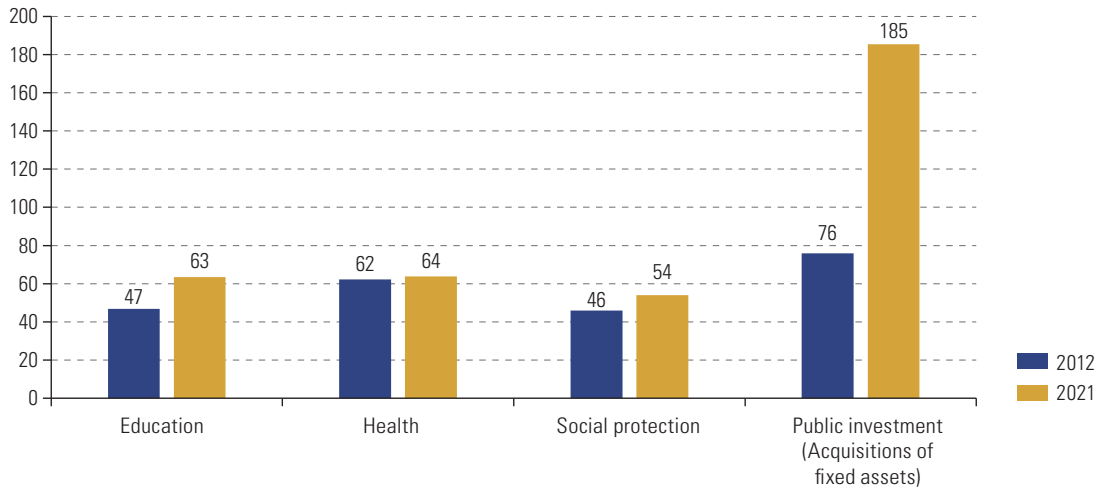
Barbados also completed a debt-for-nature swap in 2022, supported by the Inter-American Development Bank and TNC. Both institutions provided repayment guarantees, which secured a term loan facility that the country used to prepay nearly US$ 147 million in external commercial debt —outstanding Eurobonds with a 6.5% coupon— and to repurchase US$ 146 million in domestic bonds, instruments with a rate of 8%, held by the National Insurance Scheme (Central Bank of Barbados, 2023; IMF, 2022).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Ministry of Economy of Argentina, "Restauración de la sostenibilidad de la deuda pública", August 2021 [online] https://www.argentina.gob.ar/sites/default/files/2021/08/presentacion_bicameral_de_deuda.pdf; Ministry of Economy and Finance of Ecuador, *Estrategia de Mediano Plazo para la Gestión de la Deuda Pública* 2021-2024, Quito, 2021; Central Bank of Belize, *Fortieth Annual Report & Statement of Accounts for the Year Ending 31 December 2021*, Belize City, 2021; Central Bank of Barbados, "Review of Barbados' economic performance: January to December 2022", *Press Release*, 2023 [online] http://www.centralbank.org.bb/DesktopModules/DigArticle/Print.aspx?PortalId=0&ModuleId=663&Article=11126; International Monetary Fund (IMF), "Barbados: Request for an Arrangement under the Extended Fund Facility and Request for an Arrangement under the Resilience and Sustainability Facility—Press Release; and Staff Report", *IMF Country Report*, No. 22/377, December 2022.

Debt service-related development distress is apparent in Latin America and the Caribbean. Economic and social development in the region is hindered by entrenched structural gaps, such as inequality, poverty, informality, low productivity and investment, and insufficient provision of high-quality public goods and services. These weaknesses were thrown into stark relief by the COVID-19 pandemic. Prolonged low investment in health care had left public health systems unable to respond to the demands of the pandemic (ECLAC, 2022b). The underdeveloped state of social protection systems, in particular unemployment insurance, likewise hindered the ability of social protection floors to address the immediate needs of the population. In some cases, countries had to build these systems from scratch in 2020, such as in Paraguay, through the creation of an unemployment system for informal workers (Reinecke and others, 2020). The challenges of

the pandemic occurred against a backdrop of stagnation in the growth of social spending in the region in the decade prior to the crisis (ECLAC, 2022b). The rise of interest payments between 2012 and 2021 curtailed spending on key public services and contributed to a decline in public investment, as measured by acquisitions of fixed assets, which became the primary fiscal adjustment variable (see figure 14).

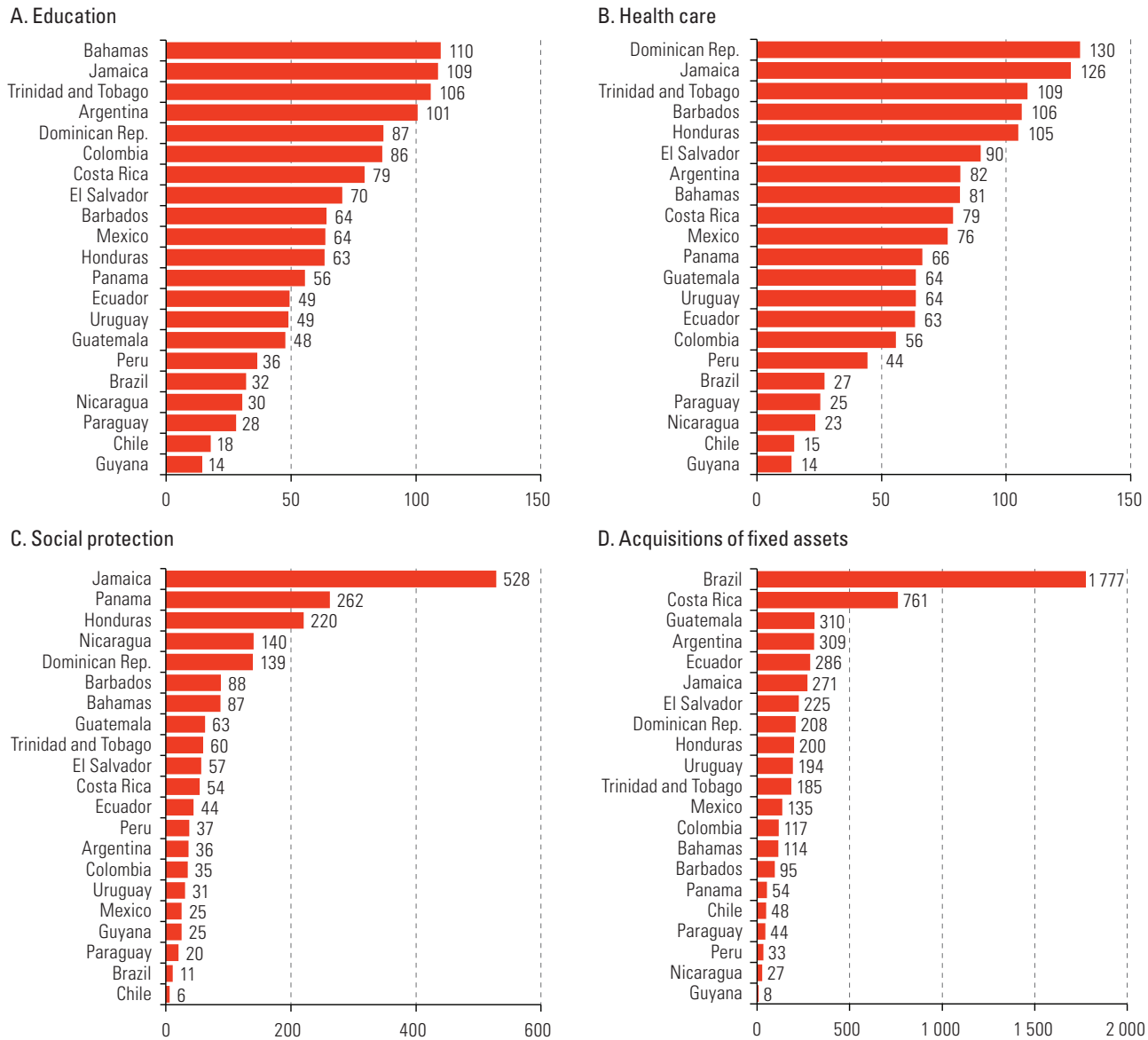
Figure 14
Latin America and the Caribbean: ratio of central government interest payments to expenditure on education, health care, social protection and public investment, 2012 and 2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
Note: Figures for Brazil, Colombia, Costa Rica, Guatemala, Paraguay and Peru correspond to the general government. Figures for Argentina, El Salvador, and Mexico correspond to the non-financial public sector. Public investment as measured by acquisitions of fixed assets. Figures for acquisitions of fixed assets as a share of interest payments correspond to the central government in all cases.

In several countries, interest payments surpass central government social expenditure on health, education and social protection. The weight of interest payments relative to other priority expenditure varies significantly in the region (see figure 15), a ratio that may be the clearest indicator of the development distress caused by high debt service levels. Public outlays for interest payments surpassed education spending in Argentina, the Bahamas, Jamaica and Trinidad and Tobago in 2021, and were equivalent to 60% or more of education spending in many other countries. Similar results are apparent in a comparison with health-care expenditure, where ratios are over 100% in Barbados, the Dominican Republic, Honduras, Jamaica and Trinidad and Tobago. In the case of social protection, the corresponding values in some countries are more than 200%, reflecting in large part the fact that pension systems in these countries are not part of the central government. Interest payments, relative to public investment —the acquisition of fixed assets— are quite large in the vast majority of countries, and in Brazil and Costa Rica, they are particularly high.

Figure 15
Latin America and the Caribbean (21 countries): ratio of central government interest payments to expenditure on education, health care, social protection and acquisitions of fixed assets, 2021
(Percentages)

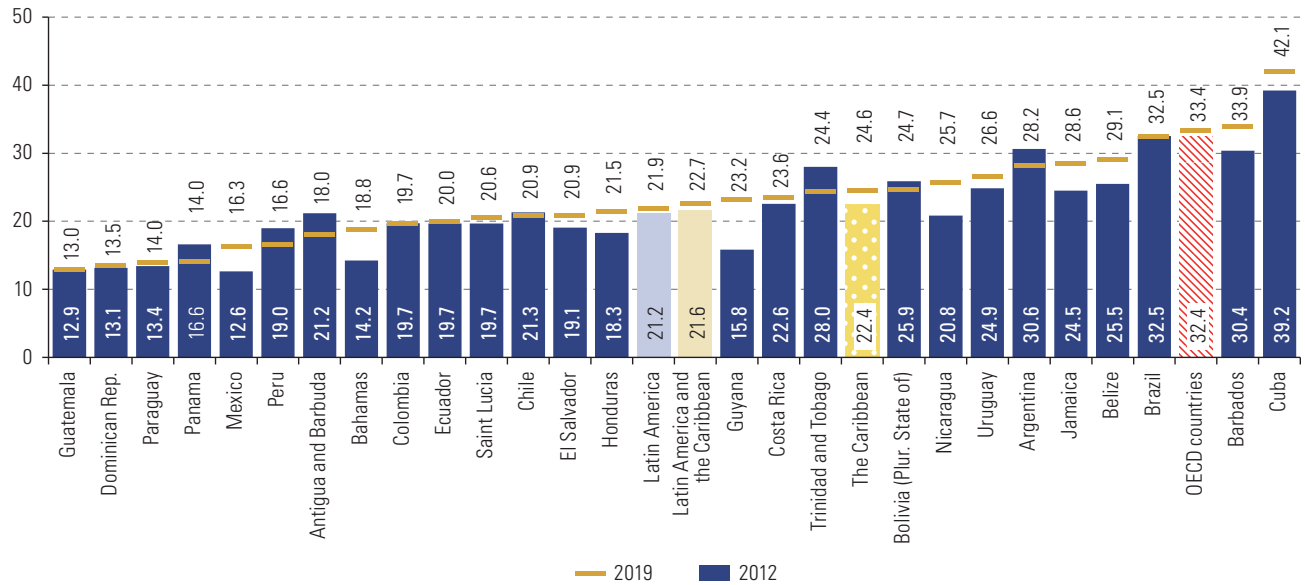


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
Note: Figures for Brazil, Colombia, Costa Rica, Guatemala, Paraguay, and Peru correspond to the general government. Figures for Argentina, El Salvador, and Mexico correspond to the non-financial public sector. Figures for acquisitions of fixed assets as a share of interest payments correspond to the central government in all cases.

Weak macroeconomic fundamentals undercut growth in the overall tax take, limiting the availability of resources to accommodate development needs and debt servicing. Tax revenues in Latin America and the Caribbean registered a modest increase between 2012 and 2019, which was outpaced by the growth in the countries of the Organisation for Economic Co-operation and Development (OECD) (see figure 16). The limited rise in the tax take was largely attributable to the Caribbean, where several countries experienced large increases, often resulting from efforts to respond to debt sustainability concerns. By contrast, many

countries in Latin America saw little or no rise in their tax take over the period. However, the relative stability of tax revenues, in a context of anaemic economic growth and plunging international commodity prices, was only possible through a high level of tax activism. Many countries enacted substantial tax reforms or adopted measures to generate tax revenues by closing tax evasion and avoidance loopholes. An example of this is Chile, which adopted a structural tax reform in 2014, with the aim of providing revenues to finance social programmes and public investment. The revenues generated by this reform largely offset the sharp decline in income tax receipts from mining, which fell from 2.5% of GDP in 2012 to 1.0% of GDP in 2019.[2]

Figure 16
Latin America and the Caribbean and countries of the Organisation for Economic Co-operation and Development: general government tax revenues, 2012 and 2019
(Percentages of GDP)

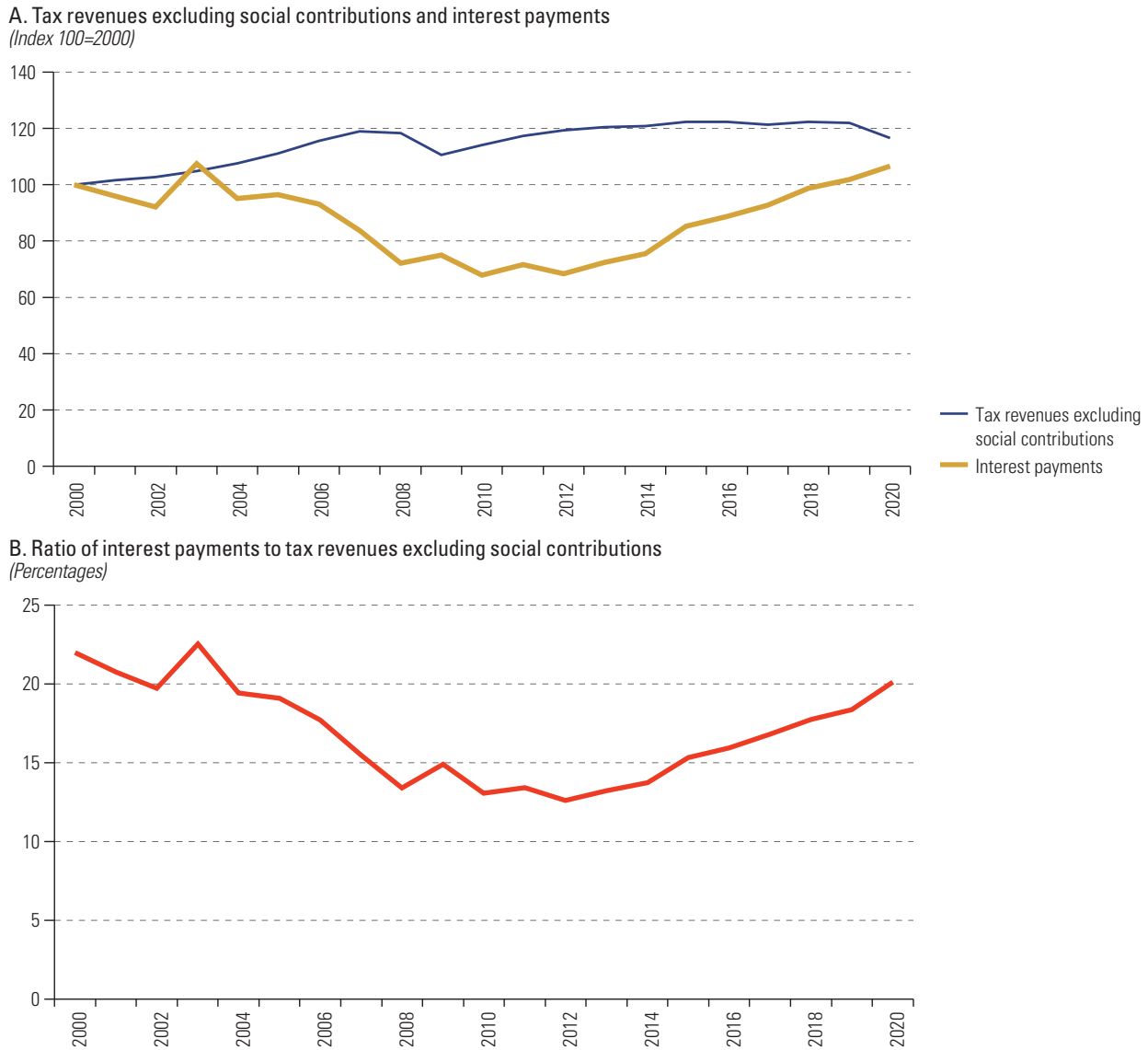


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organisation for Economic Co-operation and Development (OECD) and others, *Revenue Statistics in Latin America and the Caribbean 2021*, Paris, OECD Publishing, 2021.

Higher interest payments are increasingly depleting the domestic resources available for public investment and social spending in Latin America. The increase in interest payments on gross central government debt over the last decade has coexisted with stagnation in the growth of central government tax revenues (see figure 17).[3] After registering a strong increase during the commodities supercycle, tax revenues essentially remained flat, at 2006 levels, between 2012 and 2019. The increase in interest payments easily outpaced any gains in the tax take. As a result, over the past decade, the share of tax revenues allocated to covering interest payments has risen steadily. In 2012, central governments dedicated 12.6% of their tax revenues to meeting their interest payment obligations. By 2019, that figure had reached 18.4%, meaning that, on average, countries in the region were dedicating an additional 5.8 percentage points of tax revenues to the payment of interest.

2 Figures taken from CEPALstat.
3 This section excludes revenues from social security contributions, as they are not considered fungible for other expenditure purposes.

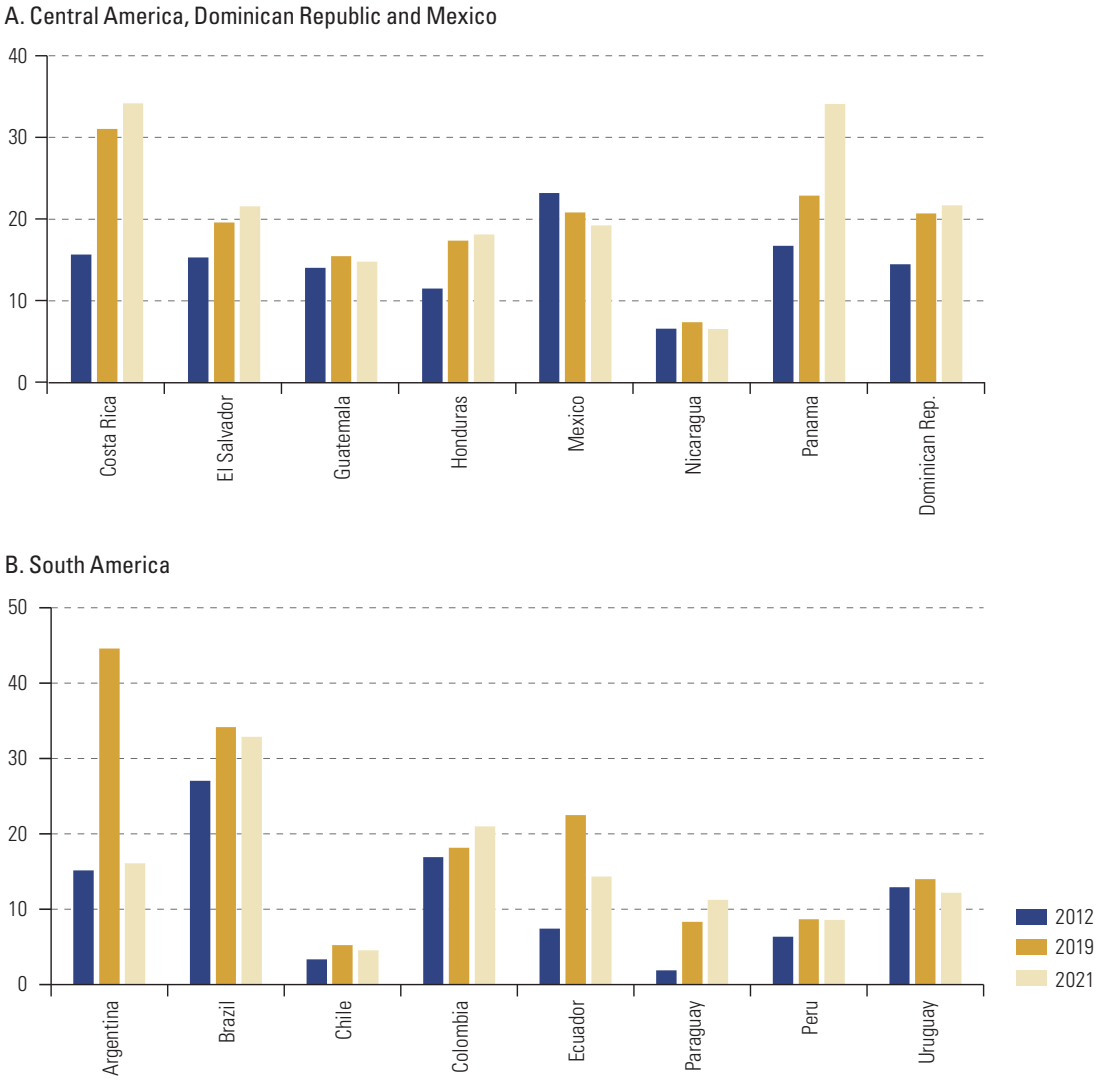
Figure 17
Latin America (16 countries): ratio of central government interest payments to tax revenues excluding social security contributions, 2000–2020
(Index and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
Note: Simple averages.

Some countries in Latin America dedicate a significant share of their tax revenues to meeting interest payment obligations. The regional averages belie the much higher share of tax revenues allocated to interest payments in some countries. Central government interest payments in Brazil, Costa Rica and Panama were equivalent to fully one-third of tax revenues in 2021, while those in El Salvador, the Dominican Republic and Colombia were more than 20% (see figure 18). In the case of Costa Rica, growth in interest payments have outpaced gains in tax revenues, including those mobilized by the tax reform of 2018. In Panama, by contrast, the rapid rise in the interest payments-to-tax revenues ratio is due in large part to a sharp decline in tax revenues. Argentina and Ecuador stand out for the significant decline in this ratio observed in 2020 and 2021 as a result of their respective debt restructuring agreements, which reduced the cost of servicing their public debt. In most countries, ratios exhibited volatility in 2020 and 2021, as central government tax revenues declined sharply during the pandemic before rising to record levels in 2021.

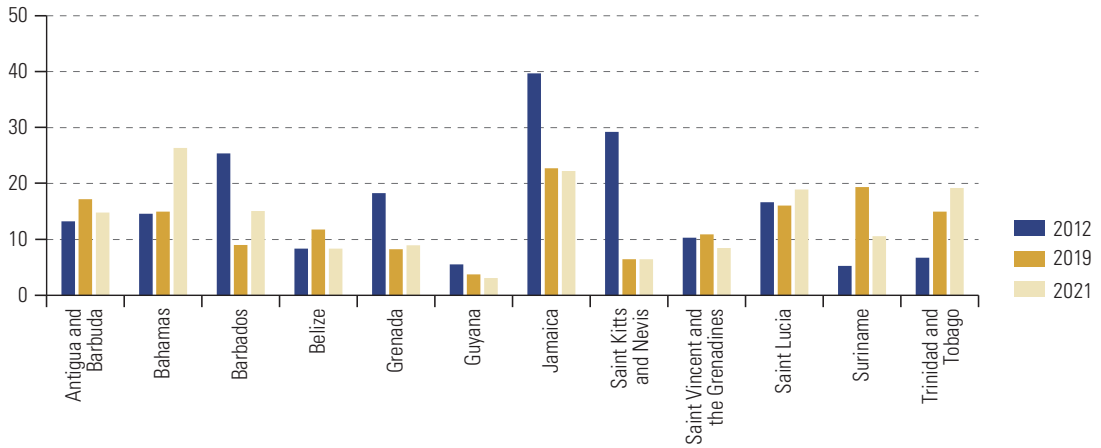
Figure 18
Latin America (16 countries): ratio of central government interest payments to tax revenues excluding social security contributions, 2012, 2019 and 2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In the Caribbean, the share of public resources allocated to interest payments is generally lower, due in part to a significantly higher tax take. Compared with Latin America, interest payments as a share of tax revenues are relatively low: a significant number of countries in the subregion had ratios of roughly 10% or less on the eve of the COVID-19 pandemic and in its aftermath (see figure 19). This situation is especially pronounced in Barbados, Grenada, Jamaica and Saint Kitts and Nevis, where interest payments fell sharply between 2012 and 2021, in some cases because of debt restructuring. In the case of Saint Kitts and Nevis, this effect would be more pronounced if non-tax revenues from the Citizenship by Investment programme, which were higher than 10% of GDP per year between 2018 and 2021, were included.

Figure 19
The Caribbean (12 countries): ratio of central government interest payments to tax revenues excluding social security contributions, 2012, 2019 and 2021
(Percentages)

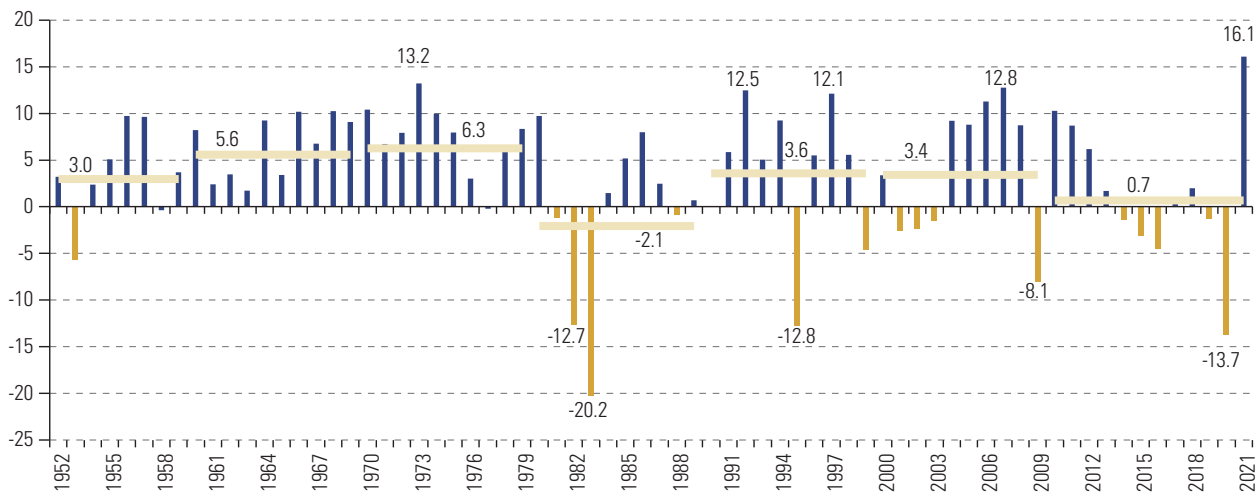


Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

B. Debt crises provoke long-lasting development distress

Episodes of debt stress in Latin America and the Caribbean have been followed by severe and protracted contractions of investment, GDP, social expenditure and consumption, as well as deterioration in labour markets and increases in poverty rates. The most severe episode was the 1980s debt crisis. A well-established stylized fact, underscored by ECLAC (2022c), is that investment growth has slowed sharply in Latin American and Caribbean economies since the 1980s. Figure 20 shows that since the external debt crisis of the 1980s, average investment growth in the economies of Latin America and the Caribbean has been slower. Between 1951 and 1979, investment grew by an average rate of 5.9% per year, peaking at an average of 6.3% in the 1970s. In the 1980s, the average regional investment growth rate was -2.1%, with contractions of 12.7% in 1982 and 20.2% in 1983. After the 1980s debt crisis, the average investment growth rate was 3.6% between 1990 and 1999, and 3.4% between 2000 and 2009, accounting for about 60% of the average growth rate before the debt crisis. However, investment growth slowed again between 2010 and 2021, with an average annual rate of 0.7%.

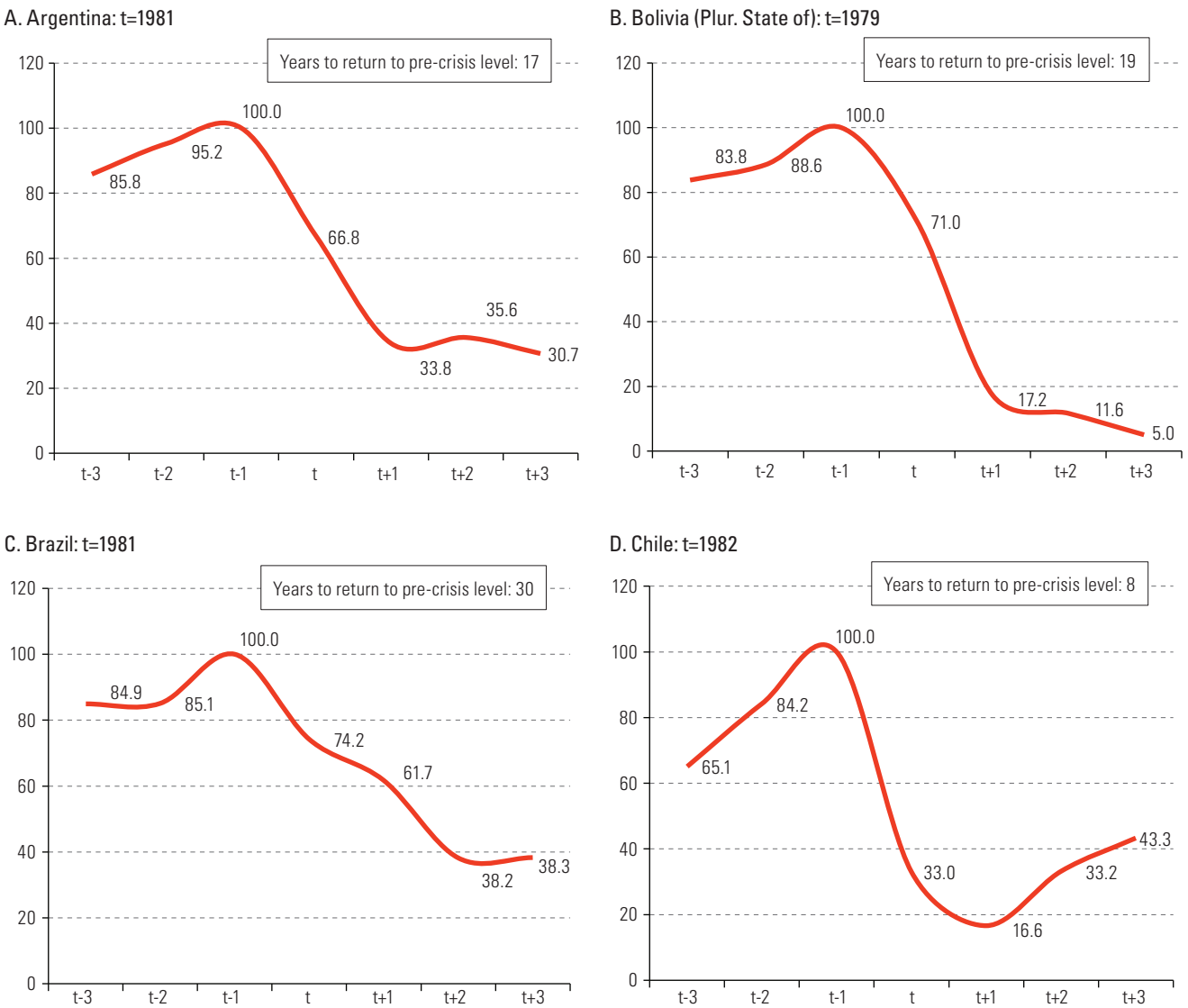
Figure 20
Latin America (18 countries):[a] real rate of growth of investment, 1952–2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

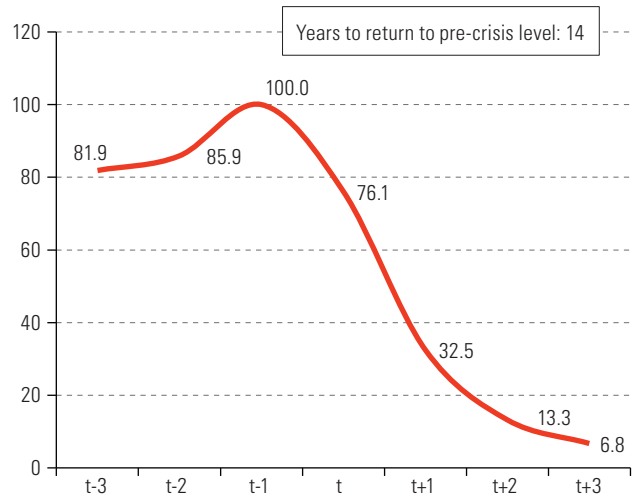
During the debt crisis of the 1980s, investment declined significantly as soon as the debt stress episode began and continued to decline for several years. Figure 21 shows investment trends in 15 Latin American economies during the debt crisis, presenting levels of investment three years before the beginning of the crisis, the year of the crisis, and three years after the crisis began.[4] In these 15 economies in Latin America and the Caribbean, investment declined significantly in the early years of debt stress: the contractions were sharp. The figure also shows that, for these 15 economies, investment continued to decline for several years after the emergence of the crisis.

Figure 21
Latin America (15 countries): pattern in fixed capital formation during the debt crisis of the early 1980s
(t-1=100)

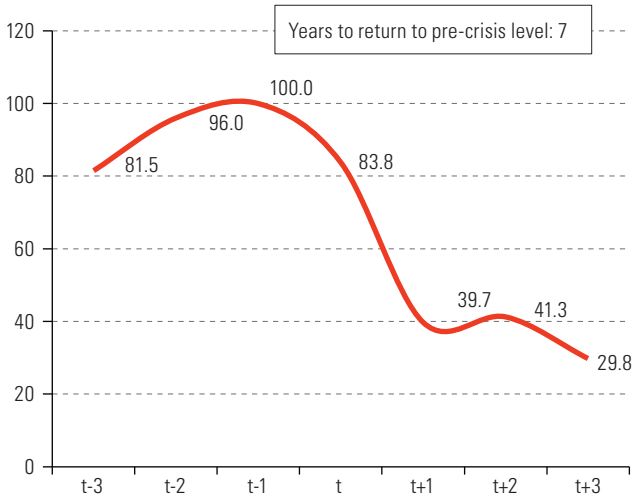


[4] To establish the year of the beginning of the crisis we are using the information provided by Reinhart, C. and K. Rogoff (2009) and official sources.

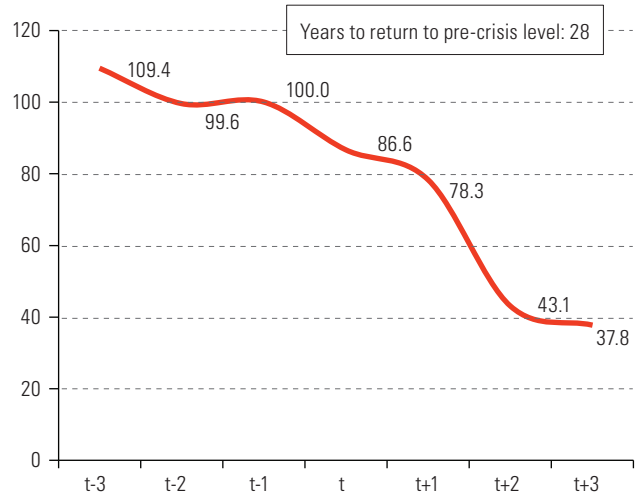
E. Costa Rica: t=1980



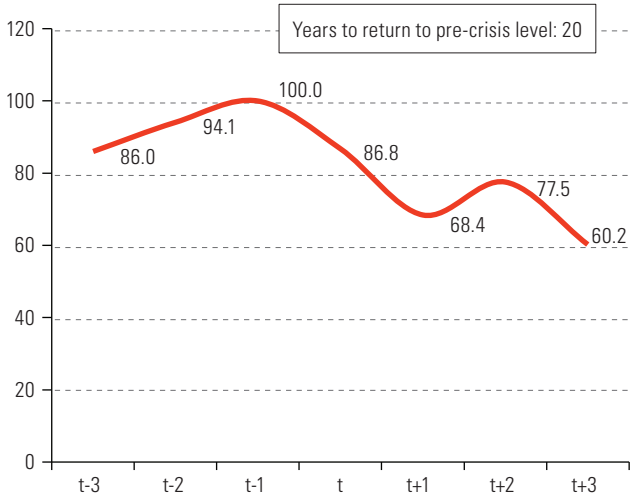
F. Dominican Republic: t=1981



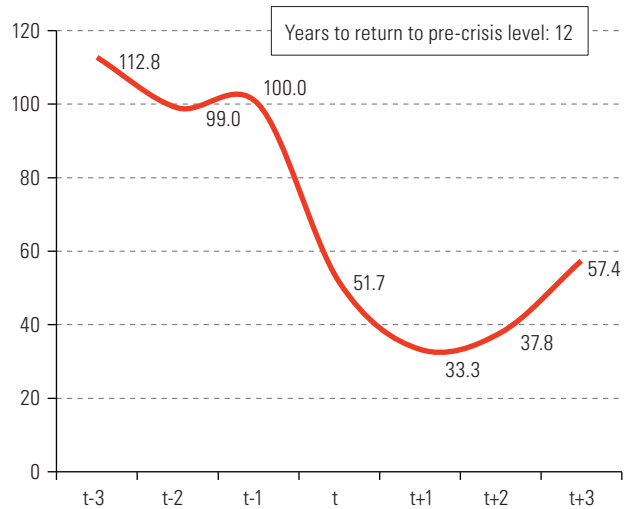
G. Ecuador: t=1981



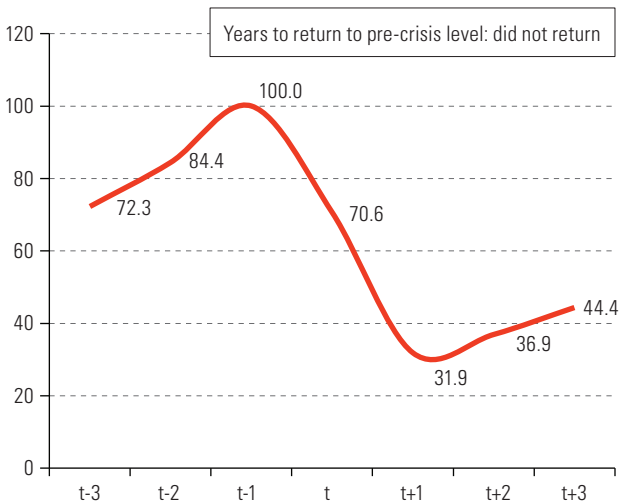
H. Guatemala: t=1979



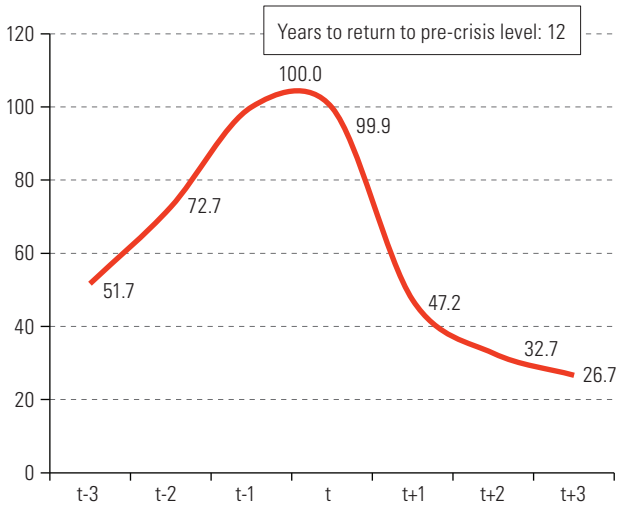
I. Honduras: t=1981



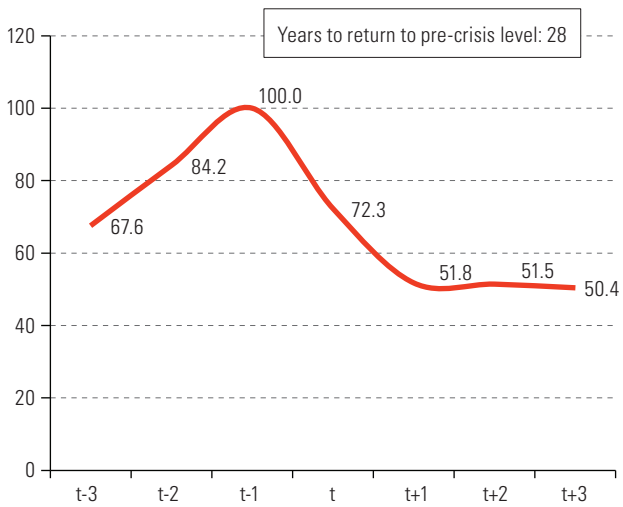
J. Mexico: t=1982



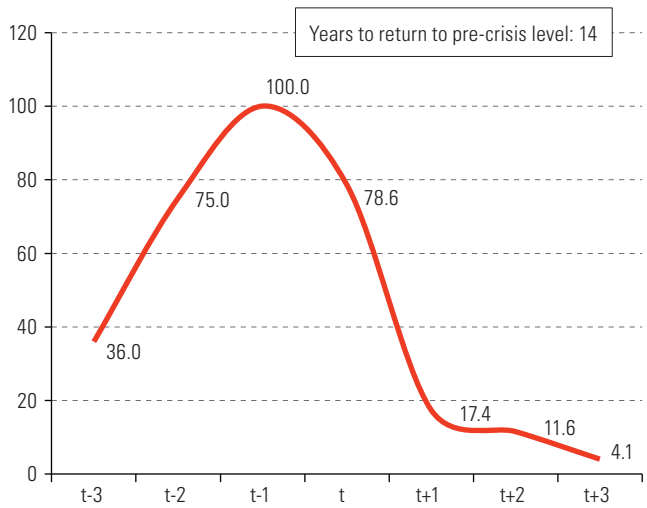
K. Panama: t=1982



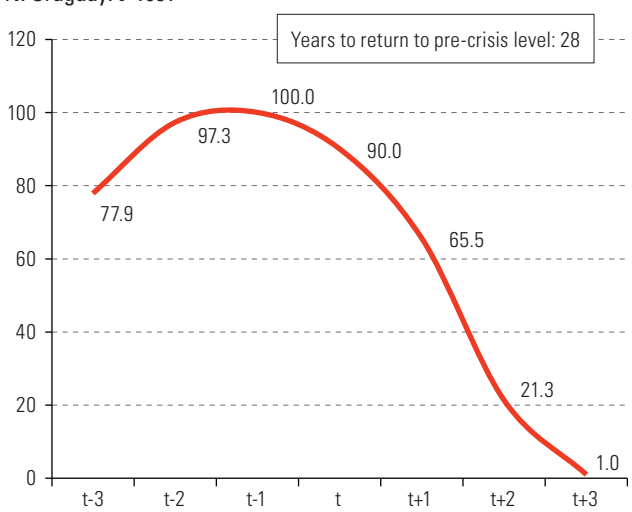
L. Paraguay: t=1982



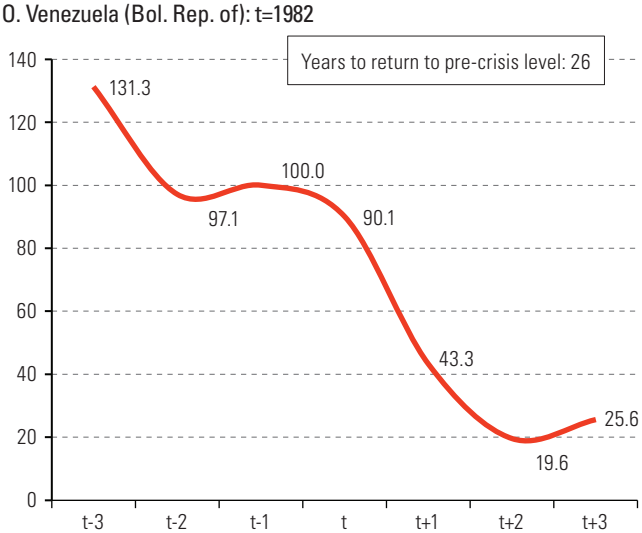
M. Peru: t=1982



N. Uruguay: t=1981



O. Venezuela (Bol. Rep. of): t=1982



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Table 2 presents additional indicators that characterize the investment trend for these 15 economies during the debt crisis. The average investment contraction in the first year of debt stress was 32.3%, and reductions of over 45% were observed in Argentina, Chile, Honduras, Panama and the Plurinational State of Bolivia. The contraction persisted for an average of nearly four years for the 15 economies, and in the case of Guatemala, the Plurinational State of Bolivia and Uruguay, for seven years. Compared with pre-crisis levels, the average cumulative magnitude of the investment contraction during this period was 73.4%.

The investment recovery process was very slow. Once the investment contraction ended, it took an average of more than 18 years for these 15 economies to recover pre-crisis levels of investment; only in the case of Chile and the Dominican Republic did the recovery period last less than 10 years.

Investment rose for the five years preceding the debt crisis. Gross fixed capital accumulation was positive in 14 of the 15 economies during the five years preceding the debt stress episode. On average, these 15 economies experienced an annual growth rate of 11.2% over that period, with the exception of the Bolivarian Republic of Venezuela, which registered a significant decline of investment even before the debt crisis, owing to the nationalization of the oil industry in 1975.

Table 2
Latin America (15 countries): pattern in investment during the debt crisis of early 1980s

	Crisis episode	Average growth (t-5 - t-1) *(Percentages)*	Growth rate in t *(Percentages)*	Duration of contraction *(Years)*	Cumulative reduction *(Percentages)*	Years to return to pre-crisis level *(Years)*
Argentina	1980	5.1	-49.3	2	66.2	17
Bolivia (Plurinational State of)	1980	10.8	-75.8	7	97.9	19
Brazil	1981	1.9	-25.8	3	61.8	30
Chile	1982	21.1	-67.0	2	83.4	8
Costa Rica	1980	14.2	-23.9	4	93.2	14
Dominican Republic	1981	5.6	-16.2	2	60.3	7
Ecuador	1981	1.5	-13.4	4	62.2	28
Guatemala	1979	17.2	-13.2	7	90.8	20
Honduras	1981	7.6	-48.3	2	66.7	12
Mexico	1982	16.9	-29.4	2	68.1	...
Panama	1983	23.2	-52.7	4	73.3	12
Paraguay	1982	17.5	-27.7	4	49.6	28
Peru	1982	28.3	-21.4	5	70.2	14
Uruguay	1981	9.9	-10.0	7	84.6	28
Venezuela (Bolivarian Republic of)	1983	-12.4	-9.9	3	80.4	26
Average		**11.2**	**-32.3**	**3.9**	**73.9**	**18.8**

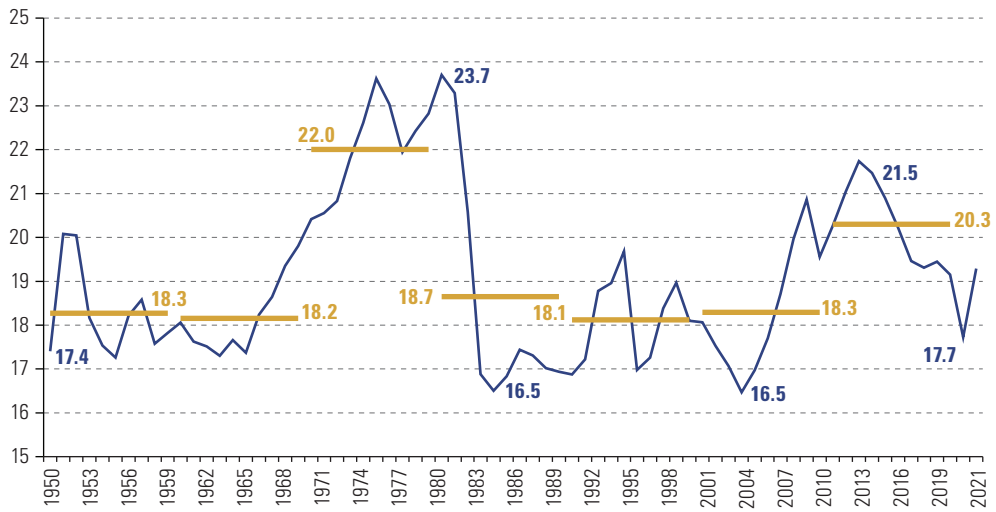
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

In the context of the debt crisis of the 1980s, "contagion" triggered a reduction of investment throughout the region. Earlier in the 1980s, all the economies of the region experienced at least one year of investment contraction, and for 30 out of 31 countries, investment declined in more than one year. That is, investment declined even in the economies of the region that did not enter a process of default or debt restructuring.[5] In fact, in 1980, investment declined in 10 of 31 economies, while in 1981, it declined in 16 of 31. The year in which investment declined in the greatest number of countries was 1982, when 27 of 31 countries experienced an investment contraction, followed by 1983 and 1984, with 23 out of 31 and 21 out of 31 countries, respectively, recording a decline. For countries in which investment contracted, the median rate of the contraction was 26.6%, 31.3%, 28.5% and 45%, in 1980, 1981, 1982 and 1983, respectively. The median regional cumulative loss of investment[6] during the debt crisis was 59%, and the median regional duration of the investment contraction[7] was three years.

5 Colombia and El Salvador did not default or restructured their sovereign debt.
6 The cumulative loss of investment for each country is estimated by comparing the level of investment prior the debt crisis, in this case 1979, with the level of investment of the last year of the episode, in this case, 1983.
7 The duration of the contraction period of investment is estimated by counting the consecutive years that investment contracted in a particular country.

Investment as a share of GDP was consistently lower in the economies of Latin America and the Caribbean following the debt crisis. As a consequence of this investment growth trend, gross capital formation as a share of GDP has declined since the crisis. Figure 22 shows that, in the 1950s and 1960s, the share of investment in the region's economies averaged 18.3% and 18.2% of GDP, respectively. Over this period, the investment share peaked in 1951 at 20% of GDP, while the lowest share (17.3%) was recorded in 1963. The 1970s was the decade in which the economies of the region posted the highest average share, with investment averaging 22% of GDP, and with a maximum of 23.6% of GDP in 1975 and a minimum of 20.4% in 1970. However, the investment share plummeted during the crisis. In 1980, the rate was 23.7%, the highest since 1950. Between 1980 and 1983, the rate dropped by 6.8 percentage points of GDP, from 23.7% to 16.9%. The rate continued to drop until 1984, by 0.4 percentage points of GDP, reaching the lowest value of the whole sample, 16.5%. On average, investment as a share of GDP was 17.0% between 1983 and 1990, 5 percentage points of GDP lower than the average for the 1970s. In the 1990s, the decade average of the investment share fell again, by 0.6 percentage points of GDP, to post the lowest decade average of 18.1%. The decade maximum was 19.7% of GDP in 1994, while the minimum was 16.9% in 1990. In the 2000s, the average investment-to-GDP ratio rose by 0.2 percentage points of GDP relative to the previous decade, to 18.3%. The highest investment ratio was 20.9% of GDP, recorded in 2008, while the lowest was 16.5%, in 2003. In the 2010s, the investment-to-GDP ratio rose again to 20.3%, reaching a maximum of 21.7% in 2012 and a minimum of 19.1% in 2019.

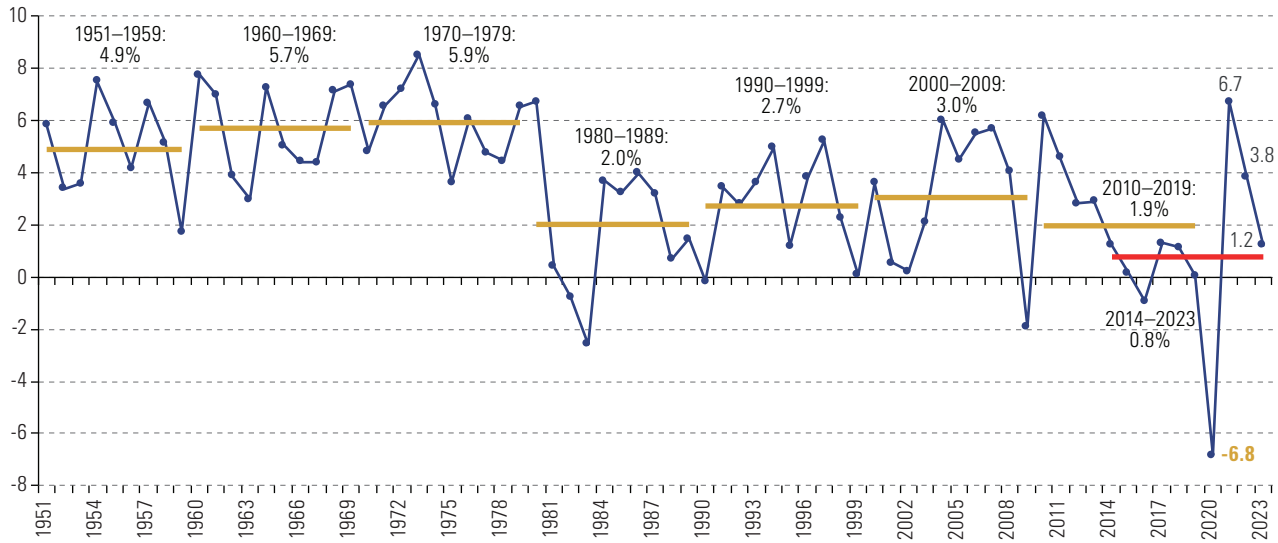
Figure 22
Latin America (18 countries):[a] gross fixed capital formation as a proportion of GDP 1950–2021
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

Economic growth in the region never recovered the momentum exhibited before the crisis of the 1980s. Following the crisis, the region experienced its first negative GDP growth rates since 1950, at -0.8% in 1982 and -2.6% in 1983 (see figure 23). Economic growth in the region has failed to recover pre-crisis levels: while average GDP growth rates in the 1960s and 1970s surpassed 5.0%, they averaged 2.7% in the 1990s.

Figure 23
Latin America (18 countries):[a] annual real GDP growth rate and average per decade, 1951–2023
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
Note: Data for 2023 refer to ECLAC projections.
[a] Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

Slower GDP growth was generalized across the region. For the 15 countries that experienced debt stress in the 1980s, economic growth recorded a steep decline after the crisis, with the average annual growth rate falling by 3.0 percentage points between the 1970s and the 1980s. On average, economic growth for these countries was negative in at least three years after the debt crisis, and the average contraction was 3.6%. In the case of Ecuador, Mexico and Uruguay, growth was negative in four or more years. These episodes of GDP contraction lasted 1.6 years on average; in Uruguay, the contraction lasted four years. If all the countries of Latin America and the Caribbean are included in the sample, including those that did not experience a debt crisis, GDP growth was negative in at least one year between 1980 and 1983 for 28 of the 31 countries. The median of those contractions was 5.8% and the median duration was two years. In Chile, Mexico and Paraguay, it took more than four years for GDP to return to the pre-crisis level (see table 3).

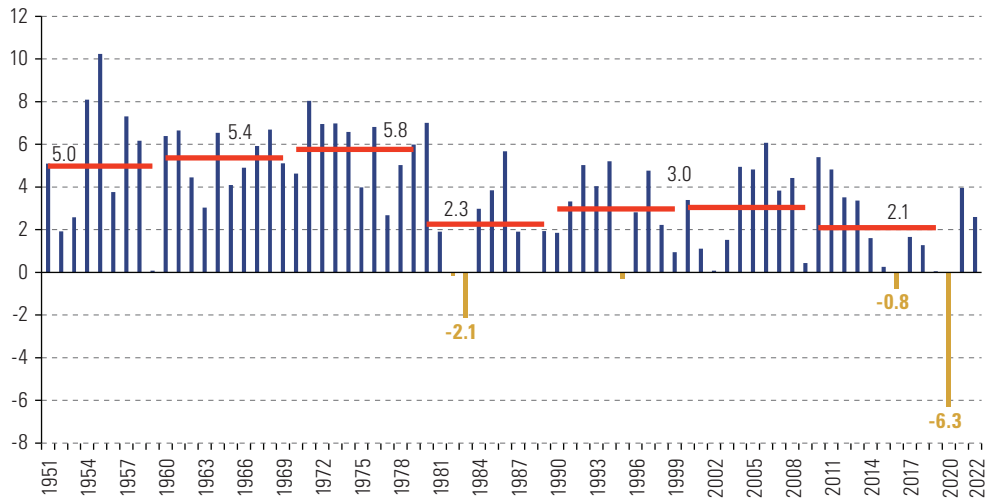
Consumption growth was also slower in the region's economies after the debt crisis. Consumption trends were very similar to those of GDP. The regional growth rate for aggregate consumption (private plus public consumption) also declined after the crisis (see figure 24); aggregate consumption growth rates recorded in the 1950s, 1960s and 1970s have not been recovered. In the first fall recorded since 1951, regional aggregate consumption contracted in 1982 and 1983, by 0.3% and 2.1%, respectively, and the average growth rate during the 1980s was 3.5 percentage points lower than in the 1970s. In addition, between 1990 and 2022, consumption rates failed to return to pre-crisis levels. The decade growth rate in the 1990s and 2000s was 3.0%, and the average growth rate between 2010 and 2019 was lower than in the 1980s.

Table 3
Latin America (15 countries): real GDP trends during the debt crisis of early 1980s

	Crisis episode	Growth in t *(Percentages)*	Years with negative growth in the 1980s	Average contraction *(Percentages)*	Average duration of contraction *(Years)*	Average growth in the 1970s *(Percentages)*	Average growth in the 1980s *(Percentages)*
Argentina	1980	0.0	3	-2.2	1.0	2.7	4.0
Bolivia (Plurinational State of)	1980	5.9	2	-2.9	1.0	4.6	2.1
Brazil	1981	1.3	1	-1.8	1.0	8.5	3.2
Chile	**1982**	**-13.6**	**2**	**-7.8**	**2.0**	**1.1**	**2.7**
Costa Rica	**1980**	**-6.4**	**3**	**-3.7**	**1.5**	**6.3**	**2.0**
Dominican Republic	1981	6.8	2	-1.2	1.0	7.3	4.1
Ecuador	1981	2.3	5	-2.9	2.5	7.7	0.0
Guatemala	1979	3.6	3	-1.0	1.0	5.2	1.9
Honduras	**1981**	**-0.9**	**2**	**-1.5**	**1.0**	**5.5**	**3.0**
Mexico	**1982**	**-0.4**	**4**	**-3.6**	**1.3**	**7.0**	**1.3**
Panama	1983	1.9	3	-3.4	1.5	5.0	2.9
Paraguay	1982	-0.7	3	-1.5	1.5	7.1	5.1
Peru	1982	0.9	3	-9.3	1.5	4.1	1.0
Uruguay	1981	2.0	4	-5.3	4.0	2.4	0.9
Venezuela (Bolivarian Republic of)	**1983**	**-7.2**	**3**	**-5.9**	**1.5**	**5.2**	**0.4**
Average		**-0.3**	**3**	**-3.6**	**1.6**	**5.3**	**2.3**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

Figure 24
Latin America (18 countries):[a] annual growth in aggregate consumption and average per decade, 1951–2022
(Percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Argentina, Bolivarian Republic of Venezuela, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Plurinational State of Bolivia and Uruguay.

Depressed consumption was generalized. Aggregate consumption was significantly affected across the region (see table 4). In the 15 countries that experienced debt stress, consumption growth was negative in several years. Dampened consumption between 1980 and 1984 was near-universal in the region, with 30 of the 31 countries experiencing a slowdown. The average contraction for the 15 countries shown in table 4 was 3.8% and its average duration was 1.8 years. For the entire region, the average contraction between 1980 and 1983 was 2.3% and the average duration was two years.

Table 4
Latin America (15 countries): pattern in aggregate consumption during the debt crisis of early 1980s
(Percentages and years)

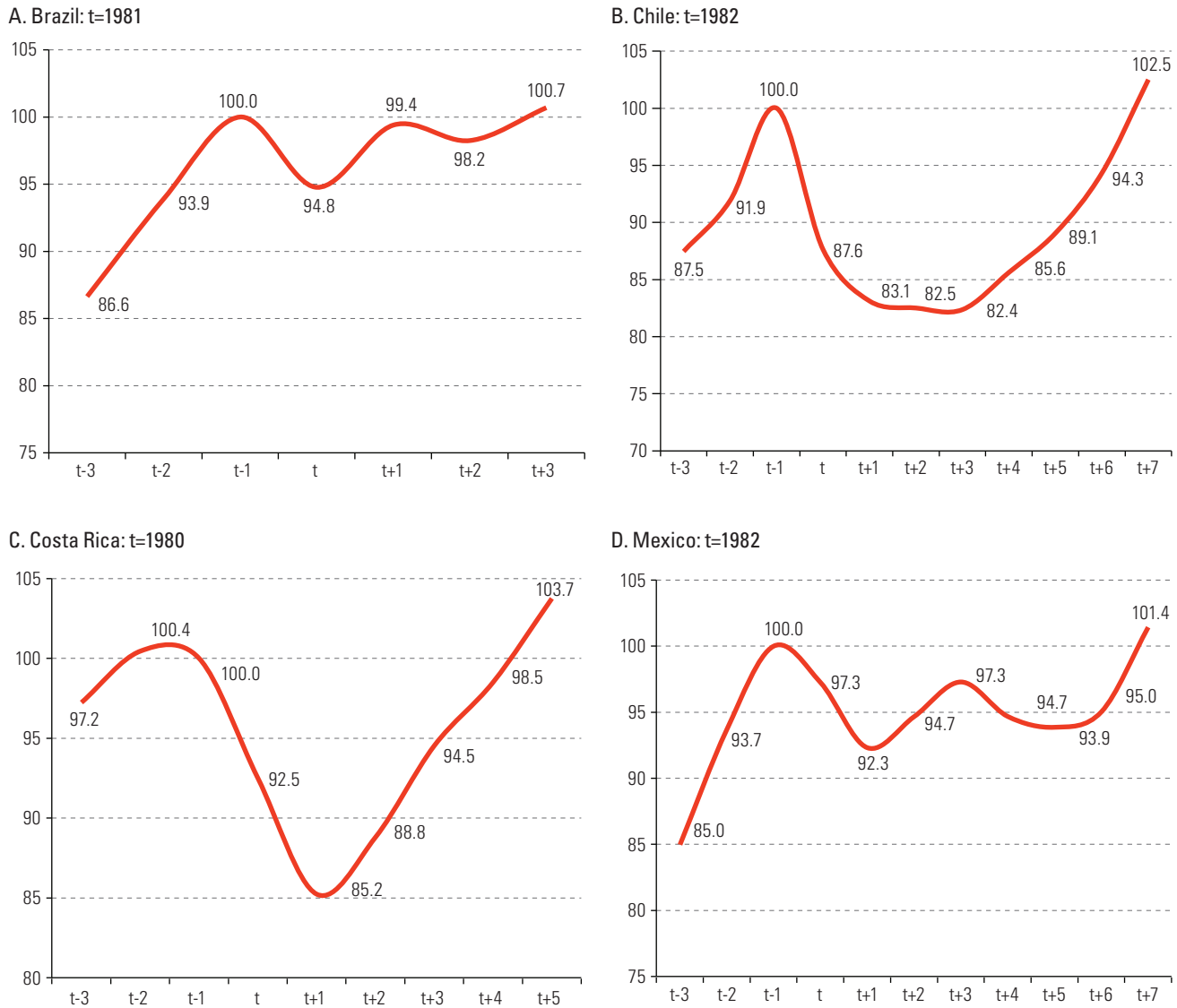
	Crisis episode	Growth in t *(Percentages)*	Years in which consumption declined in the 1980s	Average contraction *(Percentages)*	Average duration of contraction *(Years)*
Argentina	1980	0.0	1982, 1985, 1989	-3.0	1.0
Bolivia (Plurinational State of)	1980	4.7	1982, 1983	-3.6	2.0
Brazil	1981	-5.2	1981, 1983	-3.2	1.0
Chile	1982	-12.4	1982, 1983, 1984, 1985	-4.6	4.0
Costa Rica	1980	-7.5	1980, 1981, 1982	-5.3	3.0
Dominican Republic	1981	4.1	1984	-2.5	1.0
Ecuador	1981	3.9	1983, 1984, 1986, 1988	-1.9	1.3
Guatemala	1979	4.5	1982, 1983	-1.1	2.0
Honduras	1981	1.4	1983	-1.0	1.0
Mexico	1982	-2.7	1982, 1983, 1986, 1987	-2.8	2.0
Panama	1983	-1.8	1982, 1988	-8.8	1.0
Paraguay	1982	4.5	1983, 1989	-0.8	1.0
Peru	1982	2.3	1983, 1988, 1989	-9.5	2.5
Uruguay	1981	3.4	1982, 1983, 1984, 1988	-5.1	2.0
Venezuela (Bolivarian Republic of)	1983	0.4	1983, 1984, 1985, 1989	-3.2	2.0
Average		**0.0**		**-3.8**	**1.8**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

The recovery of consumption across countries that had experienced debt stress was uneven. The contraction in consumption lasted between one and four years (see table 4). For some countries, the path towards the recovery of pre-crisis consumption levels was extremely steep, and it took different shapes (see figure 25). In Brazil, the path to recovery was W-shaped, and the pre-crisis level of consumption was recovered three years after the initial fall. While the recovery in Mexico was also W-shaped, it took seven years, twice as long as in Brazil. In Costa Rica, the recovery process was V-shaped, but recovery took more than five years. In the case of Chile, the recovery process was U-shaped, and it took seven years to return to the pre-crisis level of consumption.

Lower growth in GDP and consumption together with severe deterioration in labour markets led to higher poverty rates in the region's economies during the 1980s debt crisis. As highlighted in ECLAC (1992), the adjustment process undertaken during the 1980s, the rise in macroeconomic instability, and the structural changes adopted across the region during the 1980s led to major changes in the way labour markets operated. Those changes contributed to higher rates of underemployment and more precarious working conditions. The deterioration in labour markets during the 1980s was reflected in a drop in the quality of jobs available, a rise in the unemployment rate, and lower wages and salaries. In addition, the percentage of people engaged in informal activities or underemployed rose from 31% in 1980 to 35% towards the end of the decade. As suggested by Altimir (1994), for the poor and lower-middle-income groups, the severe economic crisis of the 1980s entailed damaging declines both in real income and in social services and access to them: income concentration and poverty increased in most of the region's economies during the 1980s (see figure 26).

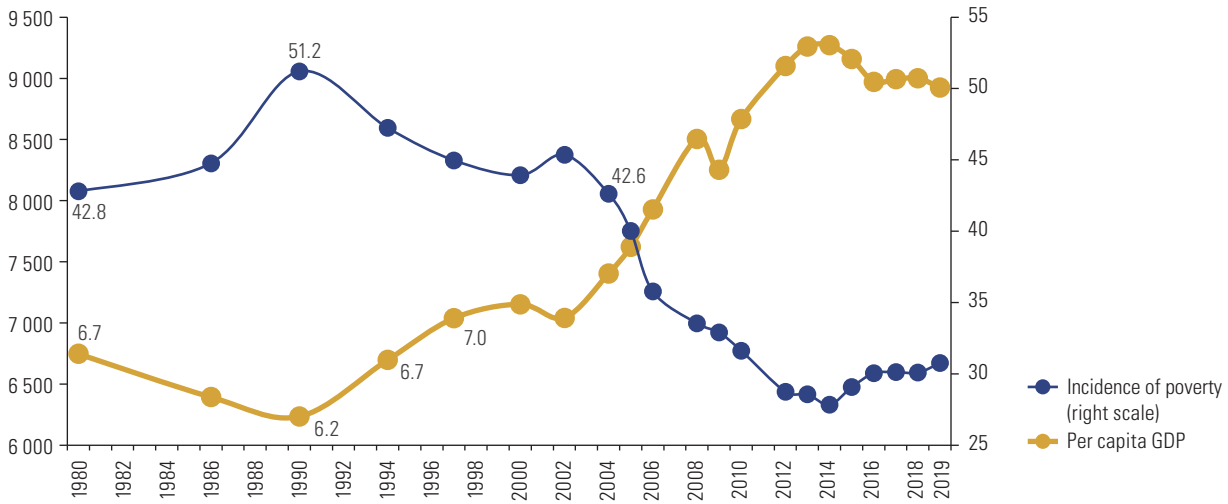
Figure 25
Latin America (4 countries): pattern in aggregate consumption during the debt crisis of the early 1980s
(t-1=100)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

It took a decade longer for poverty levels to recover than for economic activity to recover. After the crisis, poverty rose by 8.4 percentage points between 1980 and 1990, reaching 51.2% in 1990, the highest value since 1980. Although poverty declined after 1990, it took 24 years to reach a rate of 42.6%. In 1990, GDP per capita reached its lowest value since 1980; it took until 1994 for GDP per capita to return to the 1980s level (see figure 26). Even though the impact of the shock on economic activity was very severe and it took 14 years after the crisis for the region to return to its GDP level, the shock was more persistent for poverty, and it took 24 years to return to the pre-crisis poverty rate.

Figure 26
Latin America and the Caribbean: per capita real GDP and incidence of poverty, 1980–2019
(Dollars at constant prices and percentages)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

IV. Potential lasting solutions to sovereign debt resolution and restructuring processes

Higher levels of public debt, increasing development distress related to debt service and the need to finance the SDGs has put debt concerns at the centre of global discussions on development. Debt-service related development distress is apparent in Latin America and the Caribbean. Interest payments were higher than central government social expenditure in health, education and social protection in several countries even before advanced economies' central banks began to raise their interest rates. Weak macroeconomic fundamentals undercut growth in the overall tax take, limiting the availability of resources for development needs and debt service. As a result, some countries of the region allocate an increasing share of their tax revenues to meet interest payment obligations. As interest rates continue to rise, debt servicing will continue to displace domestic resources available for public investment and social spending.

Resolving the debt predicament of developing countries, including middle-income countries, is vital. Debt stress episodes in the region have been followed by severe and protracted contractions in investment, economic activity (GDP) and consumption, in addition to deteriorating labour market conditions and rising poverty rates. The debt crisis of the 1980s was the most severe of these episodes, leaving economic scars that persist to this day. Since the debt stress episode of the 1980s, investment as a share of GDP has been lower than in the period preceding that crisis. Similarly, economic growth has never bounced back to the same levels. The surge in unemployment and poverty caused by the crisis also proved to be persistent, taking almost 10 years to return to the levels seen before the debt stress episode.

Mitigating the economic damage in developing regions caused by high public debt levels combined with unfavourable global macrofinancial conditions requires a rethink of the international sovereign debt architecture. The United Nations can play a central role in building a new consensus on debt resolution that includes the broad participation of all relevant creditor and debtor stakeholders, and a publicly accessible registry of debt data to address transparency gaps. In addition, a global sovereign debt authority should be established to support effective, efficient, and equitable debt restructuring, along with supporting sound sovereign debt markets. The SDG Stimulus proposal of the United Nations, along with complementary proposals such as the Bridgetown Initiative, calls for the design of a new international financial architecture that can deliver sustainable development for all countries while addressing immediate needs.

A. Debt resolution requires a transformation of the sovereign debt architecture

Developing countries, including middle-income countries, require an inclusive debt resolution mechanism in order to deliver on the 2030 Agenda for Sustainable Development. Rising debt levels, higher costs of debt and debt distress, accompanied by lower growth and more restrictive international conditions, have significantly limited the fiscal space of many developing countries. Debt vulnerabilities have grown and sovereign credit quality has worsened for several economies, including those in Latin America and the Caribbean, regardless of their income level. According to the SDG stimulus put forward by the Secretary General of the United Nations, designed to contribute to delivery of the 2030 Agenda, in November 2022 "37 out of 69 of the world's poorest countries were either at high risk or already in debt distress, while one in four middle-income countries, which host the majority of the extreme poor, were at high risk of fiscal crisis. The number of additional people falling into extreme poverty in countries in or at high risk of entering debt distress is estimated to be 175 million by 2030, including 89 million women and girls." (United Nations, 2023a, p. 1).

Middle-income countries should have access to all debt relief and restructuring initiatives. These should be regulated by the financing needs of countries rather than by income per capita. Income per capita does not reflect the level of development of an economy. Middle-income countries face challenges and vulnerabilities that are similar to those affecting low-income countries and should benefit from debt reduction initiatives to enhance their policy space in order to foster a sustainable recovery and advance their economic and social development.

Debt reduction initiatives should avoid a one-size-fits-all approach and should be tailored to countries' economic vulnerabilities and debt profiles. All middle-income highly indebted economies should benefit from official debt relief and/or standstill agreements. Middle-income economies with short-term debt profiles and/or a high debt service burden should also be eligible to access debt relief or restructuring processes. Moreover, debt reduction initiatives should institutionalize the structural features of those middle-income countries which are highly vulnerable to natural disasters and external shocks.

The sovereign debt architecture should be transformed to provide countries with solutions that are aligned with sustainable development. The transformation of the sovereign debt architecture should start by building a consensus that seeks fairer, more transparent, sustainable solutions to the debt challenge but does so by aligning with the needs and aspirations of the SDGs (United Nations, 2023a).

The sovereign debt architecture should level the playing field between creditors and debtors. The contractionary bias built into debtor countries' typical short-term adjustment policy stance has remained a pervasive weakness of the global financial architecture and a stumbling block to global growth and full employment, as well as to the progress of developing countries. See Gallagher and Kozul-Wright (2022) and Powell and Valencia (2023).

The United Nations can play a central role in building a new consensus on debt resolution. The broad country representation of the United Nations legitimizes the urgent need for the international community to provide specific solutions to the debt challenges developing countries face, including middle-income countries. The commitment of the United Nations to advancing such a consensus is reflected in initiatives such as the Addis Ababa Action Agenda of the Third International Conference on Financing for Development and more recently the Initiative on Financing for Development in the Era of COVID-19 and Beyond. However, the urgency of the current situation calls for renewed efforts. The United Nations is uniquely placed to promote constructive dialogue and cooperation among all relevant stakeholders, including Member States, multilateral organizations, private actors and civil society organizations.

Debt sustainability assessments should be adjusted to take into account countries' needs to mobilize resources to pursue the 2030 Agenda and meet the Paris Agreement. The standard approach defines debt sustainability as the capacity of a country "to stabilize debt levels without incurring implausibly large income, expenditure or financing adjustments, emphasizing short-term flexibility and the commitment to meet creditor claims" (United Nations, 2018). As a consequence, the capacity of a country to mobilize resources for long-term sustainable development is "permanently constrained by the effort to ensure short-term debt sustainability as an end in itself" (UNCTAD, 2019). A review of debt sustainability assessments could aim to better reflect countries' SDG needs and to contribute to progress on sustainable development by recognizing the long-term value of investing in these areas. The appraisal requires the integration of a range of requirements to meet enhanced criteria for debt sustainability. These include targets for economic growth and domestic resource mobilization, integrated national financing frameworks that account for SDG commitments in the consideration of both available fiscal space and long-term investment requirements, as well as external development financing requirements, including debt relief. Efforts to enhance existing assessments are being undertaken by different United Nations bodies, including the Department of Economic and Social Affairs (DESA), the United Nations Conference on Trade and Development (UNCTAD), the Economic and Social Commission for Asia and the Pacific (ESCAP) and ECLAC (United Nations, 2019; UNCTAD, 2022; ESCAP, 2022; Titelman and others, 2022; Pérez Caldentey and Villarreal, 2023). Debt sustainability is also determined, to a large extent, by external conditions. The stabilization of debt ratios following the Brady Plan and the Heavily Indebted Poor Countries Initiative in the 1990s was largely a result of the decline in global interest rates. For its part, the Debt Service Suspension Initiative (DSSI) assumed that participating countries would have the fiscal space to pay the capitalized deferred principal and interest over a period of five years following a one-year grace period and grow at rates that would ensure the sustainability of their debt. However, countries faced a more restrictive external constraint after the pandemic.

There must be broad participation in the new sovereign debt architecture, by all relevant stakeholders, on both the creditor and debtor sides. The eligibility criteria and policy approach should widen the scope beyond those of recent multilateral efforts to address debt vulnerabilities —including the Group of 20 (G20) DSSI and the G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative— which cover only a subset of developing countries (low-income countries and some vulnerable middle-income countries) and have not succeeded in including the private sector and multilateral institutions in debt treatments.

On the creditor side, the most problematic issue is how to encourage the private sector and international financial institutions to participate. Private sector participation has never been enforced and has always been considered voluntary. A main stumbling block in this regard is fear in the private sector that debt moratoriums or debt restructuring will not be enough to guarantee full repayment of loans. Potential failure to repay loans in full also affects countries' participation as it constrains their access to capital markets, which are the main source of sovereign borrowing for developing countries, including those in Latin America and the Caribbean. In the case of international financial institutions (IFIs), it is the potential worsening of creditworthiness that limits participation. In this respect, IFIs argue that their inclusion in debt treatments would hurt their own credit ratings and funding costs unless the possibility is offset by an increase in countries' shareholder contributions. Successful examples of IFI participation in past debt resolution initiatives, such as the Heavily Indebted Poor Countries Initiative (1996 and 1999) and the Multilateral Debt Relief Initiative (MDRI) (2005), suggest that special trusts should be established, funded mainly by donor countries, to offset the costs of debt relief, thus allowing IFIs to maintain their preferred creditor status.

The sovereign debt architecture should be designed to address the complex financing structure of developing countries, including middle-income countries. The debtor base of developing countries is wider and more heterogeneous in terms of the debt profile. These countries must also contend with a diverse and fragmented creditor base, and more complex legal structures and toolkits for issuing debt. An analysis of the creditor structure of DSSI reveals a growing importance of private creditors (bondholders) and non-Paris Club foreign governments (see box 3). Creditors also include quasi-sovereign entities, State-owned enterprises and corporations (commodity traders and producers), whose core activities are not lending to developing countries. The diversity and fragmentation of private creditors fuels asymmetry problems, makes it more difficult to coordinate parties with different preferences, interests, and accounting practices —thus making coordination failure more likely— and increases the opacity of developing countries' debt situations.

Box 3
The diversity of external creditors for countries participating in the Debt Service Suspension Initiative (DSSI)

Available information on the creditor structure of DSSI for the period from 2006 to 2020 shows that the share of external debt owed to Paris Club governments declined from 27% to 11% of the total, whereas debt owed to non-Paris Club governments (including China) expanded from 2% to 22% of the total. This means that official bilateral debt negotiations are not undertaken with a set of like-minded countries, which can be an obstacle to obtaining debt relief quickly and in substantial amounts (see table).

Composition of external creditors for countries participating in DSSI , 2006 and 2020
(Percentages of the total)

Type of creditor	2006	2020
Multilateral	55	48
China	2	18
Eurobonds	3	11
Paris Club	27	11
Other private	7	8
Non-Paris Club (excluding China)	6	4

Source: Chabert, G., M. Cerisola and D. Hakura, "Restructuring debt of poorer nations requires more efficient coordination: an improved common framework for debt treatment could clear a path through an increasingly complex creditor landscape", IMF Blog, International Monetary Fund (IMF), 7 April 2022 [online] https://www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination.

China is the most important non-Paris Club creditor, accounting in 2020 for 18% of total public external debt in the case of countries participating in DSSI and 16% in the case of countries eligible for the Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative. More importantly, China accounted for 64% and 52% of total official bilateral debt, for countries participating in these two instruments, respectively (see table). Also, from 2006 to 2020, DSSI countries expanded their borrowing from the private sector (from 10% to 19% of the total). At a more granular level, countries eligible for DSSI had an average of over 20 different creditors.

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Chabert, G., M. Cerisola and D. Hakura, "Restructuring debt of poorer nations requires more efficient coordination: an improved common framework for debt treatment could clear a path through an increasingly complex creditor landscape", IMF Blog, International Monetary Fund (IMF), 7 April 2022 [online] https://www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination.

A more fragmented group of private creditors gives rise to significant transparency concerns. Not all creditors abide by the same reporting standards and loan terms, including confidentiality clauses. Bondholders are difficult to identify, as some are not required to disclose their financial positions by the law governing the debt contracts (in the case of Latin America and the Caribbean mainly the law of the State of New York, accounting for 80% of the total, while for all developing countries the percentage is 64%). Available information on underwriters reveals a high concentration of market power, which can prevent countries from issuing bonds on improved financial terms.

A publicly accessible register of debt data for developing countries should be established, to address transparency gaps. Debt transparency is a common endeavour from which both lenders and borrowers stand to benefit (UNCTAD, 2012). Lenders have the responsibility to provide information to their sovereign customers to assist borrowers in making informed credit decisions. Borrowers have the duty to disclose the relevant terms and conditions of a financing agreement. Despite the shared nature of this responsibility, most of the efforts to advance debt transparency are borne by borrowers through indirect debt data reporting organized by the World Bank and IMF. To complement these efforts, the G20 set up the Debt Transparency Initiative under OECD. The Debt Transparency Initiative aims to operationalize the Institute of International Finance (IIF) Voluntary Principles for Debt Transparency to collect, analyse and report on relevant public sector debt data from low-income countries (United Nations, 2022a). Following the IIF Principles, the Debt Transparency Initiative relies on voluntary data disclosures by commercial creditors. Despite these initiatives, significant gaps remain in debt transparency (United Nations, 2022b).

A publicly accessible register of debt data for developing countries would allow for digital end-to-end process of debt data for debtors and creditors. It would help to automate debt data recording in debtors' systems and reduce inconsistencies by providing validated data on all debt transactions. This would substantially improve debt data transparency by ensuring debtor-creditor data reconciliation. Such a system would greatly strengthen the capacity of debt management offices and contribute to the compilation and dissemination of timely and reliable statistics, allowing for full transparency on all debt agreements, transactions and financing conditions. A register would also help to eliminate costly and time-consuming reconciliation exercises, thereby also facilitating debt restructuring.

B. A sovereign debt restructuring framework must be an integral part of a new sovereign debt architecture

A new sovereign debt architecture also requires a framework for debt restructuring that levels the playing field between creditors and debtors. The lack of a sovereign debt restructuring mechanism has greatly limited participation by the private sector in debt renegotiations or restructuring with developing countries, which can be perceived as equivalent to debt default, leading to downgrades by credit rating agencies and equity loss for private investors. Such a mechanism would also reduce holdout problems.

A global sovereign debt authority should be established, independent of but engaging with all official and private creditors and debtor interests, to address the multiple flaws in the current handling of sovereign debt restructuring and to improve that framework. Such an authority would serve as a focal point for ongoing activities to improve how the global community collectively deals with debt, both immediately and progressively over the long run, providing sovereign debtors, creditors and the international community with a regularly updated list of options ready to be put into action whenever needed, as well as technical and expert support for their implementation. The authority should be able to develop, leverage and coordinate existing international expertise.

A global sovereign debt authority would focus on supporting effective, efficient and equitable debt restructuring, as well as sound sovereign debt markets. This would include supporting successful restructuring assessments and outcomes, promoting comprehensive and collaborative creditor participation, facilitating dispute settlement, providing coherent guidelines to enable automatic comprehensive temporary standstills in recognized disaster situations and encouraging the use of financing instruments that are compatible with responsible restructuring. Actions to support sound sovereign debt markets would include fostering debt transparency, encouraging responsible borrowing and lending, promoting the use of debt instruments with sustainability and responsibility requirements, promoting clear and consistent legal interpretations, and serving as an information hub and institutional base for addressing sovereign debt issues.

The backing of multilateral institutions is needed to facilitate debt renegotiation and restructuring initiatives. Involving IFIs can ensure the necessary backing, confidence and credibility for the private sector to engage. IFIs can provide support in the form of partial credit guarantees. However, this should not require a trade-off between debt renegotiation or restructuring initiatives and governments' growth, employment and well-being objectives. The backing of IFIs, particularly of IMF, often involves adjustment programmes that impose significant cuts to spending that are likely to compromise countries' future social and economic development and lead to further debt accumulation.

C. The SDG Stimulus proposal of the United Nations underlines the need for a permanent mechanism to tackle sovereign debt distress

A permanent mechanism to address sovereign debt distress is part of the SDG Stimulus of the United Nations. As explained in the SDG Stimulus of the Secretary-General, sovereign debt restructuring must be accompanied by the provision of immediate relief to all countries in need, including through debt suspension, reprofiling, exchanges, and write-downs where necessary (United Nations, 2023a). Including disaster and pandemic clauses in all debt contracts in order to provide immediate relief in times of crisis, significantly lowering the cost of borrowing for developing countries, creating an effective sovereign debt workout mechanism and expanding concessional finance and debt relief to all countries in need would reshape the way the international financial system functions, for the benefit of all.

The SDG Stimulus of the United Nations calls for the design of a new international financial architecture, that can deliver sustainable development for all countries while addressing immediate needs. It calls for a substantial increase to at least US$ 500 billion per year in financing for sustainable development and puts forward three areas for immediate action: (i) tackle the high cost of debt and rising risks of debt distress, including by converting short-term high-interest borrowing into long-term (more than 30 year) debt at lower interest rates; (ii) massively scale up affordable long-term financing for development, especially through public development banks, including MDBs, and by aligning all financing flows with the SDGs and (iii) expand contingency financing to countries in need, including by integrating state-contingent and disaster clauses into all lending, and exploring how SDRs can finance climate mitigation and be automatically issued in times of crisis (United Nations, 2023a).

A direct contribution can be made by MDBs to the SDG Stimulus by greatly expanding the volume of concessional lending. Actions to achieve this goal include increasing capital bases, better leveraging of existing capital, implementing the recommendations of the Independent Expert Panel convened by the G20 (2020) and rechannelling SDRs through MDBs. In addition, MDBs must improve the terms of their lending, including through longer-term lending, lower interest rates, systematic use of pandemic and disaster clauses, more lending in local currencies and inclusion of all vulnerable countries in lending programmes. Furthermore, MDBs —and all public and private actors— must explicitly incorporate the SDGs into their operations and all stages of the lending process. The United Nations can support this process, including through supporting the development and application of SDG-aligned integrated national financing frameworks.

Complementary to the proposals outlined above, the SDG Stimulus[8] includes the following actions (United Nations, 2023a, pp. 3–9):

1. G20 should conduct an independent review of debt initiatives related to the COVID-19 era to assess their benefits, including DSSI and the Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative. This could be done through an expert panel agreed upon by all G20 members. The panel could propose improvements to the Common Framework, including expansion of eligibility for debt relief to middle-income countries that may be under stress. This would allow for the assessment of whether such countries are vulnerable and need debt relief, and possible paths for accessing it.
2. The international system needs to find ways to incentivize the participation of private creditors in official debt restructuring efforts, such as exchanging debt for longer maturities and lower interest rates. Currently, certain private creditors have no motivation to participate in good faith efforts to restructure debt, so new tools are needed. In the past, debt buybacks, financial guarantees and collateralization under initiatives such as the Heavily Indebted Poor Countries Initiative have provided incentive mechanisms. Some countries also passed laws to limit non-cooperative creditors from undermining debt relief. The international community could also consider debt issuance with most-favoured-creditor clauses to incentivize participation in debt restructuring.
3. Debt for climate and SDG swaps can be a helpful tool for countries with limited fiscal space for sustainable development and climate investments but without unsustainable debt burdens. These swaps allow countries to redirect debt service payments towards such investments, and the value of the debt relief could be applied towards the creditor countries' climate commitments. Although there have been some successful swaps, uptake has been limited owing to high transaction costs. A reference framework, with template term sheets and performance indicators, could help standardize the contracts and reduce costs. This could be supported by official financial backing such as partial guarantees or collateralization similar to Brady bonds.
4. Official creditors, both bilateral and multilateral, should make it a standard practice to include state-contingent elements in their lending. Some lenders already have experience with this approach. This would automatically suspend debt servicing in the event of pre-defined shocks such as natural disasters, GDP declines or large commodity price changes and can be structured to ensure minimal impact on the net present value of debt. This would eliminate the need to negotiate debt service suspension during a crisis, and if used on a large enough scale, it could prevent liquidity crises from becoming solvency crises.

[8] In addition, the Bridgetown Initiative for the Reform of the Global Financial Architecture, launched by the Government of Barbados in September 2022, calls for a set of immediate actions to support the financing needs of vulnerable countries.

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Unfavourable global macrofinancial conditions have given rise to concerns about public debt sustainability in developing economies, including those of Latin America and the Caribbean. These adverse conditions threaten to worsen the already weak economic growth in the region. Public debt in the region is at levels last seen two decades ago, with a sharp increase in 2020 capping a progressive rise over the past decade. History suggests that countries may undergo development distress when similar macrofinancial and debt conditions coincide. High debt service may lead countries to face critical trade-offs between debt service and pursuing development objectives. When these trade-offs are no longer viable and market conditions deteriorate, a country may face a debt crisis, with severe and long-lasting disruptions to development, as experienced in the region after the debt crisis of the 1980s. Against the backdrop of the current macrofinancial and debt environment, there is greater urgency to transform the international sovereign debt architecture. The United Nations SDG Stimulus proposal outlines concrete steps in this direction, with solutions for all countries that are aligned with development.

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