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External debt sustainability and development

Note by the Secretary-General

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Report prepared by the secretariat of the United Nations Conference on Trade and Development on the external debt sustainability and development

Summary

In the present report, prepared by the secretariat of the United Nations Conference on Trade and Development pursuant to General Assembly resolution 77/153, the evolution of core indicators of external debt sustainability in developing countries since the last report is analysed, and differences across developing regions are highlighted. While a systemic debt crisis looms on the horizon, a development crisis is already under way. This alarming situation stems from cascading and overlapping crises and the most aggressive monetary tightening in developed countries since the 1970s. The multilateral response has been subdued, however. The report discusses the shortcomings of the current global financial architecture and draws policy recommendations for adapting this architecture to better support development.

I. Introduction: global macroeconomic environment

1. The pressures on developing countries' external debt sustainability have mounted since the previous report (A/77/206). While a systemic debt crisis – in which a growing number of developing countries move from debt distress to debt default – looms on the horizon, a development crisis is already under way. For developing countries, keeping debt default at bay has come at a high cost, with external debt service draining resources away from the implementation of the 2030 Agenda for Sustainable Development and the Paris Agreement on climate change.

2. This alarming situation stems from cascading and overlapping crises – the coronavirus disease (COVID-19) pandemic, the war in Ukraine, a deepening climate crisis and a cost-of-living crisis. In addition, the most aggressive monetary tightening since the 1970s, which is aimed at taming inflation in developed countries, has negatively affected developing countries' external debt sustainability.

3. Global financial conditions deteriorated for some developing countries from the third quarter of 2021 as developed countries' central banks signalled rises in policy rates (see A/77/206). After March 2022 – when the Federal Reserve started raising its policy rate – these conditions became even more challenging, exacerbating debt vulnerabilities. Developing countries faced increased sovereign bond spreads, capital outflows, currency depreciations, declining reserve[1] and rating downgrades (the second-worst year on record after 2020).[2] Simultaneously, global economic growth decelerated to 3.1 per cent in 2022 from 5.9 per cent in 2021, halving global trade volume growth to 5.1 per cent[3] and contributing to falling commodity prices after mid-2022.[4] From July 2022 to February 2023, fuel prices dropped by 40 per cent, while prices of minerals, ores and non-precious metals declined by 4.6 per cent and food prices by 2.5 per cent.[5]

4. The bank distress triggered by the failures of two regional banks in the United States of America – Silicon Valley Bank and Signature Bank – spread to banks and financial markets worldwide, provoking a loss of confidence in Credit Suisse, a global, systemically important bank. These events laid bare the challenges associated with the interaction of tighter monetary policy, the build-up of financial vulnerabilities since the global financial crisis of 2008 and gaps in financial regulation.[6]

5. Policymakers in developed countries responded rapidly and forcefully, with a broader arsenal of liquidity support and coordination measures than in previous episodes of market distress, thereby avoiding a global financial crisis. Nevertheless, as in previous moments of heightened uncertainty, a flight to safer assets, notably United States Treasury bonds, was set in motion, negatively affecting the holdings of developing countries' securities. As a result, apart from a brief rebound at the beginning of 2023, capital outflows resumed and sovereign external bond spreads widened.[7]

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[1] See United Nations, *World Economic Situation and Prospects* (New York, 2023).

[2] See FitchRatings, "Another challenging year for EM Sovereigns in 2023", 19 January 2023.

[3] See International Monetary Fund (IMF), *World Economic Outlook: A Rocky Recovery* (Washington, D.C., April 2023).

[4] See World Bank, *Commodity Markets Outlook: Lower Prices, Little Relief* (Washington, D.C., April 2023).

[5] See United Nations Conference on Trade and Development (UNCTAD) secretariat calculations based on UNCTAD commodity price index.

[6] See IMF, *Global Financial Stability Report: Safeguarding Financial Stability amid High Inflation and Geopolitical Risks* (Washington, D.C., April 2023).

[7] See UNCTAD, "Trade and Development Report update" (April 2023).

6. The spillover was milder on larger emerging market economies with investment grade bonds, lower debt vulnerabilities and the ability to initiate early policy rate increases. Conversely, frontier market economies, especially in Africa, were particularly affected. Most frontier bonds maturing up to 2025 were traded at spreads of more than 700 basis points by the end of March 2023, pointing to a loss of market access or unexpectedly high borrowing costs. Concerns arise as these economies face a significant increase in external bond refinancing needs in 2024, raising the risk of defaults if market access is not restored.[8]

7. The mixture of banking stress and ongoing policy uncertainty has darkened the world economic outlook. Projections of multilateral institutions for global growth in 2023 span from 2.1 per cent to 2.8 per cent. World trade volume is forecast to increase by 2.4 per cent, while oil prices are expected to fall by 24 per cent and non-fuel commodity prices to remain broadly unchanged. Food prices are anticipated to remain above pre-pandemic levels, posing challenges to household budgets and food security.[9]

8. Financial stability risks remain high, as demonstrated by the collapse of First Republic Bank in May 2023. In the meetings that followed, the Federal Reserve and the European Central Bank raised their policy rates by 25 basis points but signalled that the tightening cycle might be nearing its end,[10] as financial and price stability is balanced to avert a global recession.

9. Therefore, developing countries face an exceptionally challenging global outlook. According to the Debt Sustainability Analysis of the International Monetary Fund (IMF) and the World Bank, as of May 2023, 56 per cent of low-income developing countries (36 out of 69 countries) were either at high risk of or already in debt distress. These countries are home to 40 per cent of the world's poor and among the most climate-vulnerable countries.[11] In addition, as of April 2023, IMF estimated that about 25 per cent of emerging market economies were at high risk.[12]

10. Tighter global financial conditions would make it even more difficult for developing countries to roll over their existing debt and may push more countries towards the financial precipice, including major emerging market economies that have so far been spared. Moreover, a further global slowdown would reduce their capacity to generate foreign currency revenues to pay for escalating external debt servicing. Geopolitical tensions and the climate crisis compounded this bleak outlook.

11. A bolder multilateral policy response is necessary to avoid a systemic debt crisis in the developing world and address the existing development crisis. After presenting the main external debt trends in 2022, the present report discusses shortcomings of the current global financial architecture and draws policy recommendations for adapting this architecture to better support development.

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[8] See IMF, *Global Financial Stability Report: Safeguarding Financial Stability amid High Inflation and Geopolitical Risks*.

[9] See UNCTAD, "Trade and Development Report update"; IMF, *World Economic Outlook: A Rocky Recovery*.

[10] See IMF, *Global Markets Monitor*, 4 May 2023.

[11] Full list of countries available at www.imf.org/external/pubs/ft/dsa/dsalist.pdf.

[12] See IMF, *World Economic Outlook: A Rocky Recovery*.

II. Main trends in external debt sustainability[13]

12. The external debt of developing countries[14] reached a record level of $11.4 trillion in 2022, an increase of 1.9 per cent.[15] Regional trends in external debt sustainability are analysed in the next section.

13. This section will focus on low- and middle-income countries exclusively. For these countries, external debt reached $9.7 trillion in 2022, representing a mere 1 per cent rate of growth, which is much smaller than the 7.9 per cent rate of growth recorded in 2021.[16]

14. The virtually unchanged value of external debt for low- and middle-income countries (see figure I) reflects two main developments. First, the growth rate of short-term debt declined by half between 2021 and 2022 – from 12.7 per cent to 6.1 per cent – owing to lower demand for trade financing amid the global trade slowdown (see sect. I above). Second, long-term external debt fell 0.74 per cent, the first decrease since 2001. This was driven by a slower growth rate of long-term public and publicly guaranteed debt (1.3 per cent compared to 3.9 per cent in 2021) and a decline of 3.2 per cent in private non-guaranteed debt. This is partly because some regions were relatively credit-starved (see sect. III). Consequently, the share of short-term debt in total external debt rose for the third year in a row to 28 per cent in 2022, from 26.6 per cent in 2021. In contrast, the share of long-term debt decreased to 67.8 per cent from 69 per cent over the same period. The share of public and publicly guaranteed debt in total debt for low- and middle-income countries continued its upward trend, reaching 54.9 per cent in 2022, the highest since 2006, while the share of private non-guaranteed debt tapered to 45.1 per cent in 2022 from 46.2 per cent in 2021.

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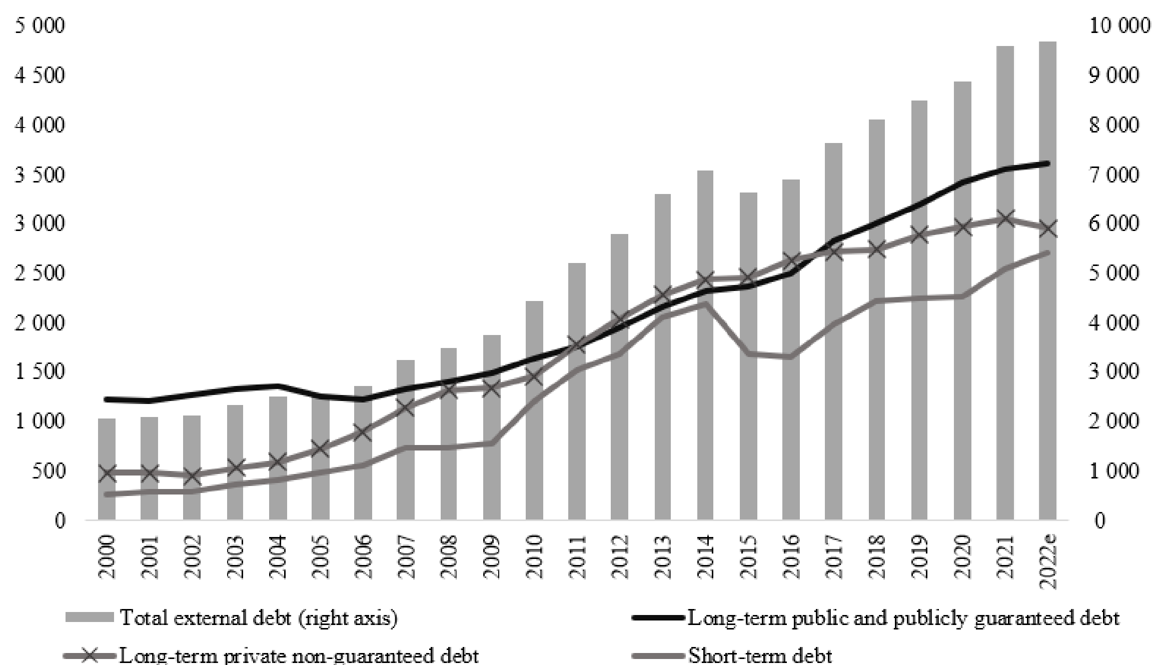
[13] All figures mentioned in this section are UNCTAD secretariat calculations based on World Bank, IMF and national sources, unless noted otherwise. Figures for 2022 are UNCTAD secretariat estimations.

[14] According to UNCTAD classification.

[15] Growth rates refer to the variation against the previous year, unless noted otherwise.

[16] According to World Bank classification as of July 2022. The nominal values and aggregated ratios changed in comparison to A/77/206 because three countries were moved to higher-income groups and three to lower-income groups between 2021 and 2022.

Figure I
Trends in total external debt composition in low- and middle-income countries, 2000–2022
(Trillions of United States dollars)



Source: United Nations Conference on Trade and Development (UNCTAD) secretariat calculations, based on World Bank data.
Abbreviation: e, estimate.

15. Supply and demand factors help to explain these trends in public and publicly guaranteed and private non-guaranteed debts. On the supply side, tightening global financial conditions led to higher external borrowing costs (see sect. I), discouraging sovereigns and corporations from tapping the international capital market. On the demand side, economic growth in middle-income countries decelerated from 6.9 per cent in 2021 to 3.2 per cent in 2022,[17] which corresponded to 98 per cent of private non-guaranteed debt of low- and middle-income countries in 2022. This weighed on the private sector's appetite for investment, curbing the demand for external financing, particularly in upper-middle-income countries – where private non-guaranteed debt contracted by 6 per cent. As for public and publicly guaranteed debt, most countries tightened their fiscal stance in 2022.[18]

16. The external solvency of low- and middle-income countries mainly depends on their export earnings. For these countries, the ratio of total external debt service to exports decreased from 14.2 to 13.2 per cent between 2021 and 2022 owing to a greater increase in export revenues relative to this service. This fall, however, was generated by the surge in commodities prices up to mid-2022 and may be short-lived. For upper-middle-income countries, which accounted for 74.4 per cent of total external debt service of low- and middle-income countries, this ratio declined from 14.3 per cent to 13.2 per cent and for lower-middle-income countries from 13.8 per cent to 12.8 per cent. Conversely, for low-income countries, this ratio rose from 18.5 per cent to 22.6 per cent in the same period because external debt servicing costs

[17] See World Bank, *Global Economic Prospects* (Washington, D.C., 2023).
[18] See Justin Damien Guénette, M. Ayhan Kose and Naotaka Sugawara, "Is a Global Recession Imminent?", *Equitable Growth, Finance, and Institutions Policy Note 4*, World Bank Group, 2023.

outgrew export revenues. The termination of the Group of 20 (G20) Debt Service Suspension Initiative partly explains the rise in 2022.

17. The situation of low-income countries is evidently unsustainable, forcing them to make difficult choices between paying off external debt and importing essential goods. But the current ratio of total external debt service to exports, of around 13 per cent for upper-middle- and lower-middle-income countries, is also of concern. It should be recalled that the London Agreement of 1953 on German war debt limited the amount of export revenues that could be spent on external debt servicing to 5 per cent of the total, so as to avoid undermining the post-war recovery of the Federal Republic of Germany.[19]

18. These huge external debt burdens are associated with the trends in public and publicly guaranteed external debt of low- and middle-income countries after the COVID-19 pandemic. From 2020 to 2022, this debt rose by 13 per cent compared to an increase of 2.5 per cent with respect to private non-guaranteed external debt. Nonetheless, public and publicly guaranteed external debt servicing costs increased much more, by 20.4 per cent. For upper-middle-income countries, these debt servicing costs increased by less than the increase in the debt stock (7.9 per cent and 13.5 per cent, respectively). For lower-middle- and low-income countries, the rise in public and publicly guaranteed debt was similar, at around 12.5 per cent, but the service on this debt surged to 46.7 per cent and 25.9 per cent, respectively.

19. The creditor composition of public and publicly guaranteed debt has become more diverse, fragmented and complex since the 1990s. This is compounded by a broader range of debt instruments and a greater presence of non-resident investors in domestic sovereign markets.

20. The growing share of private creditors, mainly bondholders, in public and publicly guaranteed debt of low- and middle-income countries (from 46 per cent in 2010 to 61 per cent in 2021) resulted in higher debt servicing costs for many developing countries[20] reflecting the higher interest costs of borrowing from private creditors.

21. Regarding lower-middle-income countries, the main driver of soaring debt servicing costs was the increase in the share of private creditors in public and publicly guaranteed external debt, which doubled from 24 per cent in 2010 to 41 per cent in 2021 (latest available data). This group includes most frontier market economies whose speculative-grade bonds experienced the largest spread increase during recent external shocks (see sect. I). The exposure to private creditors is higher for the upper-middle-income group (62 per cent in 2021), but it includes emerging market economies with investment-grade bonds that have narrower spreads and are less vulnerable to changes in global financial conditions.

22. As for low-income countries, where the share of bondholders in public and publicly guaranteed debt is small (4 per cent in 2021), private creditor holdings doubled to 13 per cent in 2021 (up from 7 per cent in 2010). The rise in external debt servicing costs stems from a marked shift away from Paris Club bilateral debt (down to 8 per cent in 2021 from 13 per cent in 2010) to non-Paris Club official creditors and, mainly, private creditors. In 2022, the share of commercial banks in this group's public and publicly guaranteed debt increased as low-income countries shifted to syndicated loans in the face of diminishing access to international bond markets. Such

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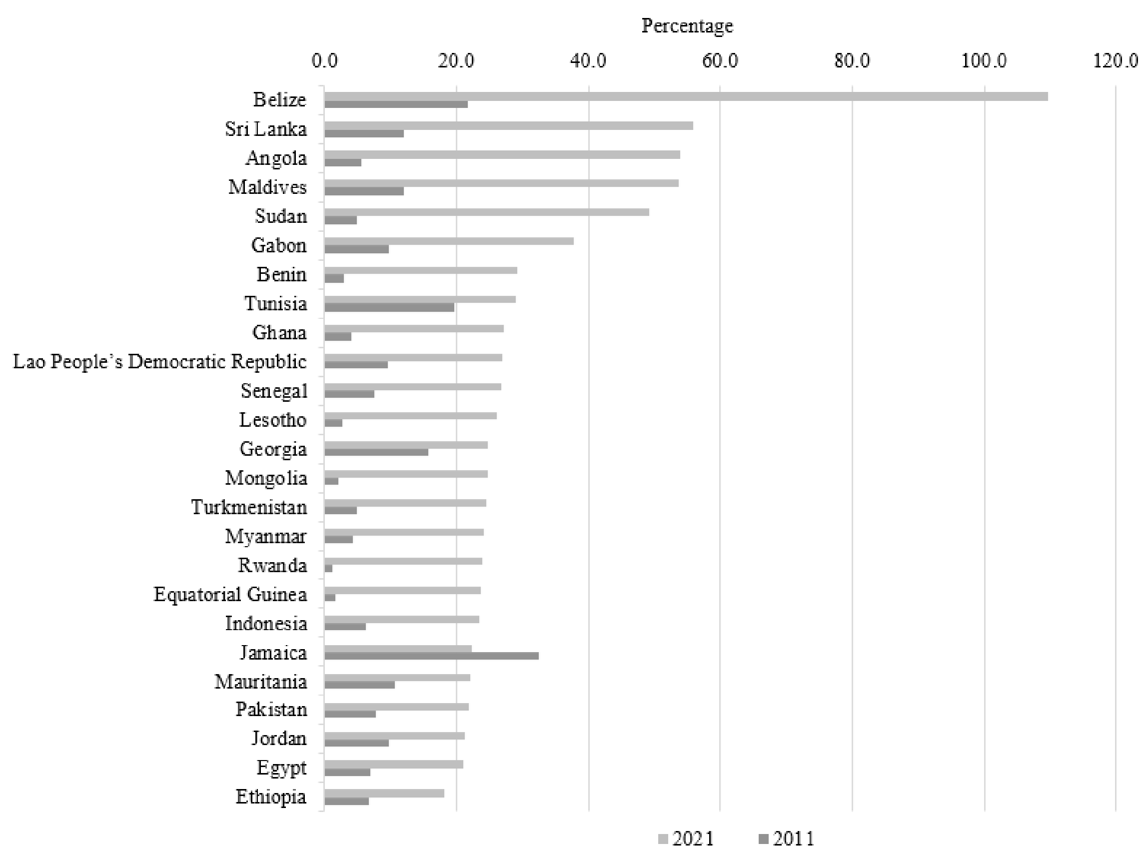
[19] See UNCTAD, *Trade and Development Report: Making the international financial architecture work for development* (October 2015).

[20] See World Bank, *International Debt Report* (Washington, D.C., 2022), pp. 11–12.

loans usually have shorter maturities and include fewer safeguards against holdouts in debt resolution compared with Eurobonds (see sect. III.B below).[21]

23. Amid mounting sovereign borrowing costs, servicing public and publicly guaranteed external debt is absorbing a significant share of government revenues of lower-middle- and low-income countries. While these more vulnerable country groups spent 10.5 per cent of their government revenues in servicing this debt in 2022, upper-middle-income countries spent only 3.6 per cent. Yet, group averages conceal important differences across countries. The situation is much more severe in the group of 25 countries with the largest proportion of revenues absorbed by public and publicly guaranteed debt servicing in 2021 (see figure II). In this list, only 10 countries are eligible for the G20 Common Framework for Debt Treatments. The other 15 countries include 8 lower-middle- and 7 upper-middle-income countries.

Figure II
Public and publicly guaranteed debt service to government revenues, top 25 countries



Source: UNCTAD secretariat calculations based on World Bank, IMF and national sources.

24. This places low- and lower-middle-income countries (and also some upper-middle-income countries) in the unenviable position of servicing their public and publicly guaranteed debt instead of achieving sustainable development. Data reveal that most countries prioritize debt payments to avoid a default, even if this means sacrificing development. A comparison of the average expenditures as a percentage of government revenues for two periods (2012–2014 and 2019–2021) for 112 countries shows that public and publicly guaranteed debt service absorbed a higher share of the

[21] See United Nations, Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2023*.

public purse than expenditure on health. For countries that are eligible for the Common Framework, while health spending grew from 6.1 per cent to 7.5 per cent on average, public and publicly guaranteed debt servicing costs almost tripled, from 5.5 per cent to 14.4 per cent. For other middle-income countries (excluding China), while health spending increased relatively little, from 10.6 per cent to 11.8 per cent, debt servicing costs almost doubled, from 4.5 to 8.6 per cent. The number of countries whose public and publicly guaranteed debt servicing costs are higher than their health spending rose from 34 to 62 between the two periods.[22]

A. Main external debt trends, by developing region

25. This section presents the main external debt trends of developing countries by region in 2022. Regarding the debt sustainability indicators, the common trend across all regions was the deterioration of the external liquidity situation, expressed as the ratio of international reserves to short-term debt. This ratio fell because the short-term debt increased in all regions (to different degrees) and, at the same time, international reserves either increased at a slower pace or declined – as central banks attempted to mitigate currency depreciations.

26. Economic growth in East Asia and the Pacific more than halved, to 3.3 per cent in 2022, from 7.3 per cent in 2021. The region's growth is expected to improve to 4.2 per cent in 2023.[23] Recovery across the region has been uneven, however, as output levels in some subregions, such as the Pacific islands, remain below pre-pandemic levels.[24] On average, in the wake of the pandemic, countries have experienced a quadrupling of fiscal deficits from 1 per cent of gross domestic product (GDP) to 4–5 per cent of GDP between 2020 and 2021.[25] Total external debt remained relatively flat in 2022 at $4.76 trillion compared with $4.73 trillion in 2021, after growing around by 9 per cent in 2020 and 2021, mainly due to the drop in private non-guaranteed debt by 7.61 per cent, which accounted for 60.1 per cent of long-term debt in 2022. This aided the slight decrease in total external debt servicing costs to exports to 9.9 per cent from 10.3 per cent; nevertheless, the ratio of public and publicly guaranteed debt service to government revenues increased to 2.7 per cent from 2.0 per cent. The ratio of reserves to short-term debt decreased to 212 per cent from 233.4 per cent in the same period.

27. Despite a robust recovery from the pandemic in 2021, economic growth in Europe and Central Asia contracted sharply in 2022 following the invasion of Ukraine by the Russian Federation. Economic growth for the region, excluding the Russian Federation and Ukraine, contracted to 4.7 per cent in 2022 from 8.3 per cent in 2021. The invasion resulted in a sharp rise in inflation, particularly in energy and food prices, and a deterioration in monetary and financial conditions that negatively affected private consumption, investment and trade.[26] Total external debt rose 7.6 per cent in 2022, the fastest rate of increase of any region, reaching $759.6 billion. The rise was primarily due to an increase of 36 per cent in short-term debt, to $195 billion (now accounting for 26 per cent of total external debt stocks). Public and publicly guaranteed debt grew only 1.71 per cent, amounting to $551.2 billion or 41.9 per cent of long-term debt. External solvency indicators have improved from their peaks from

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[22] For similar data on public education spending, see UNCTAD, "Trade and Development Report update".

[23] See Economic Commission for Asia and the Pacific (ESCAP), *Economic and Social Survey of Asia and the Pacific 2023: Rethinking Public Debt for the Sustainable Development Goals*, 2023.

[24] See World Bank, *Reviving Growth: East Asia and Pacific Economic Update*, April 2023.

[25] See ESCAP, *Economic and Social Survey of Asia and the Pacific 2023*.

[26] See World Bank, *Europe and Central Asia Economic Update: Weak Growth, High Inflation, and a Cost-of-Living Crisis* (Washington, D.C., 2023).

2020 to 2022: the ratio of total debt service to exports decreased to 25.2 per cent from 42.4 per cent – though it is still the highest of any region – and the ratio of public and publicly guaranteed debt service to government revenues decreased to 6.8 per cent from 9.2 per cent. The ratio of reserves to short-term debt declined to 108.8 per cent – the lowest of any region – from 112.3 per cent over the same period.

28. Countries in Latin America and the Caribbean also faced deteriorating global financial conditions in 2022. International bond issuance amounted to $64 billion, the smallest value since 2008, with an average coupon 1.3 per cent higher and an average maturity three years lower than in 2021.[27] Economic growth slowed to 3.6 per cent in 2022 from 6.8 per cent in 2021 and is expected to slow to 1.4 per cent in 2023.[28] Total external debt in the region grew at a slower rate in 2022 than in 2021 (2.3 per cent compared to 5.5 per cent), reaching $2.69 trillion. Public and publicly guaranteed debt decreased by 0.5 per cent, amounting to $1.1 trillion or 51.1 per cent of long-term debt. The commodity price boom in the first half of 2022 boosted export revenues, resulting in a decrease in the ratio of total debt service to exports to 23.4 per cent from 26.2 per cent. It also enabled a decrease in the ratio of public and publicly guaranteed debt service to government revenues to 7.5 per cent from 9.4 per cent. The ratio of reserves to short-term debt fell to 227 per cent from 267 per cent in the same period.

29. In the Middle East and North Africa, the impact of the war in Ukraine affected oil-exporting and oil-importing countries differently as a result of higher hydrocarbon prices up to mid-2022. Tightening global financial conditions translated into higher borrowing costs in the region in 2022, but the wider range of sovereign bond yield spreads (from 130 to 3,000 basis points) shows mixed outcomes.[29] Total external debt increased at a slower pace in 2022 (0.9 per cent compared with 8.3 per cent in 2021), reaching $1.4 trillion. The public and publicly guaranteed debt, which accounts for 71.3 per cent of long-term debt (the second highest share of any region), decreased by 3 per cent, amounting to $766.3 billion. As oil-exporting countries predominate in the region, the ratio of total debt service to exports fell to 9.9 per cent in 2022, from 11.5 per cent in 2021. Export growth reached 5.7 per cent in 2022, relative to 3.7 per cent in 2021,[30] which boosted economic growth – and, therefore, government revenues. The ratio of public and publicly guaranteed debt service to these revenues fell to 6.1 per cent from 10.4 per cent in the same period. The ratio of reserves to short-term debt steadily declined from the peak in 2013 of 736.7 per cent to 405.4 per cent in 2022 – still the highest ratio of any region.

30. South Asia sustained the most significant output losses in value across the developing regions owing to prolonged COVID-19 lockdowns and associated macroeconomic challenges triggered by the pandemic. Economic growth slowed to 5.6 per cent in 2022 from 7.9 per cent and is predicted to slow down again, to 4.8 per cent in 2023. In 2022, several countries in South Asia turned to multilateral financial assistance to address high levels of sovereign debt and unsustainable debt servicing burdens (Bangladesh, India, Maldives, Pakistan and Sri Lanka).[31] Growth of total external debt more than halved (4.3 per cent in 2022 compared with 10 per cent in 2021), reaching $949.5 billion. Private non-guaranteed debt rose by 12.4 while public and publicly guaranteed debt fell by 1.6 per cent. Consequently, as a percentage of total long-term debt, the share of public and publicly guaranteed debt decreased to 54.5 per cent in 2022, from 57.8 per cent in 2021. Nonetheless, the ratio of public and

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[27] See Economic Commission for Latin America and the Caribbean (ECLAC), "Capital flows to Latin America and the Caribbean", *Briefing Note*, 6 March 2023.

[28] See United Nations, *World Economic Situation and Prospects*.

[29] See IMF, *Regional Economic Outlook: Middle East and Central Asia 2023 – Safeguarding Macroeconomic Stability amid Continued Uncertainty* (Washington, D.C., May 2023).

[30] See World Bank, *Global Economic Prospects*.

[31] See United Nations, *World Economic Situation and Prospects*.

publicly guaranteed debt service to government revenues increased to 6.7 per cent from 4.7 per cent, as debt servicing costs outgrew public revenues. The ratio of reserves to short-term debt decreased to 401.6 per cent from 482.5 per cent over the same period.

31. Economic growth in sub-Saharan Africa fell to 3.9 per cent in 2022 from 4.7 per cent in 2021. The region has experienced an external credit squeeze, with disproportionate, soaring borrowing costs and a loss of market access since the first quarter of 2022, resulting in a collapse of Eurobond issuance.[32] While 19 of the region's low-income countries were classified as being in debt distress or at high risk of debt distress at the end of the second quarter of 2023,[33] the growth of public and publicly guaranteed debt almost ground to a halt – at 0.6 per cent in 2022 compared to 3.3 in 2021, reaching $475.3 billion. That debt accounted for 76.3 per cent of long-term debt in 2022, the highest share of any regions. Total external debt increased by 2.2 per cent compared with an increase of 5.1 per cent in 2021, amounting to $812.4 billion. The region's economic challenges are reflected in the ratio of public and publicly guaranteed debt service to government revenues, which increased to 18.4 per cent in 2022 from 13.6 in 2021, reflecting faster growth in debt servicing costs than in government revenues amid the economic slowdown. The ratio of reserves to short-term debt declined to 162.5 per cent from 189.3 per cent over the same period.

B. Main external debt trends: Least developed countries and small island developing States

32. In 2022, all the indicators of external sustainability for the least developed countries deteriorated. The ratio of total debt service to export revenues rose to 18.9 per cent in 2022 from 18.3 per cent in 2021 as external debt servicing costs (22.7 per cent) rose relative to export revenues (18.5 per cent). The long-term public and publicly guaranteed debt of the least developed countries accounted for 62.0 per cent of total external debt in 2022. The share of government revenues spent on servicing that debt rose to 17.0 per cent in 2022, from 15.6 per cent in 2021. Although government revenues grew by 13.4 per cent – as these countries continued to recover from the COVID-19 pandemic[34] – debt servicing costs on long-term public and publicly guaranteed debt increased at a much higher rate (by 23.3 per cent). The soaring external borrowing costs in the international financial market for the frontier market economies from this country group amid monetary tightening help to explain this sharper rise.[35] At the same time, the group's liquidity buffer (ratio of reserves to short-term debt) fell from 336 per cent in 2021 to 277.5 per cent in 2022.

33. Contrary to the least developed countries, the external solvency of small island developing States[36] improved in 2022. The ratio of total debt service to export revenues fell to 16.5 per cent in 2022 from 20.6 per cent in 2021 owing to a strong recovery in tourism that boosted these revenues.[37] In turn, government revenues increased by 18.4 per cent in 2022, which helped to reduce the share of these revenues spent on servicing public and publicly guaranteed debt to 10.2 per cent in 2022, from 12.5 per cent in 2021. Meanwhile, the ratio of reserves to short-term debt decreased to 148.3 per cent in 2022, from 181.9 per cent in 2021. The lower liquidity buffer

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[32] See IMF, *Regional Economic Outlook: Sub-Saharan Africa 2023 – The Big Funding Squeeze* (Washington, D.C., April 2023).

[33] Full list of countries available at www.imf.org/external/pubs/ft/dsa/dsalist.pdf.

[34] The estimated growth rate for this group is 4.3 per cent in 2022. See United Nations, *World Economic Situation and Prospects*.

[35] See UNCTAD, "Trade and Development Report update".

[36] Analytical classification of small island developing States, according to UNCTAD statistics.

[37] See World Tourism Organization, "Tourism recovery accelerates to reach 65% of pre-pandemic levels", 23 November 2023.

makes this group of States relatively more vulnerable to external financial shocks than the least developed countries.

III. In focus: shortcomings of the global financial architecture

34. This section focuses on two shortcomings of the current global financial architecture. The first is the IMF charges and surcharges policy. The second refers to the existing legislative and contractual tools to incentivize, encourage or enforce private creditor participation in debt restructurings.

A. IMF charges and surcharges

35. IMF has been instrumental in providing financial support to developing countries in response to the overlapping global crises in recent years. The significant increase in borrowing from this multilateral institution has exposed these countries to the risk of rising interest rates, however. As a result, a greater portion of their resources are being allocated to repay IMF. The situation is particularly stressful for countries with substantial IMF loans, as they are burdened with additional interest in the form of surcharges. This dynamic underscores that the existing structure of IMF charges and surcharges is both inefficient, as it operates procyclically, and inequitable, as it leaves the most distressed countries bearing the heaviest financial burden.

36. An urgent revision of surcharges is necessary, considering the growth in IMF lending and the associated costs. Total IMF credit grew by $53 billion to $152 billion from 2019 to 2022 in response to the COVID-19 crisis and the war in Ukraine.[38] Over this period, most of the lending was facilitated through the IMF General Resources Account, with the number of countries with outstanding General Resources Account credit growing from 31 to 52, and the balance rising to $131 billion (from $90 billion).

37. Large IMF General Resources Account credit balances present two significant challenges for borrowing countries.

38. First, the General Resources Account lending rate, known as the rate of charge, comprises not only one fixed margin[39] but also a component based on market interest rates.[40] That component is the special drawing rights interest rate, calculated as the weighted average of interest rates on three-month instruments in the currencies included in the special drawing rights valuation basket.[41] This structure renders the rate of charge highly sensitive to changes in the monetary policies of the countries within the basket. Consequently, increases in interest rates in the United States, the euro area and the United Kingdom of Great Britain and Northern Ireland from December 2021 to June 2023 resulted in a surge in the General Resources Account lending rate from 105 to 482 basis points. This caused an estimated additional interest expense of $4.7 billion in 2023 for IMF General Resources Account borrowing countries.[42]

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[38] IMF figures for total credit outstanding for 31 December of each year. Figures for this section use a special drawing rights valuation to United States dollar exchange rate of 1.34701.

[39] This margin is determined annually by the IMF Executive Board, currently standing at 100 basis points.

[40] A third element is a burden-sharing mechanism designed to compensate IMF for lost income. This is currently set at 0 basis points. See IMF, “Review of the Fund’s strategy on overdue financial obligations”, policy paper, 9 July 2018.

[41] The basket includes the Chinese yuan, euro, Japanese yen, pound sterling and United States dollar. See www.imf.org/external/np/fin/data/sdr_ir.aspx.

[42] Estimation based on the total IMF General Resources Account outstanding credit as at 31 December 2022. The estimation compares the interest expense using a rate of charge of 1.077 (as of December 2021) and a projected rate of charge of 4.70675 for 2023.

39. Second, an additional surcharge of 200 basis points is applied on the amount of credit outstanding above 187.5 per cent of the country quota. If credit remains above 187.5 per cent of quota after three years, this increases to 300 basis points.[43]

40. A growing number of countries are subject to IMF surcharges (7 countries in 2019, 16 countries in 2022). The countries affected by surcharges are Albania, Angola, Argentina, Armenia, Barbados, Costa Rica, Ecuador, Egypt, Gabon, Georgia, Jordan, Mongolia, Pakistan, Seychelles, Tunisia and Ukraine, representing a combined outstanding General Resources Account credit of $104 billion as of December 2022. IMF interest rates, including charges and surcharges, surged from 405 to 782 basis points from December 2021 to June 2023 and now approach or exceed the weighted average coupon on these countries' sovereign bonds.

41. Owing to the IMF charges and surcharges policy, the cumulative projected interest payments for these 16 countries may increase by $36.6 billion, to $43.9 billion, from 2023 to 2030,[44] of which $24.4 billion arise from higher charges and $12.2 billion from surcharges.

B. Legislative and contractual landscape

42. Soaring sovereign debt levels have motivated countries to seek legal solutions in order to address debt distress. Legislative efforts in key jurisdictions, particularly the United States and the United Kingdom, which govern most of the sovereign debt contracts, are currently under way, but are meeting with resistance. In the United States, three legislative bills envisage limiting the recoverable amount for creditors in New York courts,[45] establishing a sovereign bankruptcy procedure in New York,[46] and invalidating debt transfers if acquired for the purpose of filing lawsuits.[47] In the United Kingdom, a recommendation by the House of Commons International Development Committee to introduce legislation compelling private creditor participation in international debt relief initiatives[48] has been rejected.[49] These endeavours reflect the widespread recognition that effective legislation in key jurisdictions would represent important steps towards resolving sovereign debt crises.

43. One successful example from the past is the Debt Relief (Developing Countries) Act 2010[50] in the United Kingdom. The Act required the country's courts to restrict the recoverable amounts for creditors of the debts owed by countries participating in the Heavily Indebted Poor Countries initiative. At the time, it prevented an estimated loss of £145 million for these countries,[51] which otherwise might have accrued owing to holdout litigation. Holdout creditors, seeking full debt recovery despite the ongoing international debt relief initiatives, have often gained support from domestic courts

[43] See IMF, *Review of Access Limits and Surcharge Policies*, policy paper, April 2016.
[44] The estimation compares the interest expense using a rate of charge of 1.077 (as of December 2021) and a projected rate of charge of 4.70675 for 2023 and 4.825 from 2024 to 2030. Calculations are based on existing and prospective purchases from the IMF General Resources Account in the context of ongoing programmes on an annualized basis.
[45] See Assembly Bill A2970/Senate Bill S4747.
[46] See Assembly Bill A2102A/Senate Bill S5542.
[47] See Assembly Bill A5290/Senate Bill S5623.
[48] See International Development Committee of the United Kingdom House of Commons, "Debt relief in low-income countries", seventh report of session 2022–23, 10 March 2023.
[49] Debt relief in low-income countries: Government response to the Committee's Seventh Report of Session 2022–23 (parliament.uk).
[50] See Debt Relief (Developing Countries) Act 2010.
[51] See HM Treasury, "Government acts to halt profiteering on Third World debt within the UK", press release, 16 May 2011.

in the spirit of prioritizing contractual rights.[52] Public and international interests, however, including the rights of taxpayers of creditor countries participating in debt relief initiatives and the development needs of the debtor countries, also need to be taken into account. Effective domestic legislation promoting equitable debt restructuring requires thorough consultations with all stakeholders on legislative design, based on the establishment of clear international debt initiatives.

44. Apart from statutory efforts, contractual developments have also helped advance sovereign debt restructuring practices. The enhanced collective action clauses published by the International Capital Market Association in 2014/15[53] facilitate negotiated debt restructuring plans supported by a supermajority of creditors. Tested in the debt restructuring of Argentina and Ecuador in 2020, the efficacy (and shortcomings) of enhanced collective action clauses have been demonstrated on sovereign bonds. A complication is that those clauses are not consistent across bond issuances, potentially creating deadlock in restructurings. Moreover, the clauses do not apply to other debt instruments, including loans, which are the predominant exposure of low-income countries. In November 2022, industry bodies published a guidance and explanatory note on majority voting provisions to be included in sovereign loan agreements.[54] Another notable contractual innovation, called Climate Resilient Debt Clauses, was presented during the twenty-seventh session of the Conference of the Parties to the United Nations Framework Convention on Climate Change in November 2022.[55] If adopted, these clauses will provide a debt deferral mechanism in case of natural disasters, so as to allow debtor countries to manage future shocks.

45. It remains to be seen how the private and official sectors will react to these new contractual designs. While the contractual tools aim to enhance sovereign debt restructuring practices, they are not commensurate with the magnitude of the problem, as discussed in the next section.

IV. Policy recommendations

46. Unsustainable debt burdens in developing countries are stretching social safety nets, causing socioeconomic distress and constraining sustainable development and the implementation of the 2030 Agenda and the Paris Agreement. The multilateral response has been subdued, considering the severity of the situation.

47. The Secretary-General, in his briefing to the General Assembly on priorities for 2023, called for a "radical transformation" of the global financial architecture. This architecture is not fit for purpose.[56] First, it does not have the tools to provide short-term external liquidity in moments of external shock. Second, it does not grant development finance at the scale required to achieve the Sustainable Development Goals. Third, it does not address unsustainable debt burdens in an orderly, fair and comprehensive manner. In his proposal for a Sustainable Development Goals stimulus to deliver on the 2030 Agenda, the Secretary-General put forward a bolder multilateral response encompassing actions, in tandem, in these three layers of the

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[52] See, for example, *Republic of Argentina v. NML Capital, Ltd.*, 573 U.S. 134 (2014).

[53] See International Capital Market Association, "Sovereign debt information". Available at www.icmagroup.org/resources-2/Sovereign-Debt-Information/.

[54] See International Capital Market Association, "Guidance and explanatory note relating to new specimen clauses for inclusion in commercial loan agreements for sovereign borrowers", 1 November 2022.

[55] See International Capital Market Association, "Private Sector Working Group – Climate Resilient Debt Clauses", Chair's summary, 9 November 2022.

[56] See A/76/214 and A/77/206.

global financial architecture: the global financial safety net, financing for development and the international debt architecture.[57]

48. This section will focus on the priorities in these areas. Besides structural reforms, immediate actions are also essential and urgent.

A. Immediate actions

49. The G20 Common Framework – currently the primary multilateral response for addressing the build-up of developing countries' debt challenges after the COVID-19 pandemic – broadens the involvement of bilateral official creditors to both Paris Club and non-Paris Club G20 members. It shares some features of previous umbrella frameworks,[58] such as the requirement that debtor countries seek comparable debt relief from private creditors on at least as favourable terms as from their official creditors, and the prioritization of debt relief through maturity extensions and interest rate reductions instead of outright debt cancellation.[59] The available evidence does, however, suggest that deep debt relief, such as debt write-offs in contrast to rescheduling, leads to improved economic growth outlook in debt-distressed countries,[60] which remains the surest basis for achieving a sustainable debt position.

50. The widely recognized shortcomings[61] of the Common Framework, including the slow pace of the process, have undermined confidence and, together with fears of downgrading, appear to have inhibited applications from the 73 eligible countries.[62] Moreover, while this framework encourages greater private sector participation, it lacks a clear methodology for accessing comparability of treatment and effective mechanisms to ensure this. But, as shown in the recent case of Sri Lanka, currently ineligible for the Common Framework, convening the official creditors without the mechanisms of the Common Framework is even more protracted.

51. In line with the Sustainable Development Goals stimulus proposal, the fastest and easiest way to ensure an improved multilateral debt relief solution, especially before large debt servicing payments become due in 2023 and 2024, is to address these shortcomings. The Global Sovereign Debt Roundtable[63] – already under way – may make a contribution.

52. An improved Common Framework should include, first, an automatic debt service standstill during negotiations that would alleviate liquidity constraints, avoid the accumulation of arrears and incentivize quicker resolutions; second, greater

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[57] See also A/77/CRP.1/Add.5.

[58] These frameworks are the Paris Club, founded in 1956; the Brady Plan of 1989; the Heavily Indebted Poor Countries Initiative of 1996; and the Multilateral Debt Relief Initiative of 2005.

[59] See World Bank, "Resolving High Debt After the Pandemic: Lessons from Past Episodes of Debt Relief" in *Global Economic Prospects, January 2022* (Washington, D.C., 2022).

[60] See Carmen M. Reinhart, Christoph Trebesch, "Sovereign debt relief and its aftermath", *Journal of the European Economic Association*, 2016, vol. 14, No. 1, pp. 215–251.

[61] See, for instance, Kristalina Georgieva, Ceyla Pazarbasioglu, "The G20 Common Framework for Debt Treatments Must be Stepped Up", *IMF Blog*, 2 December 2021.

[62] Among the four countries that have applied (Chad, Zambia and Ethiopia in 2021 and Ghana in January 2023), two countries concluded a debt agreement. Chad reached an agreement with its official bilateral and private creditors in November 2022 – which did not involve an outright debt reduction but will provide debt service relief in 2024 and protection against a drop in oil price (see Ryadh M. Alkhareif, Emmanuel Moulin, "What the Chad debt deal means", Financing for Development Lab, 19 April 2023). Zambia was the second, reaching an agreement in June 2023 with official creditors only and absent a debt reduction (see Fitch Rating, "Zambia's debt deal paves way for next stage of restructuring", 28 June 2023).

[63] See IMF, "Global Sovereign Debt Roundtable Co-Chairs Press Statement", press release No. 23/117, 12 April 2023.

predictability and reliable timelines; third, extension of eligibility to middle-income countries that are on the brink of or in debt distress; and fourth, clarification on how comparability of treatment will be determined and concrete tools to incentivize or enforce private creditors to participate in official debt restructurings. Drawing on lessons from previous umbrella initiatives, these tools may include debt exchanges for longer maturities and lower interest rates, debt buybacks, credit enhancements (e.g. financial guarantees and/or collateralization), moral suasion, tax and regulatory incentives, and legislative measures (see sect. III.B).

53. A second immediate and necessary action is to suspend the IMF surcharges, at least temporarily, as advocated by the United Nations Global Crisis Response Group on Food, Energy and Finance.[64] In the context of rising debt vulnerabilities and recurrent crises, it is imperative that IMF lending continues to alleviate the financing challenges faced by developing countries (see sect. III.A).

B. Reforms of the global financial architecture

54. The treatment of sovereign external debt distress has a long history of delivering too little support, too late, to developing countries, typically resulting in protracted debt crises that can set development progress back by a decade or more.[65] This has exposed serious weaknesses in the global debt architecture: sovereigns do not have the kind of protections provided by corporate bankruptcy law while they are treated as commercial actors in the international financial system,[66] and voluntary negotiations between the debtor country and its foreign creditors have become increasingly ill-suited to the growing complexities of the current debt landscape. Not only has creditor coordination become more difficult with the broader range of private, semi-official and official bilateral creditors (see sect. II), but claimants against the financial resources of States (such as arbitration award holders, unpaid suppliers and holders of derivative contracts) have proliferated.[67]

55. As stressed in previous reports[68] and in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development, only a multilateral sovereign debt workout framework can fully address sovereign external debt distress and provide an effective, efficient and equitable mechanism for managing debt crises in a way that is aligned with the development needs of developing countries.

56. Placing development in the spotlight also requires a new approach to debt sustainability analyses that puts the achievement of the Sustainable Development Goals at its centre and considers the balance of payments position as the dominant economic constraint on growth and development in most developing countries. In existing approaches – even those adopting a longer-term perspective – debt servicing, rather than sustainable development, becomes an end in itself. A development-focused approach should help assess whether countries need debt relief through debt write-offs to achieve the 2030 Agenda and the Paris Agreement, simultaneously with

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[64] See Global Crisis Response Group on Food, Energy and Finance, "Global impact of the war in Ukraine: Billions of people face the greatest cost-of-living crisis in a generation", 8 June 2022.

[65] See ECLAC, *Public debt and development distress in Latin America and the Caribbean* (Santiago, 2023).

[66] Martin Guzman, Joseph E. Stiglitz, "Creating a framework for sovereign debt restructuring that works" in *Too Little, Too Late: The Quest for Resolving Sovereign Debt Crises*. New York: Columbia University Press, 2016.

[67] See Lee Buchheit, Mitu Gulati, "Avoiding a lost decade: An interim update", *Virginia Law and Economics Research Paper*, No. 2023-06, 11 February 2023.

[68] See A/76/214 and A/77/206.

both external debt and public debt sustainability, within the bounds of their external position in the global economy.[69]

57. Debt transparency and strengthening debt management is necessary both to assess debt sustainability and to ensure effective debt restructuring. While there have been recent improvements,[70] transparency challenges remain, such as the limited scope of data coverage in relation to central government and government-guaranteed debt. Coverage must be expanded to include all national and local government debts, extrabudgetary debt, debt of State-owned enterprises, all contingent liabilities and collateralized debt.

58. Finally, Member States should consider enacting domestic legislative changes to facilitate timely and orderly sovereign debt restructuring processes. In the meantime, contractual tools should be more widely considered, as discussed in section III.B of the present report.

[69] See UNCTAD, "UNCTAD Sustainable Development Finance Assessment Framework: Linking debt sustainability to the achievement of the 2030 Agenda", United Nations Development Account COVID-19 Project, paper 1 no. 6/22, November 2022.

[70] See A/77/206.

Annex

External debt of developing economies

(Billions of United States dollars)

	2019	*2020*	*2021*	*2022*[a]
All developing economies[b]				
Total external debt stocks[c]	9 890.7	10 400.8	11 198.0	11 410.0
Long-term external debt	7 096.4	7 552.5	7 783.1	7 802.3
Public and publicly guaranteed debt/long-term external debt	46.5%	47%	51.4%	51.7%
Private non-guaranteed debt/long-term external debt	46.4%	47%	48.6%	48.3%
Short-term external debt	2 625.7	2 628.2	2 980.2	3 155.2
Debt indicators (percentage)[d]				
Total external debt/GDP	30.0	32.8	30.1	28.8
Total external debt/exports[e]	116.4	135.0	112.1	100.1
Total debt service/exports[e]	15.2	16.4	13.7	12.9
Reserves/short-term external debt	267.1	282.5	259.5	233.2
Debt service on PPG debt/government revenue	4.3	4.7	4.3	4.8
East Asia and the Pacific				
Total external debt stocks[c]	3 934.1	4 300.9	4 728.5	4 757.9
Long-term external debt	2 258.7	2 574.4	2 666.9	2 601.1
Public and publicly guaranteed debt/long-term external debt	34.4%	34.6%	36.6%	39.9%
Private non-guaranteed debt/long-term external debt	65.6%	65.4%	63.4%	60.1%
Short-term external debt	1 657.0	1 706.5	1 979.4	2 042.7
Debt indicators (percentage)[d]				
Total external debt/GDP	22.4	24.2	22.4	22.0
Total external debt/exports[e]	87.1	96.6	84.4	79.4
Total debt service/exports[e]	11.1	10.5	10.3	9.9
Reserves/short-term external debt	251.6	262.2	233.4	212.0
Debt service on PPG debt/government revenue	1.5	1.9	2.0	2.7
Europe and Central Asia				
Total external debt stocks[c]	694.3	704.7	705.7	759.6
Long-term external debt	551.3	542.3	547.4	551.2
Public and publicly guaranteed debt/long-term external debt	37.4%	40.7%	41.5%	41. 9%
Private non-guaranteed debt/long-term external debt	62.6%	59. 3%	58. 5%	58.1%
Short-term external debt	138.5	156.4	142.7	195.0
Debt indicators (percentage)[d]				
Total external debt/GDP	60.7	64.7	56.4	53.7
Total external debt/exports[e]	180.7	228.1	166.1	141.8
Total debt service/exports[e]	34.5	42.4	27.9	25.2
Reserves/short-term external debt	125.7	112.3	134.7	108.8
Debt service on PPG debt/government revenue	8.3	9.2	9.4	6.8

	2019	2020	2021	2022[a]
Latin America and the Caribbean				
Total external debt stocks[c]	2 476.8	2 489.7	2 626.6	2 686.4
Long-term external debt	2 028.2	2 069.0	2 137.1	2 180.8
Public and publicly guaranteed debt/long-term external debt	51.5%	52.7%	52.4%	51.1%
Private non-guaranteed debt/long-term external debt	48.5%	47.3%	47.6%	48.9%
Short-term external debt	380.7	336.2	365.3	382.0
Debt indicators (percentage)[d]				
Total external debt/GDP	44.4	53.2	48.9	44.0
Total external debt/exports[e]	198.2	231.9	190.2	164.9
Total debt service/exports[e]	29.8	32.0	26.2	23.4
Reserves/short-term external debt	225.5	266.6	255.3	226.7
Debt service on PPG debt/government revenue	9.5	9.4	7.6	7.5
Middle East and North Africa				
Total external debt stocks[c]	1 266.4	1 321.3	1 431.6	1 444.1
Long-term external debt	1 005.2	1 060.7	1 076.3	1 074.5
Public and publicly guaranteed debt/long-term external debt	72.4%	73.7%	73.5%	71.3%
Private non-guaranteed debt/long-term external debt	27.6%	26.3%	26.5%	28.7%
Short-term external debt	223.7	212.1	253.4	278.6
Debt indicators (percentage)[d]				
Total external debt/GDP	41.7	49.5	45.3	38.1
Total external debt/exports[e]	96.6	138.1	105.5	76.2
Total debt service/exports[e]	10.8	15.9	11.5	9.9
Reserves/short-term external debt	499.9	493.6	428.4	405.4
Debt service on PPG debt/government revenue	6.2	10.2	10.4	6.1
South Asia				
Total external debt stocks[c]	801.9	828.0	910.6	949.5
Long-term external debt	648.9	676.9	717.2	748.1
Public and publicly guaranteed debt/long-term external debt	56.4%	56.9%	57.8%	54.5%
Private non-guaranteed debt/long-term external debt	43.6%	43.1%	42.2%	45.5%
Short-term external debt	135.7	131.4	151.6	159.7
Debt indicators (percentage)[d]				
Total external debt/GDP	21.9	23.7	22.3	21.9
Total external debt/exports[e]	126.5	141.4	117.0	105.0
Total debt service/exports[e]	11.9	16.5	9.3	9.8
Reserves/short-term external debt	397.7	518.5	482.5	401.6
Debt service on PPG debt/government revenue	5.3	7.0	4.7	6.7

	2019	2020	2021	2022[a]
Sub-Saharan Africa				
Total external debt stocks[c]	717.3	756.2	795.0	812.4
Long-term external debt	604.0	629.1	638.2	646.6
Public and publicly guaranteed debt/long-term external debt	71%	72.7%	74%	73.5%
Private non-guaranteed debt/long-term external debt	29%	27.3%	26%	26.5%
Short-term external debt	90.2	85.6	87.7	97.1
Debt indicators (percentage)[d]				
Total external debt/GDP	40.3	44.6	41.8	39.4
Total external debt/exports[e]	178.5	233.5	181.3	157.4
Total debt service/exports[e]	18.1	22.5	19.3	17.7
Reserves/short-term external debt	163.5	168.6	189.3	162.5
Debt service on PPG debt/government revenue	13.8	15.2	13.6	18.4

Source: United Nations Conference on Trade and Development (UNCTAD) secretariat calculations based on World Bank, International Monetary Fund (IMF) database and national sources.

Abbreviations: GDP, gross domestic product; PPG debt, public and publicly guaranteed external debt.

[a] Figures for 2022 are UNCTAD secretariat estimates.

[b] Developing economies are defined as per UNCTAD statistics country classifications.

[c] Total external debt stocks include long-term external debt, short-term external debt and use of IMF credit.

[d] Data series used for ratio calculation have been adjusted according to data availability.

[e] Exports comprise exports of goods, services and primary income.