2

International assistance in catastrophes need not bankrupt countries

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2.1 Introduction: The problem is generic

Incurring debt – being able to borrow to make purchases beyond what is possible with only current income or savings – is a powerful social mechanism; indeed, it is one that may have been at the centre of human relationships for 5 000 years.[1] The nature of the obligation to repay those loans or their interest charges when they fall due has engaged philosophers and theologians for probably just as long, as they attempt to specify what borrowers and lenders *ought* to do when facing the challenges as well as the opportunities thrown up by the loans and by life in all its uncertainties. This chapter deals with a subset of situations in which borrowers should not pay lenders and lenders should not expect borrowers to pay.[2]

While such considerations may help shape bankruptcy laws and their enforcement by courts around the world, there is a special problem in addressing debtor/creditor controversies when the debtor is a sovereign government. Unlike corporations, the final remaining assets of which can be distributed to their creditors, governments do not disappear in bankruptcy. Rather, after a shorter or longer period, some resolution of the insolvency is agreed, disappointing different creditors to different degrees, while usually also increasing poverty and worsening the distribution of income in the indebted country. This further challenges governments to honour their human rights obligations.[3]

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1 D Graeber *Debt, the first 5 000 years* (2011).

2 A useful classification of when borrowers ought to pay, might ethically pay and should not pay their creditors and when creditors ought to expect and demand payment, might expect payment and ought not ask for payment is given by C Barry & L Tomitova 'Fairness in sovereign debt' in C Barry, B Herman & L Tomitova (eds) *Dealing fairly with developing country debt* (2007) 41.

3 JP Bohoslavsky 'Economic inequality, debt crises and human rights' (2016) 41 *Yale Journal of International Law* 177.

Moreover, while individual creditors can sometimes seek enforcement of their specific repayments in national courts, there is no supranational court to which appeal can be made to address an over-indebted government's full debt stock, to force it to make some payments, relieve it of some other payments, or devise an overall settlement, as in a national bankruptcy court. In addition, there are few widely-accepted principles that might guide judgments of such a court if one were somehow established,[4] although philosophy and theology do point in certain directions.[5]

In fact, there have been a disconcertingly large number of sovereign insolvencies across recorded history, involving virtually every country at one point or another, and in some periods entrapping up to half of the world's countries.[6] Power differences have largely determined how individual governments faired in bankruptcy, albeit within each era's understanding of acceptable standards of international financial and political relations. While governments no longer send warships on behalf of their bondholder citizens to collect funds that developing countries owe, they do support a complicated negotiating game between the indebted government and each class of its creditors (bondholders, bankers, governments, international institutions). Each party deploys the powers at its disposal to maximise its benefit, whatever the consequence for the people of the country or the other creditors.[7] Governments have considered ways to make the game fairer and reach solutions more expeditiously, but different interests have regularly blocked systemic reforms.[8]

In some situations, reckless political leaders and accommodating creditors push countries into default, but in other situations, unforeseen environmental, public health, financial or economic catastrophes can pull countries into the morass of bankruptcy. Given the unmitigated social and economic harm caused by sovereign insolvency, policies that

4 For an unsatisfying argument that property and creditor rights are more widely accepted than human rights, see AC Porzecanski 'Human rights and sovereign debts in the context of property and creditor rights' in I Bantekas & C Lumina (eds) *Sovereign debt and human rights* (2018) 45.

5 See, eg, B Herman 'Doing the right thing: Dealing with developing country sovereign debt' (2007) 12 *North Carolina Journal of International Law and Commercial Regulation* 773.

6 C Reinhart & J Rogoff *This time is different: Eight centuries of financial folly* (2009).

7 B Herman 'The players and the game of sovereign debt' in Barry, Herman & Tomitova (n 2) 9.

8 For an insider discussion of the political controversies that undermined the proposed sovereign debt-restructuring mechanism (SDRM), the last serious international consideration of systemic debt workout reform, see B Setser 'The political economy of the SDRM' in B Herman, JA Ocampo & S Spiegel (eds) *Overcoming developing country debt crises* (2010) 317.

reduce instances caused by the latter types of situation should be of serious international policy interest. This chapter discusses approaches to international policy that aim to do just that, based on experiences during the 2020-2021 pandemic that left many developing countries vulnerable to – or in – a debt crisis.

2.2 The expected wave of sovereign debt crises

The COVID-19 pandemic and its economic fallout provide a dramatic illustration of how unforeseen circumstances can threaten countries with sovereign insolvency. This experience also holds suggestions for how to respond better to the next international emergency.

In this case, the situation as the crisis began in early 2020 was already difficult for at least 35 vulnerable and low-income economies that had been assessed by the International Monetary Fund (IMF) and the World Bank as in sovereign debt crisis or at high risk of debt distress.[9] The situation was also unsustainable for middle-income countries such as Argentina, Ecuador, Lebanon and Venezuela. For these countries – and for the developing countries as a whole – international financial support that would not add to sovereign debt was warranted. Unfortunately, for the most part it was underprovided.[10]

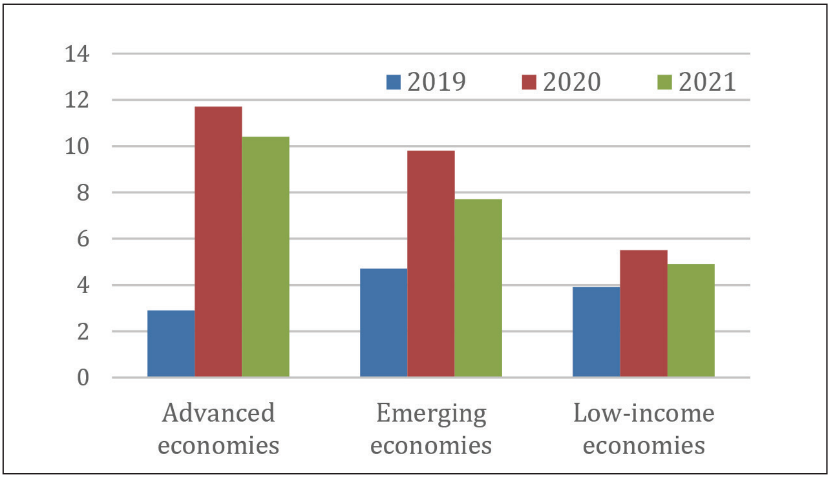
2.2.1 The inescapable surge in foreign borrowing

Beginning in 2020, the world's governments responded to the pandemic by tapping whatever sources of credit they could access, with differing results. While the governments of the countries categorised by the IMF as 'advanced economies' borrowed enough to raise their 2020 fiscal deficits by almost 9 percentage points of gross domestic product (GDP), the middle-income 'emerging economies' could only manage a fiscal deficit increase of about 5 percentage points of GDP and the low-income countries could raise their fiscal deficit by only about 1,6 percentage points (Figure 1). Only modest shrinking of the borrowing of each group was expected in 2021. The inter-country differences in borrowing paralleled differences in counter-crisis spending, both directly health-related and in supporting households and companies that lost income from the crisis (Figure 2).

9 'The evolution of public debt vulnerabilities in lower income economies' (2020) IMF Policy Paper, https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/02/05/The-Evolution-of-Public-Debt-Vulnerabilities-In-Lower-Income-Economies-49018 (accessed 18 October 2020).

10 B Herman 'The looming developing country debt crisis and the fear of imposed austerity' *Pandemic Discourses* (15 October 2020).

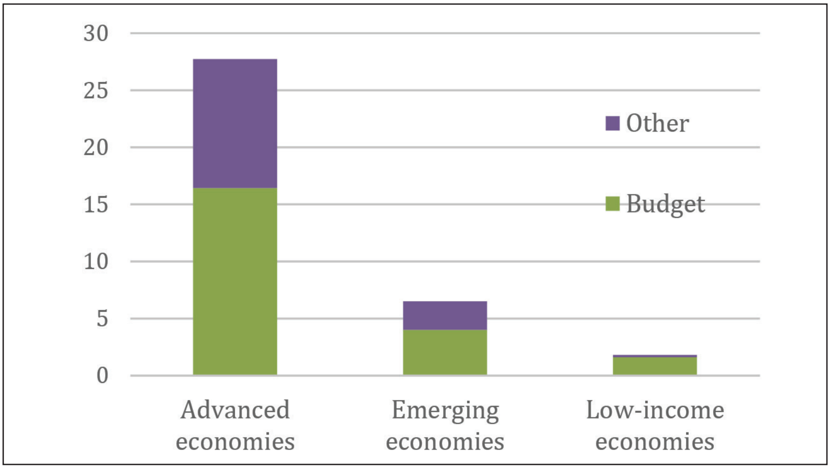
Figure 1: General government deficits in groups of countries, 2019-2021 (Percent of GDP)



Source: IMF, *Fiscal Monitor Database*, April 2021

Note: General government includes sub-national government and social security funds; IMF projection for 2021.

Figure 2: Fiscal response to pandemic in groups of countries (Amount added as percent of GDP, January 2020 to 17 March 2021)



Source: IMF, Fiscal policies database in response to COVID-19

Note: Data include measures announced or taken by 20 advanced, 25 emerging and 14 low-income countries; 'budget' measures include additional discretionary spending and foregone revenues; 'other' measures include loans, equity and guarantees that do not immediately or necessarily impact budgets.

Advanced economy countries could borrow more than lower-income countries because there is a reliably strong demand in domestic markets (to which foreign investors have access) for the domestic currency bonds of their governments. Middle-income country governments also sell domestic currency bonds at home and abroad but may also raise funds in international markets in foreign currencies to meet their financing needs. For lower-income countries, the domestic financial markets of which are less developed, issuing bonds in foreign currency is the only practical way to access bond financing.

For example, the South African government has long borrowed both in United States (US) dollars and in rand. It has addressed its pandemic financing needs in 2020 mainly by selling bonds denominated in rand to domestic and foreign investors, which in October 2020, just to illustrate, were paying interest rates of about 9 per cent (against an inflation rate of about 3 per cent, making for a 'real' return of about 6 per cent).[11] Around the same time, South Africa's US dollar bond yields were on the order of 4 to 5 per cent. By way of comparison, certain middle-income countries in Latin America and elsewhere that were rated as 'investment grade' were able to issue new bonds in foreign currency at relatively low annual interest rates in April and May 2020 just on the heels of the financial panic that had erupted in March (for instance, 2,5 per cent for Chile and 5 per cent for Mexico for bonds maturing in 2031).[12]

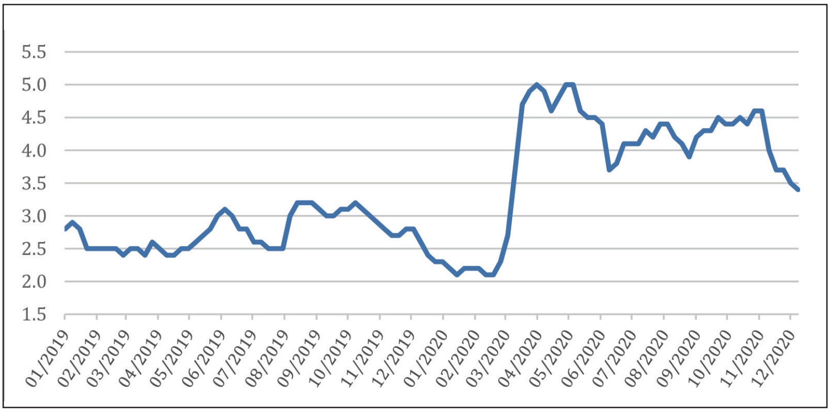
However, for governments considered as being at higher risk of not being able to repay their creditors, the onset of the crisis had a devastating impact. Financial market assessments collapsed, leading to sharp declines in the prices of their bonds. Since the interest yield on a bond is calculated as the contracted annual interest payment divided by the market price of the bond, the fall in bond prices increased the yields. Figure 3 shows how the yield on foreign currency bonds of the higher-risk countries jumped in March 2020 relative to the 'investment grade' bonds of other developing countries. While the spread eventually eased, it remained elevated for the rest of the year.

11 The yield on 10-year government bonds was 9,35% in October 2020 (data of Trading Economics), https://tradingeconomics.com/south-africa/indicators (accessed 18 October 2020).

12 JA Ocampo 'Financing and debt management for emerging market economies' Brookings Institution future development blog (26 May 2020) https://www.brookings.edu/blog/future-development/2020/05/26/financing-and-debt-management-for-emerging-market-economies/ (accessed 18 October 2020).

Clearly, 2020 was not a propitious year for high-risk sovereigns to borrow in international financial markets, as the bond yields show how high the interest rate would have had to be for these countries to attract buyers were they to try to issue new bonds. Nevertheless, some countries did issue such bonds, including El Salvador, which took on an apparently onerous debt burden in July 2020 when it raised US $1 billion through a bond that was scheduled to mature in 32 years, paying an annual interest rate of 9,5 per cent.[13] It is hard to believe that El Salvador will not have to restructure its obligations on that bond at some point and it seems that the buyers of the bond were in effect building that expectation into the interest rate they demanded to be paid. It is not something that borrowing governments should contemplate, as restructuring is costly. Indeed, Argentina's 100-year bond floated in 2017 did not last three years, as it was part of the debt restructuring negotiations completed in August 2020.[14]

Figure 3: ***Developing country sovereign bond spreads, 2019-2020 (Percentage point difference between high yield and investment grade bond yields)***



Source: World Bank *Global Economic Prospects* (January 2021) 11

Note: Based on data collected for the Emerging Markets Bond Index, based on US dollar-denominated sovereign bonds issued by developing countries; high-yield and investment grade bonds were classified as per Moody's sovereign credit ratings.

Although private sources account for only about 13 per cent of the sovereign debt of low-income countries in aggregate, their share has been

13 'El Salvador sells cross-border bonds for coronavirus funding' *Latin Finance* (9 July 2020).

14 'Argentina's "preposterous" century bond never got chance to grow old' *Wall Street Journal* (31 August 2020).

growing (Figure 4). It has been expected – and the donor community has encouraged – that borrowing from international banks and through bond sales would take over much more of the external financing needs of low and middle-income countries in future, including in Africa.[15] The pandemic and its associated economic contraction has made this seem less likely in the immediate future.

The lower-income countries nevertheless borrowed more heavily in 2020 to cover the enlarged deficits shown in Figure 1 above. The loans came primarily from multilateral institutions, many of which were disbursed quickly. The IMF has led this effort, approving requests for loans by 85 countries totalling US $110 billion between March 2020 and April 2021.[16] It disbursed US $36 billion (including US $4 billion from prior loan programmes) just between 2 March and 31 July 2020. Regional monetary institutions also responded with increased loans, such as the Arab Monetary Fund, which committed US $1,2 billion to Egypt, Jordan, Morocco and Tunisia in 2020.[17]

In addition, the World Bank Group set up a fast-track COVID-19 facility in March 2020 to disburse up to US $14 billion for emergency support, as part of a US $160 billion commitment in counter-crisis loans that the Bank promised to make available over 15 months, of which US $50 billion would be highly concessional and some of that would be grants. From April to September 2020 the Bank committed US $64 billion of those funds, about 40 per cent of which were disbursed by September. On top of this, the Bank's board of executive directors approved an additional US $12 billion to help developing countries purchase and distribute an anti-virus vaccine.[18] In addition, the African Development Bank (AfDB) created the COVID-19 response facility in April 2020 to provide US $8,6 billion to governments and regional organisations plus another US $1,35 billion for loans to private sector operations in Africa.[19]

15 O Holmey 'Capital markets: Funding Africa's future' *Euromoney* (15 May 2019).

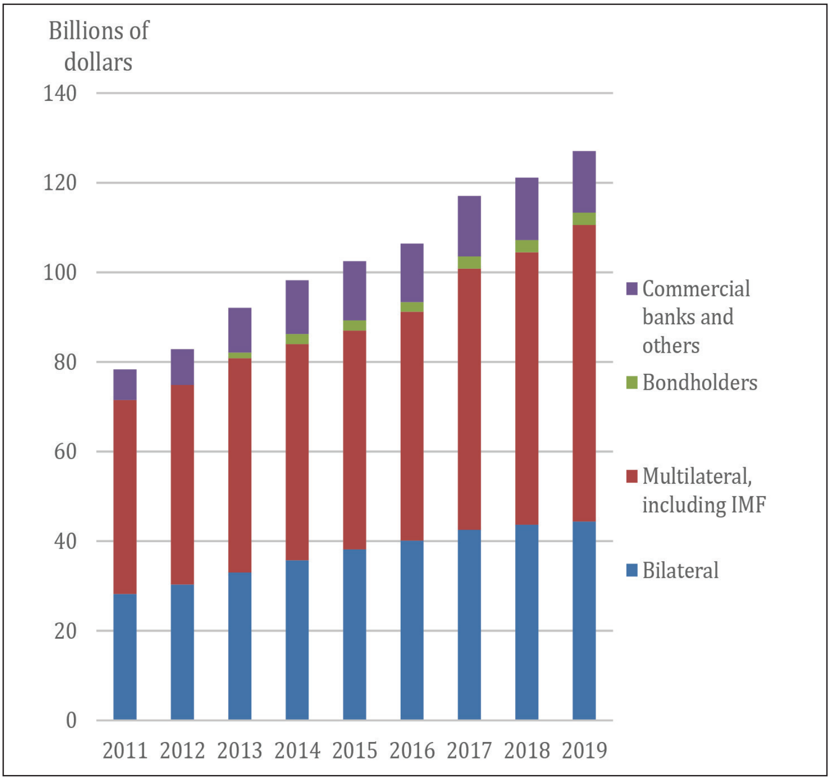
16 IMF 'COVID-19 financial assistance and debt service relief' updated 6 May 2021, https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker (accessed 26 May 2021).

17 Arab Monetary Fund *Annual report* (2020) 14.

18 'Remarks by World Bank Group President David Malpass to the Annual Meetings 2020 Development Committee' (16 October 2020), https://www.worldbank.org/en/news/speech/2020/10/16/remarks-by-world-bank-group-president-david-malpass-to-the-annual-meetings-2020-development-committee.print (accessed 18 October 2020).

19 'African Development Bank Group unveils US $10 billion response facility to curb COVID-19' (8 April 2020), https://www.afdb.org/en/news-and-events/press-releases/african-development-bank-group-unveils-10-billion-response-facility-curb-

Figure 4: Composition of public and publicly guaranteed debt of low-income countries, 2011-2019

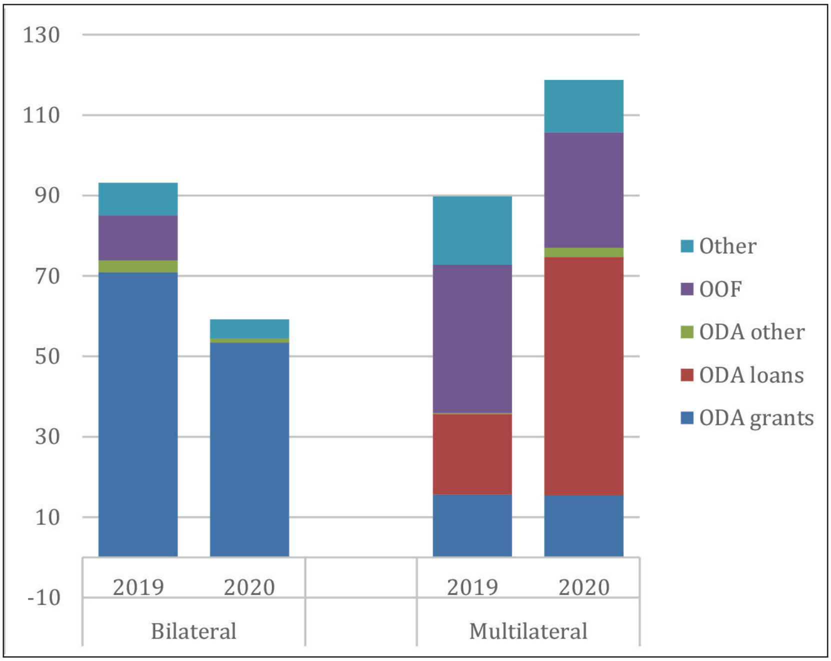


Source: Data of World Bank, *International Debt Statistics*, 2021

It is notable that the surge in official lending just described has come from multilateral sources. Indeed, commitments of assistance reported by public entities in individual donor countries declined in 2020, relative to 2019 (Figure 5). This is especially discouraging, as most of the bilateral official development assistance (ODA) flows are grants, while most of the multilateral ones are loans, although many are on highly-concessional terms. Indeed, the growth in multilateral funding was largely in terms of those concessional loans. In short, almost all the new financing of developing countries in 2020, including the new international bond issues by countries with market access and the new international institution lending, added to the foreign currency debt of those countries.

covid-19-35174 (accessed 18 October 2020).

Figure 5: Assistance commitments reported by official entities, January-November, 2019-2020
(Billions of US dollars)



Source: Data of Development Initiatives, as of 12 February 2021, based on data submitted to the International Aid Transparency Initiative

Note: ODA is official development assistance; OOF (other official flows) are loans that do not qualify as ODA; 'other' are as reported and may include equity investment. Bilateral is government-to-government assistance commitments; multilateral include international financial institutions and development agencies, but excludes IMF lending.

Although not boosting grants in aid, the governments of the Group of 20 (G20) offered in April 2020 to postpone the interest and principal payments of 73 low-income countries that were scheduled to be paid to them from May to December (joined by the members of the Paris Club of government creditors that were not also members of the G20).[20] The offer was subsequently extended to June 2021 and then again in a final extension to December 2021.[21] The G20 'debt service suspension initiative'

20 Communiqué, G20 finance ministers and central bank governors meeting 15 April 2020, http://www.g20.utoronto.ca/2020/2020-g20-finance-0415.html (accessed 14 October 2020).

21 Communiqué, G20 finance ministers and central bank governors meeting, 14 October

(DSSI) functioned as a refinancing of payments rather than as an outright reduction in the debt or debt servicing owed. It provided temporary liquidity but did not ease the debt burden of the countries.

In the event, more than 40 countries requested to participate in DSSI, freeing up more than US $5 billion, not the US $12 billion envisaged.[22] Apparently the countries that did not apply to the DSSI took account of the increased debt servicing that their participation in the DSSI would require in the next few years. They were also concerned that taking G20 relief might unnerve their bondholders, who were not offering any debt-servicing suspension of their own.

The only actual debt service cancellation was offered by the IMF. It initially mobilised funds to pay the debt servicing owed to IMF between April and October 2020 by eligible low-income countries, using grants paid into its unique Catastrophe Containment and Relief Trust (CCRT).[23] The IMF executive board then extended this relief programme until April 2021, when it further extended the relief to October 2021, with the possibility of a further extension until April 2022.[24] While the principle of cancellation of obligations embodied in the CCRT is appropriate in the circumstances of the pandemic, the amount of funds freed for other uses was relatively small, as the 29 beneficiary countries have relatively small economies and the original terms of assistance to them had been generous. That is, US $251 million was cancelled in the period April to October 2020, a further US $237 million was cancelled in the period October 2020 to April 2021, and US $238 million was approved for cancellation from April to October 2021, with African countries receiving 83 per cent of the total.[25] If full

2020, http://www.g20.utoronto.ca/2020/2020-g20-finance-1014.html (accessed 15 October 2020); Communiqué, G20 finance ministers and central bank governors meeting 7 April 2021, https://www.g20.org/wp-content/uploads/2021/04/Communique-Second-G20-Finance-Ministers-and-Central-Bank-Governors-Meeting-7-April-2021.pdf (accessed 26 May 2021).

22 Leaders' Declaration G20 Riyadh Summit, 21-22 November 2020 para 7, https://www.g20riyadhsummit.org/pressroom/?pressroom-category=declarations (accessed 3 January 2021).

23 T Stubbs et al 'Whatever it takes? The global financial safety net, COVID-19, and developing countries' (2021) 137 *World Development* 105171.

24 IMF Press release 20/304 (5 October 2020), https://www.imf.org/en/News/Articles/2020/10/02/pr20304-imf-executive-board-extends-immediate-debt-service-relief-28-eligible-lics-six-months (accessed 17 October 2020); IMF Press release 21/99 (5 April 2021), https://www.imf.org/en/News/Articles/2021/04/05/pr2199-imf-executive-board-extends-debt-service-relief-28-eligible-lics-october-15-2021 (accessed 26 May 2021).

25 Data of IMF (n 16).

relief is granted until April 2022, IMF will have cancelled US $964 million in repayment obligations.

While helpful to the beneficiary countries during the emergency in 2020 to 2021, the G20 and CCRT relief offers have not been adequate. No less than the managing director of IMF, her general counsel and a senior World Bank official expressed concern about a coming wave of sovereign insolvencies and urgently called for action on a set of reforms to improve the negotiating processes for restructuring developing country debt obligations.[26] As with previously recommended reforms in sovereign debt negotiations, these proposals may help if adopted.[27] They are, nevertheless, short of a warranted systemic reform of debt crisis workouts.

The IMF was not alone in its concern, as in November 2020 the finance ministers and central bank governors of the G20 took an additional step (joined again by the government creditors in the Paris Club that were not also G20 members). They published a 'common framework for debt treatments beyond the DSSI',[28] which offers to negotiate additional relief for any of the countries eligible for the DSSI. The new relief would free up some fiscal resources and foreign exchange payment obligations, and thus in effect compliment the funding that the IMF would make available for its adjustment programmes. The relief would apply during the IMF programme period, which could range from one to five years. The negotiation of the actual debt restructuring would apparently operate much like the Paris Club in that the creditor governments would jointly agree to a memorandum of understanding with the debtor that specified the overall terms of the relief, the details of which the debtor would then negotiate with each creditor individually. The debtor would pledge to seek comparable treatment from its other official and private creditors, not including its multilateral creditors. Finally – and most importantly – China was understood to have agreed to participate in the common framework.

26 K Georgieva, C Pazarbasioglu & R Weeks-Brown 'Reform of the international debt architecture is urgently needed' IMF Blog (1 October 2020), https://blogs.imf.org/2020/10/01/reform-of-the-international-debt-architecture-is-urgently-needed/ (accessed 21 October 2020).

27 IMF 'The international architecture for resolving sovereign debt involving private-sector creditors – Recent developments, challenges, and reform options' (23 September 2020), https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/09/30/The-International-Architecture-for-Resolving-Sovereign-Debt-Involving-Private-Sector-49796?utm_medium=email&utm_source=govdelivery (accessed 22 October 2020).

28 Statement, Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting (13 November 2020), https://www.mof.go.jp/english/international_policy/convention/g20/g20_201113_1.pdf (accessed 3 January 2021) Annex I.

Only in 'the most difficult cases' would the creditor governments operating under the common framework contemplate any outright cancellation of debts owed to them, rather than merely rescheduling repayments. Furthermore, the G20 statement notes that there is no consensus on how relief from obligations to the multilateral institutions might be conferred, as none was agreed. Readers familiar with the history of the initiative for the heavily-indebted poor countries and the multilateral debt relief initiative will perhaps see the common framework as being only the first step in a tortured but ultimately inescapable path to creditor recognition of the need for deeper relief, including multilateral debt relief.[29]

2.2.2 Towards a reform agenda

Would it not be valuable if these debt crises could be avoided in the next catastrophe? Could not the international community adopt ways to reduce the number of countries that are forced to renegotiate their sovereign debt after they seek to respond responsibly to a crisis they had not caused, such as the COVID-19 pandemic? For that to happen, the international community needs to be able to expand the amount of non-debt creating sources of financing for developing countries in crisis and offer to cancel or postpone the obligation to pay interest and principal falling due on at least certain categories of sovereign debt of certain countries during crises.

The traditional mechanism for assisting countries that have been pushed into emergencies is government-to-government grant assistance. This mechanism depends on political relationships among countries and feelings of generosity or responsibility and may or may not operate sufficiently in times of national or regional catastrophes. In a global pandemic, moreover, the constraints on the budgets of many donor governments may severely constrain their capacity to assist developing countries in need.

However, there is an international mechanism that can help. It would increase the global stock of an international reserve asset that can help meet the need for emergency supplies of foreign exchange across a wide swath of countries, as has been the case in this pandemic. It is called the special drawing right (SDR) and is created by agreement of the IMF board of governors.[30] The IMF managing director proposed and most countries

29 On that history, see E Cosío-Pascal 'Paris Club: Intergovernmental relations in debt restructuring' in Herman et al (n 8) 231.

30 B Herman 'What you really need to know about the SDR and how to make it work for multilateral financing of developing countries' (2020) 64 *Challenge* 286.

supported an allocation of SDRs, which took effect on 23 August 2021.[31] It might have been agreed in 2020, but the US administration at the time opposed it. The subsequent administration adopted a more positive view. There had been an emergency infusion of SDRs in response to the global financial crisis in 2009 and perhaps such allocations will be made in the future, as the SDR is a good tool for global emergencies. While the SDR was created in the late 1960s to meet a different need, IMF member states should consider how to repurpose this instrument for global emergencies.

However, even with support from this international non-debt creating source, developing country governments will need – and will seek – to boost counter-crisis spending by reallocating domestic expenditures, postponing what can be postponed and rethinking public expenditure priorities. One expenditure that governments do not voluntarily postpone is debt servicing. Usually, the fear that skipping debt servicing payments would cause creditors to cut off access to new loans is enough for governments to do everything in their power to make all payments falling due. Skipping payments to foreign creditors also has legal consequences that can be costly to cure.

The DSSI initiative was an offer by G20 countries to relieve a number of low-income countries from pressure to make the difficult decision to delay payment unilaterally, at least on debts owed to G20 governments. In its DSSI, the G20 called for comparable treatment by the private creditors (and pleaded with the multilateral lenders to contribute to the effort) indicating that the G20 was aware that while offering only bilateral official relief might help fight the pandemic, it also helped to assure enough resources to pay the other creditors. This is easily seen as an unfair public subsidy of private lenders. Nevertheless, no private creditors have stepped forward to voluntarily share the burden with the G20 governments. Investors may or may not be devoid of social conscience, but they can legitimately complain that no one told them such a situation could arise when they bought the bonds. In other words, private lenders need to learn to appreciate that there are circumstances in which they would have to join others in a collective sacrifice to address a higher need. One makes such an arrangement explicit by putting it into the bond and loan contracts.

31 IMF Press release 21/235 2 August 2021 https://www.imf.org/en/News/Articles/2021/07/30/pr21235-imf-governors-approve-a-historic-us-650-billion-sdr-allocation-of-special-drawing-rights (accessed 25 August 2021).

2.3 Financial terms of sovereign borrowing instruments

Any non-payment on a standard debt contract violates the contract and sets up a potential legal contest. The typical contract will say the obligation to pay is fully on the head of the borrower no matter what the state of the world. This is the problem that a different bond contract should seek to ameliorate.

2.3.1 The variety of existing instruments

The first thing to note is that the standard loan contract with its fixed schedule of repayments is not the only model of the lender-borrower relationship. Islamic finance has addressed Islam's prohibition against receiving fixed interest on loans by developing a distinct set of Shari'a-compliant financial instruments, including a medium-to-long-term security known as *sukuk*.[32] The issuer of *sukuk* securities offers for a fixed period an equity-like stake in the project for which the money is borrowed. Instead of interest on the loan, the borrower would receive a specified share of the profit earned on the asset purchased with the proceeds of the *sukuk*. The *sukuk* issuer needs to specify what assets or what project is to be financed by the money. For example, the investor could receive a fixed share of rental income from public housing on land purchased with the proceeds of the *sukuk*. In this way, the borrower would *ipso facto* share in the annual fluctuations in revenue or the loss should the project fail.[33]

Indeed, a thriving sovereign *sukuk* market exists, both domestically, as in Malaysia,[34] and internationally, with an estimated US $109 billion of *sukuk* issued in 2020.[35] While most sovereign issuers are based in Islamic

32 D Dey '*Sukuk* on the world stage' (2014) *The Treasurer* Winter 16; AR Wedderburn-Day 'Sovereign *sukuk*: Adaptation and innovation' (2010) 73 *Law and Contemporary Problems* 325.

33 In an 'asset-based' *sukuk*, the investors do not own the asset but rather enjoy beneficial ownership of the income it produces and thus cannot take over the asset should the project fail, similar to sovereign-risk bonds. This can be compared to an 'asset-backed' *sukuk*, which is more like a collateralised loan (see Bank Alkhair 'Sovereign's infrastructure projects: financing solutions' (November 2015), http://pubdocs.worldbank.org/en/241031448479778427/pdf/islamic-finance-2015-11-18-Ayman-Sejiny.pdf (accessed 24 October 2020).

34 'Malaysian government hails "solidarity" of population for supporting *sukuk* scheme' *Public Finance Focus* (25 September 2020).

35 'Global *sukuk* issuance to pull back from record highs in 2021 as financing needs ease' Moody's Investor Service (24 February 2021), https://www.moodys.com/research/Moodys-Global-sukuk-issuance-to-pull-back-from-record-highs--PBC_1267243

majority countries, other countries are also tapping the *sukuk* market. For example, South Africa issued a US $500 million *sukuk* in 2014 carrying a profit rate of 3,9 per cent with a maturity of 5,75 years.[36]

While there is a growing demand for *sukuk* in domestic and international currencies, most governments mainly borrow by issuing conventional sovereign-risk securities or borrow from banks, the IMF or other official providers, offering no collateral and only the sovereign's promise to repay. There is, however, a class of standard public securities that has one of the features of *sukuk*, namely, that the investor lends money for a specific project, such as a toll road or airport, whose revenues are meant to provide the funds to pay the interest and principal on the bond. In some instances, revenue bonds may be further like *sukuk* in that holders of those bonds are given no recourse to the government in the event of project failure but only to the project itself.[37]

There has been growing interest in bonds that, like *sukuk*, have a targeted use of the funds. In those bonds, issuers pledge to use the proceeds for named social or environmental purposes and furthermore pledge to monitor that the supported projects do meet the relevant criteria.[38] In one variant, the 'social revenue bond', bondholders would be paid from the revenue stream, fees or taxes associated with the projects supported by the bond and bondholders would have no recourse to the issuer in case of project failure. It does not seem, however, that this variant, which is closest in design to the *sukuk*, will become the standard for this type of sovereign debt. For example, investors will have full recourse to the European Union (EU) for interest and principal on its €100 billion social bond issue to support anti-pandemic programmes in 16 EU countries.[39]

However, while project-specific borrowing has an important place in public finance, governments typically also seek unrestricted financing to cover budget deficits for which they issue general obligation bonds (and

(accessed 26 May 2021).

36 'South Africa working on rand-denominated *sukuk* issue' *Salam Gateway* (7 May 2020).

37 AD Flachsbart 'Municipal bonds in bankruptcy § 902(2) and the proper scope of "special revenues" in chapter 9' (2015) 72 *Washington and Lee Law Review* 955.

38 See 'Social bond principles: Voluntary process guidelines for issuing social bonds' International Capital Markets Association (June 2020), https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Social-Bond-PrinciplesJune-2020-090620.pdf (accessed 29 October 2020). Comparable guidelines exist for 'green' and 'sustainability' bonds.

39 See 'European Commission to issue EU SURE bonds of up to €100 billion as social bonds' European Commission press release (7 October 2020), https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1808 (accessed 29 October 2020).

short-term notes). Governments typically offer market investors and bank lenders a range of debt instruments with a variety of maturities and specifications of the periodic interest payments. As the relative use of different designs has implications for the overall risk and cost of the government's debt, it has inspired a literature on sound sovereign debt management,[40] and even a theory of the optimal debt portfolio for a sovereign.[41]

Yet not all countries can issue all types of general obligation debt instruments or, rather, cannot issue every instrument at reasonable cost. For example, long-dated bonds are attractive to governments as they delay repaying the principal or rolling over the maturing bond with a new issue. At the time of maturity, will the government be short of funds or will the market demand a high interest rate for the new bond issue? No one can know the answers and the terms of a long-dated bond when initially sold to the public will reflect that uncertainty. For example, the 9,5 per cent annual interest rate on the aforementioned El Salvador 32-year bond reflected that uncertainty. On the other hand, it has been proposed that India could issue at reasonable cost perpetual bonds that never mature, saving the government the need to ever worry about maturity or refinancing risk.[42]

Usually, when innovations depart from standard bond structures, it is to reduce the risk that investors fear they would face in buying a standard bond. For example, there is a long history of protecting bond investors and bank lenders from inflation. That is, the terms of the bond or loan would specify an inflation adjustment to the interest and/or principal payments to compensate the investor for inflation's erosion of the value of the asset.[43] In contrast, there are very few instances of bond or loan structures that intend for investors to share additional risk with the borrowing government, although there are some, as will be discussed

40 T Jonasson et al 'Debt management' in A Abbas, A Pienkowski & K Rogoff (eds) *Sovereign debt: A guide for economists and practitioners* (2020) 192.

41 R Greenwood et al 'The optimal maturity of government debt' in D Wessel (ed) *The $13 trillion question: Managing the US government's debt* (2015) 1.

42 S Mukherjee 'Sovereign perpetual bonds: An idea whose time has come' *The Economic Times* (5 January 2021).

43 While inflation rates have fallen substantially around the world, there remains a significant market for inflation-linked bonds, including in developed economies, such as the United States, and in many emerging economies. On the former, see 'Treasury inflation-protected securities (TIPS)', https://www.treasurydirect.gov/indiv/products/prod_tips_glance.htm (accessed 24 October 2020), and on the latter, see N Upadhyay & O Yangol 'Inflation-linked bonds in emerging markets' (May 2019) HSBC Global asset management, https://investorfunds.us.hsbc.com/resources/documents/articles/EMD/AMUS_Article_EM%20ILB_May19_FINALCopy.pdf (accessed 24 October 2020).

below. The argument of this chapter is that such instruments should be much more common.

2.3.2 Additional instruments for sharing risk with lenders

There are various proposals and some examples of financial instruments in which bond buyers and lenders would share some of the risk of negative developments that developing country governments need to manage but ultimately cannot control. One proposed bond would link the interest it paid to movements in the country's overall economic output. The standard approach in this model is to tie the interest coupon to changes in the growth of the country's GDP.[44] Advocates of this proposal note that the bondholders would not only share the disappointment of poor GDP growth or outright decline, but would also share in the benefit of strong GDP growth. Nevertheless, although a term sheet was drafted for such GDP-linked bonds,[45] no country has stepped forward to issue one yet. One reason is that in addition to the uncertainty of the impact of actual events and policies on economic growth, bond investors appear reluctant to trust that the national account statistics that would determine their interest income would be free from manipulation. They would probably demand an interest premium to overcome that reluctance.

This notwithstanding, in workouts from sovereign insolvency, bondholders have accepted as a 'sweetener' in the new deal inclusion of a warrant that would pay an interest premium based on GDP growing more rapidly than had been expected. This benefit may be viewed as a possible partial offset to the loss in the face value of the new securities that replaced defaulted old ones. Indeed, in 2005 76 per cent of Argentina's bondholders accepted to swap defaulted bonds for new bonds carrying a warrant that would pay a premium if real GDP growth exceeded 3 per cent per annum, which it did.[46]

44 Perhaps the greatest attention paid to this proposal followed the publication of a study authored by a team from the Bank of England, the Bank of Canada and the Central Bank of Argentina, 'Sovereign GDP-linked bonds' (September 2016) Bank of England Financial Stability Paper 39, https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-paper/2016/sovereign-gdp-linked-bonds.pdf (accessed 4 January 2021).

45 'Indicative term sheet – GDP bonds' (London term sheet – English law version 2017) Allen & Overy LLP https://www.icmagroup.org/assets/documents/Resources/Open-docs/GDP_Termsheet_140317.pdf (accessed 24 October 2020).

46 One additional attractive feature is that the warrants could be detached from the bonds and sold by bondholders who did not want to hold speculative assets. On the Argentine case, plus Greece and Ukraine, see SK Park & TR Samples 'Towards sovereign equity' (2016) 21 *Stanford Journal of Law, Business and Finance* 241.

This is all well and good, but a complete deferral or cancellation of debt servicing rather than a reduction may be required during catastrophes. Moreover, dependence on GDP linking is likely to delay the debt service reduction if creditors need to see the actual fall in GDP before accepting the reduced government obligation, as even preliminary data would likely not be reported for several months after the initial shock. The need is for a faster-acting escape clause.

There is an argument that sovereign bonds and loans implicitly already have a catastrophe-based escape clause that would at least temporarily defer debt servicing, although the argument has not been tested in the courts. This argument invokes the international legal concept of 'necessity'. That is, if a sovereign unilaterally deferred debt servicing and one or more of its creditors challenged that in court, the country could invoke necessity as a warranted reason for non-payment during the emergency.[47] While people might quibble whether the emergency actually warranted invoking necessity, it would take a very hard-hearted judge to find for the bondholder in the current situation or in the face of how hurricanes have decimated certain islands in the Caribbean or how food deficits have been exacerbated in Africa owing to drought. Moreover, the delay in payments would be acceptable only for the duration of the crisis, so it might be that creditors would decide to wait and then seek payment rather than immediately press their case in court.

One drawback, however, is that the concept of necessity is said to derive from customary international law, whereas sovereign bonds and loan contracts with private creditors typically specify the municipal law of a specific country as the applicable law for adjudicating disputes.[48] While this might challenge the applicability of the concept to privately held financial instruments, 'necessity' might apply to inter-state debt obligations or to payments owed to international institutions. In fact, we look to those parties to voluntarily step forward to assist developing countries during emergencies such as the current pandemic. As discussed above, limited debt suspension is already a policy of the G20 for inter-state debt and the CCRT is being used to take over payment obligations of certain countries to the IMF. Nevertheless, the concept of necessity – along with a range of desirable considerations of soft law – could be applied to sovereign debts owed to private creditors by explicitly writing them into bond and loan contracts.[49]

47 M Weidemaier & M Gulati 'Necessity and the COVID-19 pandemic' (2020) 15 *Capital Markets Law Journal* 277.

48 As above.

49 SL Schwarcz 'Soft law as governing law' (2020) 104 *Minnesota Law Review* 2471.

In fact, a step in the direction of recognising the concept of necessity in sovereign bond contracts has been taken in the drafting of a model contract that specifies a trigger mechanism that would allow the debtor to defer payments falling due. In this case, a term sheet was drafted for bonds of countries subject to hurricanes, leaving the determination that a debt-deferring event occurred to the decision of an independent body, the Caribbean Catastrophe Risk Insurance Facility.[50] Such terms were introduced into the new bonds that emerged from the debt restructurings of Grenada in 2015 and Barbados in 2019.[51] While bondholders were under pressure to include these clauses as part of the negotiations to resolve the insolvency of the two countries, comparable clauses will apparently be included in subsequent Barbadian bonds, based on the precedent of its debt-restructuring bonds.[52] It will be interesting if the precedent from these two countries carries over to other vulnerable island nations.

A different contingency mechanism has been developed for a class of bilateral official loans, specifically loans that the development ministry of France offers to a group of low-income African countries. These loans, called *prêts très concessionnel contracyclique* (PTCC), were designed as a variant of one of France's standard concessional long-term loans for low-income countries, which have a 10-year grace period and 30-year final maturity. The innovation was to shorten the grace period to an initial five years and allow the borrower to defer ten semi-annual principal payments at any time in the remaining 20-year duration of the loan (if the full deferral were taken, the final maturity would be 30 years as before; interest accrues on the deferred payments). While the decision to defer is left to the borrowing government, a specified economic stress needs to occur to open its availability, such as a collapse in the international price of the country's main commodity export. As of 2016, 16 of these loans worth €344 million had been extended to five African countries.[53]

50 'Indicative heads of terms for extendible hurricane bonds (coupon-preserving maturity extension version-bullet structure)' Clifford Chance and International Capital Markets Association (23 November 2018), https://www.icmagroup.org/assets/documents/Resources/Indicative-Heads-of-Terms-for-Hurricane-Bonds---Bullet-271118.pdf (accessed 25 October 2020).

51 T Asonuma et al 'Sovereign debt restructurings in Grenada: Causes, processes, outcomes, and lessons learned' (2018) 10 *Journal of Banking and Financial Economics* 67; M Anthony, G Impavido & B van Selm 'Barbados' 2018–19 sovereign debt restructuring – A sea change? (2020) IMF Working Paper 20/34 https://www.imf.org/en/Publications/WP/Issues/2020/02/21/Barbados-201819-Sovereign-Debt-RestructuringA-Sea-Change-49044 (accessed 25 October 2020).

52 Avinash Persaud, Chairperson Barbados Financial Services Commission, statement at 'D-DebtCon' (15 September 2020), https://vimeo.com/460146794/46440cf45e (accessed 25 October 2020).

53 The trigger mechanism to allow the moratorium to be invoked is specified in the loan

Apparently, the pandemic would not qualify as a reason to invoke the PTCC payment deferral, as the contingency specified usually pertains to disappointing export earnings (nor would it be necessary now as France is participating in the G20 deferral of debt servicing). In addition, Barbados has sought pandemic debt relief, but it has been told that the relief will not be coming owing to its relatively high level of income per capita among emerging economies.[54] However, relatively high income per capita was not a barrier to inclusion of the hurricane clause in Barbadian bonds, as Barbados is also highly vulnerable to massive weather destruction. The problem was that Barbados was not facing a hurricane in 2020 and there was no provision for debt deferral under any other circumstances. Such bonds are quite specific in what catastrophes they cover.

This brings us, finally, to the limit of the current approaches to what economists refer to as 'state-contingent' debt for developing countries. While the overall GDP link has not found favour among private investors, the triggers that have found favour for debt-servicing deferral are very narrowly and carefully drafted. In particular, the hurricane clauses specify in detail how a country would qualify for relief, leaving no room for interpretation, no room for nuances. Anything less precise puts an extra measure of uncertainty into the valuation of the financial instrument, which reduces its price and raises its yield in the financial markets where sovereign bonds are actively traded.

It seems, in conclusion, that the contractual approach to debt relief needs to be refined with an enabling clause that would recognise the concept of 'necessity' and specify how necessity would be specified in practice, which is discussed in the next part of this chapter. The clause might also say whether the relief would entail a specified deferral or cancellation of payments. If this proposal raised risk premia on sovereign bonds of developing countries, it would only reflect risks that really exist, which seems an improvement over the current practice of risks ignored by creditors and borne only by the sovereign.

contract. A detailed analysis of the loan structure was prepared for the Commonwealth Secretariat. In the end, no British version of the loan was offered to developing countries. See 'Extending countercyclical loans: Lessons from Agence Française de Développement (2016) Commonwealth Secretariat, http://thecommonwealth.org/sites/default/files/inline/Extending%20countercyclical_0.PDF (accessed 25 October 2020).

54 'Barbados told not to expect debt relief' *Barbados Today* (10 October 2020).

2.4 Toward a stronger international policy mechanism

A way is evidently needed to trigger sufficient sovereign debt relief in a catastrophe, and addressing it is unavoidably political. However, that should not be a discouragement as the world's governments do periodically mobilise themselves for collective international reform, even if imperfectly. We have seen this several times in recent years, from the responses to the global financial crisis to the Ebola crisis in West Africa to the extreme hurricanes in the Caribbean and now to the pandemic. Indeed, the excessive increases in the sovereign debt burdens of developing countries in 2020 should stimulate the design of an improved approach that might be applied in future catastrophes.

2.4.1 Engaging private creditors in relief through IMF assessment of need

One weakness in the current approach pertains to the private creditors. As noted earlier, the G20 governments offered to suspend for a short period the debt servicing owed to themselves by a limited number of countries. The G20 invited bondholders and banks to join them but they were not required to also provide debt relief. The most striking feature of the private creditor response was no response. They clearly need a stronger incentive to join in the relief. IMF has a potential tool to deploy here.

If the IMF judges a country to have sovereign debt that is unsustainable or if the country is assessed as 'sustainable with low probability' and seeks exceptional access to IMF loans (loans above its normal quota), then the IMF requires that the private creditors of that country restructure the country's obligations as a condition for the country receiving the additional IMF funds.[55] This imposes essentially a political rather than a legal obligation on the private creditors, indeed, one that all the governments of the member countries of the IMF *ipso facto* endorse when IMF's executive board, on which all member countries are represented, grants the loan.

It is not likely that a disgruntled bondholder who went to court to collect a missed debt payment would receive a favourable response in such a situation of active international cooperation to ease the debt constraint

55 This may entail negotiated debt reductions or 'reprofiling' (ie rescheduling) payments depending on the severity of the debt difficulty. See IMF 'The Fund's lending framework and sovereign debt – Further considerations' (9 April 2015), https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/The-Fund-s-Lending-Framework-and-Sovereign-Debt-Further-Considerations-PP5015 (accessed 26 October 2020).

on the country, especially when the debtor and its cooperating creditors are simultaneously seeking to reach an agreed restructuring arrangement. The recalcitrant bondholders would thus be incentivised to join the effort to negotiate a restructuring of repayments.[56] This is a feature on which to build.

The IMF annually assesses the debt sustainability and other aspects of the macro-economic situation of its member countries (working jointly with the World Bank on the low-income countries). Based on these analyses, when a catastrophe erupts and is so identified, countries seeking emergency assistance and emergency debt relief may be quickly certified as warranting assistance. As the current experience has shown, IMF staff can quickly assess the need for a quick-disbursing loan, reach a decision on it in the executive board and disburse the emergency funds.[57]

We may thus propose that in future the executive board decisions that approve emergency loans should include statements, where warranted, calling for private creditor participation in the emergency relief. On that basis, the debtor government would be empowered to withhold the debt servicing payments falling due to its private creditors. Implicitly, if not explicitly, the government that then did not make a payment would be invoking the concept of 'necessity' that was noted earlier, now validated by the IMF assessment. This should discourage bondholders from rushing to the court house. The government would in any case be expected to enter discussions with its creditors on a timely basis on how its missed payments would be reprogrammed or cancelled.

We should acknowledge at this point that an IMF decision on granting an emergency loan and debt relief to a member country is unavoidably political. That is, appreciating the technical expertise of IMF staff and hoping for the apolitical character of their recommendations, the actual IMF decisions are made by the government representatives that sit on the executive board. While all member countries are represented on the board (most through constituencies, only one of whose members actually sits on the board), country votes are unevenly distributed and the individual members with the most votes are perforce the most influential. While the board has a tradition of seeking consensus decisions,[58] certain board

56 This should be complemented by legislation in the major creditor countries to discourage 'vulture funds' from disrupting collective creditor decisions; see IMF (n 27) paras 46-47.

57 See IMF (n 16).

58 L van Houtven *Governance of the IMF: Decision making, institutional oversight, transparency, and accountability* (2002) 20-31.

members with a large number of votes and strong political feelings about one or another IMF member country or about a policy of that country could block it from receiving a loan. That was Iran's experience in 2020.[59]

Acknowledging that the IMF thus is a 'political' institution, one may ask whether it would be more appropriate that the Security Council of the United Nations (UN), the primary international political institution, should instead be making the decisions in the loan/debt relief process. There is a reason to argue that it should in that a Security Council resolution has the force of law on all member states of the UN, which opens a path to a legally-enforceable debt moratorium on private creditors of developing countries.

There is also a precedent for engagement of the Security Council arising from the case of Iraq. In 2003 the Security Council adopted Resolution 1483, which prohibited any creditor from attaching any of Iraq's oil exports during a specified period as a way to preserve its oil earnings for its economic recovery and to push the creditors to step away from the courts and negotiate a restructuring with the government to resolve their claims against the country.[60] The prohibition on attaching Iraqi assets thus had the force of law, although it was debated whether this was the case in the United States absent implementing US legislation.[61]

It does not seem, however, that the Security Council would be a propitious body for dealing with developing country debt situations. Certainly, the Council would be susceptible to blocking action by one or another of its members with veto power. It would also be unusual for the Council to assert competence to render decisions on economic and financial matters that did not have a direct security dimension, as had been the case regarding Iraq. We thus set aside this approach and propose that IMF be responsible for triggering the release of warranted relief from servicing sovereign bonds and private-sourced loans, with the hope that transparency and global solidarity might limit the number of times

59 'Iran's Rouhani says US blocking $5 billion IMF loan to fight COVID' *Iran International* (12 September 2020).

60 S Hinrichsen 'Tracing Iraqi sovereign debt through defaults and restructuring' (2019) London School of Economics and Political Science Economic History Working Paper 304, https://www.lse.ac.uk/Economic-History/Assets/Documents/WorkingPapers/Economic-History/2019/WP304.pdf (accessed 26 October 2020).

61 FL Kirgis 'Security Council Resolution 1483 on the rebuilding of Iraq' (2003) 8 *ASIL Insights*.

that unrelated political issues would trump urgent human-rights based obligations.

2.4.2 Engaging international official lenders to expand relief

In addition to engaging the private sector in sovereign debt relief, there are some country debt situations in which relief will not be deep enough unless the obligations to international financial institutions are also included. Indeed, the G20 explicitly called for their participation.[62] However, the IMF is alone among these institutions to have arranged such relief, albeit for only 29 of the poorest countries through its CCRT, as noted earlier.

While declining to offer any comparable relief, the World Bank instead promised to deliver a net positive cash flow to each of its client countries; that is, the Bank promised that the total disbursements from new and existing loans (and grants for the poorest) from the World Bank Group of institutions would exceed the interest and principal payments falling due.[63] The Bank's approach, however, seems most unhelpful. While it provided a net transfer of financial resources during 2020, it further raised the countries' debt.[64]

The reluctance of the World Bank and the other international development banks to offer relief has been attributed to a fear that if they relieve repayment obligations of their poorest developing country clients, they will pay for it in future. This is based on a fear of how such relief would impact the primary business model of the banks. That is, in the loan programmes for mainly middle-income countries, which is the bulk of their business, the banks essentially function as a financial intermediary, borrowing cheaply in financial markets and then loaning out the funds at an interest rate that covers the borrowing cost of the banks plus a mark-up to cover the cost of administering the institution. The arrangement is attractive to the client countries because the development banks can borrow at substantially lower interest rates and for longer maturities than the borrowing countries.

62 Communiqué, G20 finance ministers (n 20) 7; October Communiqué (n 21) 7.

63 'World Bank COVID-19 response' Factsheet (14 October 2020), https://www.worldbank.org/en/news/factsheet/2020/10/14/world-bank-covid-19-response (accessed 26 October 2020).

64 In the event, most bank clients received a net positive transfer of financial resources in 2020, but not all. See J Duggan et al 'Is the World Bank's COVID-19 crisis lending big enough, fast enough? New evidence on loan disbursements' (2020) Centre for Global Development Working Paper 554, https://www.cgdev.org/sites/default/files/world-banks-covid-crisis-lending-big-enough-fast-enough-new-evidence-loan-disbursements.pdf (accessed 26 October 2020).

In fact, the bonds of the international development banks are mostly rated AAA and carry very low interest rates because the financial markets know that the government shareholders of the banks, including the world's richest countries, have arranged for a strong level of paid-in shareholder equity, backed by the legal obligation to pay the callable portion of shareholder subscriptions if needed. The fear, as stated by the World Bank president, nevertheless is that granting relief from the obligations of any of its client countries would make investors who buy their bonds fear that the bonds had greater risk of default than previously thought and that investors would thus demand higher interest coupons on subsequent bond issues.[65]

The intention of the G20 was only to offer relief to the poorest countries, whose loans from the development banks are, in fact, not primarily funded by bond issues. Loans to low-income countries are largely funded by triennial replenishment contributions by high-income shareholder governments, recycled loan repayments and a share of profits from loans to middle-income countries. It thus must be that the World Bank worried that offering relief to the poorest countries would set a precedent that would lead to relief for middle-income borrowers, whose repayment obligations are larger. The G20 acknowledged this concern in its invitation to the development banks to participate in DSSI. It stated that their participation should not impair the current high market ratings of their bonds and low cost of funding.[66] However, it strains belief that the major shareholder governments of the World Bank and the regional development banks – which are members of the G20 – would allow the institutions, which are well capitalised, to miss a coupon payment. Moreover, the DSSI offered only to postpone debt servicing, not cancel it, and only for the lowest income countries.

In other words, one might propose that if the G20 actually wished for World Bank and regional bank participation in the DSSI programme, it should have given assurances in its Communiqués that would have assuaged any bondholder fears of heightened 'credit risk' (risk of non-payment) in their bonds. Alternatively, the G20 could have motivated the World Bank and the regional banks to adopt variants of the CCRT, wherein donors would pay the debt servicing for a target group of debtor

65 'World Bank Group President David Malpass: Remarks at high-level event on financing for development in the era of COVID-19 and beyond' (28 May 2020), https://www.worldbank.org/en/news/speech/2020/05/28/world-bank-group-president-david-malpass-remarks-at-high-level-event-on-financing-for-development-in-the-era-of-covid-19-and-beyond (accessed 27 October 2020).

66 Communiqué, G20 finance ministers (n 20) 7; October Communiqué (n 21) 7.

countries so that the institutions would have received their payments while the debtor obligations would have been cancelled.

Should the development banks create CCRT-like facilities, additional funding would be required, the traditional source of which has been donor country aid budgets. However, as bilateral aid flows are also necessary components of the catastrophe response, there is a high opportunity cost of this financing source. There is an alternative: The funds to cover multilateral debt relief could be drawn from SDR balances held at the IMF by rich countries.[67] For example, almost all the countries that are eligible for DSSI relief borrow from the International Development Association (IDA), the concessional lending arm of the World Bank Group.[68] IDA is a 'prescribed holder' of SDRs, meaning that G20 members can transfer some of their holding of SDRs to IDA, which could use them to cover the interest and repayment obligations coming due. However, IDA lends 'hard' currencies, not SDRs, and so one might expect IDA to return the SDRs to the donor government in exchange for the equivalent in hard currency. In effect, the donor would thus reduce the share of its reserves in hard currency and increase the share in SDRs. In fact, governments could directly transfer some of their foreign exchange reserves without reducing total reserves in light of having received their SDRs.[69]

Governments holding surplus SDRs have actually been considering a different approach, wherein potential SDR recyclers would loan their SDRs but insist they maintain their reserve nature, which is to say be assured that the SDRs have virtually zero risk of losing value or liquidity (i.e., being immediately exchangeable into a hard currency) and can also be immediately returned to the providing country on demand.[70] SDRs could be lent to an institution for some agreed period, such as the duration of its regular replenishment cycle, and thus expand its lending capacity during that cycle. This approach, however, would add to borrowing country debt, not reduce its debt servicing.

67 B Herman 'An easy way to provide debt relief for the world's poorest countries' *The Globalist* (17 July 2020).

68 Angola is the one exception; while it is eligible for DSSI as a member of the group of least developed countries, it graduated from eligibility to draw from IDA in 2014 (World Bank 'IDA graduates', http://ida.worldbank.org/about/ida-graduates (accessed 8 January 2021).

69 'Using the United Kingdom's SDRs to tackle Covid-19 and climate change' Catholic Agency for Overseas Development (May 2021) https://cafod.org.uk/content/download/56376/774304/version/1/file/Using%20the%20UK%20SDRs.%20CAFOD%20discussion%20paper%20May%202021.pdf (accessed 8 November 2021).

70 M Plant 'The challenge of reallocating SDRs: a primer' Centre for Global Development (August 2021) https://www.cgdev.org/sites/default/files/challenge-reallocating-sdrs-primer.pdf (accessed 7 November 2021).

2.5 Reform requires deeper international cooperation

Pulling different pieces of the argument together, we can see that there were missed opportunities to provide sufficient non-debt creating international assistance and adequate emergency debt relief. The latter was in part because contractual provisions of financial instruments, even when they are state-contingent, do not take account of the diverse and multiple sources of emergencies that ought to ease country repayment obligations, and because international organisations have largely eschewed relief. Many developing countries have had little choice in fighting the pandemic but to increase their external debt burden until its sustainability became questionable. It did not have to be this way and should not be this way in the next crisis, but that requires more effective international cooperation at global and, where relevant, at regional level.

2.5.1 Revitalise global financial cooperation

The discussion here has highlighted how the G20 took upon itself the burden of directing the international financial response to the pandemic. Although concerns about the legitimacy of the G20 as an intergovernmental forum have never been resolved,[71] there is no other practical option. However, the G20 needs to function better.

Recall that the government leaders of what became the G20 were brought together by US President George W Bush in November 2008 to address the unfolding global financial emergency which, it was apparent, could not be adequately addressed by individual nations or through existing coordinating bodies in which the US government, in particular, had sufficient confidence. The G20 expanded its remit to include development in 2010, under which it built up a work programme on development finance, focused on as yet unfilled expectations of a larger role for international private finance in development. Apparently by default, the G20 then became the primary inter-governmental forum for addressing financial aspects of the coronavirus pandemic and its economic consequences. This is not because of any public health expertise in the G20 but because it has the potential to mobilise a lot of money, which it did – if inadequately – through multilateral if not bilateral channels (also, trade wars had to be put on pause).

71 J Jokela *The G-20: A pathway to effective multilateralism?* (2011) European Union Institute for Security Studies.

As the G20 is an informal club of large nations without a permanent secretariat, it necessarily relies on the existing system of international organisations for expertise on technical issues that demand international cooperation in such areas as communications, transportation, trade, financial regulation, macro-economic stabilisation, public health, food and hunger, weather, and, more generally, sustainable development and scientific cooperation. Because the G20 members are the largest financial contributors to these organisations, they exert leadership over them, shaping their work agendas and largely determining their financing.

It has been in the mutual interest of the G20 countries (and all the other government members of the organisations on which the G20 rely) that the technical work prepared for them be independent, reliable and shielded from political interference. Until recently, one could say that the family of international institutions had the relevant experts – if often not enough of them – to assess, design, implement and monitor outcomes of their priority programmes. Unfortunately, the ability to maintain that standard at the World Health Organisation (WHO) was challenged by the United States for domestic political reasons and with unfortunate heavy consequences.[72] While underlying concerns still needed to be addressed, the situation at the WHO improved in 2021 under the succeeding US administration. Nevertheless, for the G20 to continue to serve as the confidence-inspiring coordinator of emergency responses to catastrophes, it needs to resolve disputes that arise among its members in the 'front line' international organisations on which it perforce must depend.

A further imperative for the G20 is to fully appreciate that effective and inclusive recovery from the pandemic will need to be nurtured. Unfortunately, the long history of international financial assistance to developing countries shows this not to have been the case. Recovery programmes have usually been underfunded, which is to say they have traditionally forced socially-harmful austerity on adjusting countries as well as delayed development, as has been documented in studies of the numerous national programmes of recovery from the global financial crisis.[73] This time, however, the IMF has led the international community in promoting more reassuring levels of spending by governments to meet the challenge of the pandemic.[74] However, international civil society is

72 LO Gostin et al 'US withdrawal from WHO is unlawful and threatens global and US health and security' (2020) 396 *The Lancet* 293.

73 I Ortiz & M Cummins 'Austerity: The new normal: A renewed Washington consensus 2010-24' (2019), https://ssrn.com/abstract=3523562 (accessed 28 October 2020).

74 V Gaspar & P Mauro 'Fiscal policies to protect people during the coronavirus outbreak' IMF Blog (5 March 2020), https://blogs.imf.org/2020/03/05/fiscal-policies-to-protect-people-during-the-coronavirus-outbreak/?utm_medium=email&utm_

worried that the IMF under G20 oversight will quickly revert to tradition and soon re-emphasise austerity.[75] Preliminary indications that give some credence to this fear have been seen in IMF conditions for receipt of loans to developing countries in 2020.[76]

Early in its history, the member states of the IMF realised that they needed to pressure national policy makers to maintain 'sound' macro-economic policies and to insist on corrective policy measures as a condition for financial support when assisting countries to change unsustainable policies.[77] This led to annual macro-economic surveillance of all IMF members and to setting specific sets of conditions for receiving IMF loans. As views naturally evolve on what constitutes appropriate policies and as experience accumulates with existing policy requirements, the IMF periodically reviews its principles and practices of programme 'conditionality'[78] and country surveillance.[79]

However, IMF surveillance and conditionality do not exist in a policy vacuum, nor do decisions on how large or small IMF and other multilateral loans should be. A broader global forum of governments should address – and sometimes it does address – such broader sets of questions, namely, the General Assembly of the United Nations.[80] For example, IMF, the World Bank and the G20 have all embraced the sustainable development goals (SDGs) adopted by the General Assembly in 2015.[81] In 2020 the UN hosted a policy dialogue, including at heads of

source=govdelivery (accessed 28 October 2020).

75 'Over 500 civil society organisations signed the civil society organisations' statement against continued IMF austerity' (6 October 2020), https://www.eurodad.org/civil_society_organisations_open_letter_to_imf_austerity (accessed 28 October 2020).

76 'Arrested development: International Monetary Fund lending and austerity post COVID-19' Eurodad report (October 2020), https://www.eurodad.org/arrested_development (accessed 28 October 2020).

77 S Dell 'On being grandmotherly: The evolution of IMF conditionality' (1981) Essays in International Finance 144 Princeton University, https://ies.princeton.edu/pdf/E144.pdf (accessed 9 January 2021).

78 The most recent review of conditionality was concluded in 2019. See '2018 review of programme design and conditionality' (2019) IMF Policy Paper, https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/05/20/2018-Review-of-Program-Design-and-Conditionality-46910 (accessed 9 January 2021).

79 See '2021 comprehensive surveillance review – Overview paper' IMF Policy Paper (May 2021), https://www.imf.org/en/Publications/Policy-Papers/Issues/2021/05/18/2021-Comprehensive-Surveillance-Review-Overview-Paper-460270 (accessed 27 May 2021).

80 B Herman 'United Nations as a forum for reform of global institutions' *Economic and Political Weekly* (Mumbai) (8 November 2008).

81 United Nations 'Transforming our world: The 2030 agenda for sustainable

state level, on how to respond to the pandemic, how to 'build back better',' and how to get on track, finally, to deliver the SDGs by 2030, their target date.[82] Further discussions at the UN have taken place in 2021 on some of the policy initiatives proposed in 2020, in particular in the Financing for Development Follow-up Forum in the Economic and Social Council and in *ad hoc* initiatives. It was unclear as of October 2021 that they would reach actionable conclusions in the UN that might be carried forward by the more specialised bodies of the international system.

While the UN remains a credible forum about development principles and for negotiation under treaty bodies, such as the UN Climate Convention,[83] the UN has only in exceptional circumstances been a forum that forges agreement on international economic and financial policies.[84] In the current global configuration, that work is perforce done at the G20 or not at all.

2.5.2 Strengthen regional cooperation: The SADC opportunity

Any new global policy framework that emerges to address recovery from the pandemic and its successor crises in developing countries will necessarily be quite broad. A crucial question thus is how the cooperation policies would be implemented at country level and that seems increasingly a function of how effective national policy making is and is seen to be. National policy inevitably reflects the contest between different stakeholders pursuing what they perceive to be their own interest along with – it may be hoped – their perception of the national interest. Some countries have been more successful than others in shaping such political contests into developmentally-effective policy making. Regional cooperation organisations, where they exist, may help strengthen the political forces in member countries that are working to strengthen national policy making. The Southern African Development Community (SADC) is a case in point.

development' General Assembly Resolution 70/1 adopted 25 September 2015.

82 See 'Initiative on financing for development in the era of COVID-19 and beyond, co-convened by Canada, Jamaica and the United Nations' (2020), https://www.un.org/en/coronavirus/financing-development (accessed 29 October 2020).

83 United Nations, 'What is the Paris Agreement?' https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (accessed 27 August 2021).

84 One such circumstance was the 2002 Monterrey Conference on Financing for Development; see B Herman, 'The politics of inclusion in the Monterrey process,' in JF Green & WB Chambers (eds) The Politics of Participation in Sustainable Development Governance (2006) 153.

From a financial perspective, the question may be phrased in terms of the budget constraint. Every country has one, but the amount of public expenditure it allows is not God-given. In other words, the funding envelope for public programmes will reflect, not only the adequacy of international cooperation, but also the willingness of societies to raise tax revenues from those enterprises and households capable of contributing more, while also limiting corruption, tax avoidance and other leakages, efficiently managing public programmes, and avoiding spending that reflects priorities that are demonstrably not national priorities. The techniques for drafting development plans, medium-term expenditure and revenue frameworks, annual budgets, public financial management programmes and post-expenditure audits are well known. The difficult part is forging the domestic agreement to achieve the desired results. Engagement with peers from neighbouring countries on policy matters that also affect the neighbours can contribute.

It may be helpful, in other words, if political energy is put into cooperation among regional partners. In this regard, it may be of some note that SADC celebrated its 40th Anniversary Summit in August 2020, when it adopted a new vision document (SADC Vision 2050) and a new ten-year cooperation plan to operationalise the vision document (Regional Indicative Strategic Development Plan 2020-2030).[85]

SADC has a long and mixed history of economic cooperation, including both successes and failures in implementing policy agreements.[86] Its 16 members include high-income diversified economies, commodity-dependent middle-income economies, landlocked and island nations, and least developed countries.[87] Their heterogeneity and the primacy of their integration into the global trading environment have served as centrifugal forces against which the forces for closer economic integration have had to contend.[88] Nevertheless, the 2020 joint political commitment to the new

85 SADC 'Communiqué of the 40th ordinary summit of SADC heads of state and government' (17 August 2020), https://www.sadc.int/files/8115/9767/2537/Communique_of_the_40th_SADC_Summit_August_2020_-ENGLISH.pdf (accessed 9 January 2021).

86 SADC Secretariat 'Status of integration in the Southern African Development Community' (2019), https://www.sadc.int/files/9915/9154/2991/Status_of_Integration_in_the_SADC_Region_Report.pdf (accessed 9 January 2021).

87 SADC member states are Angola, Botswana, Comoros, Democratic Republic of the Congo, Eswatini, Lesotho, Madagascar, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Tanzania, Zambia and Zimbabwe.

88 R Mafurutu '40th SADC Summit and the anticipated key trade issues on the agenda' Tralac blog (Trade Law Centre) (14 August 2020), https://www.tralac.org/blog/article/14848-40th-sadc-summit-and-the-anticipated-key-trade-issues-on-the-agenda.html (accessed 9 January 2020).

documents and the urgency of more effective cooperation in the present circumstances in which a pandemic does not pay attention to borders, could strengthen policy making across many dimensions.

One such dimension is macro-economic. SADC long ago adopted the goal of becoming an economic union whose citizens would enjoy the free flow of people, trade and finance across their borders, eventually adopting a common currency. To this end, SADC countries adopted a memorandum of understanding on macro-economic convergence in 2002,[89] one of the commitments of which was to draft a binding protocol on finance and investment, which was adopted in 2006.[90] The objective has been to work together toward macro-economic stability, including low and stable inflation and prudent fiscal stances.[91] The countries also agreed to mutual surveillance of their macro-economic policies and have sought common statistical standards by which to monitor their respective performance, upgraded most recently in the 2020 summit by agreeing to include high-frequency data in the Surveillance Mechanism.[92] Moreover, civil society in the SADC region is poised to assist in capacity building on public finance and sovereign debt for legislators in the region.[93] The structures thus are in place, the political commitments have been freshly made and civil society is offering support. Perhaps it is a propitious moment.

2.6 Conclusion: A reform agenda

By way of conclusion, the proposals that the analysis leads to may be brought together here. The starting point is recognition that the kind of economic and natural catastrophes that the world increasingly seems to be throwing at its more vulnerable people are beyond the capacity of most developing countries to address alone. Some countries may be able to self-insure by accumulating a huge stock of liquid reserve assets; however, holding huge reserves rather than investing them in development has a

89 See https://www.sadc.int/files/6513/5333/7917/Memorandum_of_Understanding_on_Macroeconomic_Convergence2011.pdf (accessed 9 January 2021).

90 The Protocol entered into force in 2010. See https://www.sadc.int/files/4213/5332/6872/Protocol_on_Finance__Investment2006.pdf (accessed 9 January 2021).

91 SADC Memorandum of Understanding (n 90), art 2.

92 SADC Communiqué (n 86) para 10.

93 African Forum and Network on Debt and Development (AFRODAD) 'COVID-19 debt sustainability impacts and economic rescue packages analyses in Southern African Development Community (SADC) region' (6 July 2020) 13, https://www.africaportal.org/publications/covid-19-debt-sustainability-impacts-and-economic-packages-analyses-in-southern-africa-development-community-sadc-region/ (accessed 9 January 2021).

huge opportunity cost. Most developing countries, especially the poorest among them, will need international assistance. It should be available, especially in emergency situations.

One form is government-to-government emergency grant assistance to spend on responding to a crisis. The traditional form of assistance has been donor government humanitarian and development assistance, but as seen in the current pandemic, there has not been an adequate response from donor governments. Governments left it to the multilateral institutions to provide the necessary funding, which they quickly expanded, albeit primarily in the form of loans. However, there is a form of international non-debt creating finance that can and has been expanded by the IMF in global crises called the special drawing right (SDR). It requires the governments in IMF to agree to allocate additional SDRs when the need arises. They did so act in response to the global financial crisis, and again – if with a delay –in the pandemic. A policy to use the SDR this way in future catastrophes should be considered.

A second form of international assistance would ease the external debt burden of poor country governments. As we have seen, the G20 governments (joined by members of the Paris Club that were not also members of the G20) offered to temporarily suspend debt servicing owed to them, which thus was at no long-term cost to themselves. These creditors were subsequently willing to acknowledge that there may be exceptional circumstances in which they ought to reduce repayment obligations of certain countries. However, no other creditors, neither private creditors nor multilateral institutions, with the exception of the IMF, has offered any prospect of debt relief. The question thus becomes how to design the relief programme in a way that responds to crises and engages all groups of creditors fairly.

One proposal made earlier in this chapter (part 4.1) was that when the IMF board approves a quick-disbursing loan for emergency needs or accords emergency debt relief through its CCRT, it should include in its announcement, when appropriate, a statement warranting private and official creditor relief of obligations of the country falling due during the emergency period. With that endorsement, the debtor government could temporarily suspend its debt servicing and offer to negotiate with its creditors how it would cover the suspended payments. Standard term sheets might be made available in advance of such situations to simplify the negotiations.

A more permanent version of this proposal might also be considered, beginning with the introduction of standard clauses into bond and loan contracts that would recognise that there are situations in which a temporary (ultimately possibly permanent) suspension of government debt servicing payments to foreign creditors was warranted. Because it seems impossible to specify each and every contingency requiring relief, it was proposed that the responsibility for the decision to invoke the relief clause be given to the IMF executive board (under the supervision of the IMF's board of governors), advised by the relevant international agency having expertise in the source of the catastrophe, such as the World Health Organisation in the case of a pandemic. Such a decision would trigger the relief the possibility of which had already been envisaged in the clauses of the bond, bank loan, bilateral or multilateral credit contracts. As the kind of relief offered in each case would be expected to follow a set of standardised term sheets and model contracts, the question of a fair sharing of risk among different creditor classes would also be addressed before the crisis erupted.

Moreover, if in a future catastrophe the G20 were to call on multilateral financial institutions to join in the debt relief programme, as it did without effect in its DSSI programme for the pandemic, it could remind the financial markets in its Communiqué that the G20 members are the major shareholders in the institutions and not only are obligated to cover the debt servicing of institution bonds, but they also fully intend to ensure there would be no interruption in payments. In other words, the G20 should ease the fear of the World Bank that offering any debt relief to its poorest member countries would somehow jeopardise its AAA bond rating. In addition, the World Bank could adopt an initiative such as that of the CCRT at the IMF under which all debt servicing owed by covered countries falling due during the emergency period would be paid to the institution on their behalf. Indeed, the SDRs that boosted the total reserves of rich countries could justify those countries transferring some of their other reserves to fund such facilities.

Finally, it seems that instituting such reforms requires a deeper level of international cooperation than was apparent in 2020. The G20, with its collective influence on the financing of the multilateral system, thus needs to reinvigorate and arrange better funding of the specialised agencies that carry out the technical analyses on which collective responses to crises depend. In addition, governments should use the inclusive and legitimate forum of the UN to update broad guidelines on appropriate policies of international cooperation, including on the issues discussed in this chapter. In addition, the international community will inevitably scale its assistance to the confidence sustained in the effective use of international funding. To this end, it was suggested that regional organisations, such as SADC, could contribute to that confidence – not to mention improve the economic situation in the countries themselves – by furthering mutual cooperation of peers on their adopted regional priorities, including on macro-economic policy.

Certainly, this is an ambitious agenda. That does not make it any less warranted.

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