

Liquidity and Debt Solutions
to Invest in the SDGs:
The Time to Act is Now

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Introduction¹

COVID-19 has caused an extraordinary socio-economic crisis throughout the world. More than a year into the pandemic, the world is still in firefighting mode. Long-term economic scarring effects and an uneven recovery, potentially leading to a sharply diverging world, are also increasingly coming into focus. The severe fiscal impacts of the crisis are triggering debt distress in a growing number of countries, severely limiting the ability of many countries to invest in recovery, climate action, and the sustainable development goals (SDGs).

Such fiscal impacts, along with the rise of vaccine nationalism, have also resulted in developing countries facing enormous difficulties in accessing vaccines against COVID19, which threatens to prolong the recovery period. Unless we take decisive action on debt and liquidity challenges, we risk another 'lost decade' for many developing countries, putting the achievement of the SDGs by the 2030 deadline definitively out of reach.

In my April 2020 policy brief on debt, I proposed a three-pronged approach to address impending debt and liquidity issues caused by the pandemic in developing countries:² i) a debt standstill to provide immediate breathing space for all countries that need it; ii) additional, targeted debt relief for countries that require support beyond a temporary suspension of debt service;

and iii) addressing structural deficiencies of the international sovereign debt architecture to prevent defaults from leading to prolonged financial and economic crises in the future.

The international community's response was significant, but not sufficient. Initial measures included monetary easing, access to fresh concessional financing, a suspension of debt service payments on bilateral debts, and targeted but limited relief on some multilateral debt. More action is needed.

The purpose of this policy brief is to take stock of the global policy response since April 2020, assess remaining gaps and challenges for their implementation, and propose updates to the original recommendations in light of developments over the last year.

ONE YEAR INTO THE CRISIS: A STOCKTAKING

Over the last 12 months, countries have taken unprecedented policy actions to control the spread of the deadly virus and mitigate its socioeconomic impact. To reduce pressure on overwhelmed health systems, governments imposed exceptional social distancing policies, including lockdowns, business closures and travel bans. These emergency policies

1 This Policy Brief draws on the Financing for Sustainable Development Report 2021 of the Interagency Task Force on Financing for Development, as well as Kharas, H. and Dooley, M. (2021). Debt Distress and Development Distress: Twin crises of 2021. Working Paper 153. Washington, D.C.: Brookings, 35 pp.

2 United Nations, 'Debt and COVID-19: A Global Response in Solidarity,' Executive Office of the Secretary-General (EOSG) Policy Briefs and Papers No. 4, <https://doi.org/10.18356/5bd43e89-en>.

succeeded in flattening the curve of contagion and saved lives, but they also resulted in a 4.3 per cent contraction of world GDP,³ the first increase in extreme poverty since 1998, and the loss of the equivalent of 114 million full-time jobs relative to the level in 2019.⁴

These impacts could have been significantly worse in the absence of extraordinary national fiscal support measures, which amounted to a global total of \$18 trillion as of March 2021. However, the capacity to respond to the crisis differed markedly across country groups. In 2020, advanced economies increased their fiscal expenses by more than 13 per cent of their GDP, compared to less than 4 per cent and less than 2 per cent for middle-income and low-income countries respectively. These differences reflect the existence of constraints to fiscal spaces and difficulties of access to external financing.⁵

In fact, many least developed countries entered the crisis with already elevated debt risks. Globally, debt risks had been on the rise since the 2008-2009 global financial crisis, as the world experienced the largest, fastest, and most broad-based episode of sovereign and corporate debt build-up in the past 50 years.

In March 2020, at the outset of the pandemic, capital flows massively exited developing countries, threatening to cause a major financial crisis, but a massive expansion of central bank liquidity in developed countries stabilized global financial markets and facilitated a return of capital flows to some developing economies. However, the recovery in portfolio flows has been highly uneven. While some middle-income countries have returned to international bond

markets since April 2020, only two countries in Sub-Saharan Africa have been able to issue new bonds. Going forward there is a risk that many middle-income SIDS and LDCs with very high refinancing needs in 2021 will not have access to financial markets at affordable rates.

The rapid growth of financing needs and the collapse in revenues and GDP growth caused by the pandemic have exacerbated debt burden risks across the globe. Over half of least developed and low-income countries that use the IMF-World Bank Debt Sustainability Framework (LIC-DSF) are now assessed as being at a high risk of debt distress or in debt distress. And, according to a new IMF methodology for assessing the risk of a fiscal crisis using machine learning, more than a third of emerging market economies are at high risk of fiscal crises.

Among the 151 economies that borrow from capital markets and, consequently, are rated by the three major rating agencies, 42 have experienced downgrades since the start of the pandemic, including 6 developed countries, 27 emerging market economies, and 9 least developed countries. Sovereign downgrades cause borrowing costs to rise, especially for developing countries, which can, in turn, increase the risk of more countries tipping over into unsustainable debt – especially if the COVID-19 pandemic is more protracted and deeper than expected.

As the world gradually recovers from the current crisis, catch-up growth will remain vulnerable due to the risk of a premature phase out of current fiscal support measures, continuing debt service obligations, and low levels of public and private investment, which need to

3 United Nations (2021). *World Economic Situation and Prospects*. New York, United Nations, p. viii.

4 ILO Monitor (2021). *ILO Monitor: COVID-19 and the world of work*. Seventh edition. Updated estimates and analysis. www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/briefingnote/wcms_767028.pdf.

5 www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19.

be boosted substantially.⁶ It is our common responsibility to ensure that adjustments to current policies do not happen too soon or in a disorderly manner. After the worst peacetime global contraction since the Great Depression, we will only recover if we respond together.

In May 2020, the Prime Minister of Canada, the Prime Minister of Jamaica and I convened the initiative on Financing for Development

in the Era of COVID-19 and Beyond to enable discussions of concrete financing solutions to the COVID-19 health and development emergency, as well as options to recover better and invest in a more sustainable and inclusive future. Many of the recommendations below originated in the discussion groups that came together under this initiative.⁷

⁶ World Bank (2021). Global Economic Prospects. Washington, D.C.: World Bank, p.115.

⁷ For further detail on the Initiative on Financing for Development in the Era of COVID-19 and Beyond, see www.un.org/en/coronavirus/financing-development.

SDG investments for response and recovery

The main priority at the moment is to ensure that developing countries will have enough fiscal space to recover from the pandemic, vaccinate their populations, and invest in the SDGs, including climate action. This will require fresh financing, in some cases combined with debt relief measures. New borrowing should not be considered a concern, provided that it finances productive investments that enhance the resilience of the economy in the long run. Debt relief can free up resources and create conditions under which countries can return to voluntary market access and lower borrowing costs.

PROVISION OF FRESH FINANCING

Governments need to:

- **Meet ODA commitments and provide fresh concessional financing for developing countries, especially LDCs and SIDS;**
- **Recapitalize multilateral, regional and national development banks and accelerate the timetable for agreeing on a fresh replenishment of funds; and**
- **Provide long-term⁸ financing to developing countries for investment in inclusive growth and sustainable development.**

Productive investments aligned with sustainable development should help countries improve debt management in the long run, even while raising debt levels in the near term. Multilateral development banks (MDBs) have an important role to play in offering long-term and counter-cyclical financing to developing countries. Some multilateral funds have front-loaded their commitments in response to the crisis. However, without further action from donors, the funds could dry up at a time when client countries still require considerable support. As an example, IDA increased its spending in response to the pandemic to the extent that it is now seeking a new replenishment one year ahead of schedule, with negotiations starting as early as April 2021.

Going forward, the MDB system should significantly scale up financing, consider extending maturities, and explore more options to provide long-term financing. MDBs should provide concessional financing for all developing countries, including middle-income countries.

Non-concessional lending windows of MDBs also provide an important avenue for middle-income countries to access long-term affordable finance, critical to building back better and stimulating growth and development. Regional and national development banks should also be recapitalized so that

⁸ United Nations (2020). Financing for Sustainable Development Report. New York: United Nations, p. 110. https://developmentfinance.un.org/sites/developmentfinance.un.org/files/AUV_2021%20FSDR.pdf.

they can extend concessional finance to all countries in need. Development banks could also adopt more flexible criteria for lending.

To complement additional financing from public development banks, proposals have been made for new facilities and funds. One proposal has been to set up a Liquidity and Sustainability Facility (LSF) to address liquidity and financing needs of middle-income countries with strong macroeconomic fundamentals.⁹ This promising facility, which should be equipped with an adequate design and governance

structure, could prioritize financing for recovery and green-linked investments, ensuring additional financing is used for the SDGs.

Another proposal is to set up a Fund to Alleviate COVID-19 Economics (FACE), with the objective of mitigating the economic impact of the pandemic on individuals and the productive sectors of developing countries.¹⁰ The fund, which would be channelled through the MDBs, would have a capital of US\$500 billion and provide loans with 50 years maturity and a zero or very low interest rate.

⁹ United Nations (2020). Financing for Development in the Era of COVID-19 and Beyond: Menu of Options for the Consideration of Heads of State and Government, Part II, p. 72. www.un.org/sites/un2.un.org/files/financing_for_development_covid19_part_ii_hosg.pdf; see also, UNECA (2021). Liquidity and Sustainability Facility. PowerPoint presentation, 22 March, 10pp.

¹⁰ United Nations (2020), op. cit.

Liquidity support

As noted above, central banks across the world introduced monetary easing measures on an unprecedented scale, which helped prevent a new global financial crisis. However, massive injections of liquidity are not without risk as ultra-low interest rates can fuel high asset prices and speculation. In addition, many developing countries have not been able to access capital markets because of low credit ratings and corresponding high borrowing costs. At the onset of the pandemic these countries faced an impossible choice between: (i) continuing to service their external debts; (ii) addressing urgent needs related to combating the pandemic and supporting jobs and income, including through basic social protection; and (iii) investing in the SDGs and a more sustainable and resilient future.

To support developing countries in need, the IMF temporarily doubled access to its Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI), providing over US\$100 billion to member countries, in addition to the more than US\$200 billion delivered by MDBs.

In addition, in April 2020, the G20 Finance Ministers endorsed the Debt Service Suspension Initiative (DSSI) to bolster crisis mitigation in IDA-eligible countries. The DSSI temporarily suspends debt service payments to bilateral official creditors for countries eligible to borrow from the IDA, plus Angola, upon request. The G20 invited private creditors to suspend the debt services of participants in the DSSI on the

same terms. By early March 2021, 46 out of 73 eligible countries had benefited from around US\$5 billion in debt service suspension, with savings contributing to the pandemic response.

However, the financial impact of the DSSI has been blunted by the lack of participation of private creditors, to whom DSSI eligible countries collectively owe about one third of their total debt service obligations in 2021. Debtors participating in the DSSI were reluctant to request private creditors to join the initiative out of fear that this could lead to downgrades in their sovereign credit ratings and higher borrowing costs. In addition, some hybrid (semi-public) G20 lenders have opted out of the DSSI. As a result, the DSSI has important gaps.

Another gap is that the DSSI eligibility criteria excludes nine of the 34 countries with a substantial risk of debt default, which includes some highly vulnerable small island developing States (SIDS). In addition, middle-income countries not eligible to the DSSI have US\$31 billion in bilateral debt service due in 2021 compared to US\$16.6 billion for eligible countries¹¹ and while some of them have adequate market access to refinance their debts, many do not. Without international support these countries will need to cut fiscal expenditures to be able to service their external debts, curtailing their response and recovery prospects.

¹¹ Kharas and Dooley (2021), op. cit.

Recommendations to provide liquidity to developing countries fall into two main categories: an SDR allocation (and voluntary reallocation) and an extension of the DSSI to temporarily bridge foreign exchange and fiscal shortfalls.¹²

A NEW GENERAL ALLOCATION OF SDRs

- **Provision of a new allocation of SDRs (as discussed by the IMF Board), and voluntary reallocation of SDRs from countries with sufficient international reserves to countries facing persistent external deficits or emergency situations, including vulnerable and conflict-affected countries.**
- **IMF member countries are also urged to consider (i) replenishing the Poverty Reduction Growth Trust (PRGT) of the IMF and (ii) establishing a new trust fund hosted by the IMF to support middle-income countries in their response and recovery efforts.**

The IMF occasionally issues SDRs to supplement IMF member countries' foreign exchange reserves. A new allocation of SDRs in a crisis context is not without precedent: in 2009, during the global financial crisis, the IMF issued 182.6 billion SDRs, bringing the total cumulative allocations to about 204.2 billion SDRs, equivalent to around US\$294 billion in 2020.

As of 19 March 2021, the G7 endorsed a “new and sizeable” allocation of SDRs,¹³ with most experts recommending between 350 billion and 455 billion SDRs (equivalent to US\$500 billion to US\$650 billion).¹⁴ SDRs are distributed across the IMF members in proportion to their quota shares, with developed countries receiving 60.4 percent and developing countries 39.6 percent,¹⁵ including 3.5 per cent to least developed countries.

Thus, to ensure that the new SDRs go to countries that need them most, IMF member countries with strong external positions could voluntarily reallocate their existing SDRs, either bilaterally or through existing mechanisms such as the IMF's Poverty Reduction and Growth Trust (PRGT). However, only low-income countries are eligible to borrow from the PRGT. The establishment of a new trust fund to be housed at the IMF should therefore be considered to support middle-income countries, and SIDS in particular, in their response and recovery efforts.

In addition to the proposals above, other suggestions could be considered through multilateral or bilateral arrangements on a voluntary basis to utilize SDRs, including for making vaccines available and helping countries in their response and recovery plans.¹⁶

Overall, a new SDR allocation combined with a range of options to reallocate excess SDRs to countries that need them most will send a powerful signal of a cooperative multilateral response.

¹² United Nations (2020). Financing for Development in the Era of COVID-19 and Beyond: Menu of Options for the Consideration of Heads of State and Government, Part II, pp. 72–74. www.un.org/sites/un2.un.org/files/financing_for_development_covid19_part_ii_hosg.pdf.

¹³ G7 (2021). Chancellor and G7 Finance Ministers agree milestone support for vulnerable countries. Press release, 19 March. www.g7uk.org/chancellor-and-g7-finance-ministers-agree-milestone-support-for-vulnerable-countries.

¹⁴ See for instance Ocampo, J.A. (2021). <http://project-syndicate.org/commentary/new-sdr-allocation-calls-for-two-reforms-by-jose-antonio-ocampo-2021-03>, 5 March; and Gallagher, Ocampo (2020) “It's time for a major issuance of the IMF's Special Drawing Rights”, available at ftalphaville.ft.com/2020/03/20/1584709367000/It-s-time-for-a-major-issuance-of-the-IMF-s-Special-Drawing-Rights.

¹⁵ According to United Nations classifications.

¹⁶ Kharas H. and Dooley, M. (2021). Debt Distress and Development Distress: Twin crises of 2021. Working Paper 153. Washington, D.C.: Brookings, 35 pp.

Extension of the debt service suspension

The G20 is strongly encouraged to:

- **Extend the DSSI at least until the end of June 2022;**
- **Include middle-income countries in the DSSI, in particular SIDS, conflict-affected and other vulnerable countries that have been seriously affected by the crisis; bilateral and multilateral creditors should consider offering DSSI terms to these countries on a case-by-case basis;**
- **Ensure that debt relief is additional to existing concessional aid; and**
- **Bilateral G20 creditors, including hybrid lenders, should consider mechanisms to include private sector participation in the DSSI and in future debt standstills.**

A proposal to encourage private creditor participation in standstills is the establishment of a Central Credit Facility (CCF)¹⁷ at financial institutions with preferred creditor status, such as the World Bank and/or regional development banks. Countries seeking forbearance could redirect their interest and principal payments to the CCF and receive them back as low-interest loans for specific pandemic mitigation spending. While not a replacement for creditor coordination, such a facility would allow debtor countries to initiate a debt suspension process without waiting for lenders to coordinate. In exchange for releasing the debtor from its obligations to the private creditor, the relevant amount would be credited to the creditors' account in the CCF.

State-contingent elements in bond contracts can provide another mechanism to increase private participation in future debt standstills.

¹⁷ Bolton, P. *et al.* (2020). Born out of necessity: A debt standstill for Covid-19. CEPR Policy Insight Nr. 103, April.

Debt relief and the Common Framework

In my brief dated April 2020, I urged the international community to consider targeted debt relief beyond a moratorium. I commend the G20 for establishing the Common Framework on Debt Treatments Beyond the DSSI in November 2020, a welcome extension of the initial focus on providing liquidity support towards addressing solvency concerns.

Early in the pandemic, the IMF had already provided debt service relief to its poorest and most vulnerable members through grants from the Catastrophe Containment and Relief Trust (CCRT). The G20's Common Framework for Debt Treatments Beyond the DSSI (the Common Framework) extends the provision of debt relief to all the DSSI-eligible countries. Its goal is to facilitate on a case-by-case basis a timely and orderly debt restructuring of bilateral official debts with members of the G20, including hybrid lenders. Other, non-G20 official creditors, as well as private creditors are invited to participate and provide debt relief on the same terms. Three countries have so far requested debt restructuring through the Common Framework.

The Common Framework, however, faces similar limitations to the DSSI. First, vulnerable middle-income countries remain ineligible. Second, in the absence of additional measures to incentivize or compel private creditor participation, comparable treatment of commercial creditors will remain challenging in practice. The recent downgrade of the sovereign credit ratings of one of the countries that applied for

debt relief through the Common Framework could further disincentivize countries from approaching their private creditors. Despite these limitations, the Common Framework can be an effective platform for creditor coordination, which could serve as a starting point towards creating a more universal and permanent framework for sovereign debt resolution.

The international community is urged to:

- **Build on the Common Framework to offer legal and technical advice on options for debt and debt service relief to help countries in need – including debt swaps, debt buy-backs, credit enhancements, reprofiling or exchanging debt, and/or cancellation – depending on a country's specific circumstances and debt challenges;**
- **Extend the eligibility to debt relief under the Common Framework to other vulnerable countries on a case-by-case basis; and**
- **Consider other mechanisms that would allow countries to access the Common Framework without creating a stigma or compromising the credit rating of the beneficiaries, including funds and other instruments within existing institutions.**

The international community should consider an initiative to build on and complement the Common Framework, both by reaching a wider group of countries and by offering capacity building and legal advisory services to debtor countries around a range of debt reduction

strategies. Its focus would be on (i) maintaining sound debt management, as well as (ii) freeing up resources for investment in the COVID-19 response, including securing vaccines, and the SDGs, including climate action. In this context, integrated national financing frameworks (INFFs) can play a role in helping debtor countries determine their long-term financial needs.

In providing debt relief, this complementary initiative to the Common Framework would consider a range of instruments and initiatives, including debt swaps, buy-backs, exchanges, and credit enhancements, and offer a spectrum

of tailor-made relief initiatives depending on the debtor country's situation. As it would offer a wide range of legal and technical advice, requests from countries for support through this initiative should not *per se* trigger a downgrade by the rating agencies, unlike what has been observed with the Common Framework. The initiative could also help support debtors in debt restructuring negotiations with their creditors. In addition, as indicated by the IMF proposals in the 2020 Annual meetings, international financial institutions could offer complementary credits to countries involved in debt restructurings to facilitate reaching an agreement.¹⁸

¹⁸ Ocampo, J.A. (2021), "Future Development Managing developing countries' sovereign debt", available at www.brookings.edu/blog/future-development/2021/03/08/managing-developing-countries-sovereign-debt.

The international debt architecture

While the dramatic impact of the current crisis requires an immediate response, the crisis has also highlighted the need to address underlying challenges, both at national levels and in the global architecture. The current debt architecture has been ineffective in both preventing repeated episodes of unsustainable debt buildups and in restructuring debts, when needed, in an efficient, fair, and durable manner. It is characterized by numerous gaps in transparency and a lack of clarity about roles and responsibilities. More importantly, there are no processes that incentivize all creditors and debtors to act cooperatively in accordance to a uniform set of principles and standards.

Architecture reform will require new tools, instruments, and legislative backing, but also a shift in mindset towards a set of principles including responsible borrowing and lending with fair, transparent, efficient and equitable workouts. The new architecture must also be aligned with the SDGs and the goals of the Paris Agreement, and acknowledge the need to transition to a sustainable, inclusive and resilient economy in all of its aspects. Any reforms must be based on a process with accepted legitimacy by a wide range of stakeholders that includes Paris and non-Paris Club official creditors, private creditors, and sovereign debtors. It is in the interest of all parties that international institutions facilitate this process by providing a space for open dialogue and to build trust and transparency in a systematic way.

The reform of the international debt architecture should have two objectives: (i) to facilitate expedient, fair and orderly debt workouts,

when needed, and (ii) to address the underlying causes of unsustainable increases in sovereign debts and prevent their recurrence. An effective debt architecture should give countries greater room for investing in sustainable development and play an important role in increasing the resilience and stability of the international financial system in the face of future pandemics or climate-related disasters.

STRENGTHENED ARCHITECTURE THROUGH PRINCIPLES

- **As a basis for the international debt architecture, a wide range of stakeholders should agree on a set of principles and considerations.**

Possible considerations include the following:

- **Debt transparency and management.** Transparency should be promoted in order to enhance the accountability of the actors concerned, which can be achieved through the timely sharing of both data and processes related to sovereign debt workouts.

Gaps in debt transparency have grown larger over time with more diverse creditors. The World Bank reports that half of all IDA countries do not have adequate capacity in their debt management policy and institutions, including data collection and reporting.

Building consensus for new norms and standards for transparency in debt reporting and data is the foundation for a more resilient

international architecture. One solution is to provide additional technical assistance to improve such capacity. Another is to shift incentives for all debtors and creditors, public and private, to provide more accurate and complete information. Close collaboration among international organizations, particularly the United Nations, the IMF and the World Bank, will be essential in this regard.

- **Sustainability.** Workouts from a sovereign debt crisis should aim to restore sound public debt management, while preserving access to financing resources under favourable conditions, including concessional financing which is important in accelerating the achievement of the SDGs and Paris Agreement. Consistent with the Doha Declaration on Financing for Development and the Addis Ababa Action Plan, workouts should not compromise the ability of debtor countries to achieve sustainable development and the SDGs.
- The Addis Ababa Action Agenda **recognizes that while maintaining sustainable debt levels is the responsibility of the borrowing countries, lenders also have a responsibility to lend in a way that does not undermine a country's sound debt management.** Multiple initiatives by the International Financial Institutions are underway to promote responsible borrowing and lending practices, as well as 'soft-law' approaches such as the G20 Operational Guidelines for Sustainable Financing or the UNCTAD principles on promoting responsible sovereign lending and borrowing.¹⁹
- In the Addis Ababa Action Agenda, United Nations Member States had committed to work towards a global consensus on guidelines for debtor and creditor responsibilities,

but such global consensus remains elusive to date.

- **Shared responsibility and fair burden sharing among creditors and between debtors and creditors.** The Addis Ababa Action Agenda recognizes that there is scope to improve coordination between debtors and creditors to minimize both creditor and debtor moral hazards, and to facilitate fair burden-sharing and the need for debtors and creditors to share responsibility to prevent and resolve unsustainable debt situations. The Basic Principles on Sovereign Debt Restructurings of the United Nations provide additional guidance for debtors and creditors in restructuring processes.²⁰

BUILDING ON EXISTING INITIATIVES

- **Include mechanisms that consider the risk of credit rating downgrades, including through an open conversation with investors, market participants and credit rating agencies.**
- **Develop long-term credit ratings (10 years or more) to complement existing assessments.**

Long-term productive investments in the SDGs can enhance long-term debt management, but they are not accounted for in credit ratings. Yet if investments improve debt management in the long term, they should be financeable in the near term. Credit rating agencies should consider issuing long-term ratings alongside traditional ratings, building on similar assessments already conducted by the IMF and the World Bank. Indeed, a favourable long-term rating could both create incentives for countries to invest more effectively in sustainable development and help them raise long-term capital for that purpose.

19 UNCTAD, "Principles on promoting responsible sovereign lending and borrowing," 10 January 2012. Available at https://unctad.org/system/files/official-document/gdsddf2012misc1_en.pdf.

20 General Assembly Resolution on Basic Principles on Sovereign Debt Restructuring Processes (A/69/L.84), July 2015.

- **Include state-contingent clauses in public debt contracts to 'automatize' standstills in times of crisis, and to set a precedent for private markets.**

State-contingent debt instruments (SCDIs) link debt servicing to a predefined variable such as GDP, national income, exports, or commodity prices. Similarly, some loans contain clauses for extreme events such as hurricanes and other natural disasters. They can be designed to provide additional creditor compensation in good times or relief in bad times such as disasters. They thus build debt standstills into contracts and eliminate the need for renegotiation in times of stress. In the context of debt restructurings, they may help avoid protracted disputes about the economic outlook by tying debt service to future outcomes.

The use of such instruments in the past has been rather limited. To realize their potential, the official sector, including G20 members, should consider incorporating standardized SCDIs in official lending and debt restructurings and enhance data provision to facilitate the use of common state variables not subject to manipulation risk. They would also need to explicitly recognize the resilience afforded by SCDIs in assessments of the sustainability of debt management.

- **Complement existing instruments for more effective debt crisis resolution, including collective action clauses, anti-vulture legislation and creditor committees.**

Reforming the international debt architecture is necessary, especially to address a potential increase in sovereign debt restructurings in the aftermath of the pandemic, including the risk of a systemic crisis. Reforms should be aimed at providing speedy and sufficiently deep debt relief to countries that need it, benefitting not only these countries but the system as a whole.

After the IMF's endorsement in 2014, Collective Action Clauses (CACs) have been included in almost all new sovereign bonds to date. CACs allow a qualified majority of bondholders to make a restructuring agreement with a debtor binding to all bondholders, preventing an uncooperative minority of bondholders from blocking it. CACs can work in conjunction with anti-vulture fund legislation. Such legislation, currently enacted in a few countries, limits the ability of holdout creditors to receive, through litigation payment at face value, debt bought in secondary markets at deeply discounted values. However, while CACs represent a promising future mechanism for greater debt cooperation, they are not retroactive – many developing countries have outstanding debt stock without CACs. The architecture could be strengthened over time if all major financial centres made it mandatory to include CACs in all maturities exceeding one year.

Creditor committees have been used to varying degrees in sovereign debt restructurings. They can help bring official and private creditors together and allow the debtor to negotiate with a single body. Once a consensus is reached, committees can limit holdouts by endorsing the deal, and applying pressure on others to sign. They can be useful in a world of non-transparent debt data as all creditors receive access to the same financial information and can see what others' claims are.

- **Use the G20 Common Framework as a step toward a more universal and permanent framework for sovereign debt resolution.**
- **Launch a global forum for sovereign debt resolution and coordination to build consensus for new norms and standards for debt transparency and management, considering options of mediation and arbitration in debt restructuring.**

Proposals include the establishment of a sovereign debt forum, which could provide a platform for discussions between creditors and debtors, in the context of SDG debt relief, and facilitate agreements on voluntary stays, coordinated rollovers and other measures. An alternative is an international sovereign debt authority or mechanism, an expert-based authority or standing body independent of creditor and debtor interests that could coordinate and further develop many of the proposals mentioned above. The establishment of a public multilateral credit rating agency that would not be subject to conflicts of interest between private and public interests has also been proposed.

- **The international community should build on (i) existing principles put forward in the Addis Ababa Action Agenda and in other forums and (ii) existing instruments and mechanisms.**
- **Dialogue among stakeholders can elaborate further these principles, instruments and mechanisms in the follow-up process to the Meeting of Heads of State and Government on the International Debt Architecture and Liquidity.**

Discussions at the United Nations in follow-up to the High-level Event on Financing for Development in the Era of COVID-19 and Beyond have underscored the importance of progress on structural solutions as a necessary condition for achieving the SDGs. The COVID-19 crisis has once again shone light on these issues. Now is the time to take action by bringing together all stakeholders for an evidence-based discussion on feasible options for long-lasting solutions.

Conclusions and call for action

Recommendations to create space for investment in crisis response and the SDGs, including strong climate action are divided into six areas, addressing (i) liquidity constraints, (ii) provision of fresh financing, (iii) a new general allocation of SDRs, (iv) debt service suspension, (v) debt relief and the Common Framework, and (vi) the international debt architecture.

LIQUIDITY CONSTRAINTS

There are two main recommendations to support liquidity for developing countries:

- An SDR allocation (and voluntary reallocation) to provide balance of payment support to countries in need; and
- An extension of the DSSI to temporarily bridge foreign exchange and fiscal shortfalls.

PROVISION OF FRESH FINANCING

Governments need to:

- Meet ODA commitments and provide fresh concessional financing for developing countries, especially LDCs and SIDS;
- Recapitalize multilateral, regional and national development banks and accelerate the timetable for agreeing on a fresh replenishment of funds; and

- Provide long-term financing to developing countries for investment in inclusive growth and sustainable development.

A NEW GENERAL ALLOCATION OF SDRs

- Provision of a new allocation of SDRs (as discussed by the IMF Board), and voluntary reallocation of SDRs from countries with sufficient international reserves to countries facing persistent external deficits or emergency situations, including vulnerable and conflict-affected countries.
- IMF member countries are also urged to consider (i) replenishing the Poverty Reduction Growth Trust (PRGT) of the IMF and (ii) establishing a new trust fund hosted by the IMF to support middle-income countries in their response and recovery efforts.

DEBT SERVICE SUSPENSION

The G20 would need to:

- Extend the DSSI at least until the end of June 2022;
- Include middle-income countries, in particular SIDS, conflict-affected and other vulnerable countries that have been seriously affected by the crisis; bilateral and multilateral creditors should consider offering DSSI terms to these countries on a case-by-case basis;

- Ensure that debt relief is additional to existing concessional aid; and
- Bilateral G20 creditors, including hybrid lenders, should consider mechanisms to include private sector participation in the DSSI and in future debt standstills.

DEBT RELIEF AND THE COMMON FRAMEWORK

- The international community should build on the Common Framework to offer legal and technical advice on options for debt and debt service relief to help countries in need – including debt swaps, debt buy-backs, credit enhancements, reprofiling or exchanging debt, and/or cancellation – depending on a country’s specific circumstances and debt challenges.
- Extend the eligibility to debt relief under the Common Framework to other vulnerable countries on a case-by-case basis.
- Consider other mechanisms that would allow countries to access the Common Framework without creating a stigma or compromising the credit rating of the beneficiaries, including funds and other instruments within existing institutions.

INTERNATIONAL DEBT ARCHITECTURE

- As a basis for the international debt architecture, a wide range of stakeholders should agree on a set of principles and considerations.
- Include mechanisms that consider the risk of credit rating downgrades, including through an open conversation with investors, market participants and credit rating agencies.
- Develop long-term credit ratings (10 years or more) to complement existing assessments.
- Include state-contingent clauses in public debt contracts to ‘automatize’ standstills in times of crisis, and to set a precedent for private markets.
- Complement existing instruments for more effective debt crisis resolution, including collective action clauses, anti-vulture legislation and creditor committees.
- Use the G20 Common Framework as a step toward a more universal and permanent framework for sovereign debt resolution.
- Launch a global forum for sovereign debt resolution and coordination to build consensus for new norms and standards for debt transparency and management, considering options on mediation and arbitration in debt restructuring.
- It would provide options for strengthening the international debt architecture, building on (i) existing principles put forward in the Addis Ababa Action Agenda and in other forums and (ii) existing instruments and mechanisms. Dialogue among stakeholders can further elaborate these principles during the follow-up process to the Meeting of Heads of State and Government on the International Debt Architecture and Liquidity.