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The Debt Burden:
How to Create a Better Debt Management Framework

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Introduction

In February 2021, the International Monetary Fund (IMF) issued a warning about the state of public debt. While the world's poorest countries were openly facing debt vulnerabilities, many emerging markets were also facing significant risk.[1]

Of the ten countries in debt distress (Eritrea, the Gambia, Grenada, Mozambique, the Republic of Congo, Somalia, Sao Tome and Principe, Sudan, South Sudan, and Zimbabwe), eight were fragile states.

Out of 70 low-income countries, 36 were either already in debt distress or at high risk of succumbing to it. Of the ten countries in debt distress (Eritrea, the Gambia, Grenada, Mozambique, the Republic of Congo, Somalia, Sao Tome and Principe, Sudan, South Sudan, and Zimbabwe), eight were fragile states.

Increasing debt levels have been worrying for some years. In 2018, the total debt for Emerging Markets and Developing Economies (EMDEs) amounted to 170% of GDP, with the share of government debt accounting for almost three-fifths.[2] For Central African countries (including Angola, Burundi, the Central African Republic, Cameroon, the Republic of Congo, Democratic Republic of Congo, Gabon, Equatorial Guinea, Nigeria, and Sao Tome and Principe) the average debt-to-GDP ratio was 53.4%.[3] In the Gambia and Zimbabwe this ratio was respectively 88% and 82% at the end of 2017; in Mozambique it climbed from 48% in 2013 to 102% in 2018.[4]

There are several factors that help to explain the pace of debt accumulation. The debt position of the oil-exporting countries, for instance, was exacerbated by the collapse of oil prices in the years following the global financial crisis. Higher oil prices from 2017 to 2020 slowed the pace of debt accumulation for these countries, but debt-to-GDP ratios[5] continued to rise in non-oil exporting ones, resulting in some of the debt being downgraded. Low interest rates have also played a role; bond issuances by the 120 low- and middle-income countries that are included in the Debtor Reporting System (DRS) were 376 billion dollars in 2019, 16% higher than in 2018.[6] Low interest rates further drove ambitious investment plans that were mainly financed by non-concessional loans, as in the case of Ethiopia and Kenya.[7]

When the Covid-19 crisis began in February 2020, it demanded extraordinary policy measures to protect lives and provide support to those who lost their livelihoods. By then, the public debt vulnerabilities for EMDEs, especially the poorest ones, were already significant, and the subsequent collapse of many economic activities, including supply disruptions, further increased the risk of debt distress for these countries.[8] As of 30 April 2021, seven low-income countries were in debt distress, and 29 at high risk.[9]

1 IMF, Questions and Answers on Sovereign Debt Issues, February 12, 2021

2 M.A. Kose, P. Negle, F. Ohnsorge and N. Sugawara, Global Waves of Debt: Causes and Consequences, World Bank Group, 2020. Chapter 4

3 F. G. Carneiro and W. A. Kouam, How much should Sub-Saharan African countries adjust to curb the increase in public debt?, World Bank blog, February 03, 2020

4 World Bank, Global Economic Prospects, January 2019, Darkening Skies, Washington, DC.

5 Within this paper we will use debt-to-GDP ratio as an indicator to illustrate the level of debt accumulation. Government debt-to-GDP ratio can prove a simplistic measure of a country's capability to service its obligations. The general principle is that as a government's public debt increases, so does the risk that they will encounter difficulties in servicing that debt, and especially so for debts contracted by LICs and EMDEs in foreign currencies (the so-called "original sin"). This measure alone does have some limitations, as each sovereign situation must be evaluated on a case-by-case basis in accordance with their underlying macroeconomic conditions. Critically, we are not suggesting that a high debt-to-GDP ratio impairs debt sustainability. For more information on how debt-to-GDP ratio can impact on debt sustainability see A. Porzecanski (2018). Debunking the Relevance of the Debt-to-GDP Ratio

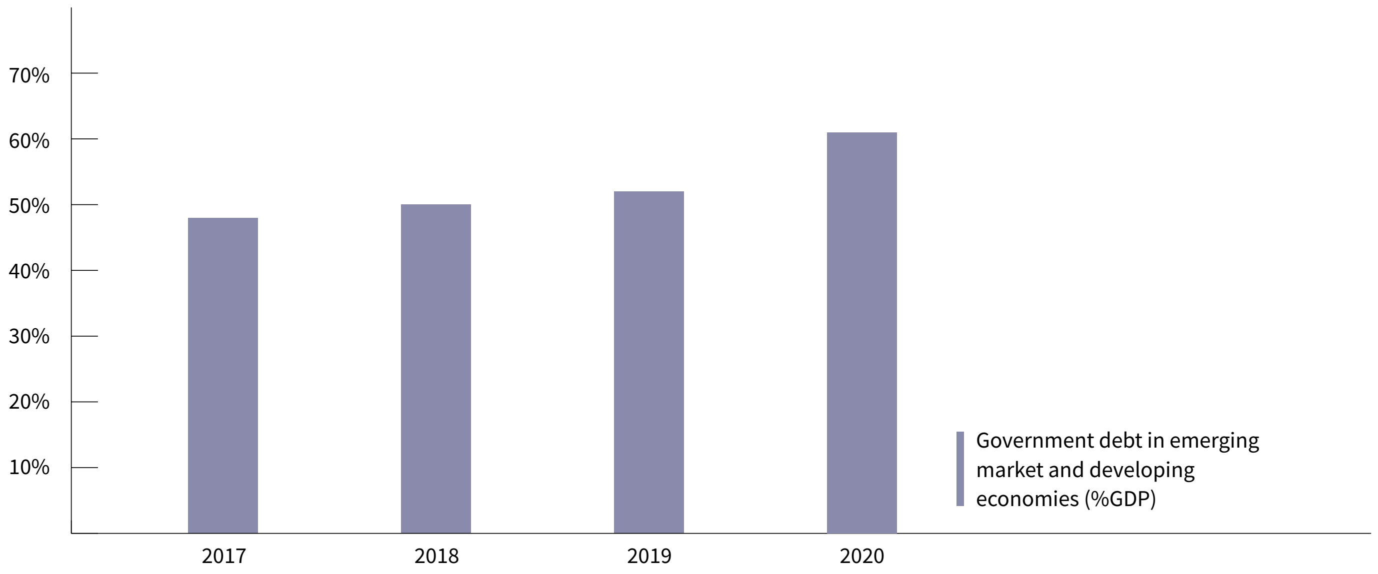
6 International Debt Statistics 2021, World Bank Group

7 International Monetary Fund. Strategy, Policy, & Review Department; The Evolution of Public Debt Vulnerabilities In Lower Income Economies, February 10, 2020

8 R. Allen, Emre Balibek, Yasemin Hurcan, and Sandeep Saxena, "Government Cash Management under Fiscal Stress", IMF, April 29th, 2020

9 IMF, List of LIC DSAs for PRGT-Eligible Countries As of April 30, 2021, https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf

Figure 1: EMDEs Government Debt as percentage of GDP



Source: P. Nagle & N. Sugawara, What the pandemic means for government debt, in five charts, World Bank, January 11, 2021

The impact of the health emergency has of course varied across countries, depending on factors such as the contribution of tourism to GDP and the severity of lockdown measures.[10] However, due to the increased spending on healthcare and benefits, it has resulted in higher budget deficits across the board. Countries have turned to various funding sources to finance their deficits, such as international capital markets, multilateral borrowing and domestic resource stabilization funds, which in turn has pushed debt levels to new heights. Among the EMDEs, government debt increased by almost 9 percentage points of GDP in 2020 as illustrated in the chart above (Figure 1). Debt servicing costs and the risk of default have increased as well.[11]

Given the impact of Covid-19 on the already critical debt positions of the EMDEs, in this paper we assess how countries can build financial resilience to manage exceptional events, but also how they can build resilience to shield from volatility in commodities prices and fluctuations in export demand. We argue that debt management should be an *ex ante* crisis prevention policy framework (i.e. before it actually occurs), rather than an *ex post* crisis-resolution intervention (i.e. after it has occurred).

As things currently stand, national governments and multilateral institutions tend to intervene when a debt crisis is already underway. This is costly for the country involved and for international lenders, as it results in a negative impact on economic growth, hardship for people, stress for the banking system and capital losses. Ex post crisis-resolution interventions have also become extremely complex due to different categories of creditors involved in debt restructuring (Box 1). In recent years there has been as a shift in creditor composition to non-Paris Club, non-concessional lenders such as China, and an increase in lending either through direct bilateral loans or through other vehicles such as publicly backed development funds and/or investment funds. In addition, there has been a change of players in the private sector spectrum. Less known institutional investors and retail investors have been replaced by bigger institutional investors, as restructurings in Latin America have shown. For instance, the fragmented group of creditors seen in Argentina in 2002-2005 has been replaced by institutional players such as Blackrock, Fidelity and Pimco – just to name a few.

The preventative framework that we propose will instead consist of a debt management framework centered around transparency, the rule of law, and holding actors to account. It will pay careful attention to the intergenerational element of debt, as the money borrowed today will be repaid by a different generation tomorrow. It will also uphold a sound macroeconomic framework as the necessary condition for sound debt management, and good practices – i.e., transparency and accountability – in the decision-making process related to borrowing and the assessment of the real need of the expenditure and its potential return (i.e., a legal and economics analysis).

This paper is organised as follows. **The first section** provides a brief description of the nature of the current status of the debt accumulation problem, including an overview of how sovereigns have reached the current status and a discussion of the initiatives that have been recently put in place in order to address some of the causes (and consequences) of the debt accumulation issue in the context of the *Covid-19* crisis. In **the second section** we look at preventative measures and argue that these are critical to avoid the debt accumulation problem. **The third section** introduces the pillars of what a solid debt management strategy should encompass. Here we highlight the importance of accountability and the rule of law as cornerstones of any debt management programme. In **the conclusion** we consider the implementation of these principles through a successful debt management landscape.

10 IMF, Questions and Answers on Sovereign Debt Issues, November 18, 2020

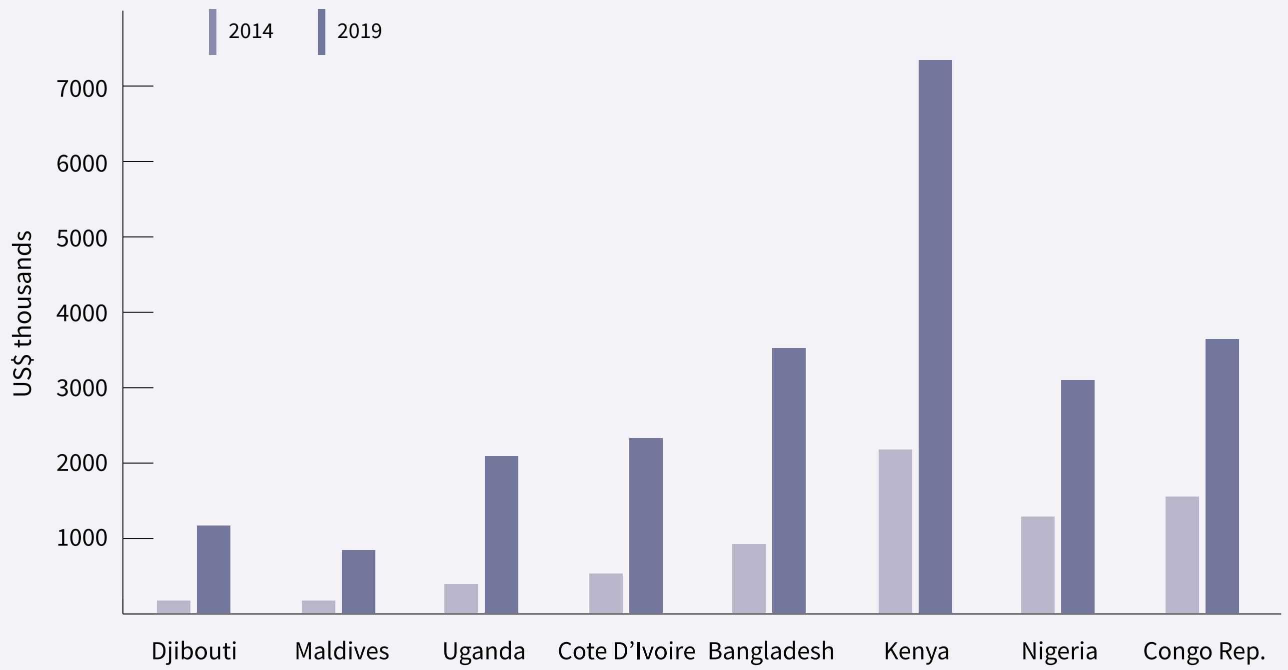
11 C. Pazarbasioglu, Current sovereign debt challenges and priorities in the period ahead, November 16, 2020

Box 1: Shift in Creditor Composition?

In recent years, non-Paris Club lenders such as China have increasingly provided funding to EMDEs, either through direct bilateral loans or through other vehicles such as publicly backed development funds and/or investment funds. Among these vehicles, sovereign wealth funds (SWFs) have become major players in global capital markets. The number of SWFs has increased almost fivefold since 2000. Furthermore, the volume of assets under management of SWFs has grown 400 billion to 500 billion dollars per year since the global financial crisis, reaching a current total of over 6.5 trillion dollars[12]. These players need to be included in the increasingly heterogenous group of international lenders, given the role they play in bilateral, direct and non-concessional lending. Taking advantage of their long-term investment's horizons, these funds can provide financing arrangements to extend the term of available private credit. Outstanding non-concessional debt in low-income countries, which is mostly held by China, Russia, India and some Arab countries rose to 55% in 2016 and non-Paris Club debt accounted for more than a fifth of the median low-income countries' external debt, and about 13% of their public debt.[13] In Africa, the Democratic Republic of Congo, Ethiopia, Mozambique, Tanzania, Uganda, and Zimbabwe have been increasing borrowing from non-traditional lenders such as commercial creditors and non-Paris-Club lenders (mainly China).[14]

Between 2014 and 2019 the Republic of Congo, Djibouti and Angola significantly increased their debt exposure to China. For instance, for Djibouti debt as share of gross national income (GNI) increased from 7.71% to 34.64%.[15] The chart below (Figure 2) shows the growth of total debt service owed to China for a select group of Asian and African countries between 2014 and 2019 in US$ millions:[16]

Figure 2: Total debt service to China, select countries



Source: World Bank International Debt Statistics, https://datatopics.worldbank.org/debt/ids/

12 R. Sharma, Sovereign Wealth Funds Investment in Sustainable Development Sectors, Global Projects Center, Stanford University, 2017

13 Ibid. M.A. Kose, P. Negle, F. Ohnsorge and N. Sugawara. Chapter 4

14 World Bank, Global Economic Prospects, January 2019, Darkening Skies, Washington, DC

15 Brief: Public Debt in the Belt and Road Initiative (BRI) — How Covid-19 has Accelerated an Ongoing Problem of China's Lending, by Mengdi Yue, Christoph Nedopil Wang, December 8, 2020

16 Ibid., World Bank International Debt Statistics, IIGF Green BRI Center (2020)

1. Crisis-response mode

The unprecedented level and speed of debt build-up driven by the financing needs of the Covid-19 crisis has increased the risk of debt distress and the odds of a new debt crisis cycle.

EMDEs are most at risk because of their exposure to international capital flows and the fact that some of their debt is issued in hard currencies, namely the US dollar. This leaves them exposed to changes in US monetary policy and so to sudden outflows when risk aversion and international financial volatility are high. Some EMDEs have learned lessons from previous debt crisis cycles[17] – as is evident, for example, in the development of local-currency securities markets which mitigate the risk of foreign-currency borrowing – but such resilience is patchy and far from being systemic.

Figure 3 on the right shows the percentage of debt issued in foreign currency (as a percentage of total debt) for selected Latin American countries in 2020 and highlights the dependency of countries such as Argentina and Ecuador on external borrowing. Brazil, on the other hand, has developed one of the highest shares of local-currency debt among G20 emerging-market countries, at well over 90%.

The risk of financial instability and sudden outflows leading to liquidity crunches became evident at the time of the global financial crisis. At the April 2009 London summit the G20 and the IMF agreed to create a non-concessional flexible credit line designed to offer respite to countries trapped in liquidity crises. A similar but more extensive intervention was agreed in April 2020 in response to the Covid-19 crisis, with the IMF making 250 billion dollars available for various lending facilities and debt service relief. To date, the IMF has deployed about 107 million dollars in total financial assistance for 85 countries.[18] This assistance has materialised via the granting of funds through different IMF programmes, such as Rapid Financing Instruments (RFI), Rapid Credit Facility (RCF), Stand By Arrangements (SBA), and the extension of the Catastrophe Containment and Relief Trust (CCRT) – a fund created in order to fight the consequences of the 2015 Ebola outbreak in Africa – to include Covid-19 pandemic relief. As part of the IMF financial assistance, borrowing countries have undertaken to implement several good governance measures in order to promote accountability and transparency in the spending of those resources. These undertakings include: the publishing of periodic reports on pandemic-related spending, spending audits, and the involvement of external auditors, as part of an effort to improve best practices.[19]

In addition to the IMF action, the G20 agreed on the Debt Service Suspension Initiative (DSSI), an initiative by which bilateral official creditors agreed to suspend debt payments obligations for 73 low-income countries. This initiative is being supported by the IMF and the World Bank, which help in monitoring the use of the resources to address the pandemic shock.[20] The aim of the DSSI is to temporarily freeze debt servicing so that these countries can allocate these resources to their immediate needs and mitigate the impact of the COVID-19 crisis on their population.

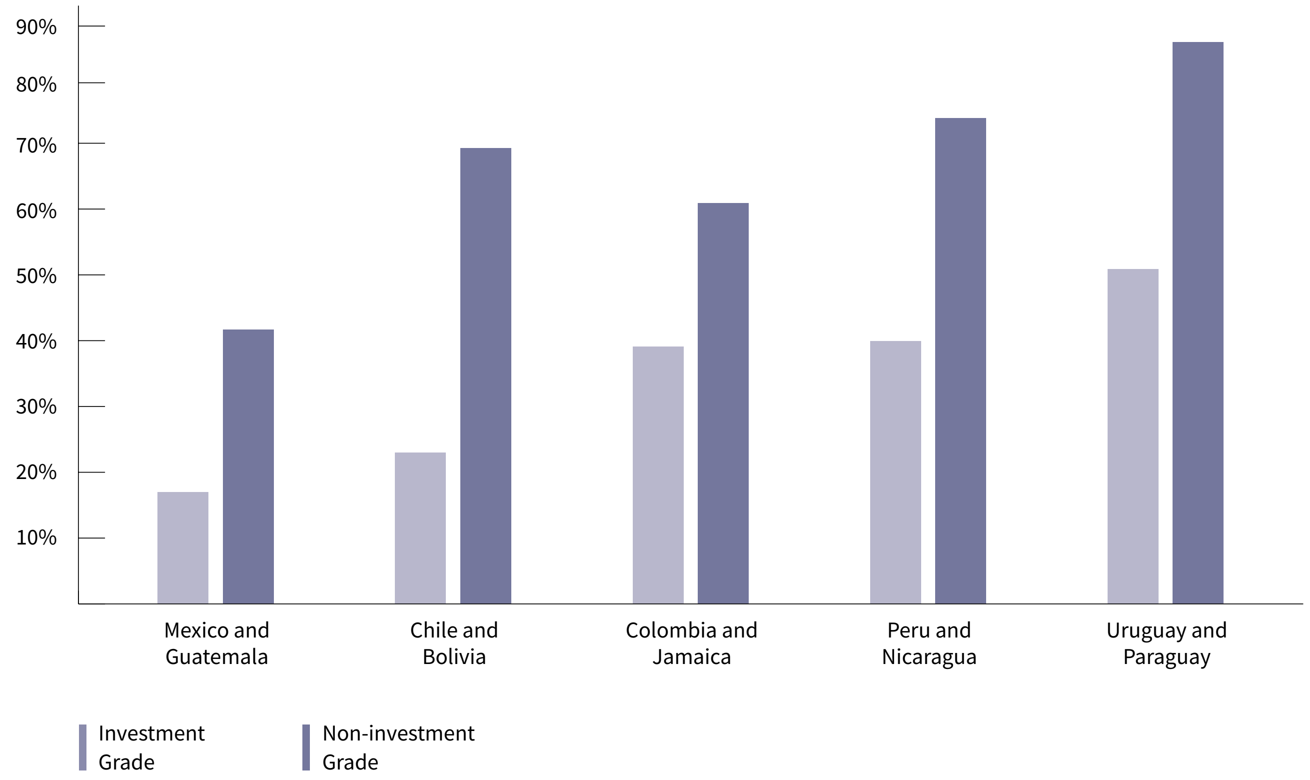
17 Ibid 2. M.A. Kose, P. Negle, F. Ohnsorge and N. Sugawara

18 IMF, COVID-19 Financial Assistance and Debt Service Relief

19 Governance commitments in Letters of Intent for Covid-19 Related Rapid Instruments, IMF, 29 January 2021

20 IMF, Questions and Answers on Sovereign Debt Issues, February 12, 2021. The IMF is also providing debt relief through grants to the 29 poorest countries under the Catastrophe Containment and Relief Trust amounting to approx. US$500 million

Figure 3: Debt issued in foreign currency (as a percentage of total debt) for selected Latin American countries in 2020



Source: Fitch Ratings, Debt Management Is Important in LatAm Sovereigns' Crisis Response, 24 June 2020

Focused on the International Development Association (IDA) countries, the eligibility to the DSSI Initiative is limited to countries involved in an IMF financing arrangement or to those which have requested financing (including emergency financing) from the IMF. Since May 2020, the DSSI has delivered relief amounting to more than 5 billion dollars (65% of the eligible countries have applied).[21]

The G20 agreed to extend the initial debt service suspension until the end of December 2021 and 80% of the initial applicants re-applied for the extension.[22] The DSSI, however, covers just a small portion of the total indebtedness of sovereigns and for a limited period.

The table on the next page (Figure 4) compares the total government debt as a percentage of GDP vis-à-vis potential temporary DSSI availability of resources that could be used to face the COVID-19 crisis.

21 The World Bank, COVID 19: Debt Service Suspension Initiative, 28 May 2021

22 IMF, Questions and Answers on Sovereign Debt Issues, February 12, 2021

Figure 4: Total government debt v. potential DSSI temporary availability of funds for African countries (as a percentage of GDP)

Country	Total Government Debt (% of GDP)[23]	Potential DSSI Savings May-December 2020 (% of GDP)[24]	Potential DSSI Savings January-June 2021 (% of GDP)[25]
Angola	120.29	1.9	1.4
Benin	41.79	0.1	0.1
Burkina Faso	46.62	0.2	0.1
Burundi	65.03	0.1	0.1
Cabo Verde	136.79	0.9	0.8
Cameroon	44.73	0.9	0.7
Central African Republic	46.57	0.3	0.4
Chad	46.37	0.6	0.4
Comoros	30.42	0.2	0.2
Congo Democratic Republic	16.14	0.3	0.2
Congo Republic	104.52	1.4	1.5
Cote d' Ivoire	41.73	0.4	0.1
Ethiopia	56.07	0.5	0.4
The Gambia	83.1	0.6	0.4
Ghana	76.67	0.6	0.3
Guinea	44.88	0.5	0.2

Country	Total Government Debt (% of GDP)	Potential DSSI Savings May-December 2020 (% of GDP)	Potential DSSI Savings January-June 2021 (% of GDP)
Guinea-Bissau	79.81	0.1	0.1
Kenya	66.39	0.7	0.7
Lesotho	47.17	0.4	0.2
Liberia	61.75	0.1	0.1
Madagascar	44.17	0.3	0.1
Malawi	70.66	0.2	0.2
Mali	44.8	0.5	0.3
Mauritius	85.65	1.2	1.3
Mozambique	121.33	1.9	1.6
Niger	48.35	0.2	0.2
Nigeria[26]	34.98	0	0
Rwanda	61.6	0.1	0.1
São Tomé and Príncipe	73.64	0.4	0.7
Senegal	65.41	0.6	0.4
Sierra Leone	77.37	0.2	0.2

Source: The World Bank, COVID 19: Debt Service Suspension Initiative

23 International Monetary Fund data mapper, source AFR Economic Outlook (October 2020)
24 COVID 19: Debt Service Suspension Initiative, February 19, 2021
25 Ibid.

26 Not covered under joint Bank-Fund Debt Sustainability Framework for Low-Income Countries

The DSSI is certainly no solution to countries' debt problems as it is partial and temporary in nature. The following is a brief list of the objections which are generally made to the DSSI:

- **For the initiative to be successful, the private sector and multilateral lenders must participate.** DSSI will not work unless all stakeholders are represented, particularly, the private sector.
- **Countries participating in the initiative must be fully transparent with their data and other debt information.** Data on debt owed by all countries should be made available in a well arranged and useful manner, so that lenders and borrowers can have a full and clear picture.
- **Commitments to responsible debt management.** All participants should make commitments to better governance of debt, which would make debt sustainable and make it less likely that they are unable to repay again.[27]

The shortcomings of the DSSI have been officially recognized by the G20 which, in late 2020, endorsed the "Common Framework for Debt Treatments beyond the DSSI".[28] Under the Common Framework, eligibility is based on the IMF-WBG Debt Sustainability Analysis (DSA). The Common Framework requires the applicant to disclose the necessary public sector information on financial commitments (debt) but respecting commercially sensitive information (without clarifying what is this composed of). The Common Framework also requires the participating debtors to seek treatment on comparable basis from other creditors, including the private sector and brings on board official creditors previously left aside, like China.[29]

The new framework proposes the signing of legally non-binding Memorandum of Understanding (MoU) by all participating creditors and by the debtor, stating the key parameters of the agreement, later to be implemented through bilateral agreements. Chad was the first African country that requested a "Common Framework" procedure between the G20 and the Paris Club to address its debt management issues. Chad appears to be a good candidate for this process, since it has almost no publicly traded external debt.[30] While the Common Framework is a first step in the right direction, it remains a temporary solution along with the DSSI. Both provide relief at the time of crisis but do not address the issues of over-borrowing and debt sustainability, which are the cause of the problem.

On the last joint update on the implementation of the DSSI,[31] the IMF and the World Bank have acknowledged the fact that creditor disclosure on terms and amounts lent remains limited and is unlikely to change with the implementation of the Common Framework. As it can be observed in the recent cases of Angola and Zambia (Box 2), the lack of transparency in public debt delayed the resolution and difficulted the implementation of debt relief.[32] Angola reprofiled its debt with two of its largest creditors outside the DSSI process and Zambia defaulted on its sovereign debt, particularly hit by the crisis as it is a major copper producing country although most of the debts were pre-Covid and problems were evident prior to the pandemic.[33]

27 F. Robertson, The Common Framework on Debt Treatment: A game changer? 18 November 2020
28 G20 Statement Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting November 13, 2020
29 Kristalina Georgieva, Remarks by IMF Managing Director Kristalina Georgieva During a Virtual Extraordinary Meeting of G20 Finance Ministers and Central Bank Governors, November 13, 2020
30 Chad becomes first country to ask for debt overhaul under G20 common framework, Reuters, by Andrea Shala, January 28, 2021
31 Implementation and Extension of the Debt Service Suspension Initiative, WB-IMF, September 28, 2020
32 D. Munevar, The G20 Common Framework for Debt Treatments beyond the DSSI. Is it bound to fail?, 28 October 2020
33 Global Economic Prospects, World Bank Group, Flagship Report, January 2021

Box 2: Zambia and Angola - The Common Framework's first tests

In November 2021, Zambia defaulted on a 42.5 million dollar coupon payment, becoming the first African Nation to default on its debt during the Covid-19 pandemic. Even though Zambia's macroeconomic conditions had been worsening because of changing macroeconomic conditions (mainly given the plummeting of one of its major exports, copper), the pandemic put the final straw on the ability to service debt payments. As a result, Zambia decided to commence its debt restructuring process under the IMF's common framework. As of this moment, Zambia and the IMF are in negotiations and according to IMF officials "significant progress has been made". IMF officials highlighted that "fiscal reforms to correct large fiscal imbalances, ramping up revenues and improving governances", were still needed however.[34]

Angola went through a whole different story. In the end of 2020, Angola completed a renegotiation of its debt with one of its largest creditors – China.[35] That renegotiation resulted in a relief of approximately 6.2 billion dollars of its public debt and allowed for the release of up to 1 billion dollars by the IMF. However, in this scenario we can observe the difficulties included in a debt renegotiation process that does not include all the relevant actors, mainly coordination and transparency difficulties.

34 IMF, Press Release No. 21/59, IMF Staff Completes Virtual Mission to Zambia, March 2021
35 K. Strohecker and J. Bavier, Angola negotiates $6.2 billion debt relief from creditors: IMF, September 2021

2. Why crisis prevention is better than crisis resolution

The DSSI and the Common Framework are ex post solutions that do not address the structural problems that cause excessive debts to build up. Sovereign debt accumulation is caused by structural underlying problems – such as over-spending, low GDP growth and low or declining tax revenues.

This situation often is exacerbated by a lack of transparency, which hinders monitoring, proper management and accountability, and encourages unnecessary debt accumulation and corruption. While the financial aid programmes established in response to the Covid-19 crisis are welcome, they do not provide a long-term solution to the debt problem.

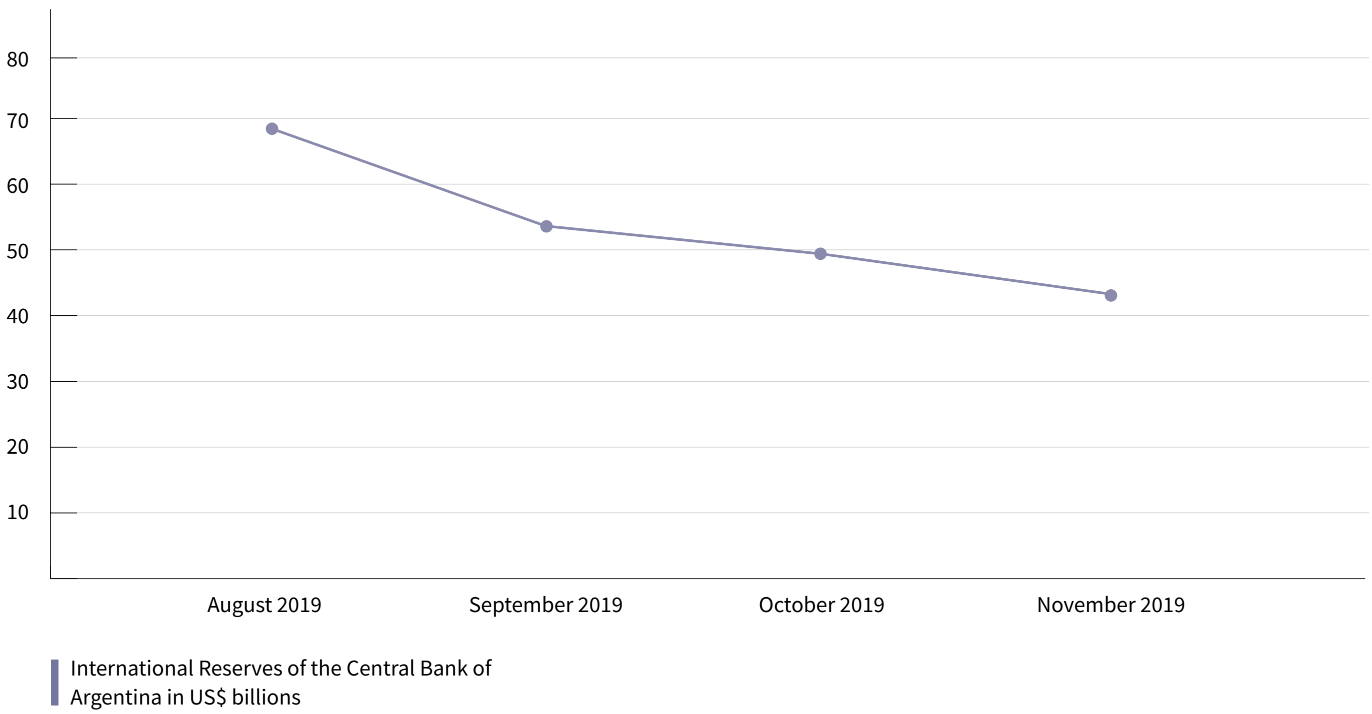
Drawing on the experience of countries that have undergone debt default and/or debt restructuring, in this section we argue that these processes are costly and painful. We look at the experience of Latin America to show how strong debt management tools coupled with a coherent macroeconomic framework and a deep understanding of the dynamics of international capital markets result in a balanced access to financial resources. Indeed, this was the case of Peru and Uruguay, but not of Argentina and Ecuador which suffered repeatedly from debt crises.

As described in an IMF Staff Statement dated February 2020,[36] Argentina's debt service capacity deteriorated materially in contrast with the IMF's prior Debt Sustainability Analysis of 2019. At that time, the IMF assessed Argentina's public debt to be sustainable, but with certain risks such as:

- a further weakening of the exchange rate due to the trajectory of public debt, a large share of which was denominated in foreign currency;
- heightened rollover risks due to the increasingly short maturities of new issuances;
- large external financing needs, which often predicate external crises.

36 IMF Staff Statement on Argentina, February 19, 2020

Figure 5: International Reserves of the Central Bank of Argentina in US$ billions



Source: Central Bank of Argentina[37]

The circumstances surrounding the pandemic have made these risks a reality. In March 2020, the Argentine government announced its decision to restructure the debt – the nineth restructuring in its history. This followed the depreciation of the Argentine peso by over 40% against the US dollar – the largest in 2020 after Venezuela – the deterioration of Argentina's sovereign risk after its presidential election in September 2019, and a larger than expected drop in real GDP – despite significant IMF disbursements.[38] On the back of the announcement of debt restructuring, Argentina's net international reserves took another plunge after approximately a 30% drop – from 67.7 to 43.3 billion dollars – in the months following the election (Figure 5).

As the debt crisis became evident amongst pressures from the Covid emergency, the government unilaterally extended deadlines on some of its domestic law governed debt and implemented foreign exchange control measures to avoid a run on its local currency. In addition, it began a debt renegotiation which took place during the first half of 2020. In August 2020, Argentina reached an agreement with its creditors to restructure 65 billion dollars of external debt[39] which resulted in bondholders accepting a reduction of almost 40 billion dollars over the 2020-2024 period. However, after an exhausting seven-month negotiation with creditors, Argentina's public debt to GDP ratio is now set to reach levels of around 110%, with almost no change in the share of public debt denominated in foreign currency (approximately 70%).[40] The case of Argentina shows that debt restructuring once a crisis has occurred, even if it is pursued in an orderly manner, is onerous. This is because of the short-term costs of emergency measures, such as implementing fiscal austerity to rein in public spending and reassure lenders about debt sustainability. There are also long-term effects that are often overlooked, such as the loss of credibility that a country suffers as a consequence of debt restructuring. IMF research on the effects of sovereign credit history on a country's sovereign interest yield found that the default premium rises with the number of years a sovereign stays out of the market after a default, and that the interest rate cost of default has been underestimated in previous studies.[41]

37 Central Bank of Argentina official statistics available at: http://www.bcra.gov.ar/PublicacionesEstadisticas/Principales_variables_datos.asp?serie=246&detalle=Reservas%20Internacionales%20del%20BCRA%A0(en%20millones%20de%20d%F3lares%20-%20cifras%20provisorias%20sujetas%20a%20cambio-%20de%20valuaci%F3n)

38 Ministry of Finance, Argentina's Debt Sustainability Framework, 20 March 2020

39 Press release from the Ministry of Economy of Argentina, August 2020

40 P. Guidotti, Argentina on the brink, again, Official Monetary and Financial Institutions Forum 7 October 2020

41 IMF Working Paper, Asia and Pacific Department, Default Premium, prepared by Luís A. V. Catão and Rui C. authorized for distribution by Brian Aitken July 2015

Hence, a defaulter will experience a risk premium of 2% of GDP, with an extra difference of one per cent of GDP remaining after five years. The effects are worst in the case of 'serial' defaulters such as Argentina. The interest rates on debt issuances between 2016 and 2018 ranged between 6% and 8%, in contrast with other countries in the region that averaged between 3% and 4% over the same period.

An additional burden for countries that default is the legal and financial costs charged by professionals that assist in the process of restructuring, including lawyers, financial arrangers and even the information agents who help administer the restructuring. Often the costs of litigation need to be added to legal and financial costs. In the 2020 Argentine restructuring, the government limited the commissions of the professionals involved to a maximum of 0.1% of the total amount to be restructured – almost 69 billion dollars.[42]

Contrast Argentina's debt situation with that of Peru and Uruguay; they entered the crisis with balance sheets in good order and so have been able to tap international capital. The 2020 annual consultation of the IMF with the Peruvian authorities resulted in Peru being considered as one of the best-performing Latin American economies, with an annual real GDP growth averaging 5.4% over the past fifteen years.[43] Its macroeconomic policy framework allowed Peru to take advantage of the uncertainty generated by the Covid 19 crisis – despite domestic political tension during 2020, which included the impeachment and replacement of the incumbent president Martin Vizcarra. In November 2020, Peru issued dollar denominated bonds maturing in 2032, 2060 and 2121, for a total amount of 4 billion dollars, at historic low rates of 1.86%, 2.78% and 3.23%, respectively.[44] This issuance adds to the April issuance of dollar denominated bonds maturing in 2026 and 2031, for a total amount of 3 billion dollars at rates of 2.39% and 2.78% respectively.[45]

Uruguay has been on a similar path over the last twenty years. Real GDP has grown at the annual average rate of 4.7%, and this has driven poverty reduction – the poverty rate dropped from 40% in 2003 to 8% in 2019. After the last restructuring of its public debt in 2003, Uruguay had primary surpluses averaging 2.3% in the 2003-2007 period, primary surpluses averaging 1.3% of GDP in the 2008-2012 period and had a primary balance i.e., zero deficit as of 2018. In June 2020, Uruguay issued foreign currency denominated debt at a 2.48% and 3.75% rate, maturing in in 2031 and 2040 respectively.[46]

"

An additional burden for countries that default is the legal and financial costs charged by professionals that assist in the process of restructuring, including lawyers, financial arrangers and even the information agents who help administer the restructuring.

42 See Article 4 e) of Law No. 27544 and Executive Order No. 250/2020 (available in the link in Spanish)

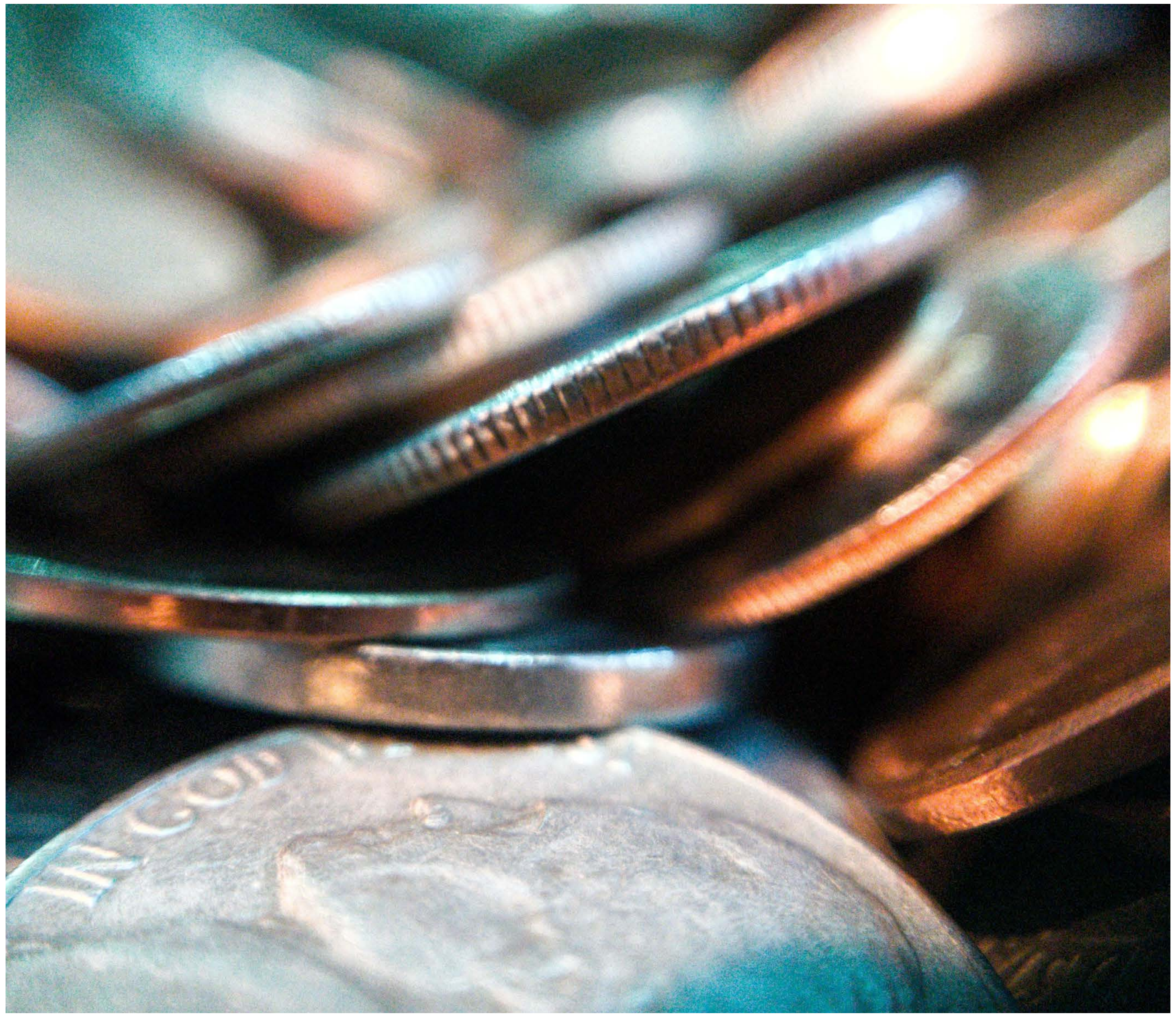
43 2019 Article IV Consultation—Press Release; Staff Report; Staff Statement and Statement by the Executive Director for Peru, IMF Country Report No. 20/3, January 2020

44 Press release from the Ministry of Economy and Finance of Peru, December 24, 2020

45 Press release from the Ministry of Economy and Finance of Peru, April 20, 2020

46 Sovereign Debt Report from the Sovereign Debt Management Unit, Ministry of Economy and Finance of Uruguay, January 2021

3. *Ex ante* measures: prevention rather than curing



The cases above highlight that focusing on debt resolution only deals with problems as they occur and do not tackle the source of the problem: it cures rather than prevents.

Preventative measures must assess whether there is a real need to incur new debts, and also improve transparency in sovereign borrowing. This means assessing whether and under which conditions countries should take up new debt obligations. Several recent debt scandals confirm that debts are sometimes wrongly incurred.

This section explores good practices and voluntary measures that can guide the borrowing, i.e., the new debt incurrence. The focus is on preventing unnecessary or excessive debt on the back of poor governance and a lack of transparency. Clearly established procedures, transparency, oversight and accountability are broad public goods, and people should be fully informed about the steps that their countries undertake when they borrow internationally, as well as being fully aware of their countries' debt obligations and liabilities. A framework where each step in the process of taking up debt, and the necessary checks and balances are clearly enunciated, is critical to proper and responsible borrowing.

3.1 Transparency

As defined by Mustapha and Olivares-Caminal, transparency, in the context of the public debt management sphere, can be defined as "making information publicly available, so that it is accessible to interested stakeholders and the wider public". Transparency is a public good. More quantity and quality of information on public debt can allow both borrowers and lenders to take efficient borrowing and lending decisions, ultimately preventing the formation of new debt crises. Publicly available data on public debt can also directly impact on rating agencies' assessment, thus lowering borrowing costs.[47] But it is not only a question of how much information is disclosed, but also of the quality of the reported data. Reporting lump figures without including details on maturity dates, material contractual clauses, composition of creditors and any contingent liabilities in place, means that the information is not of much use for market players, civil society, and other stakeholders.

The recent shift towards non-concessional lenders that we discuss in Box 1 has brought an additional, constraint to transparency. Due to confidentiality clauses in non-traditional loans and hidden obligations, the full extent of debt obligations is sometimes unknown, especially in relation to collateralised debt, and only revealed when the debt crisis materialises, such as in the cases of Chad and Congo.[48] Ecuador, one of the largest oil producers in the world, is an example of unreported official debt data. In recent years it has seen its non-oil public sector revenue deteriorate. Such a deterioration, as well as a changing political context, resulted in Ecuador having difficulties in obtaining traditional balance sheet funding. However, Ecuador decided to systematically finance its public expenditure by selling oil derivatives owned by its publicly-owned oil company to obtain additional funding. In Ecuador, these liabilities were worth about 9% of GDP, but went unreported in official debt data as it is not fully qualified under the definition of "reportable liabilities".

The G20 have stressed the importance of transparency (G20 Operational Guidelines for Sustainable Financing)[49] while the Institute of International Finance has recently published a set of voluntary principles to improve transparency in private sector lending, especially to low-income countries (IIF Principles for Debt Transparency).[50] The latter covers various types of financial agreements in foreign currency, including loans, guarantees, asset-backed lending and repos.[51] The focus is to promote consistent and timely disclosure of information. The IFF encourages borrowers and lenders alike to disclose as much information as possible about the financial arrangement. In summary, the Voluntary Principles for Debt Transparency encourage disclosing identified essential features of the transaction, including parties involved, type of financing, ranking, amount borrowed and currency, maturity, interest rate, use of proceeds, applicable law, whether the operation is collateralised, dispute resolution mechanism, and the presence of a waiver to sovereign immunity. The Principles also encourage disclosure by the private sector lender where the arrangement is bilateral or by the intermediary where the arrangement is syndicated.[52]

To monitor the actions taken by a sovereign to improve transparency, the World Bank has developed the Debt Reporting Heat Map for IDA borrowing countries.[53] The map assesses public debt dissemination practices in IDA countries; it covers public debt statistics dissemination practices and publication of key debt management documents relating to borrowing plans and managing the disbursements.[54] Dissemination practices are assessed by: (i) data accessibility: whether the information is centralised and publicly available); (ii) completeness – whether the information available covers all debt instruments and all types of external debt of the country; and, (iii) timeliness in posting the statistics.

The countries that show the lowest transparency according to the assessment conducted in April 2020 are Burundi, Chad, Comoros, Djibouti, Eritrea, Haiti, Kiribati, Lao PDR, Marshall Islands and the Federated States of Micronesia. By 2019, of the 17 LICs with available data, only eight countries complied with minimum disclosure requirements in debt, and only four with monitoring guarantee requirements.[55]

47 S. Mustapha and R. Olivares-Caminal, Improving transparency of lending to sovereign governments, ODI, July 2020
48 H. Bredenkamp, R. Hausmann, A. Pienkowski, and C. Reinhart, Challenges Ahead, Sovereign Debt: A Guide for Economists and Practitioners, September, 2018
49 IMF and World Bank Group, G20 Operational Guidelines for Sustainable Financing Diagnostic Tool, November2019, approved by Kristina Kostial (IMF) and Marcello Estevão (World Bank).
50 IFF, Voluntary Principles for Debt Transparency, June 10, 2019
51 IFF, Voluntary Principles for Debt Transparency, June 10, 2019
52 IFF, Voluntary Principles for Debt Transparency, June 10, 2019
53 Debt Reporting Heat Map, World Bank Group, April 2020
54 The map also evaluates contingent liabilities such as guarantees
55 World Bank Group, Global Economic Prospects, Flagship Report, Chapter 1, page 17, January 2021

This more transparent approach was evident in the allocation of Covid-19 budgetary support to Air Côte d'Ivoire, the public transportation company and the port of Abidjan.

After Mozambique's recent debt scandal,[56] the focus has also been placed on guarantees and loans to state-owned companies (SOES), since these usually receive budgetary support to cover for deficit and ultimately rely on central governments for loan repayment due to lack of clear division between the state and the companies.

Côte D'Ivoire provides an example of improvements in transparency with regard to the SOEs through the creation of a dashboard that enables a broad-based overview of SOEs' financial health and strengthening accountability capacity of SOE management, with biannual financial reports of Air Côte d'Ivoire, the national airline, and performance contracts for the management of eight SOEs.[57] This more transparent approach was evident in the allocation of Covid-19 budgetary support to Air Côte d'Ivoire, the public transportation company and the port of Abidjan.

Other examples include Cabo Verde, Cameroon and Ghana where official reports have been published on SOEs performance, the Gambia and Niger which strengthened governance and the auditing of operations of SOEs, and Cameroon, Guinea and Mozambique that updated the legal framework for SOEs.[58] This is a positive trend towards increasing transparency and awareness. However, the devil remains in the detail as the quality and amount of information to be revealed is very important to avoid situations like that of Ecuador where due to a technical definition certain liability were not properly disclosed.

56 The original financing arrangements were: (1) a $622m loan to ProIndicus, a state-run security firm, to perform coastal surveillance; (2) a $535m loan to the Mozambique Asset Management Company (MAM) to build and maintain shipyards; and (3) a $850m loan to Ematum, a state-run fishing company, to build a tuna-fishing fleet. All these loans were guaranteed by the central government. The loans were arranged by the banks, VTB and Credit Suisse. Of the three loans, only the one to Ematum was publicly disclosed; later, it was converted into loan participation notes (LPNs), which were traded in open markets. The Ematum LPNs were, in turn, legally extinguished in April 2016 through an exchange for $727m of sovereign Eurobonds issued by the Mozambique government — an entirely new legal obligation. See Rodrigo Olivares-Caminal, Why does Mozambique need to pay its non-odious debt? FT Alphaville

57 Côte D'Ivoire, IMF Country Report No. 20/321, December 2020

58 IMF, The Evolution of Public Debt Vulnerabilities in Lower Income Economies, February 2020, approved by Seán Nolan (IMF) and Marcello Estevão (WB)

3.2 Debt Management

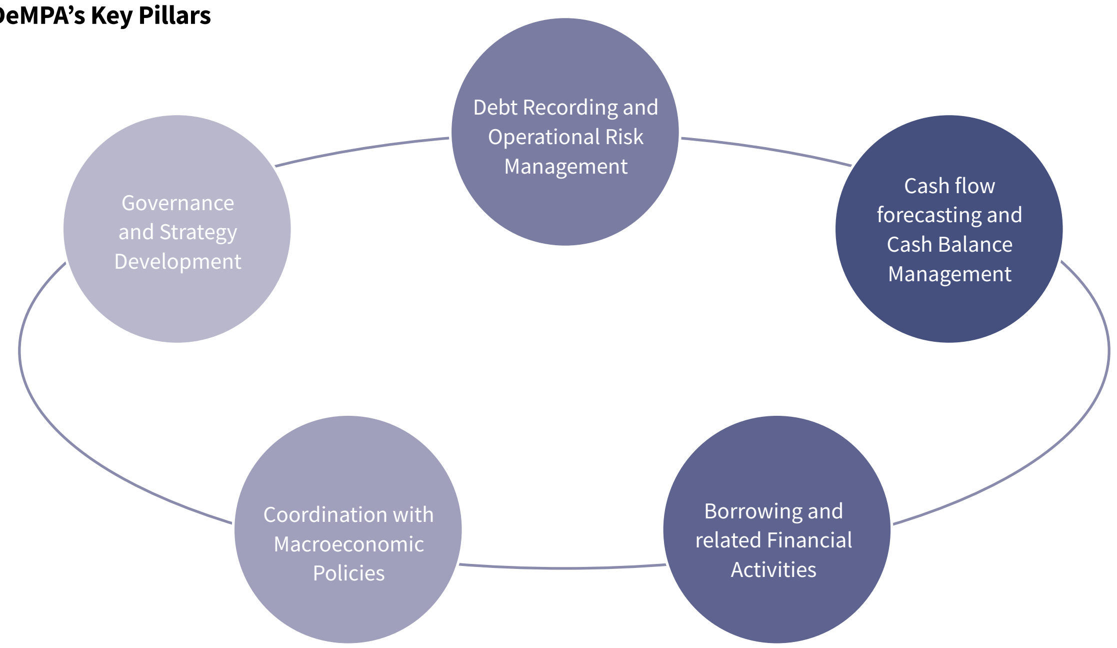
Sovereign debt management is "the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding, achieve its risk and cost objectives, and to meet any other sovereign debt management goals the government may have set, such as developing and maintaining an efficient market for government securities".[59] Officials in charge of debt management should observe that public sector indebtedness remains on a sustainable trajectory and that a sensible strategy is executed to address growing levels of indebtedness. Debt terms such as maturity, currency, or interest rate are factors which influence a responsible debt management strategy, which if well executed should be successful in avoiding financial crises.

Proper debt management should be at the cornerstone of any country seeking to prevent unnecessary or excessive debt and making sure that if it is incurred it is used for the purpose established in the loan. Certain EMDEs, particularly LICs, still do not have a solid framework in place to distance borrowing decisions from political pressures.[60] The IMF reported that there are currently major gaps in debt management and transparency and that most LICs have not implemented minimum debt management standards,[61] despite the many tools and guidelines that have been developed in the recent years. These tools and guidelines are assessed below.

3.2.1. The Debt Management Performance Assessment

To address some of the debt management shortcomings, the World Bank has developed the Debt Management Performance Assessment (DeMPA),[62] a programme aimed at strengthening capacity and institutions in developing countries to improve debt management capabilities. The DeMPA produces assessments for sovereign states and sub-sovereign players. The sovereign assessment focuses on five key pillars related to central government debt management activities, as described in the figure below (Figure 6). These five key pillars are: (i) debt recording and operational risk management; (ii) cash flow forecasting and cash balance management; (iii) borrowing and related financial activities; (iv) coordination with macroeconomic policies; and (v) governance and strategy development. Within these pillars the DeMPA has 14 performance indicators that are measured to determine the performance of each country.[63]

Figure 6: DeMPA's Key Pillars



Source: https://www.worldbank.org/en/programs/debt-toolkit/dempa, authors' elaboration

59 Guidelines for Public Debt Management, IMF-WB, March 21, 2001

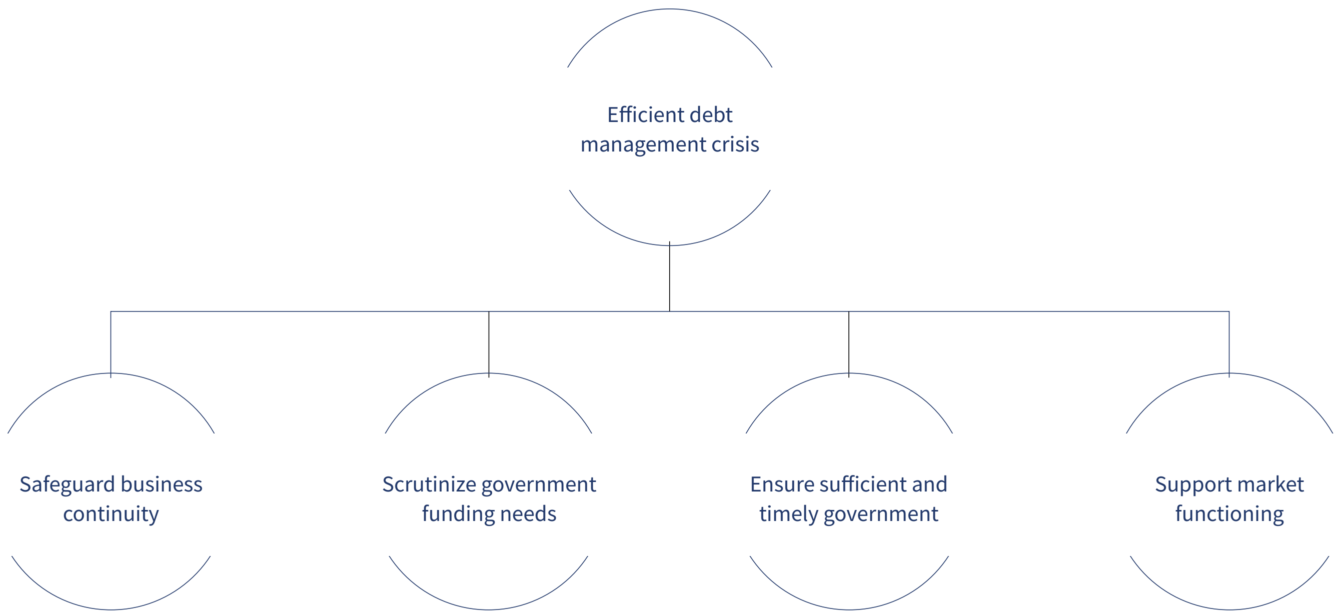
60 Global Economic Prospects, World Bank Group, Flagship Report, January 2021

61 Ibid. The Evolution of Public Debt Vulnerabilities in Lower Income Economies, February 2020, Approved By Seán Nolan (IMF) and Marcello Estevão (WB)

62 Debt Management Performance Assessment (DeMPA), World Bank, 2015

63 Debt Management Performance Assessment (DeMPA) Methodology, World Bank Group, 2015

Figure 7: DMF's debt management crisis respons



Source: World Bank Covid-19 Debt Management Crisis Response, 2020.

3.2.2. The Sustainable Development Finance Policy (SDFP)

IDA has also developed the Sustainable Development Finance Policy (SDFP) that applies to all IDA-eligible countries with the aim of moving towards transparent, sustainable financing, and promoting coordination between the IDA and other creditors. The SDFP was issued in July 2020 and replaced the Non-Concessional Borrowing Policy. The SDFP has two pillars built on the back of two different albeit related programmes: (i) the debt sustainability enhancement programme; and (ii) the programme of creditor outreach.[64]

Under the debt sustainability enhancement programme, countries will be screened annually for debt-related vulnerabilities and will need to implement performance and policy actions (PPAs) defined in consultation with IDA and established based on a sound analytical framework. The World Bank will support the design and implementation of PPAs through analytical work and lending instruments. Countries that do not satisfactorily implement their PPAs would not be able to access 10 or 20 per cent of their annual IDA allocations.

The creditor outreach programme consists in advancing dialogue among a broader range of development partners towards putting in place a set of principles on transparent and sustainable financing, facilitating coordination at the country level among different creditors, including traditional and non-traditional creditors and enhancing transparency and communications on sustainable financing.

3.2.3. The Debt Management Facility initiative

The World Bank's Debt Management Facility initiative (DMF) is a multi-donor funding initiative that offers advisory services and training on investment matters to developing countries to strengthen their debt management capacity, processes, and institutions by improving debt transparency. The DMF has supported until today over 74 countries and 18 subnational entities with their debt management initiative.[65]

Due to the COVID-19 pandemic, the World Bank has developed a debt management crisis response guideline for LICs under the DMF. The aim is to help them adapt their debt management strategies to emergency funding to tackle the current sanitary crisis.[66] According to this crisis response guidelines, LICs should focus on the following four aspects: (i) safeguarding the business continuity; (ii) scrutinising government funding needs; (iii) ensuring sufficient and timely government funding; and (iv) supporting market functioning. The figure above (Figure 7) illustrates DMF's debt management crisis response.

3.2.4. The Stockholm Guiding Principles for Managing Sovereign Risk and High Levels of Public Debt

Sovereign investor relations also play a crucial role in debt management. One of the first initiatives in this area was the Stockholm Guiding Principles for Managing Sovereign Risk and High Levels of Public Debt, which was originally developed in 2010 and updated in 2017.[67]

64 Sustainable Development Finance Policy, Promoting sustainable borrowing and lending practices in IDA Countries, Effective July 1, 2020
65 World Bank, Debt Management Facility (DMF), July 10, 2019
66 World Bank Covid-19 Debt Management Crisis Response, 2020
67 IMF, Stockholm Principles on Guiding Principles for Managing Sovereign Risk and High Levels of Public Debt, 2017.

These principles contain three main pillars: (i) framework and operations; (ii) communication; and (iii) risk management. Within the first pillar, framework and operations, a debtor should define the scope of debt management to include all variables such as contingent liabilities and other less obvious debt liabilities. Information sharing should take place among relevant public authorities, and where appropriate, also with the private sector. Debtors should also have flexibility to adapt the debt issuance format and/or adopt different issuance technique.

The second pillar, communication, involves timely and transparent market communication to reduce uncertainty and create a predictable operational framework for debt management. Prior consultation with investors and other stakeholders should be undertaken to garner feedback and support for the planned changes. Debt managers and monetary, fiscal, and financial regulatory authorities should also actively communicate between each other.

For the final pillar, risk management, close, and continuing dialogue with the investor is crucial to understand investment philosophy, identify potential vulnerabilities and new opportunities. This involves keeping the debt portfolio at prudent levels and the range of risk factors considered should be consistent with the broadest definition of the debt portfolio. This risk management strategies covering the full range of risks facing sovereign debt managers should be adopted and communicated to investors.

3.2.5. Operational Guidelines for Sustainable Financing

The G20 also joined the spectrum by issuing the Operational Guidelines for Sustainable Financing. These guidelines were developed in 2017 to *"enhance access to sound financing for development while ensuring that sovereign debt remains on a sustainable path by fostering information sharing and cooperation among borrowers, creditors and international financial institutions, as well as learning through capacity building."*[68] The effectiveness of the guidelines and principles was undermined, however, by a lack of practical guidance for implementing them and monitoring compliance by debtors and creditors.[69] To this end, the IMF and the World Bank Group developed in 2019 a diagnostic tool that allows bilateral creditors to evaluate their compliance with the principles set out in the guidelines. These are summarised below:[70]

1. **Adequacy of Financing:**
   Creditors shall work together with the debtor to ensure debt sustainability and financing options. The creditors should analyse where the debtor will be able to comply with the financing terms that are being proposed. The diagnostic tool suggests that a strong practice for lenders is to have an internal framework for debt sustainability assessments and to offer a range of financing terms that enable borrowers to mitigate risks of the debt portfolio at reasonable costs. Special focus is given to providing transparency in collateralised debt obligations backed by natural resources and commodities, due to the LICs increased use of these types of instruments to overcome credit constraints.

2. **Information-sharing and transparency:**
   Making loan-by-loan data publicly available on a centralised basis to ensure that any lending is adequately disclosed is a must. However, focus is not only on hidden debts, but also on hidden terms (or terms not properly understood by the debtor). A strong practice consists in avoiding confidentiality clauses. Additionally, a creditor shall also make publicly available any participation in debt restructuring processes.

3. **Consistency of financial support:**
   In relation to the adequacy of financing, a strong practice for creditors would be to ensure that the financing provided to the borrower complies with the IMF's Debt Limits Policy (DLP)[71], IDA's Sustainable Development Finance Policy (SDFP)[72], and the World Bank's Negative Pledge Clause[73]. In case of a downturn, the creditor should also have a debt restructuring framework in place determining how to act in these situations, always considering the borrower's technical capacity.

4. **Coordination of Stakeholders:**
   The creditor should promote interaction with other stakeholders including IFIs.

5. **Promoting of contractual and financial innovation and minimizing litigation issues to strengthen resilience:**
   The creditor should promote financial innovation in lending and enhancing resilience to shocks by using enhanced contractual clauses, including, the recent version of the single limb collective action clauses and the streamlined version of the *pari passu* clause, both recommended by the International Capital Markets Association.[74] The creditors should also provide technical support to the borrower to avoid disruptive litigation by minority of creditors.

68 IMF and World Bank Group, G20 Operational Guidelines for Sustainable Financing Diagnostic Tool, November2019, approved By Kristina Kostial (IMF) and Marcello Estevão (World Bank)
69 Ibid. S. Mustapha and R. Olivares-Caminal, Improving transparency of lending to sovereign governments, ODI, July 2020
70 Ibid 10. G20 Operational Guidelines for Sustainable Financing Diagnostic Tool
71 The DLP establishes the framework for using quantitative conditionality to address debt vulnerabilities in IMF supported programmes
72 The main objective of the SDFP is to incentivize countries to move towards transparent, sustainable financing and to promote coordination between IDA and other creditors to support the efforts of recipient countries
73 The negative pledge clause is a standard lending undertaking used by the World Bank which prohibits or restricts the promisor from creating encumbrances over its assets to facilitate lending without special security from the member concerned.
74 Draft recommended versions of these clauses are available at https://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-topics/collective-action-clauses/

As a result of the revision, a new framework was proposed and is expected to be in effect by the end of 2021.

3.2.6. The Debt Sustainability Framework (DSF)

Introduced in 2005, and with a last revised version published in 2018, the DSF for LICs works as a support tool for the development goals of LICs, while trying to evaluate and address the risk of creating an unsustainable debt trajectory. The DSF is an analytical framework to guide future borrowing decisions of LICs and lending policies of their creditors, with the aim of balancing countries' financing needs and debt sustainability. The analysis under the DSF includes an assessment made over the country's projected debt burden (including its vulnerability to economic and policy shocks, based on baseline and stress test scenarios) and an assessment of external and overall public debt distress risks (based on indicative debt burden thresholds and benchmarks). The WB and IMF recommend countries to produce a full analysis once a year.[75]

The DSF for LICs uses a template to analyse different scenarios. These inputs are in turn based on a comprehensive macroeconomic framework consisting of historical data and interrelated projections of key macroeconomic variables, often referred to as the baseline scenario. The template applies a series of shocks, or stress tests, to gauge the sensitivity of the debt burden indicators to changes in the baseline scenario. All the debt burden indicators are based on Public and Publicly Guaranteed (PPG) debt and the solvency indicators are reflected in Present Value (PV) terms. The DSF for LICs template classifies countries basedon their debt-carrying capacity. It also compares countries' debt indicators under the baseline and stress scenarios to the relevant established thresholds. Risk signals from the template, referred to as mechanical risk signals, which are combined with critical judgements to determine the risk ratings of external and overall public debt distress.[76]

LICs should therefore also match their debt management strategy with DSA carried out regularly under the DSF, as DSA is key when evaluating borrowing and lending decisions.[77] The IMF has also developed a DSF for Market Access Countries (MACs) which has recently been revised. As a result of the revision, a new framework was proposed and is expected to be in effect by the end of 2021. This framework has a new and enhanced methodology covering a broader debt coverage and longer projection horizon in three stages:[78] (i) near-term horizon predicting sovereign stress over one and two years, (ii) medium term horizon, focusing on analysis of roll over risks and stress test to model specific risks, and (iii) an optional tool to analyse long-term risks (over five years).

The roll over analysis is a critical aspect of any debt management strategy. An important element that builds into the transparency element is that to achieve a successful analysis under the new framework, more transparency is needed as additional information is required to make the assessments. The new framework proposes a categorisation of debt into applicable law, marketable/non-marketable debt, currency composition of foreign exchange debt, and additional information about the holders' profile. The report also considers that a broader coverage of debt is needed to include contingent liability risks, government guarantees, private-public partnerships (PPPs), and special purpose vehicles (SPV) and central bank liabilities, such as currency exchange swaps.[79]

The debt analysis is also impacted by the ability of countries to meet gross financing needs (GFNs), which varies substantially across the wide spectrum of MACs. As explained by the IMF, countries with a small domestic investor

75 "The Debt Sustainability Framework for Low-Income Countries. Introduction" IMF, July 13, 2018

76 D. Cassimon, The IMF-WB Debt Sustainability Framework: procedures applications and criticisms, September 2016

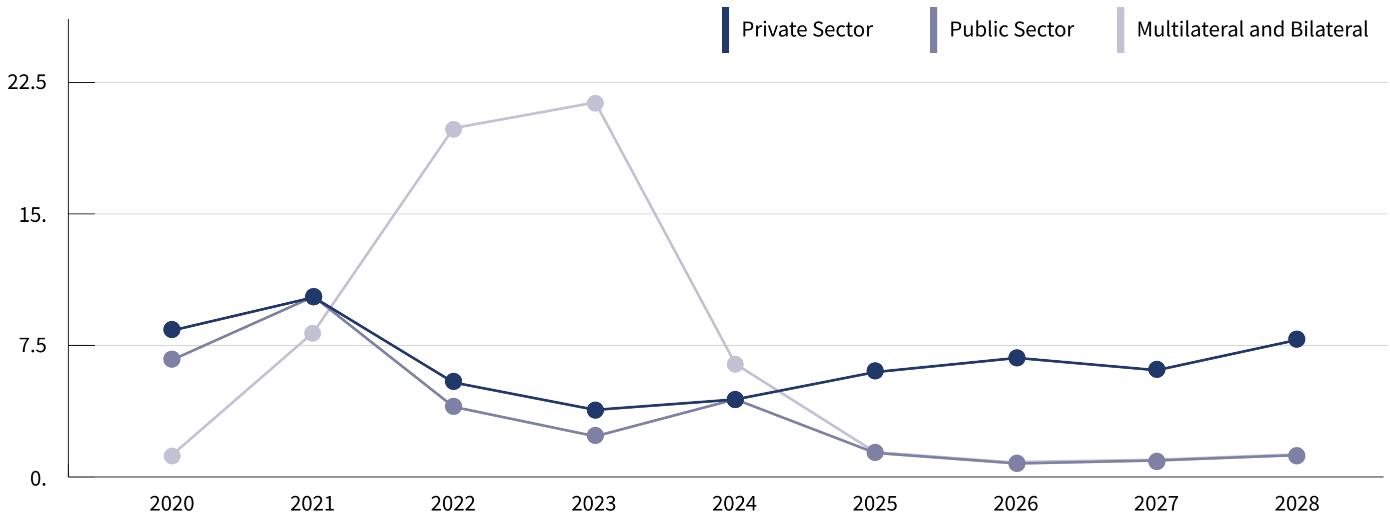
77 Joint World Bank-IMF Debt Sustainability Framework for Low-Income Countries, March 12, 2020

78 Review of The Debt Sustainability Framework for Market Access Countries, International Monetary Fund, Strategy, Policy, & Review Department, February 3, 2021

79 Ibid.

Figure 8: Argentina's principal payments between 2020-2028 (disaggregated by sector)

Maturity of capital payments in $ billions



Source: Official Statistics, Government of Argentina

base, given their macroeconomic conditions or dependency on sole commodities, (such as oil, crops, etc.), can face serious liquidity pressures to meet medium size GFNs, especially considering those countries which do not have a stable and developed capital market, and who depend on the capital flow of international investors and their prevalent appetite for local debt. The new framework, therefore, also endorses a new GFN assessment methodology that considers the needs for extra financing caused by shocks and whether countries have the capability of increasing debt exposures before shocks.[80]

Argentina, as explained above, provides a clear-cut example of the importance of analysing the roll over possibilities in relation to debt planning of maturities, with the government itself declaring debt was un-financeable in March 2020.[81] The graph below (Figure 8) shows principal maturities due between 2020 to 2028 disaggregated by sector and prior to the restructuring that took place in August 2020.

Figure 8 shows a concentration of payments between 2021 and 2023, with interest rates ranging between 6 and 8 %.[82] Argentina also had a private creditor concentration represented by three groups of private creditors: (i) the Ad Hoc Group of Argentine Bondholders; (ii) the Argentina Creditor Committee; and (iii) the Exchange Bondholder Group[83]. This concentration of payments combined with internal and external shocks (e.g., political tension due to presidential elections in September 2019 and droughts that affected the export of agricultural commodities), triggered the need for a new debt restructuring for Argentina. This new debt restructuring could perhaps have been avoided with a better debt management strategy, based on the pillars explained above. However, an important aspect to be considered is that the multilateral and bilateral sector debt has not been rolled over or restructured, which poses Argentina's next challenge after nine defaults.

3.3. Financial Management Tools

Within all these debt management tools, guidelines and programmes; financial management tools and technology play a major role in helping to administer the debt and manage data. Somalia was one of the latest countries to acquire the Commonwealth Secretariat Meridian debt recording and management system with financial assistance from the African Development Bank.[84] Meridian is a debt management software programme produced by the Commonwealth Secretariat which enables countries to record and report debt instruments according to the recommended statistical methodology of the IMF and World Bank Public Sector Debt Guide. It covers a broad range of debt instruments, including contingent liabilities.[85]

In South Sudan, poor public financial management created a credibility gap with donors, including aid being disbursed and implemented outside of government systems with inefficient cash management and poor governance structures. However, the authorities received technical assistance from both the IMF and the World Bank and committed to implementing the recommendations, including reviewing and verifying loans and contracts collateralised or guaranteed against crude oil, and establishing a Public Procurement and Asset

80 Ibid.

81 Ministry of Finance, Argentina's Debt Sustainability Framework, 20 March 2020

82 Official statistics from the Ministry of Economy of Argentina

83 Press release from the Ministry of Economy of Argentina, Argentina and three creditor groups reach a deal on debt restructuring, Tuesday, August 4, 2020

84 Somalia, IMF Country Report No. 20/310, November 2020

85 Commonwealth Meridian Frequently Asked Questions, Development Finance Institute

Disposal Authority and Treasury Single Account. The authorities have also committed to using financial assistance under the Rapid Credit Facility in a transparent way agreeing to keep disbursement in a dedicated account at the Bank of South Sudan (i.e., the Central Bank).[86] In the context of the COVID-19-pandemic, several countries introduced special measures tailored to improve the management of their Debt. The IMF has acknowledged on their periodic country reports that countries such as Costa Rica[87], Indonesia[88] and Nigeria[89] have introduced measures to disclose and manage their debts effectively and transparently.

3.4. Based on these frameworks, what should a proper debt management framework consider?

Aligned with the principles and guidelines discussed herein, a proper debt management framework should therefore be based on the following five pillars and should include regular auditing and assessment or stress testing of the global macro-economic environment. The five pillars are:

1. **Decision-Making procedure:**
A clear decision making and approval process for incurring debt and for guaranteeing SOE and sub-sovereign obligations. This should be set out in the law, with a legal and economic analysis, and an assessment of whether there is a real need for the debt. Issues to be considered include which body or authority can issue or contract debt, for which purpose, and what is the legal process for approval, complemented with clear polices on when, how and under which conditions shall the government incur in debt and or in guarantees. This will prevent certain litigious experiences such as those seen recently regarding the debt obligations of Mozambique, Ukraine, and Venezuela's state-owned oil company (PdVSA's 2020), where the validity of the debt was questioned due to issues of capacity (acting ultra vires or in breach of domestic law) and authority.

2. **Independence of the debt management body:**
An effective debt management structure with sufficient personnel in place, and with clear division of powers from other governmental bodies to allow the decision making and execution of debt issuances and agreements according to the debt management strategy, and not to current political needs. The debt management authority should have an organisational chart with clear indications of duties and power of the officers to interact with creditors, issue debt securities, negotiate and execute agreements, and process payments. In this context, independence is of monumental importance to avoid the incurrence of debt resulting from political reasons and/or opportunistic behaviour. Regular capacity building further plays an essential role.

3. **Debt management strategy:**
The strategy in place shall set objectives and evaluate short-, medium- and long-term needs. Cost-effective analysis of financing instruments adapting the debt issuance format and/or adopt different issuance technique according to the needs should be carried out in each opportunity. Hedging techniques and risk amelioration tools should be in place. Any analysis should clarify the assumptions and context used to perform such evaluations. Countries should also plan issuances ahead, considering both external and domestic borrowings. Any roll over strategy should be a priority and clearly set out in within the debt management strategy.

4. **Coordination with fiscal and monetary policies:**
The debt management authority and strategy should be aligned and coordinated with other government authorities, especially with the monetary policy authority but always maintaining independence. Permanent and close dialogue with the investors will be also crucial to understand the investor's profile and assess the possibilities of rolling over the debt. The debt management strategy should therefore be complemented with cash flow forecasting and cash balance management prepared by the fiscal authority or the relevant authority.

5. **Transparency Policy:**
A transparency policy with a clear procedure for debt recording, tracking payments of outstanding obligations, and publication of regular disaggregated debt statistics, including guarantees, collateralised obligations, sub-sovereign debt, and private external debt to facilitate DSA or similar evaluations.

86 Republic of South Sudan, IMF Country Report No. 20/301, November 2020

87 Costa Rica, IMF Country Report No. 20/310, March 2021

88 Indonesia, IMF Country Report No. 20/310, January 29, 2021

89 Nigeria, IMF Country Report No. 20/310, February 2021

4. Accountability and reliance on the Rule of Law

To be effective, transparency and debt management must be combined with accountability. This is a two-way road. Debt transparency and debt management is complex, requiring stakeholders to work together for the same objective. Full compliance with the IIF Principles - and the other guidelines described above regarding debt management tools, guidelines, and programmes—alone will not curtail irresponsible borrowing and lending. Decision-makers need to be accountable for their actions and accountability needs a well-functioning domestic legal system and a strong rule of law to curb any criminal activity related to sovereign debt from the borrower's side. The same applies to lenders if they acted in concert.

The most notorious case involving dubious practices is the so-called Mozambique 'tuna' scandal. This episode started with three state-owned enterprises (SOEs) in Mozambique borrowing 2 billion dollars in 2013 and 2014. The three loans were arranged by Russia's state-owned VTB and Credit Suisse, and were fully guaranteed by Mozambique's state. However, information about two of the loans was initially hidden from the public. The loans were used to acquire military equipment instead of the official purpose which were, coastal surveillance, building a tuna-fishing fleet and a shipyard. Only one loan was made public (Ematum loan) and when the other two were disclosed in 2016, the IMF and bilateral donors suspended their budgetary support, causing severe financial difficulties for the country which ultimately defaulted on external commercial debt as subsequent corrupt findings were made. The country's administrative auditing court also declared the state guarantees illegal for violating the constitution and previous budgetary laws.[90]

In December 2018, a US prosecutor indicted multiple individuals, including high-level Mozambique officials (e.g., the then Minister of Finance), for allegedly conspiring to defraud investors through numerous material misrepresentations and omissions. Mozambique also filed a claim in London against Credit Suisse, among others, for its involvement in the financing (domestic indictments were also issued). In October 2020, Mozambique's Attorney General's Office – with the country's Supreme Court approval – pursued the extradition of three former Credit Suisse bankers implicated in the scandal who acted as arrangers.[91] In parallel, Privinvest, the contractor for the projects in which the monies from the loans should have been invested, launched an arbitration against the three state-owned companies for breach of contract. Mozambique – to remove liability – sued Privinvest and Credit Suisse in London's High Court arguing the debt was not a valid obligation.

The key point here is that even if a loan is hidden, this does not mean it is not valid and therefore countries need clear rules on disclosing and contracting debt. While two loans in Mozambique's case operated under a cloak of secrecy the contracting of the Ematum financing was not hidden as it was discussed in various IMF country reports and had been included in the country's public debt statistics. The loan was later converted into loan participation notes (LPNs) that were traded in open markets, and at a later stage transformed into Eurobonds approved by the National Assembly, counteracting any claims of invalidity. Initially, the court rejected Privinvest arguments, but recently another court upheld Privinvest's appeal against the High Court's decision.[92]

The morale about this debt episode is that not only debt transparency but also accountability is quintessential for any nation. Mozambique's is not an isolated case. In 2019, the UK's Court of Appeals also ruled that Ukraine's Minister of Finance had the authority to contract a debt obligation and creditors were not aware of any breach (Ukraine disputed the validity of the loan on different grounds).[93] Instead of pursuing presumably meritless claims to avoid responsibility, Mozambique's concern – and those of every country in distress – should be on fixing its own economic problems and putting bad practices behind it. The additional expenses generated in defending and on initiating these claims has already produced a dent in Mozambique's economy. Moreover, these are ongoing matters, and they undermine foreign direct investments.

90 R. Olivares-Caminal, Why does Mozambique need to pay its non-odious debt?, Opinion FT Alphaville, April, 2019

91 Mozambique to seek extradition of ex-Credit Suisse bankers involved in $2 billion debt scandal, by Reuters Staff, October 21, 2020

92 British court upholds Privinvest appeal in case over $2 bn. Mozambique debt scandal, by Reuters Staff, March 11, 2021

93 Olivares-Caminal, Why does Mozambique need to pay its non-odious debt, cit.

Concluding Remarks

The DSSI has provided countries with some relief; it has created a breathing space by deferring payments so that resources can be re-directed to fight the pandemic, but clearly this is not enough. Although the Common Framework shows some improvements to broaden the stakeholders trying to bring China into the equation, it is still incomplete and slow, being an *ex post* partial solution to a broader problem.

It is clear that we need to shift focus before debt accumulation reaches unsustainable levels – and not after. The focus should be driven by the preventative measures discussed in this paper: transparency, debt management, and accountability. Although there are many frameworks in place that should help stakeholders manage debt accumulation, it is clear these have not been properly or thoroughly applied given the current excessive debt exposure for many countries. This is a fault of both debtors and creditors.

On the debtors' side, it is plain vanilla. Debtors have either not been prioritising debt management or have not been using it efficiently, despite the many benefits that this can bring. Debtors need to have proper debt management mechanisms in place and understand how internal and external shocks can affect repayment capabilities and roll over capacity. However, the consequences are being learnt the hard way, except for a few cases like Peru and Uruguay where the hard work has proved beneficial during the pandemic. Implementing debt management tools and full transparency have no immediate benefits and high costs, both in terms of investment to develop the frameworks and political costs of disclosing the entire debt portfolio. Given the usual short-term vision of some authorities, the answer could be simply the lack of incentives and immediate benefits of applying these tools.

However, creditors could also be to blame for not making proper analyses of the risks of lending to a country that it is highly indebted, and for being tempted by the high interest rates offered by some high-risk countries. Creditors should also perform a dynamic roll over and cost-benefit analysis to assess whether the debt can be considered sustainable in different simulation scenarios, to avoid excessive over lending.[94] The shift in the composition of creditors has also played a key role. The usual players, such as the IMF, WB, and Paris Club members, previously had total dominance, but, due to the liberalisaton of capital flows and the rapid development of the capital markets since the 1980s, there has been a significant increase in bilateral lending by non-concessional lenders and the private sector. Even so, the multilateral creditors do have responsibilities in this debt accumulation problem. The Argentinian government is currently negotiating with the IMF under the Stand-By Arrangement of 2018 with the objective of agreeing on an Extended Fund Facility with longer terms of payment.[95]

In terms of transparency, the main problem remains the new forms of bilateral credit arrangements that are often performed via alternative financing methods, such as off-balance lending, execution of swap agreements, or via the participation of SOEs. In most of those cases, it is difficult to obtain a clear picture of the facilities' terms and conditions, given the nature of confidentiality clauses that are usually included, thus affecting transparency. The lack of clear disaggregated and truthful public data and information regarding public debt has been a problem for lenders to assess the actual status of public accounts and repayment schedules. Accurate publication of data has also become difficult due to debt structure being now more complex and diversified in the private sector.

94 Vincent S.J. Buccola, An ex-ante approach to Excessive State Debt, Duke Law Journal, November 2014

95 Argentine Government Notifies IMF of Request for New Fund Arrangement, August 26, 2020. In June 2021 the Argentinian government ordered the deferral of debt payments with participating countries of the Paris Club until May 31, 2022. https://www.marval.com/publicacion/argentina-difiere-los-pagos-de-su-deuda-con-el-club-de-paris-14017&lang=en

Lack of accurate data about public debt also makes the IMF's DSA difficult and borrowing and investments decisions harder.[96] The application of a centralized information platform regarding the composition of the public debt has also proven problematic for most developing countries. Software such as Meridian has improved the availability of such data, but there is much to be done by key players to support this. Ultimately, the lack of accurate and complete data complicates restructuring procedures.

Transparency and debt management are not magical fixes, but they can contribute significantly to solving the debt problem. Without transparency, there can be no proper debt management strategy, planning, or debt sustainability analysis. All stakeholders – borrowers and lenders – have a role to play to create greater transparency, especially bilateral lenders. Once transparency is achieved, we can focus on debt management, analysing status and planning in the short, medium, and long-term. Both debtors and creditors also have a key role here. In all cases, countries need sound macroeconomic policies in place as these tools alone are not enough.

Although it is true that the focus of the debt burden issue is slightly shifting from ex post responses to debt restructuring to ***ex ante*** analysis, cooperation by all stakeholders in the debt building process remains critical. Lenders should also provide incentives by including robust loan clauses and covenants such as accurate presentation of financial information, inclusion of certain financial ratios, and even debtors' compliance with some of the guidelines described above so to have more suitable contractual tools. The downside is that sometimes these are difficult to implement when sovereign borrowers are involved.

To achieve debt sustainability, good lending practices are equally as important as good borrowing practices. Debt sustainability requires a sense of shared responsibility among all stakeholders. Although it is a long and tedious path, this is the only way to make debt sustainable over the long term. The final building block is accountability, i.e., assuming responsibility, which can only be built on the back of a strong rule of law. In this paper we have argued that measures of debt prevention are preferable to *ex post* debt-restructuring.

We leave, however, some open questions, notably on how the crisis-prevention framework should look like and which vulnerabilities it should address. Furthermore, we leave open how such a framework should fit in to the international financial architecture. There are indeed two issues that have emerged from our discussion and suggest the need to improve the structure and governance of lending for development and financial sustainability. The first is the issue of conditionality that still pushes countries in need away from the international financial institutions. The debt management framework that we have explored in this paper is an example of constraints that countries with limited financial resources and poor governance are not prepared to face, especially when the option of borrowing bilaterally seems easier. The second issue is the potential 'moral hazard' that informs the action of bilateral lenders, knowing that poor countries will eventually be rescued by the international financial institutions. Hence lenders may be willing to extend credit to countries with poor fundamentals, knowing that the default risk will be manageable, and will be managed at the multilateral level.

96 Global Economic Prospects, World Bank Group, Flagship Report, January 2021

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