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The 2015 Debt Crisis

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At the London G20 Summit, participants reaffirmed their commitment to the Millennium Development Goals (MDGs) and to increasing official development assistance (ODA). This aid will be important in helping the poorest countries meet the MDGs that were agreed before the crisis, but it will probably be insufficient to tackle the additional problems caused by the current economic downturn.

Hence a lot of attention has focused on the US$1.1 trillion of new financing that the G20 pledged to make available. Although this will be helpful for many developing countries facing liquidity or budget problems, the fact that this support will come mostly in the form of loans rather than grants may pose future problems for debt sustainability. This One Pager argues that the international community should move now to put in place an international mechanism for sovereign debt restructuring so that future debt crises do not have to be resolved through *ad hoc* rounds of debt relief.

Developing countries are being hit on all sides by the crisis. Their growth is projected to slip to 1.6 per cent in 2009, down from 8.3 per cent in 2007 (IMF, 2009). Slower domestic growth means lower tax collection and less investment in growth, jobs and the MDGs. And a slowing global economy means that communities are receiving fewer remittances from family members working overseas.

Exports are falling because of lower international demand and reduced trade finance. And international credit markets are frozen, imperilling not only future investment but also the ability to roll over existing loans. The World Bank has estimated that some 98 developing countries could face a financing gap of between US$268 billion and US$700 billion in 2009 (World Bank, 2009).

Like their counterparts in the North, developing-country governments have to balance their books and improve the standard of living of their electorates. With other financial flows drying up, it will be tempting to take advantage of the expanded loans available through the development banks and the International Monetary Fund (IMF). This may be a necessity for some countries, even if unwelcome loan conditions remain in place.

External public debt levels are therefore likely to rise again, but this is not necessarily a bad thing. Countries and their populations have a right to borrow, to invest in jobs and growth for the future and also to smooth good and bad times. But we may soon see warning lights flashing again. The last three decades have brought a cycle of sovereign indebtedness that has been costly not only financially but also in terms of human opportunity. The oil boom in the late 1970s led to a world in which excess liquidity washed down to the world's poorest countries. By the late 1980s and early 1990s, an unfavourable external environment, coupled with irresponsible creditor and debtor government behaviour, left citizens in many developing countries saddled with high levels of debt.

The international community slowly recognised that many poor countries were caught in a debt trap and, facing mounting pressure from civil society, creditors put in place a series of debt relief schemes such as the Highly-Indebted Poor Countries (HIPC) programme and the Multilateral Debt Relief Initiative (MDRI). These schemes have contributed significantly to reducing the debt burden of some 24 eligible countries. While another 17 could receive irrevocable debt relief once they meet eligibility criteria, many other ineligible countries still hold high levels of debt.

If developing-country debt problems come to a head once again—including because of how the international community is responding to the current economic crisis—we will need a new way of addressing the problem. A second round of debt relief schemes based on creditor largesse will lack credibility. The scene is set once again for an idea that almost reached fruition in 2003, albeit in an imperfect form. An international mechanism for sovereign debt restructuring, which includes provisions for temporary moratoria on debt servicing, could provide a better means of restructuring unpayable debts in a way that is fairer, more transparent and more efficient for the creditors, the indebted country, and its population.

To be effective and comprehensive, however, any such arbitration mechanism would need to cover the claims of the World Bank and IMF. These are not covered by the recent introduction of "collective action clauses" in sovereign bonds.

The time to put in place such a mechanism is before a new debt crisis emerges, not when the waters start to get choppier. Otherwise, 2015 may be remembered as the year that a new debt crisis emerged, rather than the year in which we celebrate achieving the MDGs.

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