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New Architecture for Sovereign Debt

Without reform, increased financial flows to developing countries are at risk of contributing to future, unsustainable debt burdens.

Despite the various multilateral and bilateral debt relief operations, developing country external debt increased to US\$3.35 trillion in 2008.

As a result of the economic downturn, there is a great probability that many developing countries will be forced to default on their debt repayments.

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Debt Sustainability

Many countries, such as the Philippines, Bangladesh and Lesotho, have been left out of the HIPC debt relief process, despite having high levels of poverty and often paying more on debt service than on essential services.

The Philippines' external debt stands at \$60.3 billion, and in 2006 it paid \$13.6 billion in debt repayments. However as a middle income country it does not qualify for debt cancellation under internationally agreed schemes. According to a 2007 study by New Economics Foundation, the Philippines require 63 percent debt cancellation in order for the government to met the basic needs of its citizens.

The Debt Sustainability Framework must be reviewed and redefined, giving centrality to human development goals and human rights, including gender equality and women's empowerment.

Global Framework for Responsible Financing

A different approach to comprehensively address the process of borrowing and lending is needed. Responsible lending must be the cornerstone and can only be achieved by the adoption of a binding legal framework that deters creditors from engaging in irresponsible lending.

The international community has repeatedly issued calls for more responsible lending for several years, including at G8 summits, in the G20, in the OECD, and the UN General Assembly. It is clear that the problem of debt accumulation and re-accumulation must be tackled in a forward-looking way that looks comprehensively at borrowing and lending and locates these processes in the broader context of the international financial system. Such a framework would take account of both the origin and impact of the debts and offer equal treatment to both debtors and creditors, ultimately affecting the incentives not only for debtors, but also for lenders, and preventing renewed indebtedness on a sustained basis.

The 2008 EURODAD Charter on Responsible Financing (attached), which outlines the essential components of a responsible loan, is an important step towards this goal. Many of the provisions in the Charter are drawn from international treaties and conventions to which lender and borrower nations are signatories.

Sovereign debt work-out mechanism

The financial crisis and the probability of increasing debt problems in the coming months, brings into sharp focus the need for an international forum to deal with sovereign debt claims.

Existing arenas for addressing debt disputes are dominated by lenders, where they serve both as interested parties and judges. Since 1996, when developed country governments including Australia started promising a 'sustainable exit from the debt crisis', only 20 countries have received significant debt relief under the IMF's Heavily Indebted Poor Countries (HIPC) initiative. Despite all the hype, 12 years of "debt relief" initiatives have seen only slightly more than US\$100 million in debt cancelled.

The creation of a new forum to which debt disputes could be brought, where parties are given equal treatment and judgments are based on impartial evaluation of cases, was strongly supported by the G77 group of developing countries at the 2008 UN Financing for Development Conference in Doha.

Recommendations:

a) Participatory Review of Debt Sustainability Framework

From G20 communiqué, Clause 25, "we have agreed to review the flexibility of the Debt Sustainability Framework and call on the IMF and World Bank to report to the IMFC and Development Committee at the Annual Meetings".

This is a welcome step; however the review process should be participatory, involving both governments and civil society. Centrality must be given to human development goals and human rights. Eligibility for debt relief should be expanded to all countries that need it to meet the Millennium Development Goals.

b) A common platform for principled and responsible financing

Any new lending must take into account the essential components of a responsible loan, as set out in The EURODAD Charter on Responsible Financing. This includes ensuring that terms and conditions are fair, that the loan contraction process is transparent, that human rights and environments of recipient nations are respected and repayment difficulties or disputes are resolved fairly and efficiently. New lending to developing countries should be conditioned on verifiable steps towards the establishment of a binding, democratic, accountable and responsible framework for sovereign lending and borrowing.

c) A fair and transparent sovereign debt workout mechanism

Steps should be taken towards establishment of a fair and transparent orderly sovereign debt workout mechanism, as supported by G77 countries.

Such a process would take account of both the origin and impact of the debts, and would give equal treatment to both debtors and creditors, acknowledging co-responsibility that creditors share for the creation of these debts, and giving scope to assess debts on the basis of illegitimacy as well as sustainability.

Attachment:

EURODAD (European Network on Debt and Development) Responsible Lending Charter