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POLICY BRIEFING

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Financing a Just, Global COVID-19 Response and Recovery
The role of debt cancellation, restructuring and new finance

At the start of the COVID-19 pandemic in February 2020, Pope Francis spoke out clearly for debt cancellation at a summit in Rome with some of the world's most powerful financial officials: "*It cannot be expected that the debts which have been contracted should be paid at the price of unbearable sacrifices. In such cases it is necessary to find – as in fact is partly happening – ways to lighten, defer or even cancel the debt, compatible with the fundamental right of peoples to subsistence and progress … it is not right to demand or expect payment when the effect would be the imposition of political choices leading to hunger and despair for entire peoples*."

One year later the Holy Father's words ring truer than ever. The immediate priority for all countries is to save lives and support livelihoods through measures such as healthcare provision, the distribution of vaccines, and social safety nets for those who have lost their jobs and income. In the long-term, the challenge is to rebuild societies and economies that put the needs of the poorest people first and care for our common home.

However, continued debt payments mean that many countries are still diverting vital resources away from meeting the needs of their citizens, most often towards servicing the insatiable appetite for financial gain from private creditors. The current debt relief launched by the G20 in April 2020 [the Debt Service Suspension Initiative (DSSI) and Common Framework, see *Background* below] has been a welcome short-term relief, but doesn't nearly match the scale of the health, economic, climate and biodiversity crisis. New finance is insufficient to respond to the crisis, let alone tackle the climate crisis and rebuild our common home.

The window of opportunity for action on debt and new finance is closing and governments need to bring the reality of those who are suffering to the forefront of the debate. In this moment of triple crises – health, economic and climate – we need policymakers to adopt a long-term vision for change based on what is really needed to care for our brothers and sisters around the globe.

Governments can take action at key moments over the next six months: **February**: G20 Finance Ministers; **March**: potential G20 leaders meeting hosted by Italy as President; **April**: UN ECOSOC Forum on Financing for Development / World Bank and IMF Spring Meetings / G20 Finance Ministers; **June**: G7, UK as President.

What needs to happen now:

1. **Cancellation of debt payments.** G20 governments need to extend their debt relief commitments to more countries and for much longer. The World Bank and IMF need to offer much greater debt relief and the IMF should sell a percentage of its gold reserves to enable this.

2. End beneficial treatment for the private sector. G20 and G7 countries need to ensure private creditors stop taking debt payments, and that they participate in discussions on long term debt relief and restructuring. This is likely to require legislation, particularly in the US (New York) and UK (London), where most private creditors are listed.

3. **New Finance without conditionality.** G20 governments and the IMF need to agree a new and large issuance of Special Drawing Rights (SDRs), which can provide finance for COVID-19 response and recovery. There is likely to only be one opportunity for this during the next decade.

BACKGROUND AND POLITICAL CONTEXT

Debt was propelled to the political mainstream at the start of the COVID-19 pandemic in early 2020, when it became clear that many countries in the global south were being forced to choose between paying back debts and using money to respond to the pandemic through providing medical services and hygiene kits; as well as through social safety nets such as food provision and cash payments for those whose livelihoods had been worst affected. In addition, highly indebted countries were hit by the worst economic recession in decades which imposed a heavy toll on the most marginalized and vulnerable people.

This shone a spotlight on the fact that the debt crisis, far from being solved through campaigns such as Jubilee 2000 and debt cancellation such as the Heavily Indebted Poor Country (HIPC) Initiative, has become entrenched and was destroying countries' economies, even before the COVID-19 pandemic. It also highlighted how the debt crisis is a structural issue and is now much more complicated, with significant debts now owed to private creditors, as well as China, on top of other bilateral and multilateral debt. Cancellation is part of the solution, but more finance and wider reform of the global financial architecture is needed.

There is a pressing need to raise civil society voices again in the first 6 months of 2021 as the political focus and space to get far-reaching action on debt is limited.

There are some new opportunities in 2021. The new Biden administration in the United States provides renewed momentum for multilateral action, such as through stronger action by G20 countries and the IMF on Special Drawing Rights (SDRs). The UK also has a strong record on debt cancellation and is hosting the G7 meeting in June 2021, with debt on the agenda.

However, governments and business are still following an economic orthodoxy that limits ambition, creativity, and willingness for structural changes to tackle flaws in the financial system. The opportunity for reform after the 2008 financial crisis was missed and we are in danger of missing this opportunity in 2021.

For example, governments have been reluctant to tackle private creditors who are in effect being subsidized by debt cancellation from creditor governments. They fear, for example, that legislation to prevent private creditors suing countries in the global south if they default on debt payments, could upset businesses registered on their stock exchanges as in the case of London. The private creditors have been given many opportunities to voluntarily postpone or cancel debts, but so far are showing no signs of acting because the current system is stacked in their favor. Indeed, they cannot act alone, which is why legislation is required.

The IMF and World Bank have been reluctant to talk about selling gold reserves, arguing that they need their full reserves as a guarantee to provide liquidity to developing countries in new loans.

If we don't change the terms of debate on the debt crisis and future financial flows from the current myopic focus of what is politically, financially and technically feasible, to a focus on what is necessary to save lives and protect our planet for current and future generations, we risk not only leaving millions of our brothers and sisters in peril, but also reinforcing cyclical crises.

WHAT NEEDS TO HAPPEN IN 2021

The following actions are needed by governments, multilateral institutions and private creditors in the first 6 months of 2021 to shift the trajectory on debt and financing a just and sustainable recovery.

1. Cancellation of debt payments.

<u>Immediate debt payments</u>

All low and middle-income countries need to be able to suspend their debt payments to their multilateral, bilateral and private creditors for the foreseeable future without having to fear penalties for doing so.

The G20 and the IMF need to deepen and expand their debt relief packages to all global south countries and extend their packages for four years until the end of 2024. The current packages and rolling extensions of 6 months give no certainty to global south countries of what finance they will have available to provide for their citizens and also exclude many countries who cannot afford to be servicing debts as they respond to a pandemic that is far from over.

The time gained from the debt service suspension should be used to conduct debt audits involving civil society in order to identify the unlawful, odious and illegitimate debts. Such debts shall be cancelled without any conditions and not be included as official development aid. The rest which is still unsustainable shall be restructured to manageable levels.

The IMF is the only multilateral creditor that has so far offered limited debt service relief thanks to the new contributions from some countries. **The IMF should consider selling its gold reserves, currently estimated at USD 140bn,** to fund further debt relief as well as future grants instead of loans (which increase debts). To put the figure in perspective, even 10% of the reserves (USD 14bn) would release almost three times what was freed up through the DSSI last year (USD 5.3bn). If the IMF cannot consider selling a portion of its gold reserves to tackle such a global crisis, then why are they keeping such large reserves?

The World Bank has so far called on all other creditors to participate in the DSSI, but itself refused to cancel debt. For a truly effective crisis response, all creditors need to participate and offer an immediate stop to all debt payments, with a view to long-term cancellation.

Broader debt relief

Beyond the suspension, comprehensive debt relief needs to be available to cancel these debt payments to prevent a lost development decade. Developing countries need to have enough fiscal space to fund health systems to be able to care for patients with COVID-19 and oversee the effective distribution of vaccines, as well as to support people whose livelihoods have been destroyed, in particular those who work in the informal sector. There are several legal grounds to suspend debt payments such as the state of necessity, the primacy of human rights over financial obligations and the fundamental change of circumstances.

In November 2020, the G20 agreed on a Common Framework for Debt Treatments. It recognizes that debt is currently at unsustainable levels. It is a step in the right direction but falls significantly short of providing an adequate framework in this crisis. It contains many of the same flaws as past debt treatment framework that were unable to provide the timely, comprehensive, and just restructurings and cancellations that countries in crisis need. **The G20 must ensure that the framework delivers timely, comprehensive, and fair debt restructuring to all countries with a debt problem, not only to the poorest countries.**

Although there is a stronger encouragement to private creditors to be involved compared with the DSSI, their full involvement is not guaranteed, which would slow down progress and make any debt relief partial, temporary, and ineffective. **Private creditors and multilateral development banks must be compelled to be fully part of any debt framework.**

Within the G20 Common Framework for Debt Treatments, any country requesting a deferral or relief of its debt must first reach an agreement with the IMF which has been imposing fiscal austerity for almost 40 years. Then it must face a united front of creditors alone. Within this framework, there is currently little or no space for the voice of the people of the South will be heard. In doing so, the G20 is not recognizing debt as a structural problem that should be addressed through massive debt cancellation and a radical reform of the international financial architecture which in the words of the President of the World Bank, "is biased in favor of rich countries and creditor countries."

The G20 framework needs to develop spaces for the voices of those most affected by unpayable debts to be heard and to be part of the solution.

2. End the beneficial treatment for the private sector.

All private creditors need to be included in debt cancellations. Private creditors, including entities such as Blackrock and HSBC, can together account for up to 50% of debt to some countries. Countries in the global south who want to participate in the G20 debt service suspension initiative (DSSI) fear the reaction of private creditors (closing market access or downgrades by Credit Rating Agencies) who hold enormous power. At the moment, there is no obligation on private creditors to provide debt relief and/or enter into negotiations to restructure debts. If private creditors do not participate in debt relief initiatives, there is the threat that freed financial resources such as those from the DSSI will not be used to finance the public COVID-19 response, but to repay private creditors.

One way is to pass legislation in countries across the world to force the private creditors to take part.

Where the creditors hold debts owed under national/sub-national law (England and New York cover the vast majority of private creditors) legislation is needed to prevent creditors from suing debtor countries. In January 2021 World Bank President David Malpass called for legislative reforms to expedite the restructuring of private sector debt.

3. New finance to support global action to tackle COVID-19 and support a green recovery.

Debt cancellation will release some money for countries to tackle COVID-19 and its impacts. But it won't be enough for the long term, and significant new finance is needed to help countries in the global south to tackle COVID-19 and to support a green recovery, especially after huge capital outflows.

The G20 and IMF need to agree to issue a large number of Special Drawing Rights (SDRs) – with estimates of USD 3tn needed to tackle the current crises. These SDRs will be transferred to each country based on their shareholder percentage in the IMF, meaning that many countries in the global south will get a relatively small percentage (which is why such a large amount overall is need), with many G7 and G20 countries receiving a relatively large percentage.

Those advanced economies such as the G7 and G20 that will receive large issuances of SDRs should therefore use their SDRs to tackle global challenges. One priority is to ensure that the **COVID-19 Vaccine is available to every person in every country** through funding vaccines for poorer countries. A second priority is to use finance from SDRs to **free up other government resources to fill the huge gap in climate** finance that is needed to both help communities adapt to the current realities of climate change, as well as to place the world on a pathway to below 1.5 degrees. Current offers of public and private finance fall way below what is needed, so new ideas for financing COVID-19 response and a green recovery are needed.

Any new finance must also ensure that it doesn't add to the existing debt burden or pile up problems for the future. Although some COVID-19 finance is being made available as grants, much is still being issued as loans, which simply threatens to push the debt crisis a few years down the road. Lending governments and multilateral banks should ensure that **all new COVID-19 finance and climate finance is given as grants and not loans**, so that there is not further accrual of debts.

Structural Change to prevent a future debt crisis.

If debts are cancelled and new finance is made available, then this will go a long way to relieving the burden on many countries in the global south for the next 2-3 years. However, it will not tackle any of the structural issues around how debt is accrued in the first place, nor will it prevent a future debt crisis. This is especially relevant as previously mentioned as some of the new finance for a COVID-19 recovery is being given to countries as loans, adding further debts to their unpayable debt burden.

The international community should therefore as a matter of urgency take steps to establish a rule-of-law-based **sovereign debt workout mechanism** at the United Nations, that would comprehensively address unsustainable, unlawful, odious and illegitimate debt, as has long been called for by churches and civil society world-wide as well as countries in the global south.

BACKGROUND DOCUMENTATION

- A tale of two emergencies - the interplay of sovereign debt and climate crises in the global south, Eurodad – December 2020
- A debt moratorium for whom? How, in 2020, debt relief is not helping those who need it most, erlassjahr.de - December 2020
- Developing Countries caught in the vice-like grip of indebtedness, CADTM – December 2020
- Under the Radar: Private sector debt and coronavirus in developing countries, CAFOD - October 2020
- Shadow report on the limitations of the G20 Debt Service Suspension Initiative: Draining out the Titanic with a bucket? Eurodad – October 2020
- Christian leaders urge IMF and World Bank to cancel debts for developing countries, CAFOD - October 2020
- Global Sovereign Debt Monitor 2020, Misereor – April 2020
- We can work it out: 10 civil society principles for sovereign debt resolution, Eurodad - 2019

This briefing note was prepared by the CIDSE Debt Task Force. The Task Force consists of the following CIDSE member organizations: CAFOD (England and Wales), CCFD-Terre Solidaire (France), Development and Peace (Canada), Entraide et Fraternité (Belgium), Maryknoll Office for Global Concerns (USA), Misereor (Germany).

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