Policy Note

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# The Future of Sovereign Debt Architecture: Priorities for the South African G20 Presidency

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# Introduction

Many African countries are experiencing a deepening financial crisis. Their access to external finance is becoming more uncertain at the same time that their debt, climate and development financing needs are becoming more urgent.

South Africa can help address this crisis by promoting a holistic approach to Africa's debt crisis during its G20 presidency in 2025. This policy note, after providing a brief overview of the financing challenge, explains how this can be done.

While this note focuses on Africa, its recommendations will also benefit other countries in the Global South, many of which are facing similar financial challenges.

## The financing challenge

The policy space available to African countries is significantly constrained by their debt servicing obligations and their climate and development financing needs. For example, the total external debt stock of sub-Saharan Africa grew from $425.8 billion in 2012 to $815.7 billion in 2021.[1] Approximately $1 460 billion of the 2021 total was owed to bondholders and about $60 billion to commercial banks. Multilateral institutions were owed about $150 billion. The total public debt of African countries in 2022 was $1.8 trillion, an increase of 183% since 2010, which suggests a growth rate approximately four times faster than the growth in GDP in dollar terms over the same period.[2] As a share of exports, Africa's external debt grew from 74.5% in 2010 to 140% in 2022.[3] Servicing these debts is taking a heavy toll on African countries, with 23 spending more on debt service than on health or education.[4]

Africa also needs $1.3 trillion per year to meet the Sustainable Development Goals (SDGs)[5] and another $1.3–1.6 trillion each year until 2030 to deal with the impacts of climate change on the continent.[6]

These numbers suggest that there are two aspects to the debt challenge facing African countries. The first relates to how African countries can raise the funds to meet their debt obligations without undermining their ability to fund their environmental and social responsibilities. The second relates to making negotiations between African sovereign debtors and their creditors sufficiently holistic that they incorporate both the debtor's obligations to its creditors and its environmental and social commitments to its citizens.

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[1] World Bank, "International Debt Statistics 2023", accessed December 2, 2024, https://datatopics.worldbank.org/debt/ids/regionanalytical/SSA.

[2] UN Conference on Trade and Development, "A World of Debt: Regional Stories – Africa (2023)", ", accessed December 2, 2024, https://unctad.org/publication/world-of-debt/regional-stories#section1.

[3] UNCTAD, "A World of Debt".

[4] UNCTAD, *A World of Debt Report 2024: A Growing Burden on Global Prosperity* (UNCTAD, 2024).

[5] UN Development Programme et al., *Africa Sustainable Development Report:* Reinforcing the 2030 Agenda and Agenda 2063 and Eradicating Poverty in Times of Multiple Crises – The Effective Delivery of Sustainable, Resilient and Innovative Solutions, Executive Summary (UNDP, 2024).

[6] Carlos Lopes, "African Countries Shouldn't Have to Borrow Money to Fix Climate Damage They Never Caused – Economist", *The Conversation Africa*, November 5, 2024.

## The global governance challenge

Africa's financial challenge is further complicated by shortcomings in the current global economic governance arrangements for dealing with sovereign debt. The key international organisation in sovereign debt restructuring is the International Monetary Fund (IMF). Over time, its ability to deal effectively with sovereign debt crises has declined.[7] The IMF now has about one-third of the resources that it had in 1946, when it opened for business. Moreover, these resources must now meet the needs of 191 member states rather than the IMF's 39 original member states. When Mexico defaulted in 1982, the IMF was able to provide about 30% of its debt servicing obligations that year. This gave the IMF the necessary bargaining power to persuade Mexico and its creditors to reach an agreement within a few months. More recently, the IMF could only provide a small fraction of what countries such as Zambia, Ghana and Sri Lanka needed to resolve their debt situations. This contributed to these countries taking years to resolve – more or less – their debt situations.

The IMF's current bargaining position is further complicated by the increased complexity of the creditor landscape. For example, the commercial banks that were Mexico's creditors in 1982 were all heavily regulated in their home countries. Consequently, the IMF could work with these regulators to pressure the banks to reach an agreement with Mexico.[8] Today, African countries raise their commercial debt primarily by issuing bonds. Consequently, their commercial creditors are relatively less closely regulated than banks and include a diverse group of institutional investors, private funds, sovereign wealth funds and individuals. These bondholders can more easily exit from their exposure to African countries than banks making loans. Consequently, they are less amenable to either financial or regulatory pressure than banks were in the 1980s.

The efforts of the G20 to deal with the debt challenge facing African countries have also not been effective. The G20 working group responsible for dealing with sovereign debt is the International Financial Architecture Working Group (IFAWG) in the Finance Ministers and Central Bank Governors (FMCBG) track. The G20's first response was the Debt Service Suspension Initiative (DSSI).[9] This offered countries meeting International Development Association criteria the possibility of suspending their debt service between May 2020 and December 2021. Thereafter, they were expected to begin servicing their debts according to the original terms, with the debts adjusted to account for the temporary relief. Initially, some qualifying countries were reluctant to take advantage of this offer because of concerns that it would adversely affect their credit ratings and access to commercial sources of finance. Ultimately, 48 of the 73 eligible low-income countries took advantage of the offer. They received a total of $12.9 billion in temporary debt relief, but only on their official debts.

At the end of 2021, the G20 agreed on the Common Framework for Debt Treatments Beyond the DSSI (Common Framework)[10] for dealing with low-income countries in debt distress. This framework sought to adapt the principles and practices of the Paris Club[11] to the changing composition of the developing

[7] See, for example, Gordon Brown and Mohamed A. El-Erian, "Toward a Fifth World Order", *Project Syndicate*, October 21, 2024; Daniel Bradlow and Stephen Park, "International Standards and the Role of Central Banks in Global Financial Governance" (Policy Brief, T20 Task Force 9, 2021).

[8] Jérôme Sgard, *The Debt Crisis of the 1980s: Law and Political Economy* (Edward Elgar, 2023).

[9] World Bank, "Debt Service Suspension Initiative", accessed December 2, 2024, https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

[10] G20 and Club de Paris, "Common Framework for Debt Treatments beyond the DSSI", accessed December 2, 2024, https://clubdeparis.org/sites/default/files/annex_common_framework_for_debt_treatments_beyond_the_dssi.pdf

[11] Club de Paris, accessed December 2, 2024, https://clubdeparis.org/.

world's official creditors. In terms of the Common Framework, the first step, after a debtor requests debt restructuring, is that the IMF completes a debt sustainability analysis (DSA). This analysis establishes how much debt relief the country will need in order to regain a sustainable debt position.[12] The DSA also helps the IMF determine how much financing it will provide to the debtor country. Thereafter, the official creditors' committee negotiates with the debtor. Once they have reached an agreement, the commercial creditors begin negotiations. The diverse range of commercial creditors means that there is likely to be more than one committee representing them. The ' agreements are only finalised once the official creditors and the IMF agree that the commercial and official creditors are giving the debtor comparable treatment.

To date, four countries have requested Common Framework treatment. Only two, Ghana and Zambia, have reached agreements with their various creditors. However, these outcomes have not fully addressed all the financial challenges facing the countries. Such challenges include the costs of dealing with the social and environmental consequences of extreme climate events in both countries.

In order to try to address some of the shortcomings in the current debt arrangements, India, the G20 president in 2022, together with the IMF and the World Bank, established the Global Sovereign Debt Roundtable (GSDR).[13] The GSDR is co-chaired by the presiding G20 country for that year, the IMF and the World Bank. GSDR participants include representatives of creditor and debtor countries, the various categories of commercial creditors and their advisors. Certain academics and representatives of non-state actors have also been invited to participate in some of its meetings. To date, the GSDR has focused on technical issues – for example, drafting specific clauses in debt contracts and reaching a common understanding on specific terms used in the agreements.

The GSDR has not yet resulted in any substantial changes in sovereign debt restructuring arrangements. This is surprising, given that the GSDR is a relatively informal forum in which all stakeholders are represented. This suggests that it may be the ideal setting to explore new ideas for reforming the sovereign debt architecture and to refine them before elevating them for more formal discussion and, if appropriate, decision-making, in the IFAWG or the FMCBG.

## Identifying a debt agenda for South Africa in 2025

In 2025, South Africa should prioritise the following three issues relating to debt.

**Priority 1**: **Formulating a holistic approach to sovereign debt restructuring**. This requires persuading African debtors and their creditors to accept that the sovereign's financial obligations should be viewed within the context of that country's financial, economic, environmental, social and political commitments. The chances of these parties reaching an environmentally and socially sustainable and responsible outcome are substantially reduced if the debt restructuring negotiations are only about how to restructure their debt agreements. In fact, given the links between sovereign debt and a country's capacity to deal with its

[12] There is an important debate about the nature, scope and adequacy of the DSA and the IMF's role in it. A full discussion of the causes of this controversy is beyond the scope of this note. For more information on the DSA for low-income countries, see IMF, "Debt Sustainability Analysis Low-Income Countries", accessed December 2, 2024, https://www.imf.org/en/Publications/DSA. For the DSA for market access countries, see IMF, "Sovereign Risk and Debt Sustainability Analysis for Market Access Countries", accessed December 2, 2024, https://www.imf.org/en/Publications/DSA/sovereign-risk-and-debt-sustainability-analysis-for-market-access-countries.

[13] Information on the GSDR is available at World Bank, "The Global Sovereign Debt Roundtable (GSDR)" (Brief, World Bank, October 23, 2024).

climate and development challenges, it is appropriate and prudent to treat its debt contracts in conjunction with its binding social and environmental obligations arising from both domestic and international law. Many official and commercial creditors are signatories to international norms and standards – and have formulated corporate policies – that establish their own environmental and social (and in some cases, human rights) responsibilities.

Operationalising a holistic approach to sovereign debt restructurings will be complicated. Nevertheless, given the importance of this issue, South Africa should advocate that the G20 prioritise this issue in 2025. As a first step, the G20 should focus on developing general principles that are acceptable to all negotiating parties and that can guide them in implementing a holistic approach in their individual debt transactions. These principles should be equally respectful of the commitments that the parties made in their original debt contracts and of the legal commitments that a sovereign debtor has to its citizens, based on domestic law and international treaty obligations.

South Africa should also advocate that these principles be designed to ensure both that the debtor country receives adequate levels of debt relief and that it uses this debt relief to promote development. This development should be environmentally sustainable, socially inclusive and consistent with all relevant international laws, norms and standards. In this manner, the principles will put pressure on creditors and debtors to behave responsibly in negotiating debt transactions and using the procured funds. This is important because a sustainable resolution of the debt situation requires both debtors and creditors being convinced that the outcome is fair. They also need reassurance that it will contribute to timely debt payments, a sustainable development strategy and a manageable debt profile.[14]

South Africa should also advocate that the principles be based on norms and standards that all parties view as legitimate and for which at least some have expressed support. Fortunately, there are over 20 relevant international norms and standards, many of which are widely accepted. These provide a basis from which to develop principles that South Africa can promote as the starting point for a new, shared approach to debt restructuring. The principles should also serve as the basis for the international community learning how to operationalise a holistic approach to development financing.

One possible version of these shared principles could be:[15]

1. **Guiding norms:** Sovereign debt restructuring should be guided by six norms: credibility, responsibility, good faith, optimality, inclusiveness and effectiveness. Optimality means that the negotiating parties should aim to achieve an outcome that offers each of them the best possible mix of economic, financial, environmental, social, human rights and governance benefits. Such an outcome should thus take into consideration the circumstances in which the parties are negotiating and their respective rights, obligations and responsibilities,

2. **Transparency:** All parties should have access to the information that they need to make informed decisions.

3. **Due diligence:** The sovereign debtor and its creditors should each undertake appropriate due diligence before concluding a sovereign debt restructuring process.

[14] Daniel D. Bradlow, "A New Conceptual Framework for African Sovereign Debt: Finding an Optimal Outcome that Addresses 5 Challenges", *Journal of African Economics* (forthcoming).

[15] Daniel Bradlow, Kevin Gallagher and Marina Zucker-Marques, 'Easing Africa's debt burdens: a fresh approach, based on an old idea,' The African Mirror, September 28, 2024. Accessed 2 December 2024, https://theafricanmirror.africa/business/easing-africas-debt-burdens-a-fresh-approach-based-on-an-old-idea/

**4. Optimal outcome assessment:** The parties should publicly disclose why they expect their restructuring agreement to result in an optimal outcome.

**5. Monitoring:** There should be credible mechanisms to monitor the implementation of the restructuring agreement.

**6. Inter-creditor comparability:** All creditors should make a comparable contribution to the restructuring of debt.

**7. Fair burden sharing:** The burden of the restructuring should be fairly allocated between the negotiating parties.

**8. Maintaining market access:** The process should be designed to facilitate future market access for the borrower at affordable rates.

**Priority 2: Promoting the use of the GSDR to stimulate interest in and agreement on new arrangements for sovereign debt restructuring.** This should involve commissioning a study on the lessons to be learned from the implementation of the Common Framework and the DSSI. This study can form the basis for discussions among participants in the GSDR and in relevant G20 engagement groups about the structures needed to promote more sustainable debt restructuring. The outcomes of these various discussions, if they have adequate levels of support, can then be reported to the G20's IFAWG. There it can be discussed among G20 participating states and fed into the G20 summit process.

**Priority 3: Initiating discussions on restoring debtor countries' access to adequate finance.** There are currently two views on the challenge countries face in this regard. One group views the debt problem as essentially a liquidity problem.[16] This group therefore advocates giving countries temporary relief in the short term in the hope that, as the global situation improves, they will regain access to official funding and financial markets on sufficiently agreeable terms that they can fund their own development. They also suggest that this access will be enhanced if the countries undertake the structural reforms needed to improve their ability to effectively absorb financial flows from both commercial and official sources. A complementary proposal in this regard seeks to improve debtor country access to financing by, for example, increasing the liquidity of developing country debt instruments.[17] This proposal involves creating a fund that, when markets are not functioning effectively, can counteract the loss of liquidity by buying the bonds of developing countries.

A second group maintains that the debt problem currently confronting African countries is more a solvency than a liquidity issue. They maintain that the debtor states will not be able to emerge from their current debt distress and regain a sustainable development path without actions to reduce their debt.[18] They are therefore calling on creditor countries in the G20 and private commercial creditors to be more forthcoming in their debt restructuring. Moreover, since the two largest groups of creditors for these countries are bondholders and multilateral development banks, the solvency proponents are arguing for these groups to provide debt relief. They have proposed creative schemes in this regard, such as debt buybacks and

[16] Ishac Diwan et al., "An Updated Bridge Proposal: A Solution to the Current Sovereign Debt Crises and to Restore Growth" (Policy Note, Financing for Development Law and Initiative for Public Dialogue, July 2024).

[17] See The Liquidity and Sustainability Facility, accessed December 2, 2024, https://lsfacility.org/; Laura Alfaro et al., "A Proposal for the IMF: A New Instrument of International Liquidity Provision for Emerging Markets and Developing Economies" (Policy Paper 345, Latin American Committee on Macroeconomic and Financial issues, Center for Global Development, 2024).

[18] Kevin P. Gallagher et al., "Africa's Inconvenient Truth: Debt Distress and Climate Resilient Development in Sub-Saharan Africa" (Working Paper, Boston University Global Development Policy Center; Centre for Sustainable Finance, SOAS, University of London; Heinrich-Böll-Stiftung, 2023).

versions of Brady bonds and of HIPC[19] initiatives funded by official sources. The solvency proponents maintain that such measures will help debtor countries regain access to official and market-based sources of funding. This group, therefore, sees new funding as coming from a mix of public and private sources.[20]

It is important to note that these two perspectives are potentially complementary. Given the large number of countries in debt distress, it is possible that some countries are facing liquidity problems and others solvency problems. It is also feasible that, as debtor countries in crisis resolve their solvency problems, they will confront liquidity challenges that can be managed using the approaches of the liquidity group.

## Conclusion

The definitive solution to the debt crisis confronting African and other developing countries is likely to be a multi-year process. However, South Africa can begin the process and make significant progress during its year as G20 president. In particular, it should focus on reaching an agreement on the principles that should guide future debt restructuring and on producing the studies that analyse the functioning of the Common Framework and the DSSI. It should also make proposals on their improvement. If successful next year, South Africa can use its membership in the G20 Troika in 2026 to advocate for the financial support that Africa will need to resolve its debt crisis.

[19] Heavily Indebted Poor Countries.

[20] Gallagher et al., "Africa's Inconvenient Truth".

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