Forum: Economic & Social Council (ECOSOC)

Issue: The question of methods to encourage sustainable debt

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Introduction

Private entities and government loans are important financial investment tools to achieve sustainable development and make up for short-term imbalances in revenue and expenditure. Government borrowing can also allow fiscal policy to play a countercyclical role in the economic cycle. However, extremely high debt burdens can have a major negative impact on growth and sustainable development. Both public and private debt must be properly managed. Developing countries have made considerable progress in reducing foreign debt within the early part of this century. Moreover, in the case of HIPCs (Heavily Indebted Poor Countries), considerable assistance by the support of the international community has been witnessed. Although some developing countries are currently in debt distress, and some countries face serious external debt risks, this makes them vulnerable to debt caused by external shocks (such as natural disasters (relief measures required) and/or falling commodity prices). In addition, some low-income countries (LICs) are entering the international capital market, bringing new financing opportunities and significant risks, such as volatile international capital flows. Even so, debt overhang can be costly and as with all forms of debt, must be managed perspicaciously.

Sustainable debt entails bonds and loans raised for environmental and social purposes. Low-income countries often struggle with tremendous external debts that may overwhelm their ability to reduce poverty or provide basic government functions. Low-income countries have historically relied on international aid, and given the recent pandemic, economic depression prevents developed countries from helping their underdeveloped allies. Although many of these countries are not traditionally important to official export credits, they recognize that the provision of export credits to the public sector may play a role in the unsustainable rise of debt levels in these countries, and due consideration should be given to this urgent issue, before receiving such support.

The issue of debt in low-income countries has been an elongated discussion for more than a decade. This is despite the progressive improvement of debt rescheduling terms. The concessionality of rescheduling terms has increased on numerous occasions, starting from 1987. The Toronto terms were introduced in 1988 (33% debt reduction), the London terms in 1991 (50% debt reduction), the Naples terms in 1994 (67% debt reduction), and the Lyon terms in 1998 (80% debt reduction) for some of the HIPCs. In 1996, the HIPC Initiative was launched, to provide a framework for multilateral debt relief. The debt overhang of the HIPs is far from being lifted. A notable parallel can be made here with the debt crisis of the 1980s of the middle-income countries: after 7 years (1982-189) the Brady plan helped end the debt problems by providing debt relief. To date, the beneficial impact of the initiative on the debt overhang of these countries remains limited.

The external debt situation of current developing countries is a focus point of ethical concern. The issues of the “Heavily Indebted Poor Countries” (HIPCs), all of which are structurally rooted, are far from being amended, whilst other poor countries continue to face a mountain of debt burden as a product of being plagued by war and natural disasters requires utmost assistance that must include debt relief. Numerous middle-income countries located in the Eastern regions of Asia have managed to overcome a phase of an acute balance-of-payments crisis, however, are yet to amend their debt issues.

Countless other middle-income countries are also encountering significant payment problems, as a result of the recent pandemic. Though, the situation has continuously worsened since the beginning of the 1990s. At that time, it seemed as if most middle-income countries were on track to emerging successfully from the periodic re-scheduling of their debt, while HIPCs and other low-income countries could expect to clear their overhanging debt issues, with additional relief from creditors.

Expected debt relief for HIPCs has always been a lethargic process, but along with declines in commodity prices, such factors have affected the export growth prospects of many HIPCs and other commodity-dependent nations. If commodity prices depress again in the future, a likely scenario is given recent circumstances; and. or exports fail to grow in volume, the debt servicing capacity of these nations would further deteriorate. Already, some nations affected by adverse development in the external environment have been obliged to reschedule their debts, particularly with the Paris Club; therefore being unable to service national disasters along with being unable to debt sustainability.

Definition of Key Terms

Sustainable Debt

Sustainable debt is defined as bonds and loans raised with environmental and social purposes in mind. Vast majority of issuance of said bonds come from government agencies and supranational bodies, borrowing money for healthcare, natural hazards and other relief measures.

Fiscal Policy

Fiscal policy is the measure by which a government alters its public expenditure and tax rates to monitor and control aggregate demand in a nation's economy.

Debt

Debt is defined as an obligation that requires the debtor to pay money or another agreed-upon value to the creditor. It is a deferred payment, or series of payments, which differentiates it from an immediate purchase.

Sustainable Development

Principle for reaching goals in relation to human development whilst simultaneously sustaining the ability of natural systems in order to supply the natural resources and ecosystem services on which a nation's economy and society depend on.

Heavily Indebted Poor Countries (HIPCs)

Group of 39 developing countries with significant levels of debt overhang and poverty which are eligible for special assistance from the World Bank and the International Monetary Fund.

Lower Income Countries (LICs)

In accordance with the World Bank, low-income countries are nations that have a per capita gross national income (GNI) of less than $1, 026.

Capital Markets

Financial market in which long-term debt or equity-backed securities are bought and sold. In contrast to a money market in which short-term debt is sold and bought.

Capital Flow

Refers to the movement of money for the purpose of investment, business operations, or trade.

Monetary Policy

Monetary policy is the measure through which governments alter the nation's money supply and interest rates to control the rate of inflation in the economy.

Liberalization

Refers to the loosening of government controls. Sometimes associated with the relaxation of laws in relation to social matters such as abortion. Most often used as an economic term; meaning reductions in restrictions on international trade and capital.

Paris Club Creditors

The Paris Club Creditors is a group of officials from hair creditor countries, whose role is to discover coordinated and sustainable solutions to the payment difficulties experienced by poor countries; or debtor countries.

Key Issues

HIPC Initiative

The HIPC Initiative was initially envisaged to span six years to completion. It is therefore hardly surprising to understand that only three countries thus far (Uganda, Bolivia & Guyana) have benefited sustainably from the exit debt relief at the completion point. It is a matter of concern that the implementation process of the HIPC Initiative is extremely futile. The slowness of the process seems to be due to two key factors:

- The complexity of the process itself, based as it is on the implementation of two ESAF programmes and on eligibility conditions; determined by a country-specific debt sustainability analysis
- Lack of adequate funding for an expedition's resolution of all cases, without damaging the financial standing of any and all public institutions whose debt is owed.

The overall efficiency of the initiative is an elongated journey through which parties are not able to gain notable benefit from. Nations are unable to mitigate the issues they are facing through numerous junctions, therefore posing the question of effectiveness. Efficiency is a ubiquitous issue within all initiatives placed to encourage sustainable debt, as seen in past resolutions presented. Basic issues stem from inadequate planning, and the removal of financial constraints on the expeditious delivery of debt relief, and the use of a less stringent definition of sustainable debt.

The prerequisites and safeguards built into the current Heavily Indebted Poor Countries Initiative must be reduced to reduce obstacles to debt relief. The predetermined list of heavily indebted poor countries does not necessarily include all low-income countries with foreign debt servicing problems. Specific entry requirements, especially the use of IMF or IDA-supported plans, and the rearrangement of the previous preferential arrangements with the Paris Club should be relaxed. Eligibility criteria based on the threshold and target range of debt indicators should become less stringent, and the analysis of debt sustainability should be based on less arbitrary standards. At present, for eligible countries to obtain multilateral debt relief, they must implement two consecutive three-year ESAF plans and make progress in social sector reforms. Deviations from these plans will cause further delays in the HIPC process. This should ideally be reduced to a singular ESAF plan, which will be sufficient to ensure that debt relief will eventually flow to countries with reasonable and reasonable macroeconomic policies.

Debt of Middle-Income Countries

Principal issues concerning the prevention and perspicuous management of financial crises in middle-income countries have been adequately addressed in the past. Present issues build on past work and elaborate more on an orderly debt restructuring process, including internationally sanctioned standstills through IMF lending. The abrupt cessation of private lending, especially of trade finance, which accompanied payments difficulties of countries in crisis had brought severe disruptions within their economic ventures and in many cases, had further weakened their capacity to pay. Moreover, the recent crises have been addressed either by a decearen of a debt moratorium, such as the case with the Russian Federation, or by the provision of financial rescue packages under the viewership of the IMF to rescue private creditors. Such responses remain unsatisfactory in their execution.

The social impact of these crises is huge. In Indonesia, the large population and low per capita income have caused a particularly sharp deterioration in living standards and caused serious social chaos. In the three most affected countries, Indonesia, Thailand and the Republic of Korea, unemployment rates have risen sharply. Obviously, many human rights have been violated in this situation. The rights contained in the International Covenant on Economic, Social and Cultural Rights include the right to work, the right to an adequate standard of living, and the right to health and education. Other rights are aimed at protecting children, women and vulnerable groups. In countries severely affected by the recent financial crisis, it has become more difficult to ensure that these rights are respected.

Debt of Lower-Income Countries

The debt problems of low-income countries have dragged on for more than a decade. Although the debt restructuring terms are gradually improving. The severity of this problem was recognised by the official creditor community in 1987, when the Paris Club decided for the first time to apply for a more favorable rescheduling clause (the so-called Venice clause) from a low-income debtor country in Africa. In the following years, the degree of preference for rescheduling the terms has increased several times. The Toronto clause was introduced in 1989 (debt reduction by 33%), the London clause in 1991 (debt reduction by 50%), the Naples clause in 1994 (debt reduction by 67%) and the most recent Lyon clause in 1998 (debt reduction by 80%) For some heavily indebted poor countries. The Heavily Indebted Poor Countries Initiative was launched in 1996 to provide a framework for multilateral debt relief.

Therefore, the debt burden of the heavily indebted poor countries is far from being lifted. This can be similar to the debt crisis of middle-income countries in the 1980s: Seven years later (from 1982 to 1989), the Brady plan helped end the debt problem by providing substantial debt relief. So far, the positive impact of the Heavily Indebted Poor Countries Initiative on the debt backlog of these countries has remained limited. Twelve heavily indebted poor countries reviewed their cases under this initiative. The debts of the two of them are considered sustainable, so they are not eligible for further relief after signing an exit agreement with the Paris Club on standard Naples terms. The other two heavily indebted poor countries reached the completion point in 1998 (when the multilateral debt relief officially began to be delivered), and the other three countries are scheduled to be completed in 1999. So far, the reduction in debt stock and debt service obligations has been relatively small. It must be noted that in passing, such debts owed by numerous HIPCs to the former USSR have been reduced significantly, as the Russian Federation has reduced debts up to 90%.

Major Parties Involved and Their Views

IMF & World Bank

The International Monetary Fund & World Bank are arguably two of the most salient parties involved within the topic of methods to promote sustainable debt. Both act as relief agencies for nations in need of loans; subsequently leading to additional debt, but comply with the HIPC Initiative. Both parties have worked extensively over the past two decades in order to mitigate the issue, with various successes seen. It was launched in 1996, with the primary aim of ensuring that no poor country would face a significant debt burden it cannot manage effectively. The initiative perspicuously encouraged sustainable debt; and has since aided over thirty countries world-wide. The main issue with the solutions presented by both parties is the implementation process of each, usually taking a minimum of six months to witness inaugural change, and within such a time period; a tremendous amount of work required that many LICs are unable to complete efficiently. In recent times, these processes have become more efficient in their methods, seeing as they have aided over five countries considerably; however, plans remain to shorten the implementation process. There is no doubt that the implementation of such policies is regarded as positive, given their obvious amendments, however, in accordance with modern times and developing situations, further policies are to be amended.

European Union

Explosion in social bond issuance was the main interest for the sustainable debt sector in the year of 2020, fuelled by investor appetite for products that addressed the impacts of the coronavirus pandemic and the subsequent recession; which caused widespread unemployment and highlighted a number of other social issues, including the problems of the gig economy and the challenges many people face in accessing healthcare. Vast majority of bonds came from governmental agencies, borrowing money for healthcare and other relief measures. The European Union was amongst the largest single bonds issuances ever, as they looked to solve social issues effectively. They work in unison, as hinted by their official title, and have aided many countries within their promenade in the fields of sustainable debt. The EU follows the guidelines set by the International Monetary Fund & the World Bank; but is able to cater specifically to certain nations due to their proximity and relationships; therefore making the process more efficient. The main issue with this is the EU itself, as it operates in Europe primarily, whereas many issues surrounding debt sustainability originate in African regions. The European Union has generated large scale positive impact within Europe, however, its efforts to aid the rest of the world are hindered by localized regions, and is therefore strenuous to deliberate a fixed notion on their impact on a wide-scale.

Paris Club

The Paris Club Creditors is a group of officials from hair creditor countries, whose role is to discover coordinated and sustainable solutions to the payment difficulties. Their stance on the topic of sustainable debt is controversial, however, they have issued numerous policies aiding those who are experiencing difficulty in paying their debts. The Paris Club creditors have issued numerous policies on the topic of sustainable debt and debt relief, notably the Toronto, London, Naples & Lyon terms; along with the HIPC Initiative. The Paris Club currently has no publicly documented future plans to further aid the issue, as their past efforts have seen considerable promise; despite each process being extremely tedious. The Club has hindered the issue considerably given their tedious processes, although its notion is thought to be positive given the successful implementation of past policies.

China

China, being an East-Asian nation, has had its fair experience with debt relief and its issues. However, being a notable P5 nation with economic power, China has been able to mitigate any negatives they have faced in the past and hope to promote debt sustainability in the future. Through its ‘Belt & Road Initiative’, China will be able to promote projects in developing countries that generate steady cash flows and profits. China's impacts are, in theory, to be positive, as their methods have been put in place for the future, rather than the present. They aim to ‘push forward’ sustainable debt in developing countries whilst also promoting green, low-carbon projects and building high-standard infrastructure to reduce their environmental impact.

United Nations Tax Committee

A subsidiary of the United Nations Economic & Social Council, the UN Tax Committee is the primary party responsible for the establishment of the Addis Ababa Action Agenda. The ‘Addis Agenda’ being their most notable effort to promote sustainable development, provides a global framework to ensure the effective mobilization of resources at both national and international levels for sustainable development. The agenda perspicuously supports the implementation of the Sustainable Development Goals (SDGs) and is an essential part of the 2030 Agenda for Sustainable Development, a historic agenda that countries adopted in 2015.

Russian Federation

The Russian Federation plays a vital role in the debt of lower-income countries, acting as a significant debtor to HIPCs. Since the start of the transition to a market economy, fiscal management has been a major issue in the Russian Federation. The limited tax base, which is characterized by a high reliance on commodity exports (particularly oil and gas) for tax collection, has failed to generate enough revenue to cover expenditures. This disparity has resulted in a significant cumulative funding gap, which has been closed.The default of Russia's debt had a hugely destabilizing effect on worldwide capital markets, putting pressure on Brazil and other emerging nations. Brazil suffered large foreign exchange outflows around the end of August 1998, which were halted by substantial interest rate increases.

Development of Issue/Timeline

Date	Event	Outcome
10/1988	Introduction of Toronto Terms	In October of 1988, the Paris Club creditors agreed to implement a new treatment on the debt of the poorest countries. This new treatment labeled “Toronto Terms” implemented a reduction of the debt of poor countries. The level of reductio was defined as 33.33%.
12/1991	Implementation of London Terms	1991 saw the Paris Club creditors agree to implement a new treatment on the debt of the poorest countries. This new treatment called “London

		Terms" raised the level of debt cancellation from the prior 33.33% as defined in the Toronto Terms (1988) to 50%.
12/1994	Implementation of Naples Terms	In December, 1994, the Paris Club creditors agreed to implement a new treatment upon the debt of poor countries. The new and improved terms, called "Naples Terms", granted two substantial enhancements with respect to the "London Terms" (1991), that could be implemented on a case by case basis, on the level of reduction and the conditions of treatment of debt.
11/1996	Introduction of the HIPC Initiative	In November, 1996, the Paris Club creditor countries, introduced the framework for the "HIPC Initiative", which was

		accepted to raise the level of cancellation up to 80% for the poorest countries with the highest indebtedness. This measure went with specific contributions of the multilateral institutions so that they could also reduce the level of their calais upon concerned parties.
7/2015	Introduction of the “Addis Ababa Action Agenda”	A groundbreaking agreement which provides a foundation for implementing the global sustainable development agenda that world leaders were expected to adopt. Strategically financed a country’s development plans and identified financing areas.

Previous Attempts to Solve the Issue

Toronto Terms

The "Toronto Terms" were introduced in October, 1988. The Paris Club creditors had agreed to implement the treatment on the debt of the poorest countries. It implemented a reduction of part of the debt of poor countries, as the level of reduction was defined as 33.33%. Since, 20 countries have witnessed notable benefits from the since amended terms. Non-ODA credits were canceled to a 33.33% level (after possible topping-up). Creditors eventually chose to implement the terms through a debt reduction option as mentioned before. 33.33% of the claims treated were canceled, the spectacular factor being rescheduled at the appropriate market rate with a 14-year repayment period; which also included a generous eight-year grace. The terms were improved upon numerous occasions, such as the London, Naples and Lyon terms; all of which initiated a cp upon the level of reduction of the debt. Whilst benefits have been noted, the main drawback stems from the process of implementation, which in the case of the "Toronto Terms" spanned over seven years; making the implementation process tedious and largely ineffective in some regions; a trend that would continue in the future.

HIPC Initiative

The "Heavily Indebted Poor Countries" Initiative was launched in 1996; and was a major step towards addressing the debt problems of the poorest countries in a comprehensive manner, and towards finding a lasting solution to their debt overhang. The HIPC process was initially envisaged to span six years to completion. Therefore, it is not surprising that only three countries have seen notable benefits to date; those being: Uganda, Bolivia & Guyana). It is a matter of genuine concern that the implementation process of the HIPC is extremely futile. The slowness of the process seems to be due to two principal factors:

- The complexity of the process itself, based as it is on the implementation of two ESAF programmes and on eligibility conditions; determined by a country-specific debt sustainability analysis
- Lack of adequate funding for an expedition's resolution of all cases, without damaging the financial standing of any and all public institutions whose debt is owed.

Addis Ababa Action Agenda

The Addis Ababa Action Agenda was passed in 2015, by the United Nations at the "Financing for Development" conference. The Action Agenda establishes a strong foundation to support the subtle implementation of the 2030 Agenda for Sustainable Development. It provides a utopian global framework for financing development sustainability by aligning all financing flows and policies with social, environmental and economic priorities. Given present circumstances, the Addis Ababa Action Agenda has no evident drawbacks, as it comprehends past drawbacks and establishes an efficient process, making it a promising tool in development.

Possible Solutions

Interpreting Country-Wise DSAs

An amicable recommendation would be to take into account the latest results of the most recent International Monetary Fund and/or World Bank country-wise debt sustainability analyses (DSAs) conducted within the joint Debt Sustainability framework, and review the corresponding programme and/or policy documents in relation to each transaction under consideration for support. The International Monetary Fund's debt limits for specific countries would be included in the programme documents, and a memorandum of understanding in those documents may also include reference to specific projects for which non-concessional lending is granted.

Understanding Public Sector Non-Concessional Borrowing

Taking into account the prevailing limits on public sector non-concessional borrowing, in accordance to methodology applied by the World Bank and the International Monetary Fund, for a specific country for transactions that involve public oligors and/or publicly guaranteed obligors in LICs that are subject to debt limit conditionality for non-concessional borrowing under the IMF's Debt Limit Policy or the World Bank's Non-Concessional Borrowing Policy.

Amicable Contingency Clauses

In addition, terms in loan contracts that allow for automatic maturity extensions in times of severe liquidity crises should be considered. Limiting these scenarios to liquidity crises coming from external shocks outside the control of debtor countries, such as severe falls in the terms of trade or sudden withdrawal of foreign capital due to contagion, might solve the issue of moral hazard. One downside to such a proposal is that including such terms could increase the cost of funding, as lenders may demand compensation for taking on more risk, and the greater cost would have to be balanced against the perceived use of such clauses in dealing with unforeseen situations. It should be emphasized that, to avoid any additional discrimination in the workplace, such clauses could equally apply to developed nations.

Transparency & Accountability

Lessons learned from the Asian crisis include the sheer importance of the question of transparency and accountability. A significant lack of transparency and accountability could exacerbate financial weakness from and national levels and considerably complicate efforts to amend the crisis. Action is required to improve the overall transparency and accountability of the following:

1. The private sector (includes national firms and banks, as well as international investment banks and other institutional investors)
2. National authorities (for the dissemination of regular information about foreign exchange liquidity and external debt positions, including short term debt)
3. Lastly, International Financial Institutions in particular, due to their ubiquitous presence

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