

Joint Civil Society Submission to the UNCTAD

Intergovernmental Group of Experts on Financing for Development

- **How can current debt vulnerabilities in developing countries be mitigated and developing country sovereign debt and financial crises be prevented?**

Debt financing has been used too often in recent years, both by sovereigns and by private sector actors. In consequence, debt levels have surged to record highs. Four out of five low-income countries are at high or moderate risk of debt distress (according to the IMF methodology) or are already in default. Thirteen middle- and low-income countries have defaulted since 2008 and more have requested bail-out finance from the IMF, which comes with harsh austerity conditionalities attached.

Debt service costs have surged massively in the wake of the borrowing boom. Debt service is competing with investment and social spending, posing a severe risk to the implementation of Sustainable Development Goals (SDGs). The trend towards increasing interest rates will have a global impact, not only in developing countries, but also in developed countries – with the risk of triggering the next global financial crises.

The **borrowing boom has been facilitated by a lending boom from developed countries** and from developing countries that have large export surpluses. The quantitative easing policies by central banks in developed countries has created excess liquidity that has been aggressively searching for profit. The result has been a bond issuance boom from countries that hardly ever had access to international capital markets before. China has emerged as a major creditor, in particular for infrastructure financing. An additional cause for concern is the increased use of collateralised debt in commodity-dependent countries by private corporations such as Glencore.

The World Bank Group's Maximising Finance for Development (MFD) approach and the promotion of public-private partnerships (PPPs) that create hidden debts serve to aggravate these critical developments even more. There is an **urgent need to make greater use of types of finance that do not create debts**, fiscal resources such as tax revenue and official development assistance (ODA). These can be complemented by monetary resources such as increased Special Drawing Right (SDR) allocation.

In the first place, tax evasion and avoidance are major reasons why developing countries are facing financing gaps that are being filled with borrowed monies: [UNCTAD has estimated](#) that the tax revenue losses related to inward investment stocks linked to offshore centres (tax havens) alone amount to an estimated US\$100 billion a year. An agenda to tackle tax dodging must include work on base erosion and profit shifting, tax and investment treaties, tax incentives, taxation of extractive industries, beneficial ownership transparency, country by country reporting, automatic exchange of information for tax purposes, alternatives to the 'arm's length' approach, promotion of progressive tax systems,

and minimising the harmful spillover effects of tax policies. We reiterate our call for a **fully inclusive intergovernmental UN tax commission** to be established.

Developed countries must also deliver on their commitment to provide 0.7% of Gross Domestic Product (GDP) as ODA. The current ratio of 0.31% of GDP for member states of the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC) brings with it a **funding shortfall of \$184 billion annually**, increasing borrowing needs. Even the ratio of 0.31% overstates the true level of resources transferred to developing countries, as it includes items that artificially inflate the figures such as costs of hosting refugees in donor countries. What is more, ODA transfers often fall short of internationally agreed principles on effective development cooperation, further limiting their impact.

ODA must be fully untied in order to promote local economic development and to maximise its effectiveness. The ODA accounting rules should encourage the provision of ODA as non-debt creating grants. However, ODA providers are currently revising the accounting rules to incentivise the ‘blending’ of ODA resources with private finance: this practice risks increasing developing countries’ debt exposure, as even if such finance is initially extended to private actors, it can rapidly create public liabilities if projects fail.

The **provision of non-debt creating grants also applies to climate finance.** An estimated two-thirds of climate finance is today given as loans. Due to the lack of transparency and differences in reporting, the concessionality of these loans, as well as the grant equivalent, is not always clear. This can lead to increased and unsustainable debt burdens for developing countries that need finance for climate adaptation and mitigation. This could, in turn, undermine the achievement of the SDGs and climate change goals.

Additional SDR allocations to developing countries: A substantial share of foreign currency loans have lain idle as developing countries feel the need to accumulate currency reserves. The IMF should provide additional SDRs, and allocate the major share to developing countries. The UN’s Department of Economic and Social Affairs ([UN DESA](#)) has calculated that an issuance of \$250 billion new SDRs annually by the IMF and an allocation of two-thirds to developing countries would boost their reserves by \$270 billion. This would provide a financial safety net as protection against shocks, and at the same time free up their own resources and reduce borrowing needs.

More metrics are needed to **assess debt in a more comprehensive analysis**, taking into account the debt service of external and domestic debt, the burden of state-owned enterprises, local government debts, and the future risks of issuing debt to finance infrastructure as an asset class.

Creditors and debtors share the responsibility for preventing debt crises. Both parties must **ensure responsible lending and borrowing** and comply with principles outlined in the UNCTAD Principles for Promoting Responsible Sovereign Lending and Borrowing, the Eurodad Responsible Finance Charter and the Afrodad Borrowing Charter. Compliance should be regularly monitored and, where necessary, enforced.

More transparency is one part of responsible lending and borrowing. Debtors and creditors should report all loans *ex ante* in public databases, so that accountability actors such as parliamentarians and civil society organisations can access loan data. Incentives are needed to ensure that all creditors report: only creditors that report their loans should have recourse to the court system.

The IMF and regional financing arrangements (RFAs) should **provide liquidity without imposing harmful economic policy conditionality** in cases where countries face short-term payment problems. While counter-cyclical lending is important for addressing temporary liquidity problems, economic policy conditionality has often been pro-cyclical, has aggravated recessions and the impacts of other crises, and has failed to restore debt sustainability in borrower countries.

Developing countries should have the policy space to use **adequate tools for capital flow management** in order to protect themselves from volatile and speculative capital flows or excessive capital flight. **Bilateral investment treaties (BITs)** and investment tribunals can undermine debt crisis resolutions. BITs should be thoroughly reviewed and, if necessary, renegotiated.

States bear the duty of **ensuring human rights** and providing essential public services to their citizens, and governments must allocate financial resources accordingly. Where sovereign debt payments reached the point that states can no longer finance the fulfilment of their human rights obligations, governments should **seek a debt restructuring** to reduce debt service burdens and create fiscal space. **Human Rights Impact Assessments** are a useful tool for assessing the impact of debt and adjustments on states' capacity to ensure human rights.

- **What institutional, policy and regulatory changes are required at the international level to ensure that global economic governance structures better support the use of responsible debt financing, by borrowers and lenders, for sustainable development?**

The international community should ensure responsible lending by official and private creditors and responsible borrowing by sovereign borrowers and the private sector. Most regulation focuses on the borrower side and on the sovereign. There is an **urgent need to better regulate lenders, and the private sector both as borrower and lender**. Most debt crises start in the private sector, and only eventually spill over to the sovereign.

The few existing tools, such as the UNCTAD Principles, should be strengthened through monitoring mechanisms for responsible lending and borrowing,

- **How can existing frameworks and tools be improved to ensure effective, fair and transparent sovereign debt crisis resolutions?**

The absence of an international debt resolution mechanism remains a gaping hole in the international financial architecture. Sovereign debt crises are difficult to manage, as there is no insolvency law to give guidance and no insolvency court to make decisions on necessary

debt restructurings. This leads to avoidable delays, collateral damage and unfair outcomes. There is an urgent need for the international community to agree on a **legal framework** for debt restructurings and to create a **debt resolution forum** or debt workout institution, as already suggested in the UNCTAD Roadmap and Guide on Sovereign Debt Workouts.

This framework should also allow states to take unilateral measures based on international law, including the suspension of payment, **carrying out debt audits** with the participation of civil society, as well as the repudiation of illegal, odious and/or illegitimate debt as recommended among others by the recent European Parliament Resolution of 17 April 2018.

We suggest that UNCTAD should continue to work on the concept of a **sovereign debt resolution mechanism** with a special focus on countries whose debt situation risks being severely aggravated through external economic shocks or the effects of natural disasters in regions that are most severely affected by climate change.

Endorsed by:

Africa Development Interchange Network (ADIN)

African Forum and Network on Debt and Development (AFRODAD)

AMI - Debt Free Project Greece/Cyprus

Bretton Woods Project

Centre for Research on Multinational Corporations (SOMO)

Civil Society FfD Group

Committee for the Abolition of Illegitimate Debt (CADTM)

Coopération Internationale pour le Développement et la Solidarité (CIDSE)

Debt and Development Coalition Ireland

Debt Free Project Greece

Debt Justice Norway

Ecumenical Academy Prague

Erlassjahr.de – Jubilee Germany

European Network on Debt and Development (Eurodad)

Jubilee Debt Campaign UK

Jubilee USA

Latindadd – Red Latinoamericana por Justicia Económica y Social

NSC – Friend of the Earth Hungary

Plateforme Française Dette et Développement

Sisters of Charity Federation

Social Justice in Development - SocDev

Society for International Development (SID)