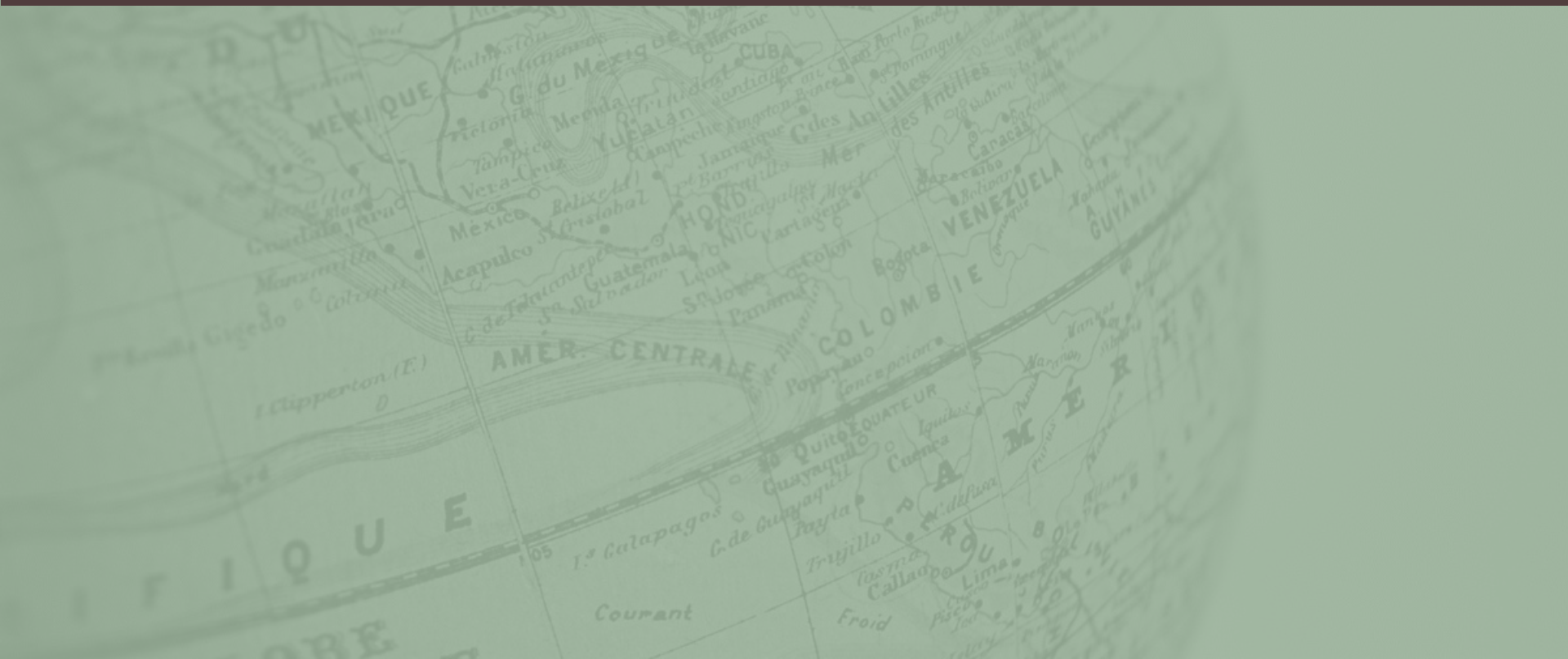


DEBT AND DEVELOPMENT: THE NEXT 15 YEARS

UNCTAD, Geneva, Switzerland

15 May 2015



SUMMARY

- FFD zero draft recognizes the importance of debt for development and asks IMF, WB and UNCTAD to continue working in this area
- Current debt situation
- Challenges UNCTAD sees in the next 15 years
- Work on crisis prevention
- Improved debt workout procedures
 - Recent developments in the GA and IMF proposals

Highlights of UNCTAD's initiatives and achievements

- 1960s -
 - UNCTAD advocated for assistance to developing countries to assist them in debt sustainability assessments and debt consolidation.
 - Advanced proposals on debt relief and guidelines for debt rescheduling.
 - Advanced the adoption of early warning system imbedded in an institutional framework to ensure rescheduling didn't disrupt the development process and is tailored to country specific circumstances.

UNCTAD's initiatives and achievements (con't)

- 1970s –
 - UNCTAD IV – developed countries pledged to promptly address the needs of LDCs for debt relief in a multilateral framework.
 - **Resolution 165** of the 9th TDB – 18 developed countries adopted measures that provided debt relief to 45 countries to an estimated \$6 billion.
 - UNCTAD V: Called for the establishment of an international debt commission
 - Debt relief should not be limited to crisis response, should examine problems in overall dev. context

UNCTAD's initiatives and achievements (con't)

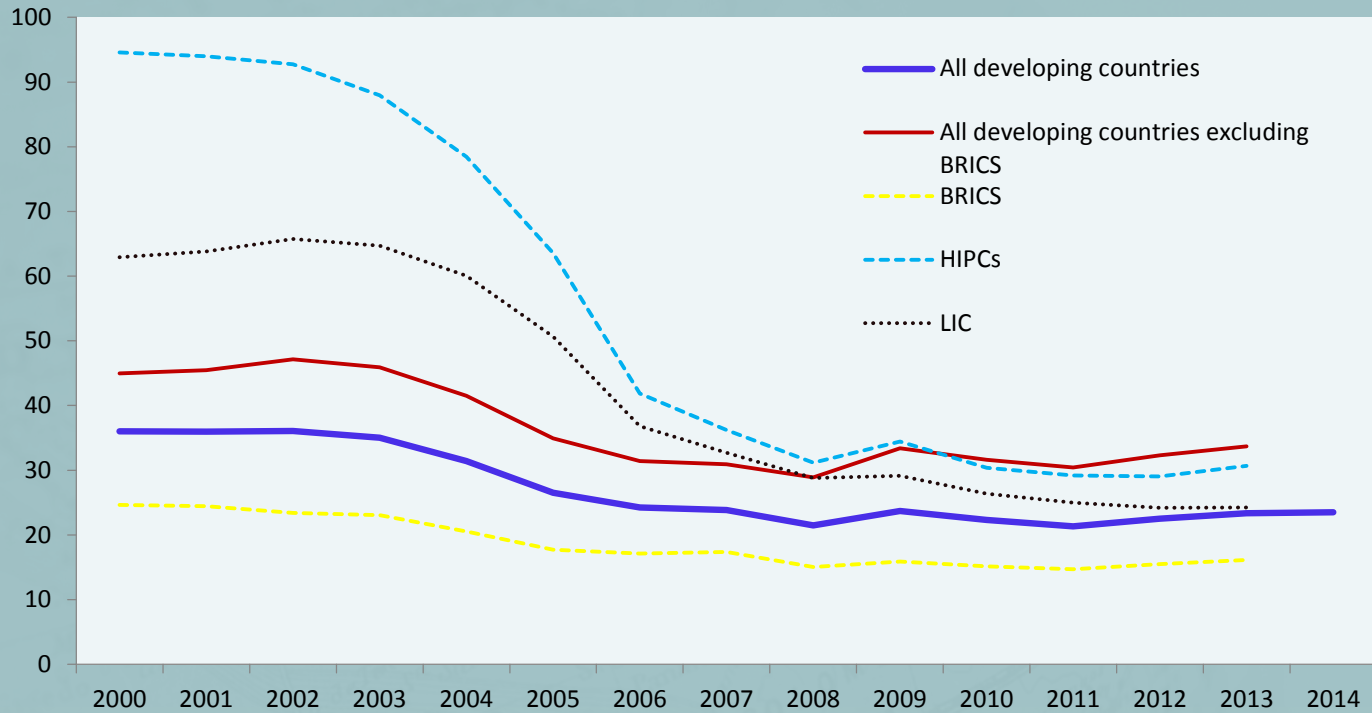
- 1980s
 - UNCTAD pointed to the lack of a well articulated, impartial framework for resolving international debt problems
 - proposed creating a chapter 11 process (US Bankruptcy code) at international level.
 - Assisted developing countries in Paris Club negotiations
- 1990s
 - Pushed for multilateral debt relief for developing countries

Current Debt Situation: Progress

- Developing countries have been successful on average in reducing their external debt ratios due to:
 - Favorable external conditions and rapid GDP growth from 2003-2007
 - Debt relief delivered under the HIPC Initiative & MDRI
 - MICs external debt reduction came in response to the financial crises that struck in the 2nd half of 1990s.

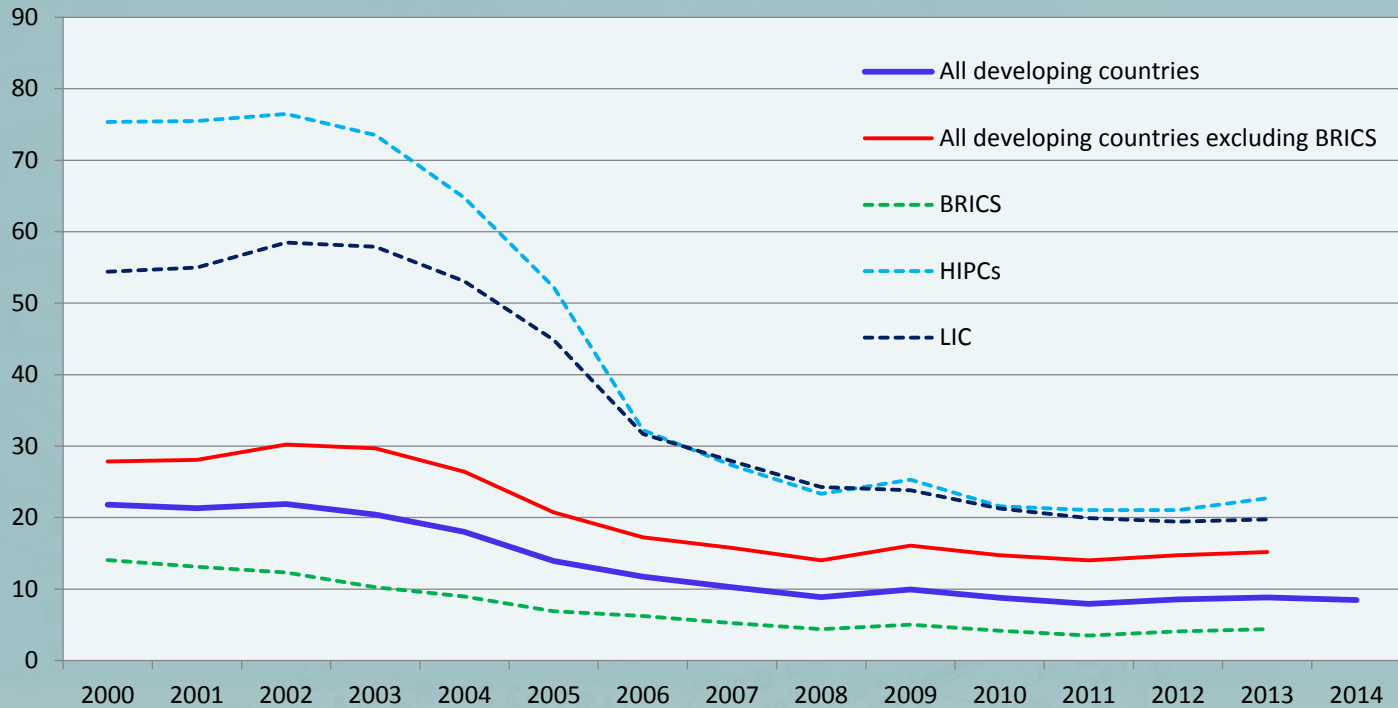
External Debt / GDP

(percentage)



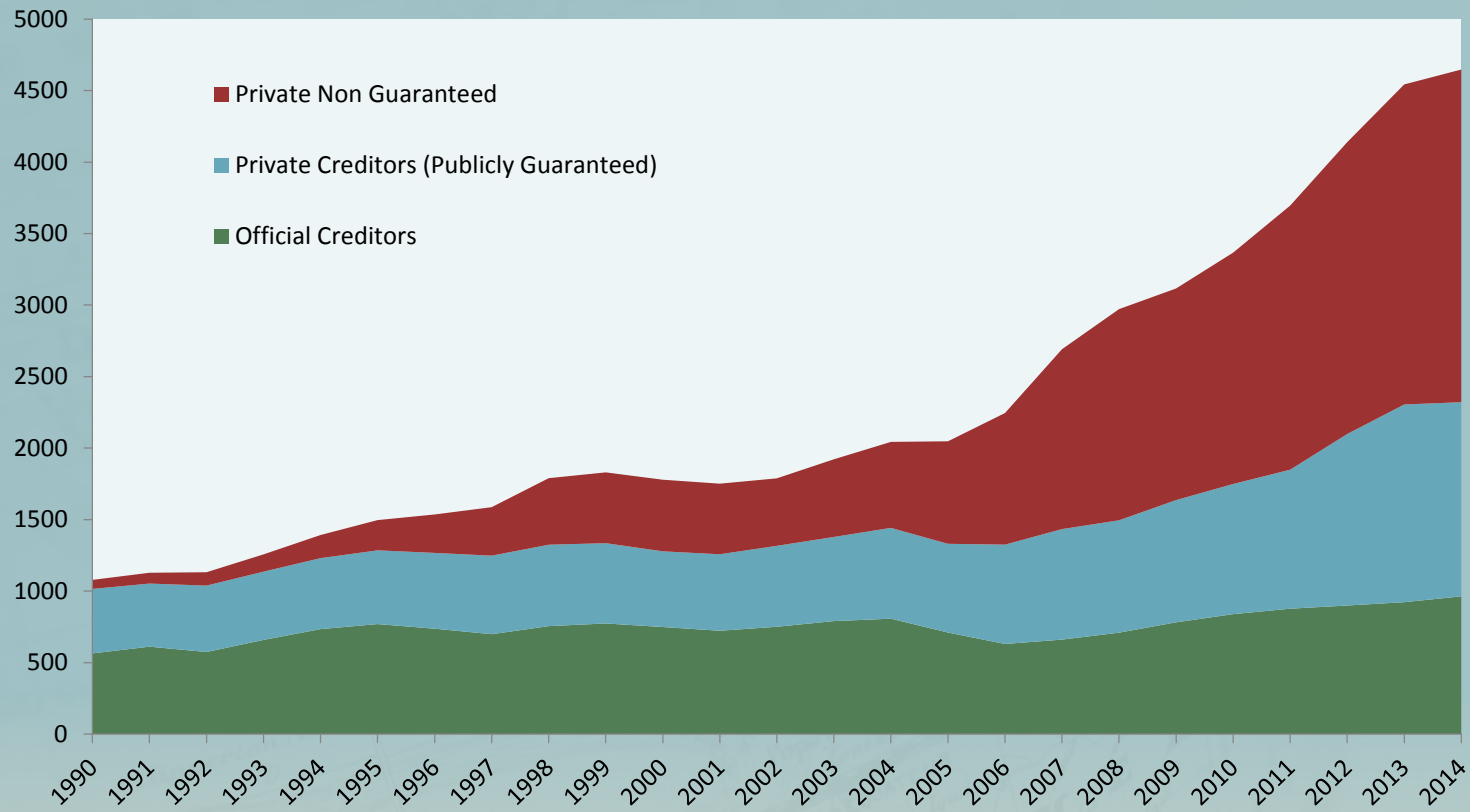
Public & Publicly Guaranteed Debt to GDP

(Percentage)



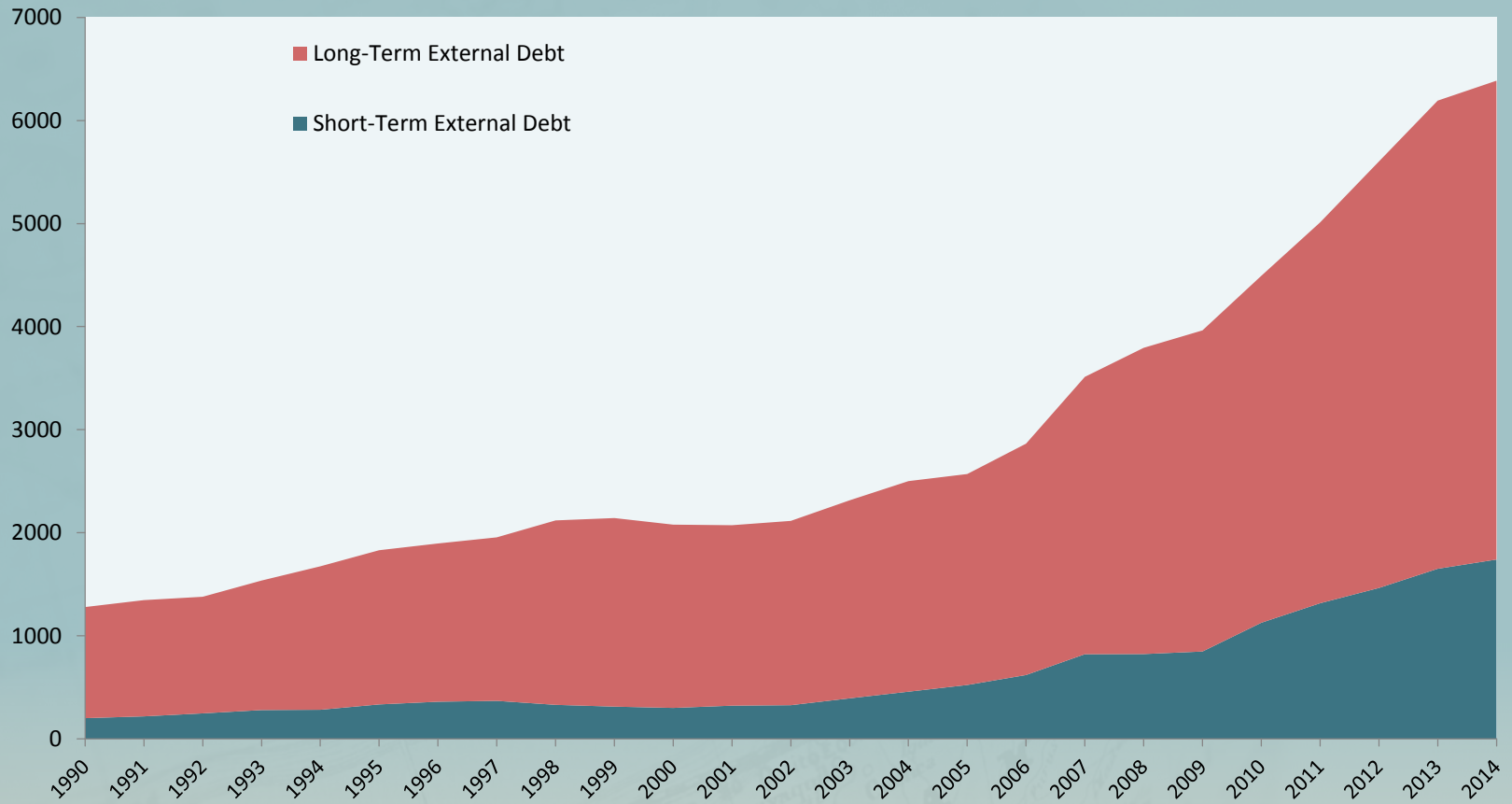
Composition of Long-term External Debt

(Billion USD)



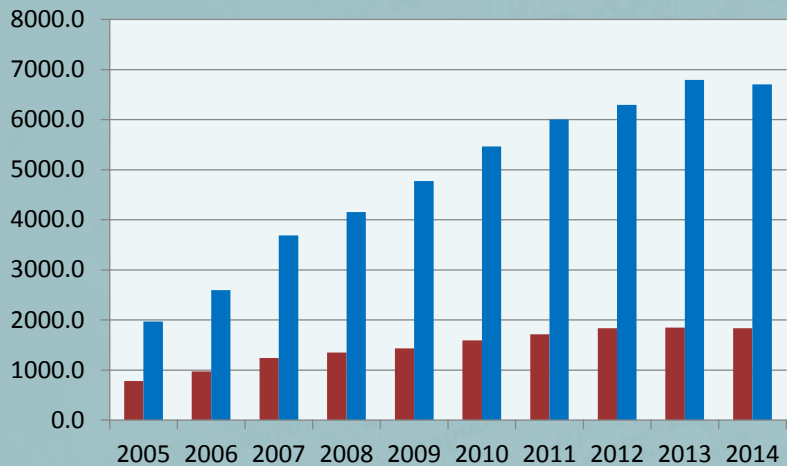
Composition of Total External Debt Stocks

(Billion USD)



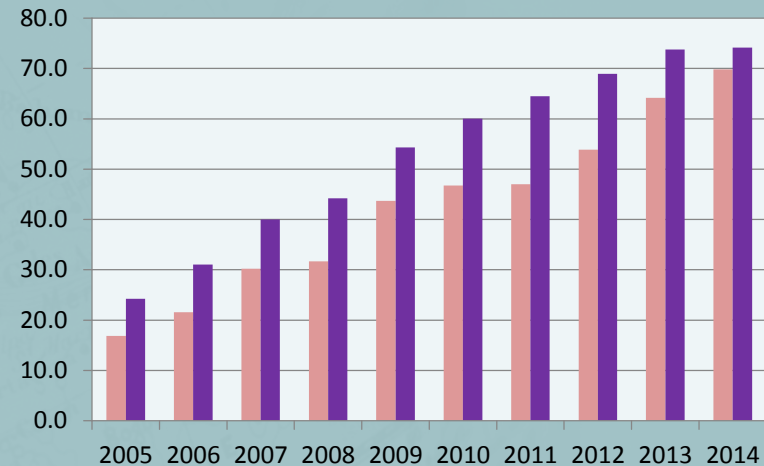
Increases in International Reserves

International Reserves
(Billion USD)



■ All developing countries excluding BRICS ■ All developing countries

International Reserves
(Billion USD)



■ Low Income Countries ■ HIPC

Current areas of work - prevention

- UNCTAD's three pillars
 - International consensus building
 - General Assembly negotiations
 - Responsible Sovereign Lending and Borrowing
 - Technical assistance
 - DMFAS Programme
 - Capacity building projects working with Ministries of Finance and Central Banks (ALM, risk management, debt sustainability, adoption of Principles for Responsible Sovereign Lending and Borrowing)
 - Research and analysis
 - Study and report on emerging issues in the international arena

Strategies to mitigate Debt crises

- Problem solving:
 - Avoid over borrowing
 - Making debt safer and improving debt management (DMFAS)
 - Establishing international norms on sovereign lending and borrowing (UNCTAD's Principles on Responsible Sovereign Lending and Borrowing)

Establishing and adhering to international norms

- UNCTAD's Principles for Responsible Sovereign Lending and Borrowing
 - To establish internationally recognized principles that promote and reinforce responsible sovereign lending and borrowing practices.
 - At present there are no such universally agreed principles that exist.
 - First step in the process of preventing (and if necessary resolving) future problems.
 - Eventually such guidelines could help identify criteria to assess whether the sovereign debt has been contracted in accordance with internationally accepted principles.

PRSLB ENDORSEMENTS

- The first round of endorsements happened during the UNCTAD Doha Conference on 22 April 2012:
- - Argentina - 22.04.2012
- - Brazil - 22.04.2012
- - Germany - 22.04.2012
- - Italy - 22.04.2012
- - Morocco - 22.04.2012
- - Nepal - 22.04.2012
- - Norway - 22.04.2012

PRSLB ENDORSEMENTS

- Other Member States joined progressively after that:
 - - Cameroon - 27.09.2012
 - - Colombia (pre endorsed) - 30.08.2012
 - - Gabon - 12.05.2012
 - - Honduras - 9.05.2012
 - - Mauritania - 25.10.2012
 - - Paraguay - 13.06.2012

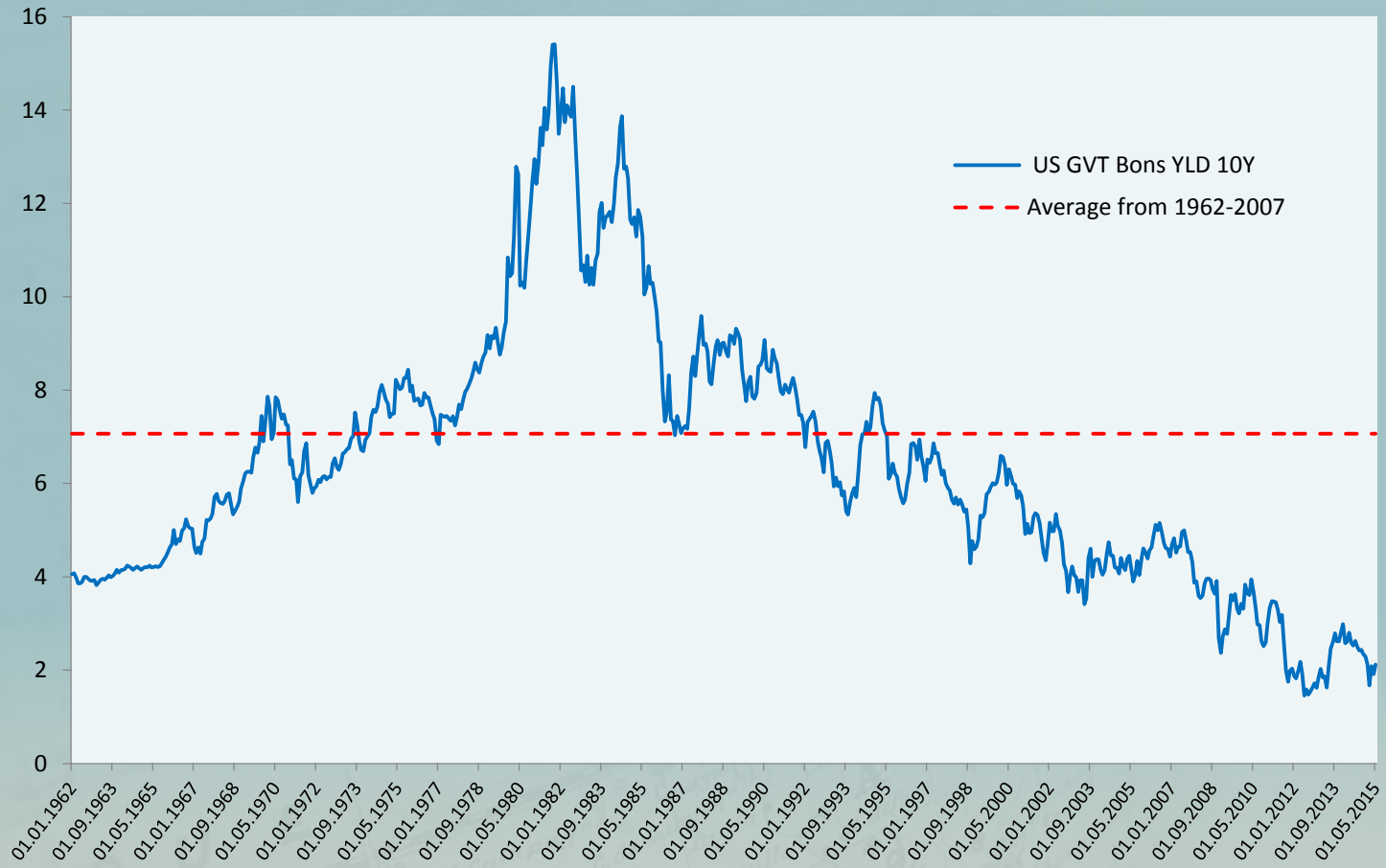
Safer debt

- Improvement in debt structure is likely to reduce the probability of a debt crisis.
 - Reducing currency and maturity mismatches
 - Switching from the international to the domestic debt market
 - This can prove to be difficult for some countries
 - Issuing contingent debt instruments
- Downside: investors are likely require higher compensation for investments with variable returns.

CHALLENGES FOR NEXT 15 YEARS

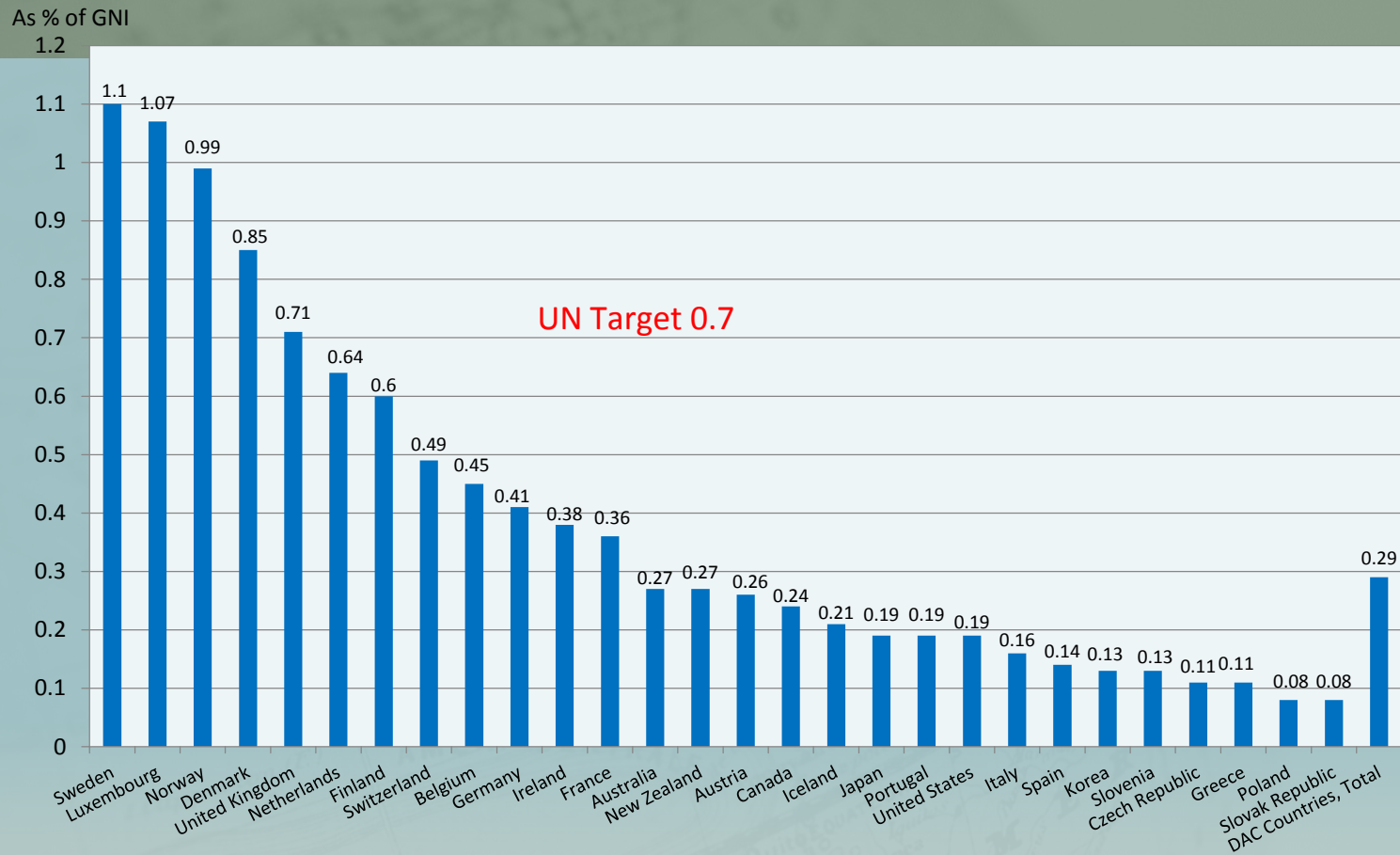
- Historically unusual macro situation and challenges of normalization of interest rates
- ODA, Debt and SDGs
- Post HIPC and sustainability
- Access to markets by new countries (pros and cons)
- Contingent liabilities for governments - private debt and ageing population
- Climate change and debt - policy implications

US 10 Yr Treasury Rate



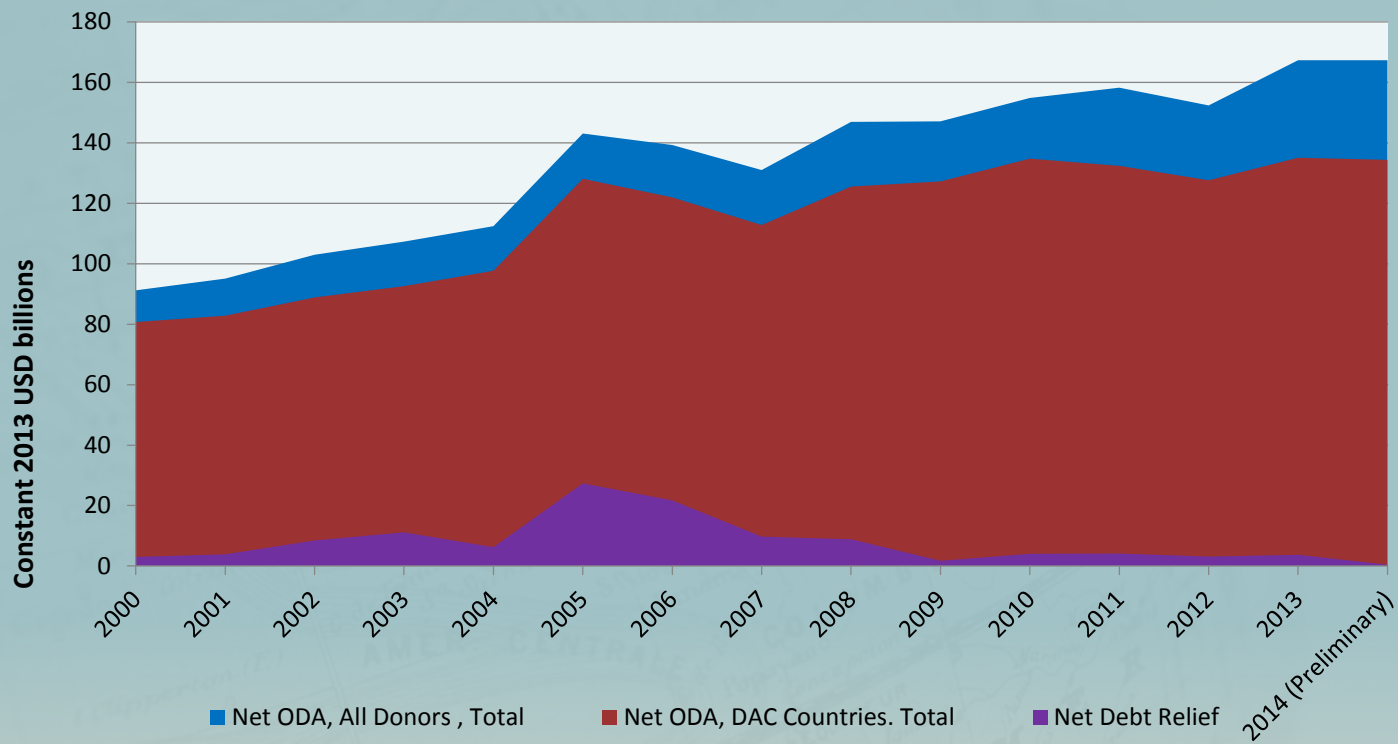
Source: Thomson Reuters DataStream

Net ODA in 2014 as a percentage of GNI



Source: OECD.Stat, May 2015.

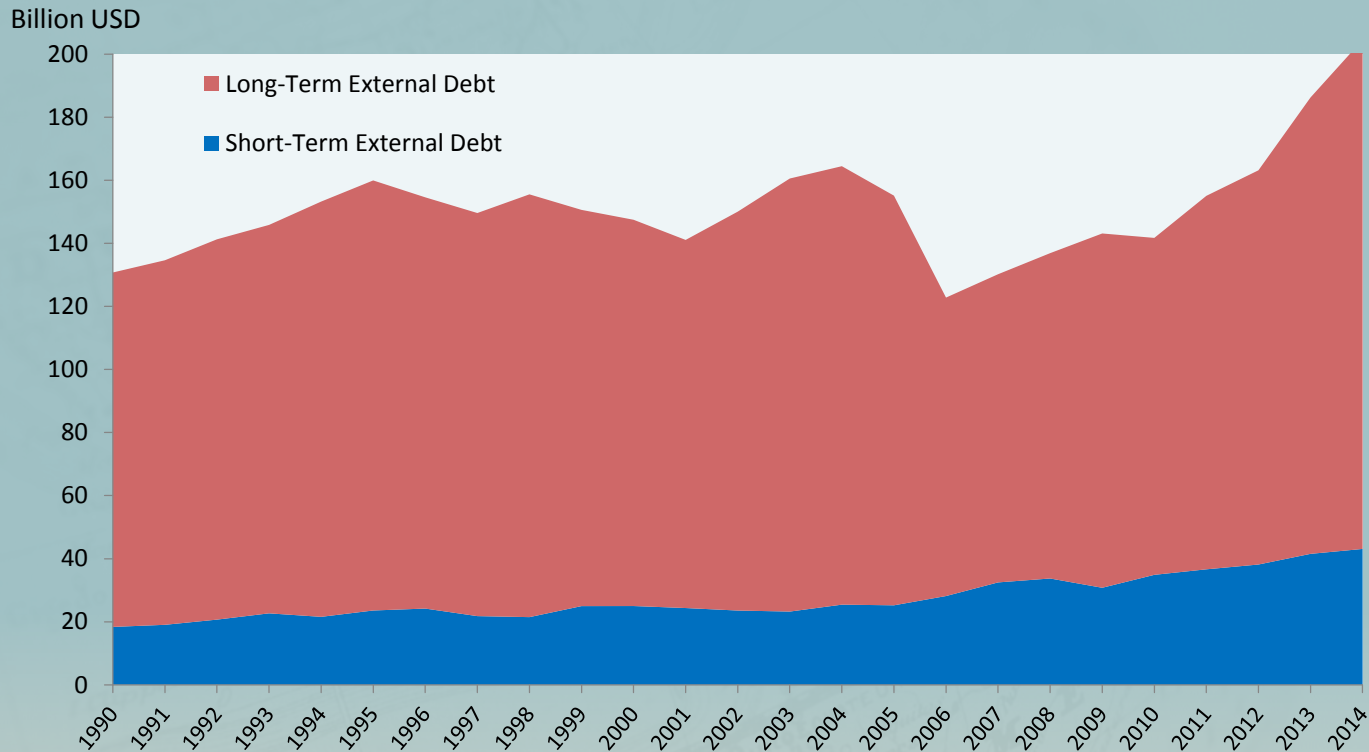
NET OFFICIAL DEVELOPMENT ASSISTANT & NET DEBT RELIEF GRANTS



Source: OECD.Stat, May 2015.

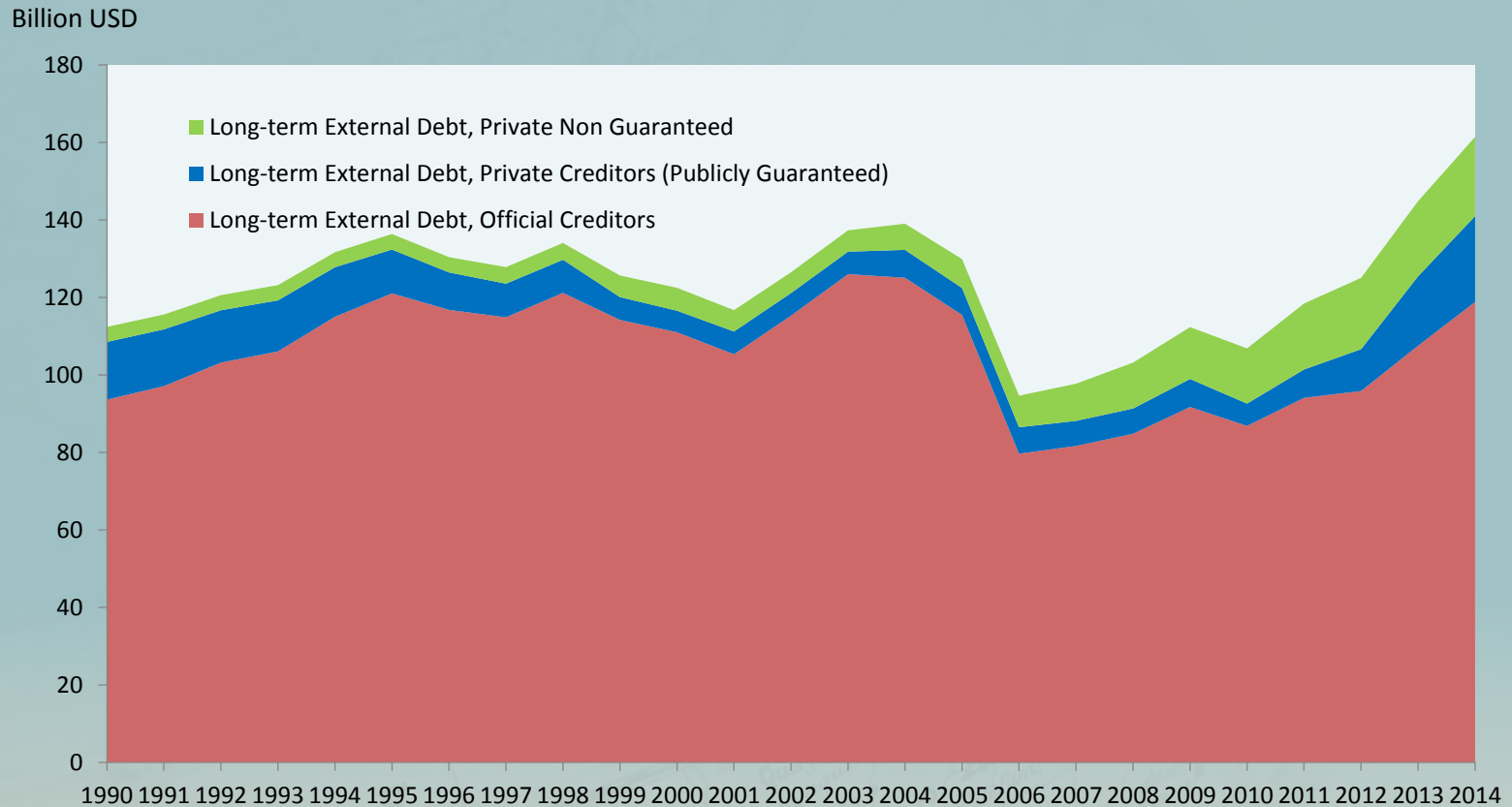
RECENT HIPC DEBT EVOLUTION

COMPOSITION OF TOTAL EXTERNAL DEBT STOCKS



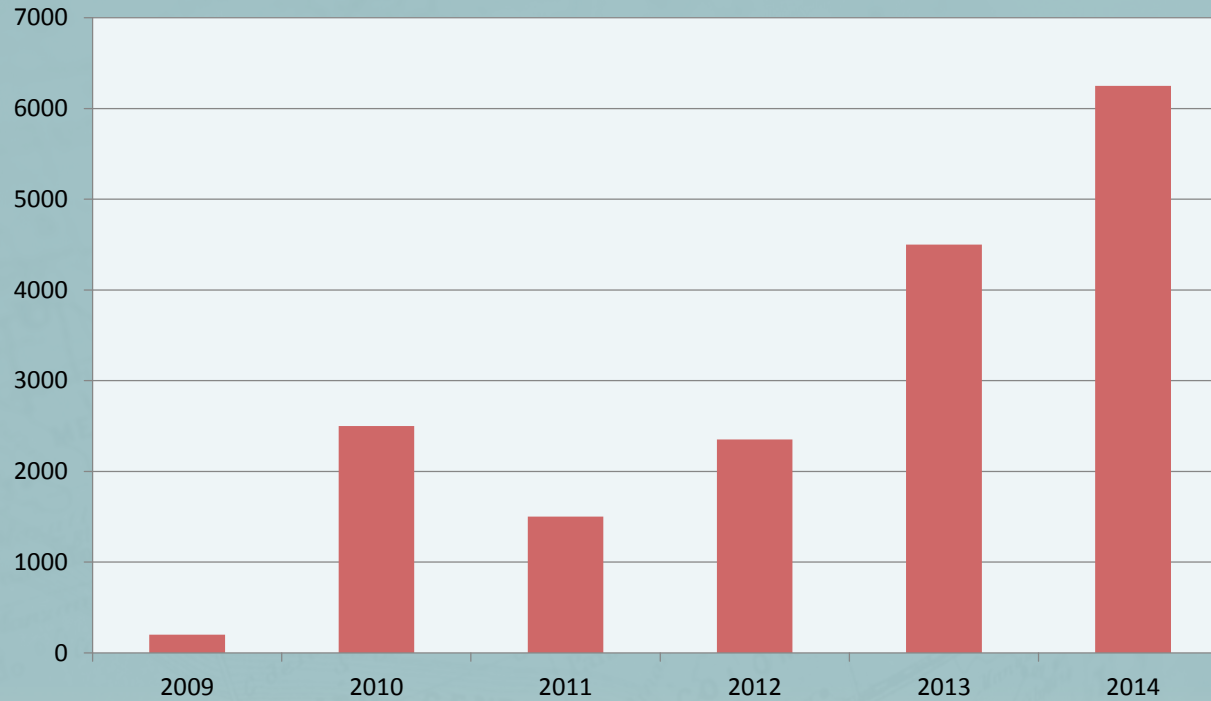
RECENT HIPC DEBT EVOLUTION

COMPOSITION OF LONG-TERM EXTERNAL DEBT



Sub-Saharan Africa Sovereign Bond Issues

(Million USD)

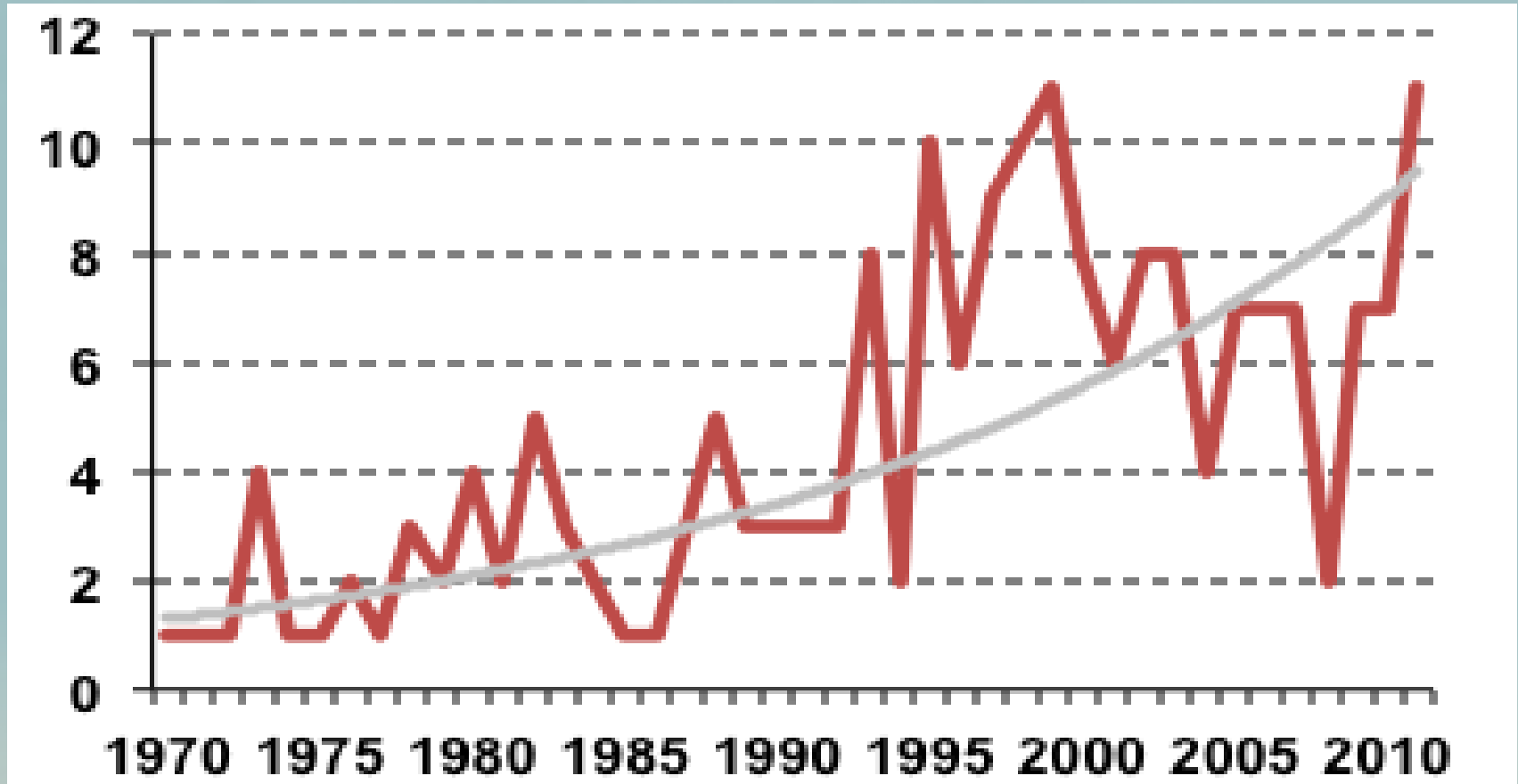


Source: Bloomberg, Dealogic, Financial Times

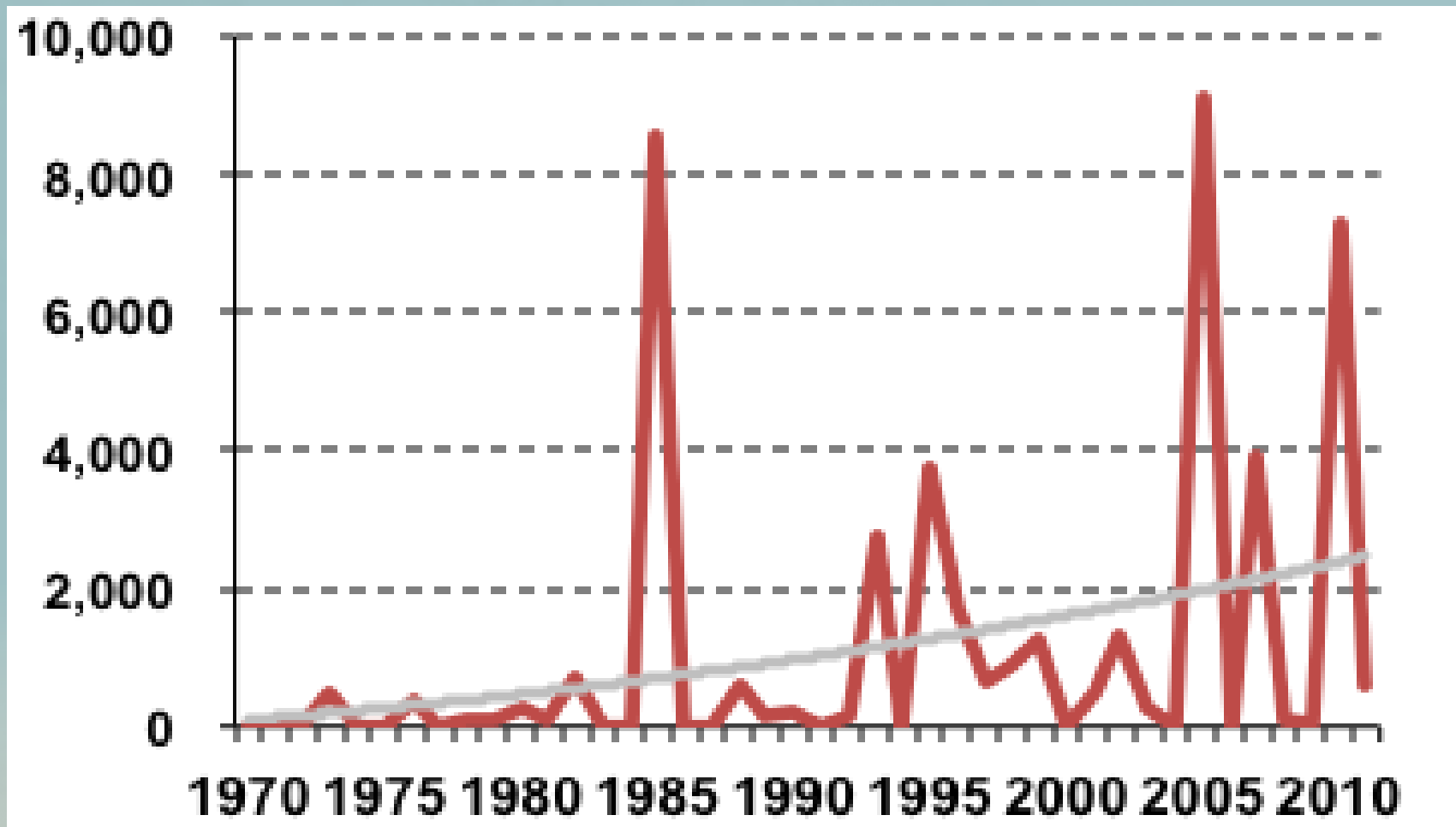
CLIMATE CHANGE AND NATURAL DISASTERS

- There were 189 natural catastrophes worldwide last year, the highest on Swiss Re records
- Disasters claimed more than 12,700 lives in 2014
- Severe thunderstorm losses are trending upward

NUMBER OF NATURAL DISASTERS IN MEXICO



ESTIMATED DAMAGE COSTS - MEXICO



Causes of Debt Crises

- Crises may be triggered by a number of exogenous shocks:
 - Currency crisis,
 - Banking crisis
 - Terms-of-trade shocks affecting the debt-to-GDP ratio and/or debt-to-export ratio.
 - Interest rate shocks.
 - Excessive borrowing or sub-optimal borrowing inconsistent with economic fundamentals.
 - Sudden capital flows reversals and contagion effects.
 - Natural disasters

Debt restructuring

- When a debt crisis occurs, there is a need for debt restructuring.
 - Debt restructuring is a central component of the discussion on external debt
 - It can only be seen as an exceptional instrument in the debt's general management over the medium term.

Current approach to debt restructuring

- Addressed through various institutions and arrangements:
 - Paris Club (official creditors)
 - London Club (private creditors)
 - Bond exchanges
 - Highly Indebted Poor Country Initiative (HIPC) & Multilateral Debt Relief Initiative (MDRI) (multilateral debt relief)

Problems with the current (non) system

1. Multifaceted (large undertaking involving numerous stakeholders)
2. Lengthy debt renegotiations
 - Costly & time consuming
 - Some cases do not restore debt sustainability
3. Need to coordinate interests of all stakeholders
 - dispersed creditors and hold out bondholders
4. Lack of access to private interim financing during the restructuring process
5. Delayed defaults
6. Holdouts.

HERE THEY COME - VULTURE FUNDS

- Countries are faced with significant setbacks
 - Social cost of loss revenue for poverty reduction
 - Development losses towards achievement of MDGs
 - Complicates financial and reserve management
- It is estimated to take HIPCs around six years to rebound from such litigation that was already drawn out for 3-10 years.
- High returns on this opportunistic behavior creates the wrong incentives

NOT ONLY ARGENTINA

- Donegal International purchased \$44 million of Zambia's debt owed to Romania for \$3.2 million (7.2%)
- Donegal sued the government for the debt and settled for a payment of \$16 million.
- After a missed payment, Donegal sued the government for full payment of the \$44 million in UK courts.
- Donegal was awarded a settlement of \$17.5 million, constituting over 540% profit

DEMOCRATIC REPUBLIC OF CONGO

- DRC reached decision point in 2002, and the completion point 2010 under HIPC (long process)
- The government defaulted on its debts during its Civil War, the fund FG Hemisphere purchased \$3 million of discounted debt
- Fund refused to participate in the debt relief scheme and sued the Congolese government in numerous courts seeking \$100 million.
- Going after the government's assets abroad FG Hemisphere won an award of \$30 million through Australian courts -- plus \$2 million in legal fees and court-imposed fines
- This was but one of many creditors pursuing large profits through litigation against the DRC

STILL GOING ON

- Currently 11 ongoing commercial creditor lawsuits against 6 HIPC's
 - Democratic Republic of Congo, Republic of Congo, Ethiopia, Honduras, Sudan and Uganda
- Court locations vary considerably
 - South Africa, France, Russia, Honduras, Sudan, Dubai, Uganda, Republic of Congo, (previous cases in US, UK, Sierra Leone)

FFD ON VULTURE FUNDS

- «we welcome legislative steps taken to impede these activities and encourage additional financial centre jurisdictions to take action»

A few examples of measures :

- Belgium “Anti-Vulture Fund” legislation (2008)
- UK Debt Relief Act (2010)
- World Bank Debt Reduction Facility
- Paris Club commitment not to sell claims on HIPC countries to creditors who do not intend to provide debt relief

Current work on improved debt workout procedures

IMF and ICMA:

- bonds with improved CACs and a strict definition of the pari passu clause

UN:

GA resolution (A/RES/68/304) “ Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes“.

UNCTAD AND GA PROCESS

A/RES/69/247: Modalities for the implementation of resolution 68/304, UNCTAD has been asked by member states to be the Secretariat of the Ad hoc Committee on a multilateral legal framework for sovereign debt restructuring processes,

- Two Ad Hoc Committee Meetings with no participation from advanced economies or IMF. Third meeting at the end of June.
- Chair will be distributing zero draft to member states at the end of May.

Debate surrounding a formal mechanism

- Arguments in favor:
 - The lack of such a structured mechanism is a major failure of the current international financial architecture which leads to long delays in debt restructuring, unfair outcomes, and loss of value for both debtors and creditors.
- Arguments against:
 - The current system has all the necessary contractual instruments for dealing with sovereign defaults and that the creation of a new institution for dealing with sovereign insolvencies would be useless at best and dangerous at worst.

ROADMAP – ELEMENTS OF A SYSTEM

- **Principle 1: Legitimacy**

Legitimacy is the property of a legal rule or a legal regime which makes it acceptable to its addressees, thereby inducing compliance.

- **Principle 2: Impartiality**

Impartiality may be defined as the absence of bias.

- **Principle 3: Transparency**

Transparency addresses the availability of information about the exercise of public authority to the general public or at least to interested stakeholders.

- **Principle 4: Good Faith**

Good faith is a principle which encompasses basic requirements of fairness, honesty, and trustworthiness.

- **Principle 5: Sustainability**

- Sovereign debt is sustainable if it can be serviced without impairing the social and economic development of society.



THANK YOU

<http://www.unctad.info/en/Debt-Portal/>