High-Level Event on Financing for Development in the Era of COVID-19 and Beyond

Convened by Canada, Jamaica and the Secretary-General

May 28, 2020

Discussion Note

Debt Vulnerability

1. Background

The global health and development emergencies caused by COVID-19 require urgent response and recovery measures for testing, tracing, isolation and treatment, as well as supporting the most vulnerable, securing livelihoods and stimulating the economy. Most developing countries do not have sufficient domestic resources and fiscal space to fund adequate response and recovery measures. International cooperation and external finance to bridge these fiscal gaps are crucial to recover better and prosper together.

As discussed in the Secretary-General's policy brief, Debt and COVID-19: A global response in solidarity, COVID-19 and its economic fallout are devastating public balance sheets. Prior to the outbreak of the pandemic, almost half of all least developed and other low-income countries were already at high risk of, or in, debt distress[1]. Debt servicing costs for these countries more than doubled between 2000 and 2019, to 13 per cent of government revenue – and reached over 40 per cent in a quarter of all Small Island Developing States (SIDS). In April 2020, to help increase liquidity to deal with the impacts of the crisis, the G20 agreed to suspend debt service on bilateral official debt to 73 low-income developing countries. The IMF offered further debt service relief to 25 of the poorest countries. The World Bank has been coordinating with regional MDBs to discuss COVID-19 support, joint initiatives, co-financing, and ways to maximize net flows to the poorest countries.

Debt vulnerability does not depend on pre-crisis per capita income levels. Many middle-income countries (MICs), including SIDS, which were not included in the G20 debt standstill, are also vulnerable given high levels of economic informality, inequality, large numbers of multidimensionally poor, and exposure to recurrent climatic and other external shocks. MICs are a heterogeneous group: some continue to enjoy access to private capital markets, while others were already on a trajectory toward default or in default before the crisis. 37 MICs are rated below investment grade by major ratings agencies, with external financing requirements of more than 14 per cent of GDP on average. Six middle-income small island developing States that are not eligible for debt suspension under the G-20 initiative have especially high public debt (61 per cent of GDP on average) and debt service burdens (41 per cent of revenue).

2. Main challenges

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High debt servicing and/or debt distress impede countries' ability to respond to the pandemic and invest in recovery and the SDGs, including making investments to build resilience to more frequent and severe climate impacts. Pragmatic solutions are needed to give countries room to make the policy choices and investments in a COVID response that will also lay foundations to recover better - supporting decent work, gender equality in the economic and social spheres, and inclusive growth that puts people and nature front and centre in the economy for sustainability. The fiscal space to make these important choices and SDG and Paris-compatible investments shoul Tw 0.3 B(.)1 ( )7 (e)0..7 3 (v)-2.6 3.1 ( )]TJ1 ( )]TJ1 (B(.)1 ( )7 (e)0..(re)-3 (s)-4 high risk of or in debt distress at the end of 2019 will require support and very possibly debt relief. Heavily indebted middle-income countries (including vulnerable SIDS) also face impossible choices between fighting the pandemic, investing in recovery, and avoiding costly defaults.

The scenario of a broader standstill that includes multilateral and commercial creditors would free nearly USD 20 billion for LDCs and other low-income countries. Because the standstill is offered on a net-present-value-neutral basis (meaning that creditors will be fully repaid), multilateral creditors should be able to consider participating without significantly impacting their ratings, with support from their shareholders. Similarly, consideration should be given to similar and other options to urgently address debt vulnerability in [illegible] 2d( )Tj-Tc 0 Tw0.7 (i)7y -0.(h)2.d-6 (r)-2.8(a)-d(-)Tj-0.001 Tc 79304 Tw 0.304

5. Continued Collaboration

A. By mid- July 2020, at the margins of the High-Level Political Forum

- Discussion of results from debt relief/restructuring initiatives.
- Exploring options to include the rest of the creditors and debtors in need in the standstill.
- Reflection on possible avenues to advance the Secretary-General's Strategy and Roadmap for Financing the 2030 Agenda in support of the process.

B. By mid-September 2020, at the margins of the UN General Assembly

- Reflection on the implementation of the debt sustainability/relief/restructuring initiatives.
- Discussion on options for debt sustainability and relief where appropriate for a sustainable recovery and the SDGs as suggested in Phase 2 of the policy brief of the Secretary-General on Debt and COVID-19.

C. By mid-December 2020

- Stock-taking and placing progress in the context of our common ambition to deliver the 2030 promise—by mobilizing together around the