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Revisiting the sovereign debt architecture

The Common Framework and considerations for a swift debt relief mechanism

Discussion Paper, October 2024

Harry Deng

UNU CPR

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Introduction

In response to the economic fallout from the COVID-19 pandemic, the Group of 20's Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (DSSI),[1] otherwise known as the Common Framework, sought to provide a coordinated approach to sovereign debt treatments for the world's poorest countries.[2] The Common Framework creates a Paris Club-like arrangement with China without China officially joining the Club. Since its launch in November 2020, however, only four countries have sought debt treatment under the Common Framework (Chad, Ghana, Zambia and Ethiopia) and all have suffered delays.[3]

The final outcome document of the 2024 Summit of the Future (the *Pact for the Future*) creates an opening to review and improve existing approaches to sovereign debt. Specifically, the *Pact for the Future* calls for relevant stakeholders to undertake a review of ways to improve the sovereign debt architecture via existing multilateral processes.[4] To this end, this paper thus seeks to contribute recommendations to improve the sovereign debt architecture ahead of upcoming multilateral processes, such as the Fourth International Conference on Financing for Development (FfD4) in 2025.

This paper advances three main arguments. First, the sovereign debt landscape has shifted considerably over three decades. Private creditors and non-Paris Club creditors, especially China, have become key lenders. Among DSSI-eligible countries, external debt owed to Paris Club creditors fell from 28 per cent in 2006 to 10 per cent in 2020 and multilateral development bank (MDB) debt fell from 55 per cent to 48 per cent; while over the same period debt owed to China rose from 2 per cent to 18 per cent and the share of debt owed to private creditors rose from 10 per cent to 19 per cent.[5] For International Development Association related loans, China's share rose to 49 per cent in 2021 from 18 per cent in 2010, while Paris Club creditors fell from 58 per cent to 32 per cent over the same period.[6]

Second, developing a shared understanding/methodology of what comparability of treatment (CoT) entails and how to enforce it should be pursued as a longer-term goal. CoT is a key principle of the Common Framework and requires debtor Governments to pursue debt treatment on comparable terms from all relevant official creditors and on at least favourable terms from private creditors.[7] Yet, creditor coordination and fair burden sharing within

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1 The G20's Debt Service Suspension Initiative (DSSI) was an initiative to suspend bilateral sovereign debt payment for 76 international development assistance (IDA) countries and least-developed countries (LDCs) for eight months as a response to the COVID-19 pandemic. Once the eight-month period expired, IDA and LDC countries had to resume the deferred payments. The DSSI expired at the end of 2020. See, Alexander Nye and Jun Rhee, “The Limits of the G20's Debt Service Suspension Initiative”, Yale School of Management Program for Financial Stability, 18 May 2020. Available at: https://som.yale.edu/sites/default/files/2022-01/International_Institutions_The%20Limits%20of%20the%20G20%27s%20Debt%20Service%20Suspension%20Initiative.pdf.

2 Diego Rivetti, “Achieving Comparability of Treatment Under the G20's Common Framework”, World Bank Equitable Growth, Finance & Institutions, 2 February 2022. Available at: https://documents.worldbank.org/en/publication/documents-reports/documentdetail/426641645456786855/achieving-comparability-of-treatment-under-the-g20-s-common-framework.

3 See, Larry Elliot, “World Bank Officials Calls for Shake-Up of G20 Debt Relief Scheme”, The Guardian, 21 April 2024. Available at: https://www.theguardian.com/business/2024/apr/21/world-bank-chief-economist-indermit-gill-g20-debt-relief-mechanism-common-framework; Blanca Ximena Talero, “Potential Statutory Options to Encourage Private Sector Participation in the Common Framework”, World Bank Equitable Growth, Finance & Institutions Notes, 2022. Available at: https://documents1.worldbank.org/curated/en/099802006132239956/pdf/IDU0766c0f2d0f5d0040fe09c9a0bf7fb0e2d858.pdf.

4 See, “Summit of the Future Outcome Documents: Pact for the Future”, United Nations, September 2024. Available at: https://www.un.org/sites/un2.un.org/files/sotf-the-pact-for-the-future.pdf. Paragraph 78(b) states that: [Member states] Invite the International Monetary Fund to undertake a review of ways to strengthen and improve the sovereign debt architecture, building on existing international processes, in collaboration with the Secretary-General, the World Bank, the Group of 20 and major bilateral creditors, and debtors, and request that the Secretary-General update Member States on progress and present proposals on this issue.

5 Guillaume Chabert, Martin Cerisola, Dalia Hakura, “Restructuring Debt of Poorer Nations Requires More Efficient Coordination”, IMF, 7 April 2022. Available at: https://www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination/.

6 World Bank, *International Debt Report 2022* (Washington DC, World Bank, 2022). Available at https://www.worldbank.org/en/programs/debt-statistics/idr/products.

7 World Bank, *Global Economic Prospects* (Washington DC, World Bank Group, 2022). Available at https://thedocs.worldbank.org/en/doc/18ad707266f7740bced755498ae0307a-0350012022/original/Global-Economic-Prospects-June-2022.pdf. See also, “Pact for the Future: Rev. 1”, United Nations, 14 May 2024. Available at: https://www.un.org/sites/un2.un.org/files/sotf-pact-for-the-future-rev.1.pdf. Paragraph 56(d) states that Member States should: improve and implement the Common Framework for Debt Treatments to enable faster and fairer restructuring processes and encourage steps to ensure comparability of treatment of sovereign and private creditors, including through respective national legislation.

the Common Framework remains a work-in-progress.[8] Therefore, a swift debt relief mechanism should be pursued while bottlenecks related to the Common Framework are worked out.

Finally, alternative debt relief mechanisms alongside the Common Framework should be pursued to provide immediate debt relief and open up fiscal space for lower- and middle-income countries (LMICs).[9] This paper argues that Brady Bond-like transactions are a useful mechanism that can provide immediate debt relief in the short-term (i.e., a stopgap measure) while States negotiate a longer-term solution, such as improving the CoT principle and the Common Framework.[10]

These arguments are developed in three sections. The first section contextualizes the current debt crisis by looking back at the 1980s debt crisis and introduces the Brady Bonds that brought an end to the 1980s debt crisis. The second section examines the politics of sovereign debt restructuring. Specifically, this section examines the rise of China as a bilateral creditor and investigates existing bottlenecks to debt relief. The third section considers the potential for debt relief through a Brady Bond-like transaction. This final section brings the previous two sections together by examining how the lessons from the 1980s debt crisis can be applied to contemporary debt challenges, and explores the actions required to achieve Brady Bond-like transactions.

Lessons from the past

While the geopolitical landscape and composition of sovereign debt has shifted since the 1980s, there are three lessons we can draw from that period. First, the features and mechanisms for sovereign debt restructurings have historically been shaped by the typology of creditors. Second, given the development of idiosyncratic debt types, a single institutional framework based on the CoT principle may be suboptimal in the context of debt restructurings that feature competing interests, as well as diverse and complex technical and legal hurdles. Third, the 1980s debt crisis suggests that in the absence of a formal multilateral sovereign debt restructuring mechanism, innovative solutions can provide swift debt relief.

The 1980s debt crisis, sometimes known as the 'Latin American debt crisis', was triggered by the massive global economic shocks of the 1970s, during which Latin America's external debt quadrupled from $75 billion in 1975 to more than $315 billion in 1983, and interest payments grew even faster due to surging global interest rates.[11]

During this period, the Paris Club was the main institutional framework for bilateral debt restructuring, where CoT was and remains a foundational principle.[12] While CoT foresees equal burden sharing across all creditor groups, in practice the Paris Club determined the scope of relief other creditors should also grant due to the fact that

8 See, "Global Sovereign Debt Roundtable – Compendium of GSDR Common Understanding on Technical Issues", World Bank, April 2024. Available at: https://documents1.worldbank.org/curated/en/099456004252424924/pdf/IDU1e19930f11b6ab14e801a24410f83a9bdd756.pdf.

9 Opening up fiscal space is important in helping developing countries meet the Sustainable Development Goals as well as the investments required to combat the climate crisis. See, "Our Common Agenda Policy Brief 6: Reforms to the International Financial Architecture", United Nations, May 2023. Available at: https://sdgs.un.org/sites/default/files/2023-08/our-common-agenda-policy-brief-international-finance-architecture-en.pdf.

10 Brady bond-like transactions have received support from Kenya, the Vulnerable 20, and World Bank chief economist, Indermit Gill. See, William Ruto, "A Consensus is Forming for IMF Reform", IMF, June 2024. Available at: https://www.imf.org/en/Publications/fandd/issues/2024/06/A-Consensus-is-Forming-for-IMF-Reform-William-Ruto. See also, Larry Elliot, "World Bank Official Calls for Shake-up of G20 Debt Relief Scheme", and "V20 Statement on Debt Restructuring Option for Climate-Vulnerable Nations", V20, 21 October 2021. Available at: https://www.v-20.org/our-voice/statements/group/v20-statement-on-debt-restructuring-option-for-climate-vulnerable-nations.

11 In the aftermath of the Bretton Woods breakdown in 1971, there was an increased flow of private capital that entered Latin American countries from the Organization of Petroleum and Exporting Countries through US financial institutions. This meant that Latin American countries were essentially borrowing against future oil revenues so when the price of oil dropped so did their ability to service their debt. See, Julianne Ams, Tamon Asonuma, Wolfgang Bergthaler, Chanda M DeLong, Nouria El Mehdi, Mark J Flanagan, Sean Hagan and Yan Liu, "The 1980s Debt Crisis", in *Prevention and Resolution of Sovereign Debt Crises* (International Monetary Fund, 2018). Available at https://www.elibrary.imf.org/display/book/9781484371329/ch001.xml.

12 The Paris Club consists of 22 permanent Member States that includes: Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Korea, Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom and the United States. It also consists of 14 ad hoc participants that includes: Abu Dhabi, Argentina, China, Czechia, India, Kuwait, Mexico, Morocco, New Zealand, Portugal, Saudi Arabia, South Africa, Trinidad and Tobago, and Türkiye. Available at https://clubdeparis.org/en/communications/page/permanent-members.

Paris Club negotiations precede debt restructuring with other creditors.[13] The Paris Club's primacy is relevant in determining whether another restructuring agreement has comparable terms or not, even if sometimes other creditor groups (e.g., private creditors) do not grant the same level of debt relief. A clear breach of the CoT clause can potentially lead to the cancellation of the agreement, granting the Paris Club significant sway in sovereign debt restructurings.[14]

Until the late 1980s, Paris Club creditors pursued a rescheduling approach that was often insufficient to restore the debt sustainability of a country.[15] This approach changed with the introduction of the Toronto Terms in 1988 when the Paris Club granted a reduction of approximately 33 per cent in outstanding debt to least-developed countries (known as the 'haircut' approach).[16] At this point, however, the debt crisis was nearly a decade old.

To expedite restructurings, Paris Club creditors have since largely relied on pre-defined restructuring terms. For example, 'Classic Terms' are made available to all Paris Club eligible countries, 'Houston Terms' for highly indebted LMICs and 'Cologne Terms' for Heavily Indebted Poor Countries Initiative (HIPC)-eligible countries.

The 1970s and 1980s also saw a rise in debt financed by private creditors.[17] Private creditors formed their own 'club', referred to as the London Club. The London Club was not a formal institutional framework like the Paris Club, but rather a customary restructuring practice developed by major western banks and debtor Governments in the late 1970s and 1980s.[18]

This presented two challenges. First, the two clubs made assessments on comparable treatment difficult; each advanced their own debt treatment preferences. For example, the Paris Club grants 'flow treatment' on non-Official Development Assistance debt while the London Club grants restructuring on the entire debt stock.[19] Moreover, while the Paris Club moved towards the haircut approach with the Toronto Terms, private creditors were less willing to take on these debt reductions ('haircuts').[20] Nonetheless, during the 1980s coordination between bilateral and private creditors was relatively straightforward in that identifying major creditors was easier, as most lending took place via syndicated loans and rarely on secondary markets.[21]

A second challenge was intra-creditor disputes amongst the London Club members. About 30 per cent of London Club restructurings suffered from intra-creditor disputes or

13 Ubaidir S. Das, Michael G. Papaioannou and Christoph Trebesch, "Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts", IMF Working Paper WP/12/203 (Washington, DC, IMF, 2012). Available at: https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf.

14 IMF, *Official Financing for Developing Countries* (Washington DC, IMF, 2001). Available at http://www.imf.org/external/pubs/cat/longres.cfm?sk=14803.0.

15 Prior to the 1980s, Paris Club creditors' rescheduling approach granted debtor countries with a longer repayment period of around ten-years that included a three-year grace period. See, Annamaria Viterbo, "The Role of the Paris and London Clubs: Is It Under Threat?", in *The Legal Implications of Global Financial Crisis*, Michael Waibal, ed. (The Hague, Brill, 2020).

16 Christina Daseking and Robert Powell, "From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries", IMF Working Paper WP/99/142 (Washington DC, IMF, 1999). Available at: https://www.imf.org/en/Publications/WP/Issues/2016/12/30/From-Toronto-Terms-to-the-HIPC-Initiative-A-Brief-History-of-Debt-Relief-for-Low-Income-3298.

17 Mareike Beck, "Extroverted Financialization: How US Finance Shapes European Banking," *Review of International Political Economy* Vol. 29, No. 5 (2022): 1723–1745. Available at: https://doi.org/10.1080/09692290.2021.1949375.

18 The London Club was not a statutory organization, like the Paris Club, nor did it have a permanent secretariat or location. It is so called because negotiations typically happened in London; although could also happen anywhere. The core element was a consultative committee, called the Bank Advisory Committee, where a group of 5–20 representative banks would negotiate with the debtor Government on behalf of all banks affected by the restructuring. See, Raman Uppal and Cynthia Van Hulle, "Sovereign Debt and the London Club: A Precommitment Device for Limiting Punishment for Default," *Journal of Banking and Finance* Vol. 21, (1997): 741–756.

19 Example from Viterbo, "The Role of the Paris and London Clubs."

20 Muyang Chen, "China's Rise and the Reshaping of Sovereign Debt Relief," *International Affairs* Vol. 99, No. 4 (2023): 1755–1775. Available at https://doi.org/10.1093/ia/iiad108.

21 In the 1980s, about two-thirds of developing countries' debt owed to private creditors took the form of syndicated bank loans and only 7 per cent took the form of international bonds (the remaining 25 per cent did not fit either of these categories). By 2008, nearly 70 per cent of debt owed to private creditors took the form of bonds and only 25 per cent syndicated bank loans. See: Ugo Panizza, Frederico Sturzenegger and Jeromin Zettelmeyer, "International Government Debt", UNCTAD Discussion Papers no. 199 (Geneva, UNCTAD, 2010), p. 5. Available at: https://unctad.org/system/files/official-document/osgdp20103_en.pdf.

holdouts that led to delays of three months or more.[22] Even though the London Club consisted only of commercial banks, the spread of debt contracts influenced individual banks' information status, their concerns, and thus their behaviour.[23] Despite the shifting landscape of creditor classes, studies find that there is no correlation between the number of creditors involved in negotiations and negotiation delays[24] – suggesting that the number of creditors is not as great a concern as the typology of creditors. Put simply, concerns of free-riding and other forms of creditor coordination failures increase as the diversity or heterogeneity of creditor preferences and practices increase.[25]

By the late 1980s, many developing countries had been in either debt distress or default for nearly a decade. It is within this context that then United States (US) Treasury Secretary, Nicholas Brady, launched the 'Brady Plan' for debt distressed Governments to restructure unsustainable debt – which featured 'Brady Bonds'. The Brady Plan had strong ownership by the US, who, in close collaboration with Japan, underwrote the Brady Bonds and used their political and financial weight to influence all creditor classes, including Paris and London Club members, to agree to debt exchanges (exchanging non-performing loans for newly issued bonds) via Brady Bonds.[26]

The Brady Plan was applied on a case-by-case basis and had several key innovations.[27] Bank loans were restructured as sovereign bonds, which were partly collateralized by zero-coupon US Treasury Bonds. The zero-coupon structures were appealing in the context of the 1980s and early 1990s high interest rate environment, as they represented deep discounts relative to regular coupon-bearing structures.[28] The second innovation was the 'menu' approach, which allowed creditors to choose between new instruments, including 1) discount bonds with a cut in face value, 2) par bonds with long maturities and a below-market interest rate but no debt reductions where banks can also elect to provide new financing with better terms, such as higher coupons, and 3) capitalization of arrears. Restructurings under the Brady Plan also came with International Monetary Fund (IMF) conditionality, which were also considered enhancements to the credit ratings on the newly issued Brady Bonds.[29]

The Brady Plan is widely considered a success and put an end to the 1980s debt crisis and normalized relations between creditors and debtors for the first time in a decade. Moreover, countries that restructured their debt via Brady Bonds experienced better macroeconomic outcomes, including faster growth, relative to non-Brady countries – this effect is known as the 'Brady multiplier'.[30] Taken together, the Brady-style mechanism was an effective tool for debt relief.[31] In total, 17 Brady Plan deals were implemented between 1989 and 1997.

22 Christoph Trebesch, "Delays in Sovereign Debt Restructurings: Should We Really Blame the Creditors?" *Proceedings of the German Development Economics Conference No. 44* (2008). Available at: https://www.econstor.eu/bitstream/10419/39906/1/AEL_2008_44_trebesch.pdf.

23 Holdouts were mostly caused by smaller regional banks who see it as the most effective tactic to give prominence to their concerns. See, Christian Kirchner and David Ehmke, "Private Ordering in Sovereign Debt Restructuring: Reforming the London Club", *Oxford University Comparative Law Forum 3* (2012). Available at: https://ouclf.law.ox.ac.uk/private-ordering-in-sovereign-debt-restructuring-reforming-the-london-club/.

24 Trebesch, "Delays in Sovereign Debt Restructurings".

25 See, Anne O. Krueger, "A New Approach To Sovereign Debt Restructuring", IMF, April 2002. Available at: https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf. See also, Rohan Pitchford and Mark L.J. Wright, "Holdouts in Sovereign Debt Restructuring: A Theory of Negotiation in a Weak Contractual Environment", *The Review of Economic Studies* Vol. 79, No. 2 (April 2012): 812–837. Available at: https://www.jstor.org/stable/23261351.

26 Neil Shenai and Marijn Bolhuis, "How the Brady Plan Delivered on Debt Relief: Lessons and Implications," IMF Working Paper WP/23/258 (Washington DC, IMF, 2023). Available at: https://www.imf.org/en/Publications/WP/Issues/2023/12/14/How-the-Brady-Plan-Delivered-on-Debt-Relief-Lessons-and-Implications-542389.

27 See Das, Papaioannou and Trebesch, "Sovereign Debt Restructurings".

28 See Shenai and Bolhuis, "How the Brady Plan Delivered on Debt Relief".

29 Reforms generally included current and capital account liberalization, reducing trade barriers, fiscal consolidation and structural reforms to stabilize the domestic rate of interest as well as exchange rates. See, William R. Cline, *International Debt Reexamined* (Washington DC, Institute for International Economics, 1995).

30 See: Shenai and Bolhuis, "How the Brady Plan Delivered on Debt Relief".

31 Ibid.

Features of the twenty-first century debt landscape

The debt landscape in 2024 is considerably different from the 1980s. Today's debt market is 'deeper' and more diversified than in the 1980s as a result of the rapid development of international financial markets and banking systems in both advanced economies as well as developing economies.[32] The rapid rise and diffusion of non-standardized debt contracts has undermined the ability to achieve a reasonable degree of inter-creditor equity (i.e., comparable treatment) in many cases.[33] More importantly, official lending is no longer dominated by the Organisation for Economic Co-operation and Development's Development Assistance Committee (DAC). Since 2014, China, mainly through their policy banks,[34] has become the world's largest bilateral creditor for developing countries.[35]

Debt Type		**Definition**
Official	Multilateral	A subset of official debt that a debtor country owes to MDBs and other international financial institutions.
	Bilateral	A subset of official debt that a debtor country owes to other Governments and/or their agencies.
Private	Sovereign Bonds	A subset of private debt that a debtor country owes to bondholders.
	Commercial Bank Debt	A subset of private debt that a debtor country owes to commercial banks.

Contemporary debt restructuring challenges mirror the difficulties facing the Paris Club (which includes many of the DAC countries), notably the Club's relationship with both China and private creditors. One institutional framework led by the Paris Club cannot adequately respond to the many competing interests and technical and legal hurdles that are now characteristic of the global debt landscape.

Despite years of effort, there are still important differences in approach to debt between China and the Paris Club members, which the Common Framework seeks to address.[36] A key hurdle in achieving comparable treatment under the Common Framework is the prevalence of No-Paris Club (NPC) provisions within Chinese policy banks' debt contracts. According to one analysis, 74 per cent of these contracts commit the debtor to exclude the debt from

32 The rapid development of international financial markets and banking systems is supported by programmes such as the Financial Sector Assessment Program (FSAP), implemented by the IMF and World Bank. See, Ying Qian, "Brady Bonds and the Potential for Debt Restructuring in the Post-Pandemic Era", Global Development Policy Center Working Paper 018 (Boston University Global Development Policy Center, 2021). Available at: https://www.bu.edu/gdp/files/2021/09/GCI_WP_018_FIN.pdf.

33 European Central Bank, "The IMF's Role in Sovereign Debt Restructurings", European Central Bank Occasional Paper Series No. 262 (European Central Bank, 2021). Available at: https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op262~f0e9e1e77e.en.pdf.

34 China's policy banks, such as the China Development Bank and the Export-Import Bank, were created in 1994 to take over policy lending duties from the State banks. Policy banks primarily extend long-term loans for infrastructure projects in developing countries. See, Cem Karacadag, "Financial System Soundness and Reform," in *China: Competing in the Global Economy*, Wanda S Tseng and Markus Rodlauer, eds. (Washington DC, IMF, 2003). Available at https://www.elibrary.imf.org/display/book/9781589061781/ch010.xml.

35 See, Sebastian Horn, Carmen M. Reinhart and Christopher Trebesch, "China's Overseas Lending", National Bureau of Economic Research Working Paper No. 26050 (Cambridge, MA, National Bureau of Economic Research, 2019). Available at: http://www.nber.org/papers/w26050. See also, World Bank, *International Debt Report 2023* (Washington DC, World Bank, 2023). Available at: https://openknowledge.worldbank.org/entities/publication/02225002-395f-464a-8e13-2acfca05e8f0.

36 Efforts date back to 2016 when China hosted the G20 Summit in Hangzhou and showed an interest in cooperating with the Paris Club, raising expectations that China might officially join the Paris Club. However, China's engagement has not extended much further since then. While China has argued that it has extended significant volumes of debt relief under both the DSSI and the Common Framework, others see China's engagement as rather reserved. See: Chen, "China's Rise and the Reshaping of Sovereign Debt Relief".

multilateral sovereign debt restructuring, including CoT under the Common Framework.[37] This puts debtor countries in a difficult position – either risk losing development assistance from Chinese policy banks or from the Paris Club creditors. While experts have advanced several arguments to explain China's approach, the inclusion of NPC provisions should be understood within the context of Chinese policy banks' preference for collateralized loans and repayment of principal in full as well as the banks' willingness to extend new credit to rollover existing debt.[38] In some cases, therefore, the use of CoT may represent a hurdle towards swift debt restructuring.[39]

On the other hand, the US and European Union (EU) have been reluctant to agree to a 'statutory approach' for a sovereign debt restructuring mechanism, which has been the preferred choice for China and many developing countries.[40] A statutory approach seeks to develop binding international law and differs from institutional frameworks, such as the Paris Club, that have neither legal status nor legal rules of procedure but maintain established soft law principles and other quasi-legal approaches. The 2014 United Nations General Assembly resolution led by the Group of 77 and China that called for "the establishment of a multilateral legal framework for sovereign debt restructuring processes" is an example of a statutory approach (A/RES/68/304). This resolution was blocked at the United Nations by both the US and EU despite having received broad support, with 124 States in favour, 41 abstentions and 11 against (A/68/PV.107). The US and EU blocked the resolution fearing that a statutory approach "could create uncertainty in financial markets" (A/68/PV.107). Instead, the US and the EU prefer a contractual market-based approach, demonstrated by their preference for Collective Action Clauses as a basis for sovereign debt restructurings for syndicated loans and international bonds as well as a starting point for CoT. This preference is reflected in the Common Framework.[41]

The prevalence of NPC provisions in Chinese policy banks' debt contracts and competing State perspectives on optimal debt restructuring frameworks, including those that privilege CoT as a fundamental principle, are slowing the resolution of contemporary debt challenges. A parallel mechanism could be envisaged which would provide swift debt relief in the short-term, without abandoning efforts to improve the Common Framework. The section below outlines some key considerations for such a parallel mechanism based on the Brady Bonds.

Key considerations

Brady Bond-like transactions today could serve as a useful mechanism to provide swift debt relief in the short-term while efforts to improve the Common Framework continue. It could act as a mechanism to deal with official debt (including multilateral debt) that would provide the most relief for countries either in debt distress or at-risk of debt distress. Brady Bond-like transactions would also address concerns related to shareholder compensation – a concern shared by both MDBs, private creditors and Chinese policy banks. Lastly, the 'menu' approach of Brady Bond-like transactions could satisfy the idiosyncratic debt treatment preferences of the Paris Club and China. Brady Bond-like transactions could, thus, be envisaged as 'carrots' for creditors to provide immediate debt relief alongside the 'sticks' (i.e., enforcement of CoT).

The original Brady Bonds re-packaged both non-performing bilateral loans and private loans. By the late 1980s, more than 50 per cent of all outstanding debt in LMICs was owed to private creditors and only 25 per cent was

37 Gelpern, Horn, Morris, Parks, and Trebesch, "How China Lends".

38 Higher levels of debt to China could indicate China's willingness to extend new credit to roll over existing debt, which would ease a debtor country's concerns regarding existing debt obligations towards the Paris Club creditors, thus making engagement and CoT less necessary. Ballard-Rosa, Mosley, and Rosendorff advance a similar argument, noting that higher levels of debt to China is associated with fewer Paris Club restructurings. This new money approach is in contrast to the 'haircut' approach to debt restructuring preferred by the Paris Club since the introduction of the Toronto terms in 1988. See, Laura Alfaro and Fabio Kanczuk, "Undisclosed Debt Sustainability", National Bureau of Economic Research Technical Report (Cambridge, MA, National Bureau of Economic Research, 2019). Available at: https://www.nber.org/papers/w26347. See also, Cameron Ballard-Rosa, Layna Mosley, and B. Peter Rosendorff, "Paris Club Restructuring and the Rise of China", paper presented at DebtCon6, Princeton, April 2023. Available at: https://www.peio.me/wp-content/uploads/PEIO16/submission_124.pdf.

39 David Grigorian, "A Modified Common Framework for Restructuring Sovereign Debt", Harvard Kennedy School, 4 April 2024. Available at: https://www.hks.harvard.edu/centers/mrcbg/programs/growthpolicy/modified-common-framework-restructuring-sovereign-debt#_ftn3.

40 Skylar Brooks, "The Politics of Regulatory Design in the Sovereign Debt Restructuring Regime", *Global Governance* Vol. 25 (2019): 292–417. Available at: https://www.jstor.org/stable/26827674.

41 Viterbo, "The Role of the Paris and London Clubs".

owed to bilateral creditors (the remaining 25 per cent was multilateral debt).[42] It has been suggested that the success of Brady Bond restructurings was their approach to private creditors, coupled with the substantial credit enhancements to debtors that were willing to undertake structural reforms.[43]

There are key differences in external debt composition today as compared with the 1980s. According to UN Trade and Development (UNCTAD), the percentage of total outstanding debt owed to private creditors amongst low-income countries (LICs) is 13 per cent and debt owed to bilateral creditors is 31 per cent. For lower-middle income countries (LMCs), on the other hand, private creditor debt represents 41 per cent of total outstanding debt and bilateral debt sits at 20 per cent.[44] For the 24 countries either in debt distress or considered to be high risk of debt distress, including both LICs and LMCs, the majority of their debt is owed to official creditors (e.g., Paris Club, China and MDBs) and only three of these countries owed at least 30 per cent of their debt to private creditors.[45] Their share of official debt ranges from 100 per cent (e.g., Somalia, Mauritania, Afghanistan) to 57 per cent (e.g., Nigeria, Chad).[46] Moreover, of these 24 countries, 12 owe at least half of their official debt to multilateral institutions (e.g., approximately 92 per cent of Burundi's debt is multilateral debt). As such, while private debt remains an important component of overall sovereign debt across all developing economies, particularly LMCs, and should be included in any debt relief effort, restructuring official debt may have a bigger impact for low-income countries as well as the most debt distressed countries.

Multilateral debt, however, has generally been excluded from restructuring processes due to the preferred creditor status of MDBs. This preferred creditor status underpins MDBs' high credit quality and inclusion of multilateral debt in restructurings could lead to negative market reactions, unless MDB shareholders are guaranteed full compensation.[47] Nevertheless, the G20 and China have called for MDBs to share the burden of debt relief and China has insisted on MDB participation in debt restructurings as a condition for further Chinese participation in debt relief efforts.[48] Private creditors and Chinese policy banks are in a similar position as MDBs, where their willingness to take losses via haircuts in debt relief efforts is directly correlated to their ability to take on those losses based on their fiduciary responsibilities.[49]

Brady Bond-like transactions could help alleviate these bottlenecks related to shareholder compensation. Brady Bond-like transactions today should include an option that is similar to the par bonds option of the original Brady Bonds with long maturities and below-market interest rate but no debt reductions or haircuts. This addresses the constraints faced by both MDBs, private creditors and Chinese policy banks. Full shareholder compensation means that MDBs are able to retain their high credit quality while private creditors and Chinese policy banks are able to fulfil their fiduciary responsibilities. However, instead of

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42 This is a stark contrast to the composition of sovereign debt of LMICs in the early 1970s where 70 per cent of total outstanding debt was due to official creditors and nearly 80 per cent of this official debt was due to bilateral creditors. See: Panizza, Sturzenegger, and Zettelmeyer, "International Government Debt".

43 Shenai and Bolhuis, "How the Brady Plan Delivered on Debt Relief".

44 "Growth, Debt, and Climate: Realigning the Global Financial Architecture", in *UNCTAD Trade and Development Report 2023* (Geneva, UNCTAD, 2023). Available at: https://unctad.org/publication/trade-and-development-report-2023.

45 Countries considered in debt distress include Chad, Somalia, Sudan, São Tomé and Principe and Zimbabwe. Countries considered at high risk of debt distress include Afghanistan, Burundi, Kiribati, Malawi, Central African Republic, Comoros, Djibouti, Dominica, The Gambia, Guinea-Bissau, Haiti, Marshall Islands, Mauritania, Federated State of Micronesia, Samoa, Sierra Leone, South Sudan, Tonga and Tuvalu. See, George Gray Molina and Lars Jensen, "Building Blocks out of the Crisis: The UN's SDG Stimulus Plan", UNDP Development Futures Series (UNDP, 2023). Available at: https://www.undp.org/publications/dfs-building-blocks-out-crisis-uns-sdg-stimulus-plan.

46 Ibid.

47 "China's Stance on Multilateral Debt Relief Could Weaken MDBs' Preferred Creditor Status", Fitch Ratings, 4 April 2023. Available at: https://www.fitchratings.com/research/sovereigns/chinas-stance-on-multilateral-debt-relief-could-weaken-mdbs-preferred-creditor-status-04-04-2023/.

48 See: Ballard-Rosa, Mosley, and Rosendorff, "Paris Club Restructuring and the Rise of China". See also: Joe Cash, "Explainer: What is China's Position on Restructuring Debt Owed by Poor Nations?" Reuters, 21 June 2023. Available at: https://www.reuters.com/sustainability/what-is-chinas-position-restructuring-debt-owed-by-poor-nations-2023-06-22/.

49 Chinese policy banks, for example, lend to make a profit and the Chinese system lacks mechanisms to compensate them for 'haircuts.' See, Shahar Hameiri and Lee Jones, "China, International Competition and the Stalemate in Sovereign Debt Restructuring: Beyond Geopolitics", *International Affairs* Vol. 100, No. 2 (2024): 691–710. Available at: https://doi.org/10.1093/ia/iiae017. See also, Lee Buchheit, Guillaume Chabert, Chanda DeLong, and Jeromin Zettelmeyer, "The Sovereign Debt Restructuring Process," in *Sovereign Debt: A Guide for Economists and Practitioners*, S. Ali Abbas, Alex Pienkowski and Kenneth Rogoff, eds. (Oxford, Oxford University Press, 2019). Available at: https://doi.org/10.1093/oso/9780198850823.003.0009.

being collateralized by US Treasury bonds, MDBs can issue policy guarantees that promise repayment while lowering overall transaction costs.[50]

The modalities of a Brady Bond-like transaction could also be packaged in a similar manner to the discount bonds with a cut in face value of the original Brady Bonds, which could align with the Paris Club's preference for the Toronto Terms for LIC debt restructurings. This option would be particularly impactful for debt distressed countries that have an outsized share of debt owed to the Paris Club (e.g., 77.9 per cent of Somalia's external debt is owed to the Paris Club).[51] The IMF and World Bank concessional lending facilities, such as the Poverty Reduction and Growth Facility, can act as credit enhancements for these Brady Bond-like transactions – similar to the structural adjustment measures of the original Brady Bonds. Lastly, a Brady Plan-like approach would streamline both private and official claims, as it would also exchange private claims into sovereign bonds and would avoid the contentions associated with requiring private creditors to provide haircuts (i.e., take on losses on their loans), which they are reluctant to do.

Concluding note

The *Pact for the Future* envisages an independent review of the sovereign debt architecture with the view of making concrete recommendations for reform to the FfD4 in 2025. This review could include an analysis of the utility of a new Brady Bond-like transaction to which this paper has sought to contribute. Given the delays to debt treatments under the Common Framework, Brady Bond-like transactions could act as a parallel mechanism that would provide swift debt relief in the short-term while States continue to improve the long-term viability of the Common Framework.

50 There is support amongst IMF staff for Brady Bond-like transactions with collateral financed by MDBs. See, Marcos Chamon, Erik Kolk, Vimal Thakoor and Jeromin Zettelmeyer, "Debt-for-Climate Swaps: Analysis, Design, and Implementation", IMF Working Paper WP/22/162 (Washington DC, IMF, 2022). Available at: https://www.imf.org/en/Publications/WP/Issues/2022/08/11/Debt-for-Climate-Swaps-Analysis-Design-and-Implementation-522184. See also Ying Qian, "Brady Bonds and the Potential for Debt Restructuring in the Post-Pandemic Era", Global Development Policy Center Working Paper 018 (Boston University Global Development Policy Center, 2021). Available at: https://www.bu.edu/gdp/files/2021/09/GCI_WP_018_FIN.pdf. See also, The World Bank, "Credit Enhancement – Guarantees". Available at: https://treasury.worldbank.org/en/about/unit/treasury/ibrd-financial-products/creditenhancement/.

51 Molina and Jensen, "Building Blocks out of the Crisis".

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