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International Development Committee

Debt relief in low-income countries: Government response to the Committee's Seventh Report of Session 2022-23

Eighth Special Report of Session 2022–23

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The International Development Committee

The International Development Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the Department for International Development and its associated public bodies.

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Eighth Special Report

The International Development Committee published its Seventh Report of Session 2022–23, Debt relief in low-income countries (HC 146), on 10 March 2023. The Government response was received on 11 May 2023 and is appended to this report.

Appendix: Government Response

Summary to response

The Government is grateful to the International Development Committee for the report on debt relief in low-income countries. The report is timely and reflects the changing context for providing sovereign debt relief, not only in low-income countries but globally.

The Government remains committed to strengthening the international debt architecture, recognising high and worsening debt vulnerabilities especially in low-income countries, how protracted debt restructurings have become, and how debt burdens are putting pressure on vital areas of development spending in low and middle-income countries.

The UK continues to play a leadership role in discussions on international debt issues. Our approach recognises the multi-dimensional nature of debt and seeks to ensure that all key actors including official creditors, private creditors, the International Financial Institutions (IFIs), and borrowing countries all take action, while recognising the evolving global macroeconomic and development context.

At a strategic level, we are pushing for enhancements to the international sovereign debt architecture, for example being a key part of the discussions to agree the new Common Framework for debt treatment in November 2020, building on the G20's Debt Service Suspension Initiative (DSSI) and our prior support of the Heavily Indebted Poor Countries initiative (HIPC), and the Multilateral Debt Relief Initiative (MDRI) that was agreed under the UK's G8 Presidency in 2005. More recently the UK has welcomed the IMF, World Bank, and Indian Presidency Global Sovereign Debt Roundtable initiative to widen stakeholder consultations, including the private sector and debtor countries, on developing country debt issues and improvements to debt effectiveness. The UK is using its seat to make sure developing country voices are heard.

Alongside this action at a strategic level, the UK is pushing for progress on specific country cases, as a member of the G20 and the Paris Club, as a creditor to countries such as Zambia and Ghana, and because the UK is a leading global financial centre. We are also leading the development and take-up of specific reforms. This includes making market-based (contractual) improvements to the debt architecture, specifically, Climate Resilient Debt Clauses (CRDCs) to pause debt repayments during a climate shock, and Majority Voting Provisions (MVPs) for private creditor syndicated loans, to make debt restructurings more efficient. We are pressing for others to follow the UK's strong track record of: helping developing countries to collect more tax and to improve management of their public finances, increasing resilience to shocks including through disaster risk financing; being responsible lenders by upholding OECD sustainable lending rules; and championing debt transparency

We are also working hard to encourage the IFIs to scale up their support to vulnerable countries. We are the third largest donor to the 20th replenishment of the World Bank Group's IDA, which is providing $93 billion of finance to the world's poorest countries. The UK has committed to channel 4 billion Special Drawing Rights to support vulnerable countries, including 1.5 billion SDR to the Poverty Reduction and Growth Trust where our contributions include implicit subsidy resources, and 2.5 billion SDRs through the new IMF Resilience and Sustainability Trust.

Through our British Investment Partnerships, we are providing honest and reliable investment to help low and middle-income countries to access the investment they need. We are also working to unlock private investment for viable projects to help countries avoid excessive public debt burdens.

This response seeks to address the Committee's recommendations in the order in which they appear in the 'Conclusions and Recommendations' section of the Committee's Report.

Debt relief initiatives

Recommendation 1. ***Given the lack of progress on the Common Framework, the UK Government must support continued emergency debt service suspension for countries that have applied for the Common Framework. This would provide fiscal space for low-income countries while the international community, including the UK, works to develop a long-term approach to debt relief through the Common Framework.***

Accept

The UK Government remains committed to the implementation of the Common Framework, which continues to represent a landmark agreement between the Paris Club and G20 to coordinate on delivering meaningful debt treatments for eligible countries.

We note the regrettably slow progress of cases under the Framework, with a debt treatment concluded only for Chad, discussions ongoing in Zambia, and the formation of an official creditor committee for Ghana on-going. Ethiopia's treatment stalled in the context of domestic conflict and a pause in the IMF's operations there, although welcome progress on implementing a peace deal provides the prospect for wider progress.

The UK is pushing for the swift conclusion of debt treatments for the existing country cases at creditor committees where the UK is represented, and at relevant debt fora such as the Paris Club and G20. The UK is also a strong advocate for improvements to the overall functioning of the Common Framework and wider debt architecture. We are also playing an active role in the newly created Global Sovereign Debt Roundtable, which brings together all relevant stakeholder groups, including debtor countries, to discuss debt sustainability and debt restructuring challenges and ways to address them, including how to accelerate debt restructuring processes.

We have used these fora to explicitly call for more clarity on timelines for delivering debt treatment under the Framework, for example through a 'user manual' which would set out clear processes and timelines in response to calls from debtor countries for greater clarity around the steps of the framework. We have also supported the idea of debt service suspensions for countries that have applied for the Common Framework, to begin after agreement between the IMF and requesting country of an IMF Staff Level Agreement. However, up to now it has not been possible to secure consensus on this in the G20. In practice, some countries have implemented payment moratoria on a case-by-case basis which operate in the same way as debt suspensions and so are not in these cases making debt repayments to their private and bilateral creditors.

Recommendation 2. ***The Government should exercise its influence at the IMF to establish a clear definition of unsustainable debt to inform potential applicant countries on the likelihood of meeting the eligibility criteria for the Common Framework.***

Reject

The G20 and Paris Club set out clear criteria on eligibility for the Common Framework at its inception in November 2020[1]. There are 73 low-income countries that may apply for debt treatment under the Framework, which comprises all International Development Association-eligible countries and UN Least Developed Countries current on their debt service to the IMF and World Bank.

As indicated in public G20 documents: 'The process [for debt treatment] will be initiated at the request of a debtor country. The need for debt treatment, and the restructuring envelope that is required, will be based on an IMF-World Bank Group Debt Sustainability Analysis (DSA) and the participating official creditors' collective assessment, and will be consistent with the parameters of an upper credit tranche (UCT) IMF-supported program.

We note that the analytical framework on which the DSA for low-income countries is conducted is soon to be reviewed by the IMF and WBG, and the UK and other countries will contribute views on where it could be improved. We also look forward to the IMF's ongoing work with the World Bank to improve the information sharing process with creditors, including on information underlying the Debt Sustainability Analysis, which we have pushed for in the IMF Committee (IMFC) and the G20 alongside other G20 countries.

Debt and development

Recommendation 3. ***The Government must acknowledge the critical interplay between debt and development by including its strategy for debt relief in (a) the next iteration of its International Development Strategy and (b) the updated Integrated Review.***

Accept

We agree debt and development are strongly linked. Borrowing can play an important role in a country's development when it is done sustainably and enables public investment that brings many benefits. But unsustainable borrowing can be a drag on growth if high debt service costs reduce space for development spending. For example, in 2021 external debt repayments in Zambia exceeded health and education budgets. If a country enters debt distress, there can be wide-ranging implications which can include significant macro-economic and social instability.

1 English_Extraordinary-G20-FMCBG-Statement_November-13.pdf (sciencespo.fr)

As set out in the current International Development Strategy, all of our work aims to support sustained, long-term progress and greater resilience of developing countries. This includes sustainable lending and handling rising debt vulnerabilities. For example, this is included in our approach to responsible investment in developing countries, as well as our work to provide more affordable finance through guarantees. The Integrated Review Refresh states our commitment to "reforming and greening the global financial system to ensure the International Financial Institutions–in particular the multilateral development banks and the International Monetary Fund–and capital markets are better equipped to meet the needs of developing countries in dealing with the economic, debt, climate and nature crises."

We will work with others across government to continue to reflect the most important development issues in future policy and strategy products, including debt. Both the Chancellor and Minister for Development have set out clear statements on our approach to debt as part of our wider objectives in Statements to the IMFC and Development Committee at the time of the Spring meetings of the IMF and World Bank[2]. Additionally, the Minister for Development's recent speech at Chatham House on Britain's international development future had a significant focus on mobilising development finance and the importance of tackling debt[3].

Recommendation 4. ***The UK Government should seek opportunities to align nature and climate objectives with debt relief frameworks. However, debt-for-nature swaps should be treated with sensitivity and caution. It is important that they occur at the right scale, that decision-making processes include local communities and that they include mechanisms to support political accountability.***

Accept

The Integrated Review Refresh recognises climate change, environmental damage, and biodiversity loss as the number one thematic challenge to our global security this decade. The UK is using its global leadership in climate, insurance, finance, and our impact as a large donor to support improvements.

The Government recognises the importance of natural assets as a way to support countries' access to green finance, as a source of domestic resource mobilisation, and way to reduce economic risks–all of which impact debt sustainability. We have also supported better inclusion of climate change in the economic modelling that informs IMF/World Bank Debt Sustainability Analysis (DSA).

We agree debt-for-nature or similar swaps should be treated with sensitivity and caution. Some examples of debt-for-nature swaps which have included debt forgiveness from donors have been quite complex to develop and implement. Some newer debt-for-nature swap instruments are emerging such as debt refinancing for nature, with examples in Seychelles, Belize, and Barbados. With these, existing debt is retired for cheaper issuances of blue or green bonds, with the help of financial support in exchange for nature and climate commitments.

2 DCS2023–0016-United Kingdom.pdf (devcommittee.org) & Forty-Seventh Meeting, IMFC Statement by Jeremy Hunt Chancellor of the Exchequer, United Kingdom, April 13-14, 2023

3 Can rhetoric match reality? Britain's international development future (chathamhouse.org)

The UK is open to debt swaps, but we do not currently participate in them. This is due to our small share of developing country debt, that the value-for-money and effectiveness of these interventions is unclear, and our continued view that debt relief should be principally to restore debt sustainability. We will continue to listen to the debate and emerging thinking, such as from the new Multilateral Development Bank (MDB) Nature Working Group.

We have pushed the MDBs to provide more climate development policy loans, and they have been scaling up their offer significantly. These loans provide budget support–supporting public finances - in exchange for climate and nature commitments.

We also support the development and issuance of green and blue bonds both through the London Stock Exchange and the development of domestic markets. For example, through the Blue Planet Fund the UK is supporting the creation of the first sovereign blue bond for ocean health and coast communities in Fiji.

The UK's approach to climate, nature and debt policy is that this must be done in the context of wider debt policy and interventions. Our current focus is on building a more shock responsive international financial system by offering Climate Resilient Debt Clauses (CRDCs) and helping to expand and improve the system of Disaster Risk Finance (DRF). CRDCs pause debt repayments when a climate shock occurs, freeing up much needed fiscal resources to respond to and recover from the shock. UK Export Finance led the way at COP27 by being the first Export Credit Agency to offer CRDCs and UK-led work produced a model CRDC for private creditors that has been launched on the International Capital Market Associations (ICMA) website. We will be using events this year and beyond to build awareness and increase take up of these clauses in sovereign debt. The UK is calling on all creditor groups to step up and offer these innovations, and looking into partnering with countries where we could pilot CRDCs. We also recognise the need to strengthen DRF to help countries better prepare for and pay for disasters, including scaling up financing available through the MDBs. This involves implementing and scaling up a new Global Shield against climate risks.

An evolving creditor landscape

Recommendation 5. *The UK Government should consult on the introduction of legislation to compel or incentivise participation of private creditors in the Common Framework, such as those proposed by the World Bank. This should include proposals either:*

a) *to prevent low-income countries facing debt distress from being sued by private creditors for a sum greater than that those creditors would have received had they participated in the Common Framework; or*

b) *to make debt restructuring agreements binding for all private creditors if the agreement is supported by at least two-thirds of private creditors.*

Reject

There has been a significant increase in the volume of private sector lending to low-income countries in the last decade. The scale of privately held debt makes it clear that we need to address the role of private sector creditors, while we continue to make progress on other aspects of the debt agenda.

The Government is committed to ensuring that private sector creditors participate in debt restructurings on comparable terms. We have been working with the private sector on several areas of their participation in debt treatments, including under the Common Framework.

First, the UK, through HM Treasury, has ongoing engagement with private sector stakeholders, including through bilateral meetings, through representative institutions such as the Institute of International Finance (IIF) and ICMA, through regular engagements that take place between the Paris Club, of which we are a member, and the membership of the IIF, and now through the new Global Sovereign Debt Roundtable, to discuss debt issues including comparable treatment.

Second, the G20 and Paris Club have set out as a fundamental principle under the Common Framework that private creditors are expected to participate on at least as favourable terms as bilateral creditors. The UK has repeatedly emphasised the importance of this principle and we are committed to making it work. The IMF and Paris Club Secretariat work with countries to engage with all their creditors, including those in the private sector, to seek such debt restructuring, and we welcome this. We note that private creditors agreed to a debt treatment for Chad, the first Common Framework debt treatment to conclude.

Third, government has focussed on enhancing market-based (also known as contractual) solutions to private sector participation in debt restructurings. While the IMF noted in its 2020 report[4] the architecture governing privately held debt has been working well in recent years, including with the wide adoption of enhanced Collective Action Clauses in sovereign bonds, which reduce creditor holdouts.

The IMF also identified some areas for improvement. To make progress on addressing these areas, the UK established a Private Sector Working Group (PSWG) under its G7 Presidency in 2021 to explore improvements to the international architecture governing sovereign debt, specifically concerning how the private sector lends and restructures its debt. The group–which brought together a range of IFIs, private sector and academic stakeholders, official bilateral creditors, and borrowing countries–looked at one particular reform designed to enhance creditor participation and inter-creditor equity in debt restructurings - Majority Voting Provisions (MVPs) for syndicated lending contracts. MVPs allow a majority of creditors to bind a minority to the terms of a restructuring, thus reducing the power of holdout creditors, supporting orderly market functioning, and increasing the speed and efficiency of restructurings for debtor countries. As a result of the Group's work, specimen clauses have been published by major industry bodies and loan market associations[5]. We are now working closely with the IMF and others to promote and ensure the wide take-up of these contractual innovations in new syndicated lending.

4 The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors—Recent Developments, Challenges, And Reform Options (imf.org)

5 Guidance and Explanatory Note – Majority Voting Provisions > The Institute of International Finance (iif.com)

At this time, the government is focussed on the approach set out above rather than on a legislative approach, which would be complex and could have unintended consequences in terms of access to finance for developing countries.

Recommendation 6. ***We recommend that the UK Government engages in bilateral talks with New York law makers to explore the scope for co-operation in legislative approaches.***

Reject

The UK Government regularly engages the US Government on the full range of international debt issues, including on private sector participation in sovereign debt restructurings. As set out in the previous answers, the Government is currently focussed on ensuring CRDCs and MVPs are adopted in future lending contracts and continues to engage the US on this issue.

Recommendation 7. ***Although the amount of debt owed to the UK by debt-distressed countries is relatively small, the UK should work to establish a consensus with other creditors that such debt should be written off.***

Partially Accept

The UK is committed to working with other creditors to build consensus to address country debt vulnerabilities and provide swift debt treatments where they are required. We are working to do this through international fora such as the G20, Paris Club, Global Sovereign Debt Roundtable, and the G20 Common Framework for specific eligible country cases.

We are not seeking agreement to write off all debt owed by debt distressed countries. Rather, we seek to build consensus around debt treatments that are sufficient to return countries to moderate risk of debt distress in line with IMF and World Bank Debt Sustainability Analyses. These DSAs set the overall envelope for debt treatments.

Debt relief is tailored to each country context and can come in a variety of forms: as write-offs (cancellation); rescheduling that may have concessional interest rates; rescheduling at market rates that reduces the debt burden through being delayed; or rescheduling at rates that keep the value of the debt the same but delays the repayments.

Recommendation 8. ***The UK Government must engage with the Chinese Government on debt relief for low-income countries both bilaterally and through the Paris Club.***

Accept

The UK Government engages China on international debt issues bilaterally and in a range of multilateral fora. For example:

- The UK has sustained engagement with China on debt issues in the G20 and its working groups, such as the G20 International Financial Architecture Working Group.
- The UK engages China on debt treatments under the G20 Common Framework, including in individual creditor committee meetings.

- China is an ad hoc member of the Paris Club and attends monthly meetings to discuss sovereign debt issues.
- The UK and China attend the newly established Global Sovereign Debt Roundtable, which has the aim of identifying and agreeing common solutions to bottlenecks in debt restructurings.
- The UK engages China bilaterally through bilateral meetings between government officials.

Recommendation 9. *'It is important to recognise the seriousness of the current crisis, but also the need to maintain liquidity within institutions to deal with future crises and to provide large-scale development financing'. Taking this into account, the UK should use its influence to encourage board-level discussion on debt cancellation by multilateral international finance institutions.*

Reject

The UK recognises there is a serious liquidity issue in developing countries. The UK position is that the IFIs should not be providing debt cancellation but rather must continue to be a much-needed source of flexible and tailored finance to developing countries.

The IFIs are a vital and major source of finance, particularly during economic crises. For example, during the pandemic MDBs committed to mobilising $250 billion. The World Bank Group provided $158 billion during the first year of the pandemic alone. The IMF quadrupled its concessional lending to low-income countries, mobilising over $110 billion. The IMF also added to global liquidity through a $650 billion worth allocation of Special Drawing Rights (SDRs), including $21 billion directly to low-income countries, and G20 countries committed to support the most vulnerable countries with $100 billion of their SDRs. The UK also played a leading role in making sure the IFIs provided 'net positive flows', that is: developing countries received more money than they repaid to the IFIs during the pandemic.

IFI finance tends to be cheaper than commercial lending, making it more affordable than other sources. Therefore, while IFIs may make up a significant share of debt stock, the share of debt service owed to them, and thus liquidity challenges, is often much smaller. For example, a World Bank International Development Association (IDA) loan to a low-income country economy would current normally be for 38 years, with a 6-year grace period, and interest rate of around 3%.

IFI finance is becoming increasingly responsive to country debt situations. For example, the UK played a leading role in shaping the World Bank's Sustainable Development Finance Policy (SDFP) for IDA in 2020, which links concessional financing to domestic debt policy actions. Other MDBs have followed suit and have the same policies or follow World Bank debt-related actions. Low-income countries at high risk of distress receive to 100% of their financing from the main MDBs (including the World Bank, African Development Bank and Asian Development Bank). The UK supported this, including for the World Bank in 2005.

Finally, IFIs do not participate in debt restructuring, unless compensated for by donors. This is due to their 'preferred creditor status', which requires borrowing countries to give priority to meeting their debt obligations to the IFIs over other creditors. This is one of the reasons why the MDBs have AAA credit ratings which allow them to borrow cheaply from capital markets and on-lend at relatively affordable rates to developing countries. If shareholders were to require the IFIs to cancel debt repayments, these credit ratings, and its benefit for wider provision of development finance could be undermined.

While a new IFI debt cancellation initiative would potentially be less costly than MDRI, it would still require large donor contributions. There have been few past instances of IFI debt relief. The IMF's Catastrophe Containment and Relief Trust (CCRT), created during Ebola, was expanded to provide debt relief on repayments by the poorest countries to the IMF during the Covid-19 pandemic. The UK led the way providing £150 million. In total the CCRT has provided $964 million in debt relief to the 25 poorest IMF member countries. Through the UK Presidency of the G8 in 2005, the MDRI was established as part of the HIPC process. This was designed to be a one-off, at a time when low-income country debt levels were 100% of GDP on average, compared with 88% of GDP in 2021, and multilateral shares were larger. HIPC and MDRI have relieved 37 countries of over $100 billion of debt. The UK has contributed $2 billion so far to these initiatives. We contributed £180m to MDRI in 2022 and will continue to contribute annually until at least 2044 to cover the lifetime of IFI loans forgiven.

As such, the UK is focused on working with the IFIs to provide additional concessional financing rather than cancelling debts. The UK will continue to engage in key international fora to progress IFI reforms that: increase the scale and volume of finance; build a shock responsive international financial system; and mobilise more private capital.

The UK also welcomes on-going discussions at the Global Sovereign Debt Roundtable. This includes ideas such as provision of positive net flows, and recognising the ex-ante implicit debt relief of the MDBs through increased concessionality and grants to countries facing higher risks of debt distress[6]. The UK will work with all stakeholders to discuss such ideas further.

Debt and transparency

Recommendation 10. ***The UK should continue to lead by example by publishing at least as much detail as that outlined by the IIF's Voluntary Principles for Debt Transparency in its 'Report on outstanding debt owed by other countries to His Majesty's Government'. It should also publish its assessment of its adherence to the Operational Guidelines for Sustainable Financing.***

Accept

The IIF principles referred to in the recommendation specifically apply to private sector creditors. The Government, as an official bilateral creditor, follows the G20 Operational Guidelines for Sustainable Financing (OGSF). The OGSF contains five core areas– adequate financing for development, information sharing and transparency, consistency of financial support, coordination of stakeholders, and promotion of contractual and new financial instruments and minimising litigation issues to strengthen resilience.

6 Global Sovereign Debt Roundtable Co-Chairs Press Statement (imf.org)

On information sharing and transparency, which is the subject of this recommendation, the UK has taken a leadership role. In 2021, as G7 President, the UK became the first country to publish loan-by-loan details of its overseas lending[7]. We committed to provide updates on a quarterly basis on any new issued and effective sovereign direct lending, sovereign called guarantees, or Paris Club restructuring agreements, in-line with the OGSF.

UK Export Finance (UKEF) and the FCDO also update the annual report on outstanding debt owed by other countries to His Majesty's Government. The data is aggregated on a country-by-country basis, covering debts arising from direct sovereign lending, Paris Club debt restructuring agreements, called guarantees under buyer credit agreements underwritten by UKEF, and historical bilateral lending administered by the World Bank's IDA.

Importantly, the UK also secured a commitment from other G7 countries to publish their debt data in the same manner. The UK Government is now pressing other G20 countries to follow suit and adhere to these standards.

The UK government will continue to update these reports in line with its commitment to best practice in sovereign lending information sharing and transparency practices, as outlined in the OGSF. The Government is content to become the first G20 member to publish its self-assessment of its adherence to the OGSF, noting that the critical information within this assessment is already publicly available in other forms as set out above.

Recommendation 11. ***The UK should use its membership of the G20 to secure commitments on publishing details of all official overseas lending on a quarterly basis from other G20 Member States. The UK should use its influence in multilateral forums to push for more transparency, including granular data, from international finance institutions on debt.***

Accept

The UK Government is a strong and consistent advocate for higher debt transparency standards across official bilateral and private sector creditors, as well as multilateral institutions.

As outlined in the previous answer, we have already made significant progress on our own transparency practices and not only publish quarterly loan-by-loan data on our overseas lending but secured a commitment from the wider G7 during our Presidency to do the same. This is in line with the G20's OGSF, which are voluntary. The UK will continue to urge all G20 members to publish their data in line with the OGSF on a regular basis in international meetings.

The UK has also worked with the IFIs to make sure they have strong transparency policies for publishing their own lending and policy advice reports. Board member and country member consent where required is typically given. For example, in 2020 98% of countries that used IMF financial resources published the reports. The IFIs are also the custodians of much of the sovereign debt data, with the World Bank International Development Statistics and IMF Global Debt Monitor the two most comprehensive sources globally. Finally, the IFIs also have a role in promoting transparency to its members. The UK played

7 UK lending to national governments - GOV.UK (www.gov.uk)

a key role in shaping the World Bank SDFP for IDA. It requires debt-related policy actions. In the last two years roughly one-third of these were related to transparency. Other MDBs copy or support these policy actions.

Beyond the G20 and IFIs, the Government welcomes recent calls to improve information sharing and debt transparency through other initiatives, such the IMF and World Bank agreeing to issue guidance on macroeconomic projections and debt sustainability assessments at an early stage of restructuring processes, as noted at the April Global Sovereign Debt Roundtable. The UK would also encourage more financial institutions to voluntarily provide information on their lending to low-income countries to the UK-funded OECD Debt Transparency Initiative in 2021. We also welcomed the India G20 Chair's Summary in February welcoming joint efforts by all stakeholders on enhancing debt transparency–including the voluntary stocktaking exercise underway with the IFIs.