

G-24 Virtual Technical Group Meeting

Addressing the Challenge of Sovereign Debt Distress

Ugo Panizza

The Graduate Institute Geneva

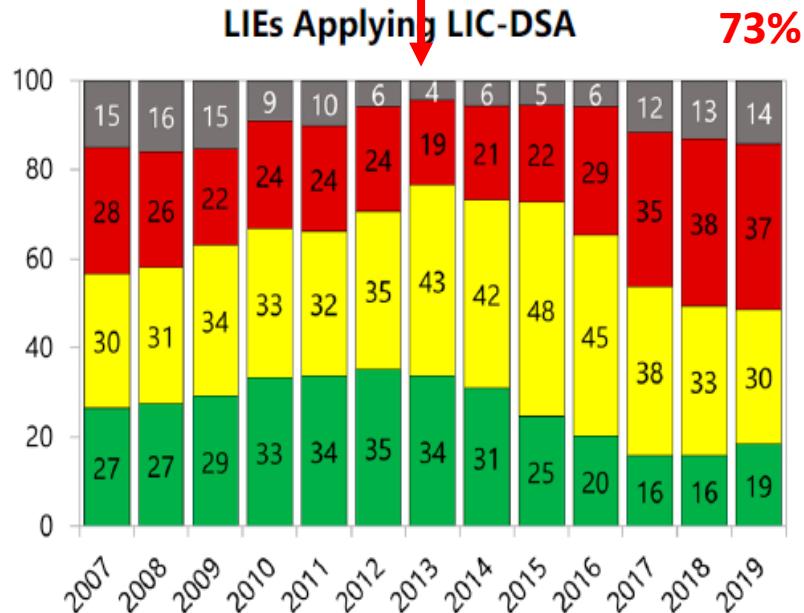
(based on joint work with Mitu Gulati and Patrick
Bolton)

March 18, 2021

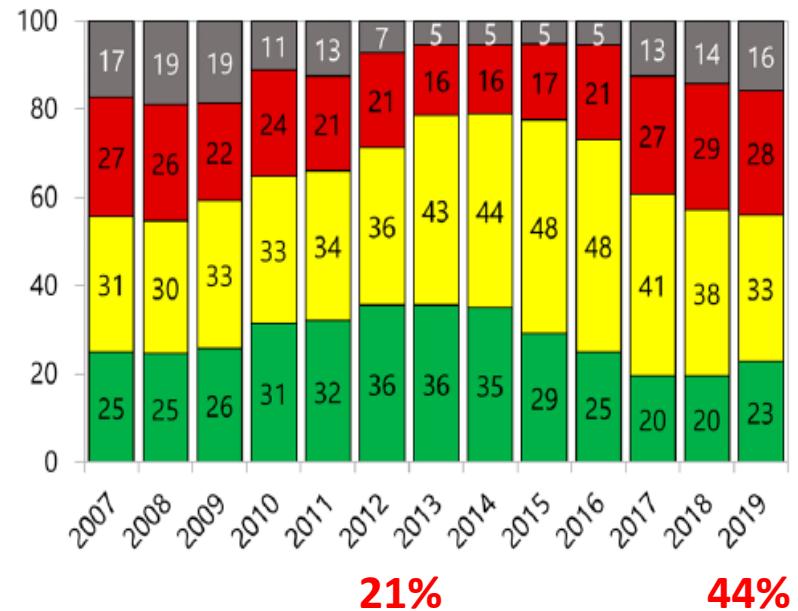
High risk of debt distress *before* the explosion of the pandemic

Figure 8. Evolution of Risk of External Debt Distress

(Share of countries with LIC DSAs)



Low-Income Developing Countries (LIDCs)



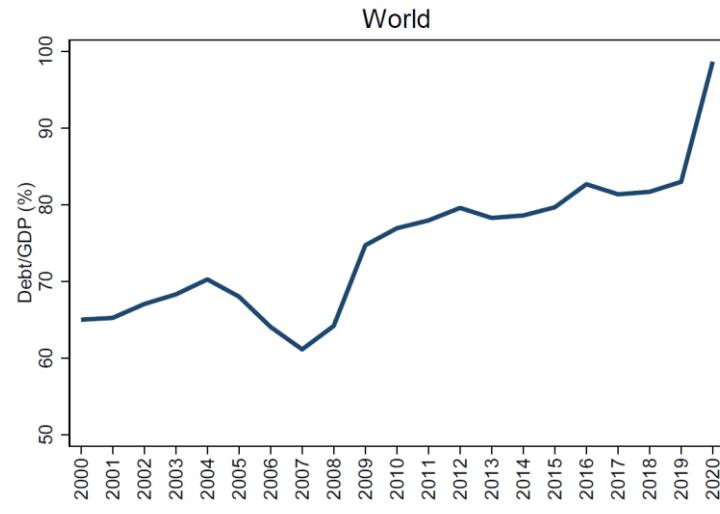
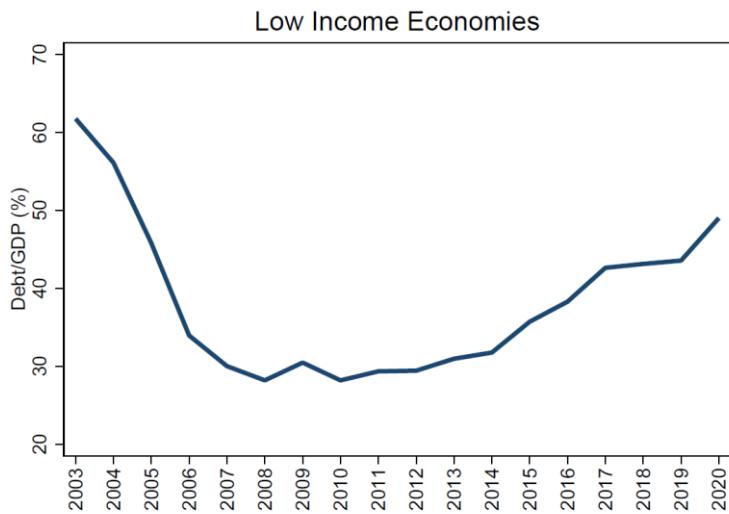
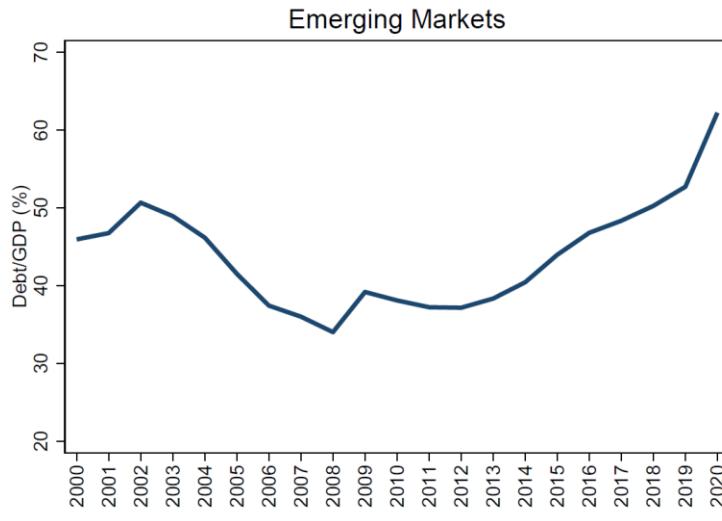
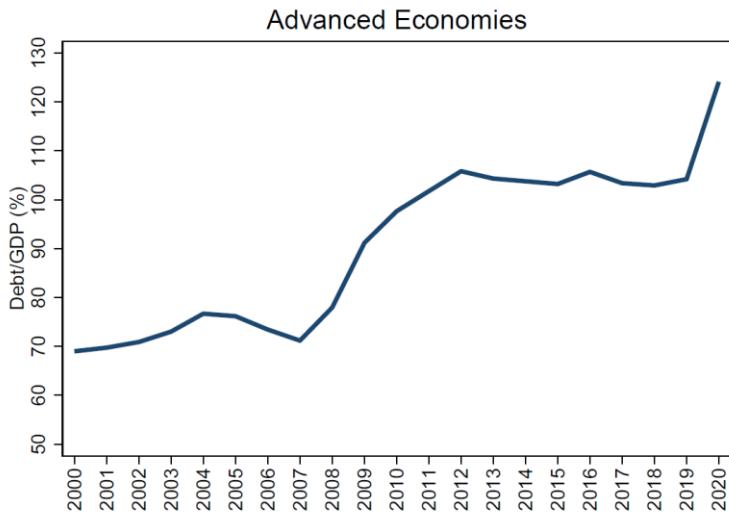
Source: LIC DSA Database as of End-October 2019.

Note: 69 out of 76 LIEs applies the LIC DSA, LIDCs constitute 59 countries (57 LICs).

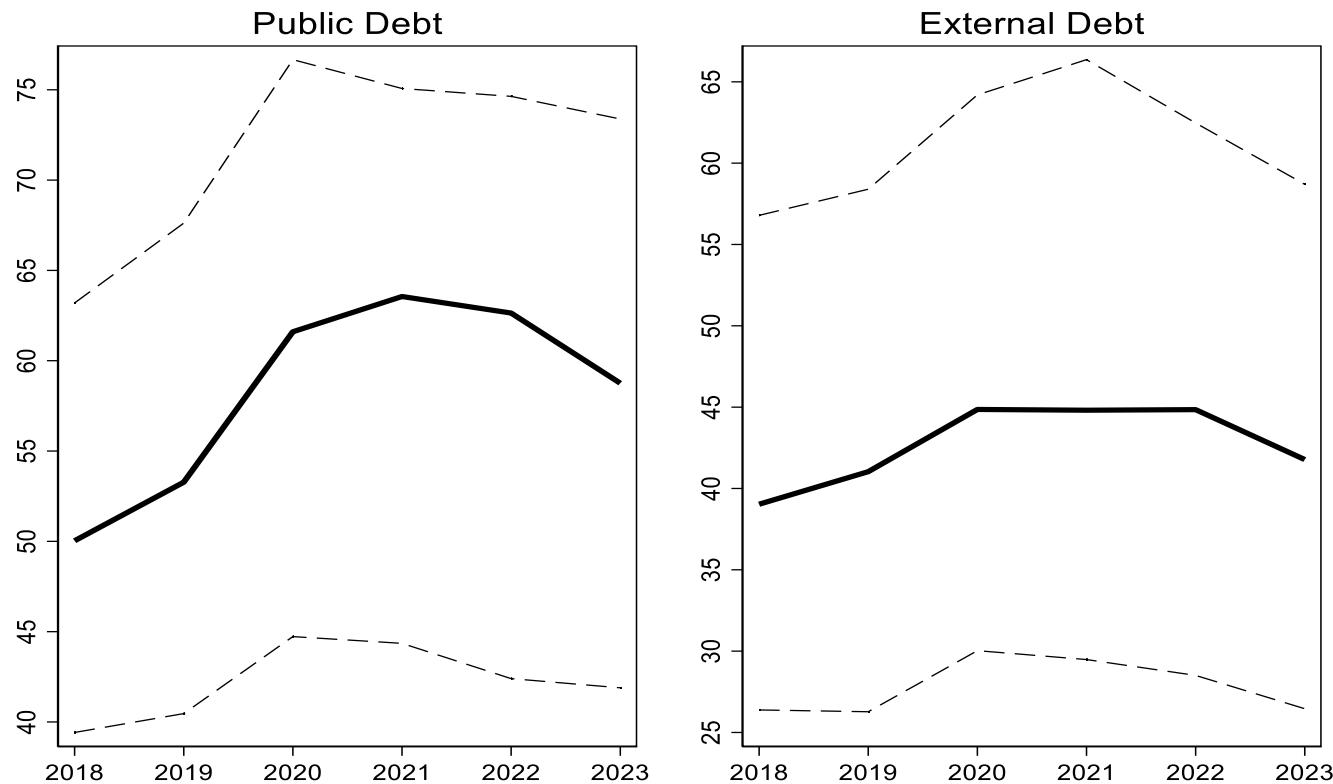
Source: IMF (2020)

27 out of 31 LICs are in Africa (87% of total)

Debt ratios went up everywhere...

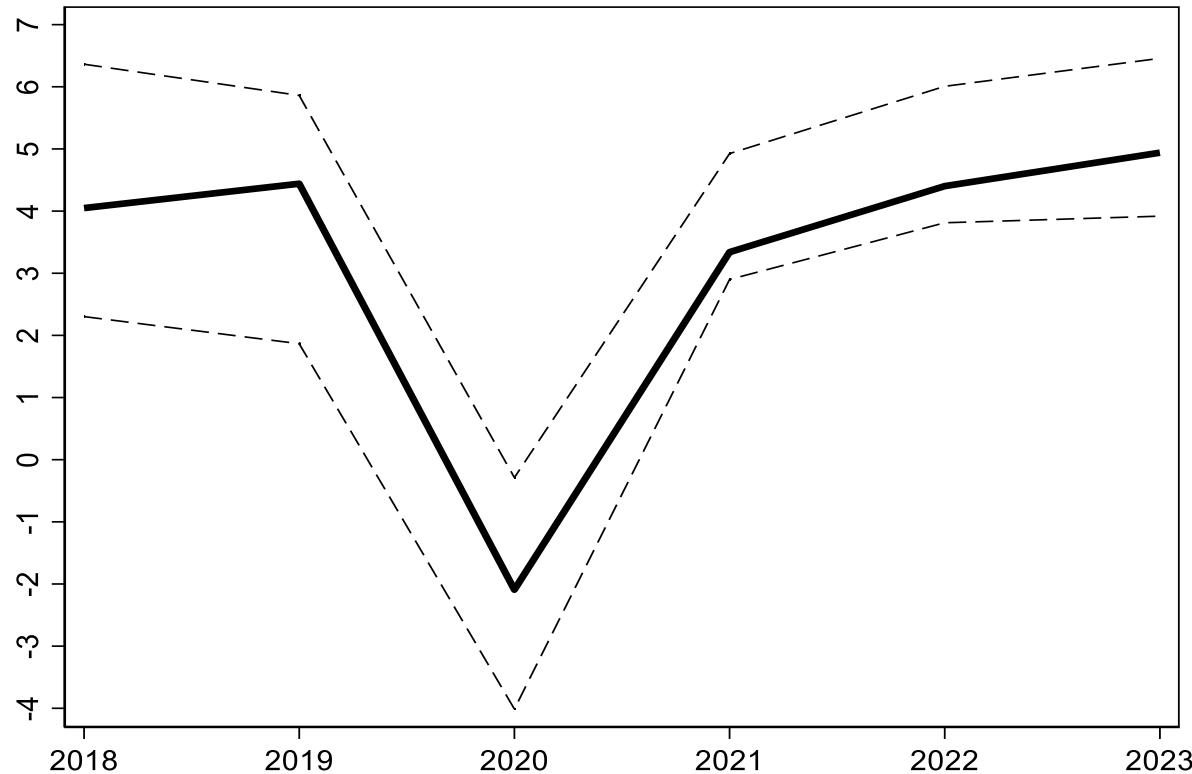


...and, in a rosy scenario, will start going down in 2022...



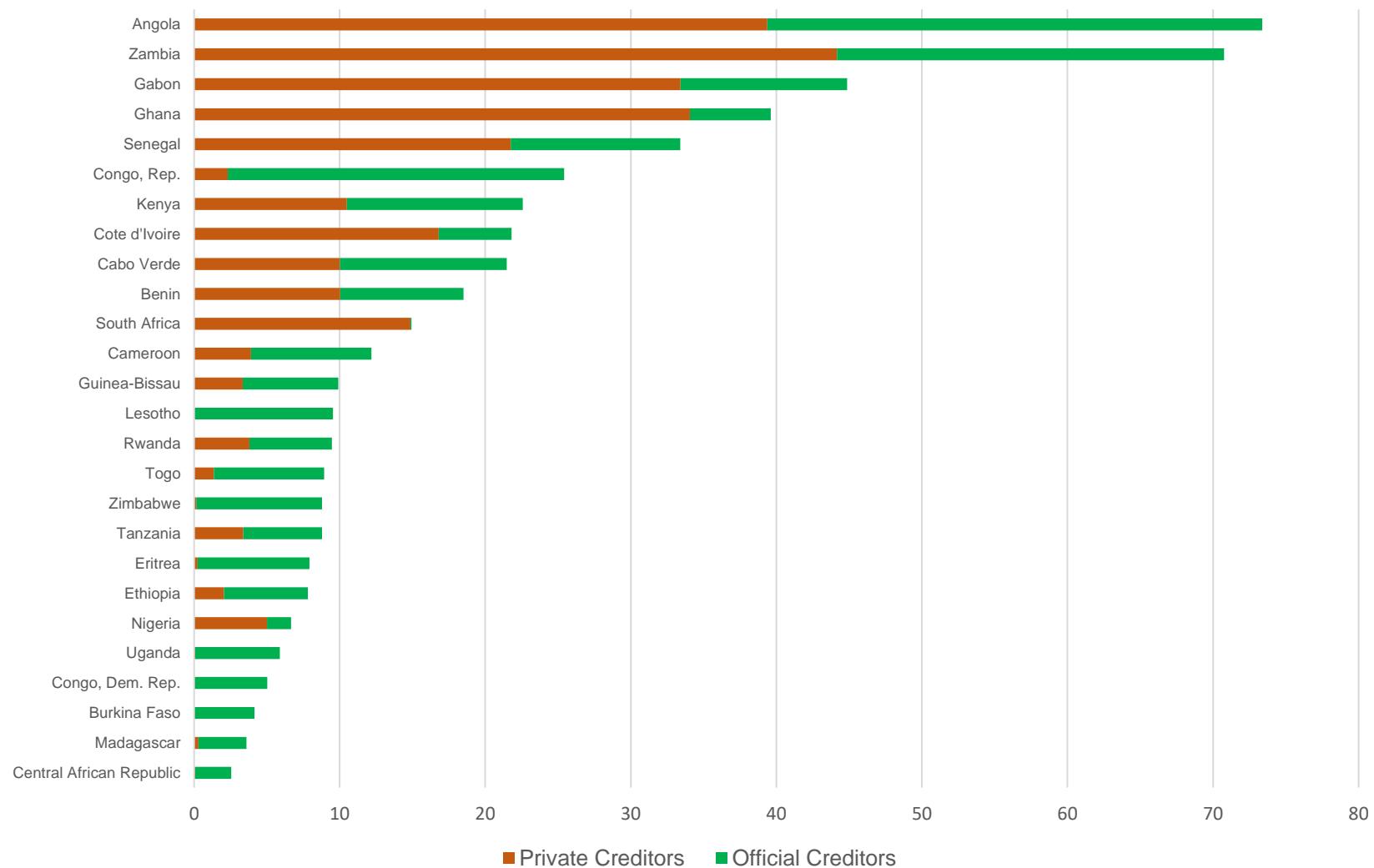
The solid lines plot the median public and external debt as % of GDP and the dashed lines the interquartile ranges for a sample of 48 Sub-Saharan Africa countries

...when (if?) the economy recovers



The solid line plots median GDP growth and the dashed lines the interquartile range for a sample of 48 Sub-Saharan Africa countries

Interest payment on external public debt % of health expenditure (2021)



The March 2020 sudden stop was short-lived, but things seem to be deteriorating again

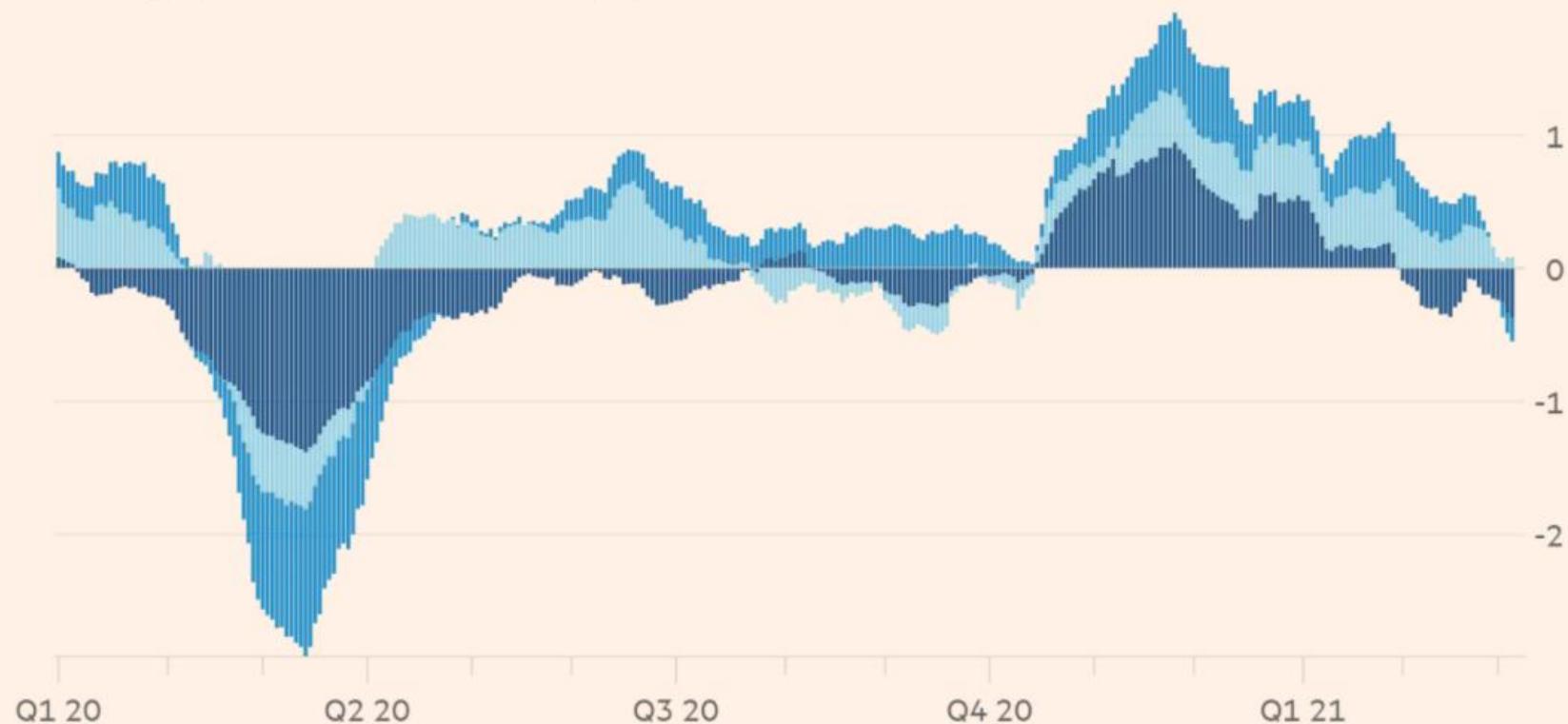
Rapidly rising interest rates revive 'taper tantrum' memories

Daily cross-border portfolio flows, six-week moving average (\$bn)*

EM equity ex-China

China equity

EM debt ex-China



Hope for the best, but prepare for the worst

- The crisis led to several useful initiatives
 - DSSI
 - Common Framework
- However..
 - While explicitly mentioning Private Sector Participation, the Framework does not detail concrete measures that could induce the private sector to participate in the Initiative
 - Countries that request a suspension of official debt service are required to ask for similar treatment from the private sector, but that does not preclude some private creditors choosing not to get involved and suing debtor countries in default
 - In the absence of such a legal mechanism, countries that want to divert resources from debt service to pandemic related expenditures risk having to fight a plethora of creditor lawsuits while approaching their creditors for a bespoke debt restructuring



Legal air cover

- In Bolton, Gulati, and Panizza (2021), we suggest that if we start observing several defaults happening at the same time, the international community should be prepared to provide “legal air cover”
- We focus on three options which can be put in place quickly, without the need for lengthy legislative wrangling or contract-by-contract and country-by-country negotiations
 - A UN Security Council Immunity Shield similar to that used to restructure the Iraqi debt accumulated by Saddam Hussein
 - An executive order by the US President and a similar legislative action by the UK parliament (most international debt is issued under either New York law or English law)
 - The doctrine of Necessity under Article 25 of the International Law Commission’s Articles on Responsibility of States for Internationally Wrongful Acts
- The air cover they provide may facilitate negotiations with creditors and buy time for conducting debt sustainability analyses, without the fear of a rush to the courthouse
- These solutions that we propose can be useful to deal with both liquidity and solvency crises in a world that still lacks a statutory mechanism for dealing with sovereign defaults

References

- Patrick Bolton, Mitu Gulati, and Ugo Panizza (2021) “Legal Air Cover,” *Journal of Financial Regulation*
- Patrick Bolton, Mitu Gulati, and Ugo Panizza (2021) “Debt risks in sub-Saharan Africa and beyond,” in (R. Arezki, S. Djankov, and U. Panizza) *Shaping Africa’s Post-Covid Recovery*, CEPR

G-24 Virtual Technical Group Meeting

Addressing the Challenge of Sovereign Debt Distress

Ugo Panizza

The Graduate Institute Geneva

March 18, 2021