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Debt sustainability in times of climate disaster and corona

How to achieve a realistic assessment of crisis impacts?

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Debt sustainability in times of climate disaster and corona – How to achieve a realistic assessment of crisis impacts?

By Jürgen Kaiser

1. Introduction

In recent years, the effects of the climate crisis, exacerbated since March 2020 by the impact of the coronavirus pandemic, have graphically highlighted what it means for heavily-indebted countries to be hit by external shocks. While the international debt architecture has responded, nevertheless, little has changed in terms of its underlying, deeply hierarchical structures. This is clearly evident from the manner in which, and by whom, the debt sustainability analyses are undertaken which form the calculation basis determining the scale of debt relief to be granted.

This Focus Paper aims to uncover the deficiencies in the existing system and identify the steps needed in order to produce more realistic debt sustainability analyses and thereby contribute to a fairer and more sustainable debt architecture. In order to achieve this, we will also refer to existing indices that reveal the vulnerability of states to external shocks and thereby contribute to answering the question of whether a state needs debt relief and, if so, in what amount.

2. Current debt relief initiatives: Who has access?

As a response to the burden on poorer countries resulting from the global recession triggered by COVID-19, in spring 2020 the forum of the 20 leading industrialized and developing nations (G20) created a debt moratorium initiative known as the DSSI (Debt Service Suspension Initiative)[1]. The aim of this Initiative was to create fiscal scope enabling rapid action to be taken, both to curb the pandemic and to maintain economic activity. In the intervening period, however, it has become clear that, due to the high levels of external debt already besetting many of these countries even before the pandemic, such countries have not only liquidity problems, to which a moratorium would have been an entirely reasonable response, but are also threatened by sovereign insolvency, which is not only incapable of being resolved through shifting payment liabilities into the future, but which is indeed further exacerbated as a result. For this reason, in November 2020 the DSSI was supplemented by way of the Common Framework for Debt Treatments beyond the DSSI[2], which is intended to enable genuine debt relief on the part of all, or at least the majority, of creditors.

In order to render both the DSSI and the Common Framework practicable, two questions first had to be answered:

1. Who is to benefit from the debt relief in question?
2. To what extent are debts to be deferred or cancelled?

[1] For further information on the objectives and functioning of the DSSI, see: erlassjahr.de/MISEREOR (2021): 'Global Sovereign Debt Monitor 2021', https://erlassjahr.de/en/publications/.

[2] See G20: 'Statement: Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting, 13 November 2020', https://erlassjahr.de/wordpress/wp-content/uploads/2020/11/2020-11-13-extraordinary-g20fmcbg-statement-of-november-13.pdf. A critical appraisal by erlassjahr.de (13.11.2020) may be found at: 'G20-Finanzministertreffen. Ein schwarzer Freitag für verschuldete Länder' ['G20 Finance Ministers' Meeting. A Black Friday for indebted countries'], https://erlassjahr.de/news/ein-schwarzer-freitag-der-13-fuer-verschuldete-laender/.

The G20 answered the first question to the effect that all IDA-eligible countries and all least developed countries should benefit. The two categories – the former established by the World Bank, the latter by the United Nations – substantially overlapped, with the result that, ultimately, 73 countries qualified. Since both groups are essentially defined by GNI per capita, it may be said that poverty is the deciding criterion.

In the case of the DSSI, the question of the scope of debt relief was answered summarily to the effect that all debt service payments owed to the members of the G20 and the Paris Club could be deferred. However, the same question still remains unanswered in relation to real debt relief under the Common Framework. Outright, full debt relief by a single group of creditors would not be a meaningful solution.

Debt relief is also an indirect instrument for fighting poverty. Primarily, however, it serves to restore a debtor's solvency, irrespective of whether the debtor is rich or poor. Debt distress can afflict the poorest countries in the world – Sudan for example – as well as middle-income countries like Argentina, or indeed industrialized nations too, such as Italy during the euro crisis. Thus, GDP per capita alone is not an appropriate criterion for assessing the eligibility of a country for debt relief. Accordingly, by the end of May 2021, only 47 of the 73 eligible poor countries had made use of the DSSI, while a whole number of middle-income countries, mostly hard-hit Small Island Developing States (SIDS), were vociferous in pointing out the injustice of their not having been included.

As a result, there is much to argue in favour of making the existence or non-existence of a debt problem the qualifying criterion, irrespective of a country's income level. It is the role of a debt sustainability analysis (DSA) to make such a determination, such analyses being regularly undertaken by the International Monetary Fund (IMF) for its members. DSAs should not only identify whether a country will likely have payment difficulties in the foreseeable future, but also how great such difficulties will be. This in turn is vital to assessing the likelihood of default actually arising. It is therefore worth taking a closer look at the instrument of the debt sustainability analysis.

3. How debt sustainability analyses work

Only since the HIPC Initiative[3] have the debt sustainability analyses (DSAs) of the IMF and World Bank played a serious role in the debt restructuring process. While, previously, they were produced and their content indeed considered by the Paris Club[4], being mostly presented by IMF observers in the Club, their influence on the debt relief actually provided by the Club was however virtually non-existent. Indeed, the Paris Club already had 'relief quotas' as specified by the G7/G8, which were applied to different groups of countries. For this reason, DSAs originating from Washington were mostly phrased such that they included customary debt reduction in a debt restructuring scenario in line with the instructions of Club members, ultimately always concluding that this served to achieve the objective of debt sustainability. As a result, even in 1996, Club members still deemed a partial relief quota of 67% to be sufficient for Nicaragua, even though the country was indebted to the tune of over ten times its economic output. Then, just a few years later, under the HIPC Initiative, sensibly, virtually all the country's bilateral debt was cancelled.[5]

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[3] HIPC Initiative = Heavily Indebted Poor Countries Initiative. A debt-relief initiative established in 1996 for heavily-indebted poor countries. For more information, see www.imf.org/hipc or https://erlassjahr.de/themen/entschuldungsinitiativen-hipcmdri/.

[4] The Paris Club is an informal cartel of traditional creditor countries set up in 1956 to negotiate debt restructuring arrangements with countries in debt distress. The Club currently has 22 member countries. For further information, see: www.clubdeparis.org.

[5] The manner in which a meticulously-constructed abdication of responsibility operated between the Paris Club and the IMF in this instance is described in Kaiser, J. (2016): 'Schuldenmanagement à la Louis XVI – Ein kurzer Gang durch Programm und Praxis des Pariser Clubs' ['Debt management à la Louis XVI – A brief examination of the programme and practice of the Paris Club']; https://erlassjahr.de/wordpress/wp-content/uploads/2016/03/fonds_louis.pdf.

Of course, in many cases, as a result of such an unsound approach, debt sustainability was not achieved. Instead, we saw a whole series of debt restructurings for countries that were obliged to resubmit their case in Paris at two-year intervals.

Introduction of the HIPC rationale from 1996 onwards changed all this; henceforth, a relief quota on the part of the Paris Club was still used as a basis, although in the interim it had been increased from 50% to 67%, then 80%, and finally even to 90%. However, in addition, the affected countries also gained access to reductions on their debts owed to multilateral creditors such as the IMF and World Bank, whose claims had been untouchable prior to the HIPC Initiative. As for how far the multilateral institutions would go in terms of debt cancellation, this was now entirely dependent on the analyses undertaken by the IMF and the World Bank, which calculated a general debt relief quota based on debts remaining after the relief granted by the bilateral creditors in Paris, whereby all multilateral creditors were to apply the same quota. This amount could turn out to be relatively modest if only very few multilateral debts were involved, or it could cover virtually an entire debt portfolio, if the country in question already had a lengthy history of taking up multilateral loans in order to be able to continue servicing its bilateral debt. Ultimately, the objective of the HIPC Initiative was to free countries from precisely such a vicious circle of debt restructuring, and everyone was clear that this required a sufficiently drastic cut in debt.

What remained problematical was that it was still the 'technicians' at the IMF and World Bank who themselves had the role of calculating how much debt reduction they were obliged to grant. However, DSAs had thereby been successfully transformed from being instruments for legitimizing imposed and persistently inadequate debt relief to becoming central building blocks for determining the scale of debt restructuring arrangements.

In spite of this qualitative progress, the parameters of the HIPC Initiative also had to be revised several times over, always with the aim of enabling more substantial haircuts. In the initial phase of the Initiative, the sustainability thresholds assumed in the DSAs were far too high in order to keep the debt relief to a minimum and thereby render the Initiative palatable to the reluctant members of the G8. As a result, the quantitative scaling of what was deemed to be sustainable was consistently running counter to the qualitative objective of restoring debt sustainability – at least until the 2005 G8 Summit in Gleneagles, Scotland. At this G8 Summit the constant readjustment of HIPC parameters was abandoned in favour of an outright cancellation of all legacy debts by the IMF, IDA, ADF and FSO[6]. This meant a temporary return to the old principle of debt relief according to quotas, although the quota, however, had been increased to 100% – at least of legacy, but not any new, debt.

However sensible this summary relief may have been, it did nevertheless once again break the link between debt sustainability analyses and debt reduction that had been established for a short period through HIPC. While DSAs continue to be produced to this day and, as we shall see below, undergo continuous refinement, the question of whether, how, by whom and to what extent unsustainable debts need to be reduced is however now subject to a largely unstructured process which, most of all, is coordinated pretty poorly between creditors who, in principle, have a reluctant attitude to the granting of debt relief. The Common Framework now constitutes an initial attempt to re-assign binding rules to this process, applicable to all parties.

Outside the HIPC group – and thus also in respect of the Small Island Developing States, which today are critically indebted - the change in function of DSAs as described above has never taken place. The reason for this is that, once the crisis of the poorest countries had been overcome through the HIPC/MDRI Initiative and several far-reaching debt restructurings in the case of larger middle-income countries such as Argentina, Nigeria or Iraq, creditors reverted to assuming that, in future, there would be no more debt crises requiring a direct link between debt sustainability analysis and decisions on debt relief.

[6] The African Development Fund (ADF) is the soft-loan window of the African Development Bank (AfDB); the Fund for Special Operations (FSO) has the same role in the Inter-American Development Bank (IDB).

Instead of a predictable debt relief option, once again, the imposition of drastic austerity measures on indebted countries, as well as new financing constructs (in particular a restriction to concessionary loans and the exclusion of market financing) were the means of choice.

This return to instruments of classic structural adjustment meant that crisis management was once again exclusively incumbent upon the indebted countries. However, two innovations in dealing with debt crises served to counter this dangerous trend:

- Through the Evian approach for countries outside the HIPC Initiative, for the first time the Paris Club created a framework for debt restructuring that was not based on rigid relief quotas, but offered the possibility of realistic debt relief. At least that was the case in theory. Since being devised in 2004, the Evian approach has only been used in very few exceptional instances.

- Behind an initially very conciliatory focus exclusively on debt restructuring, there also lies concealed within the Common Framework - launched in autumn 2020 by the G20 as a response to the coronavirus crisis - the possibility of substantial debt relief where it is needed. Here, quotas are as absent as in the Paris Club's Evian approach.

By omitting to set any fixed quotas, both the Evian approach and the Common Framework pass the responsibility for setting the scale of any debt relief back to the IMF.

However, if debt restructuring is now to be essentially determined on the basis of the relief requirement of a particular country, the question arises of how realistically the World Bank and the IMF will actually undertake, or wish to undertake, their calculations. Ultimately, as described above, they have an unfortunate long history of producing biased reports in the interests of their most important members. Furthermore, since 1995, not much has changed in terms of the power imbalance on the committees of both the World Bank and the IMF as between wealthy net creditors and poorer net debtors – apart from the fact that a few leading emerging economies, such as China and India, have gained slightly more influence. How might debt sustainability analyses now be made more realistic, and thus fairer?

4. Debt sustainability analyses for low-income countries and countries with market access: How has the vulnerability to climate change and other factors been taken into account so far?

Since refining its analytical tools at the start of the new millennium, the IMF has made a distinction between debt sustainability analyses for low-income countries (LICs) and for market access countries (MACs). This distinction is indeed just as incoherent as it appears at first sight, since ultimately there exist low-income countries which, having been granted debt relief under the HIPC Initiative, have succeeded in getting a foothold on the international capital markets, just as, on the other hand, there also exist countries outside the group of low-income countries as defined by the World Bank which have no access at all to the capital markets or which struggle to access such markets.

The rationale behind this distinction, which is nevertheless still applied, becomes clear upon a closer examination of individual LIC DSAs and MAC DSAs; whereas the former conclude with a fairly clear judgment as to whether debt sustainability is assured, at risk, or non-existent, in the case of countries such as Brazil, Indonesia or indeed Russia, naturally the IMF does not wish to venture such a conclusion. Although these reports do contain risk indications, projections, and often discussion on a realistic basis, they do not include judgments such as "(It is highly probable that) Spain's external debt is not sustainable".

At the beginning of 2021, the IMF announced reform of the MAC DSA, which is relevant to most small island states. This was to be implemented expressly with a view to taking greater account of climate risks and other external shocks. It is not yet possible to foresee what this will exactly mean, beyond a sympathetic declaration of intent. The little that we already know will be discussed in the next section of this Paper. Here, we shall first of all examine how the risks to which a country is exposed are taken into account in the current LIC and MAC DSAs.

The methodology under both frameworks aimed at taking account of external shocks appears identical; the IMF calculates a 'baseline scenario' which, in its view, provides a realistic representation of the probable economic development of the country concerned. Starting from this baseline scenario, the IMF then calculates a series of standardized stress tests which, for instance, extrapolate historical trends in terms of changes in central parameters such as economic growth or demand for export goods, rather than assuming, as in the baseline scenario, that implementation of reform measures agreed with the IMF will succeed in bringing about a significant macroeconomic improvement. In addition to standardized assumptions, for individual countries, particularly relevant stress scenarios, such as a slump in oil prices in the case of oil-exporting countries, or a slump in tourism in the case of small island states, are also applied.

In LIC DSAs, such stress tests determine a country's allocation to a particular risk group. Countries that do not exceed any of the relevant debt indicators are given a 'low' debt distress risk. In the case of countries which, while remaining below all critical threshold values in the baseline scenario, exceed one or more indicators in one or more stress scenarios, the risk will be 'medium'. If, in the baseline scenario alone, a country exceeds one or more critical threshold values, the country will be considered as having a 'high' risk of debt distress.

In MAC DSAs, there are no such final scores, but instead, there is a more complex representation of individual risks in a heat map, though these are not combined to give a final score.

The LIC Debt Sustainability Framework (DSF) was last reformed in 2016. The MAC DSF will be revised over the course of 2021 and the intention is that it will be universally applied with effect from the beginning of 2022 on a new basis, intended in particular to provide greater scrutiny of individual risks. With a view to dealing with the specific vulnerability of indebted countries, particular importance should be attached to the following points of criticism raised by civil society during the course of the last reform process:

- While the LIC DSF purports to be guided by the level of financing required in order to achieve the Sustainable Development Goals (SDGs), nowhere is this actually operationalized in the sense that, for example, SDG financing requirements are translated into debt relief. Neither would this be straightforward, as demonstrated by previous attempts to translate the set of objectives preceding the SDGs, the Millennium Development Goals (MDGs), into debt sustainability provisions.

- It is not clear how final assessments are actually derived, since particular requirements in terms of debt sustainability may also be set aside (through so-called 'waivers'), and the reasons for this are not always available in the public domain. In 2018, one study concluded that a more generous approach - in terms of which countries should be allowed higher levels of debt before the implementation of sanctions on the part of the IMF or private stakeholders - correlates strongly with the extent to which the government in question is on friendly terms with the USA.[7]

- None of the reform processes to date have called into question the de facto monopoly on sustainability assessments held by the IMF and the World Bank. While, in their DSAs and routine country reports, the World Bank and the IMF regularly stress that they have spoken with numerous stakeholders in the countries in question, as well as frequently also with other international organizations operating there,

[7] Lang, V. and A. Presbitero (2018): 'Room for Discretion. Biased Decision Making in International Financial Institutions', in: Journal of Development Economics, Vol. 130, pp. 1-16.

nevertheless, nowhere is there any clarification as to whether the expertise of such stakeholders and organizations is actually reflected in a country's assessment, and if so, how.

- As UN organizations, the International Financial Institutions bear no liability whatsoever for the results of their work. A country forced to pay unwarranted interest premiums on its capital-market borrowing as a result of an excessively negative judgement has just as little opportunity for recourse as a country which remains excluded from debt relief that might have been granted were it not for that country's excessively positive rating.

5. Reform of the MAC DSF: Meaningful progress?

In January 2021, the IMF Executive Board discussed reform of the MAC DSF and largely nodded through the IMF staff's proposed changes.[8] The plan is to build on the distinction already adopted in the last review phase in 2011 – 2013, as between 'high scrutiny' (requiring more detailed investigation) and 'low scrutiny' (unproblematic) countries. Here, the IMF staff have based their conclusions on the outcome of a prior investigation and determined on this basis whether or not a country requires more detailed investigation, also with regard to specific vulnerability to external shocks.

Naturally, it makes sense, in this way, to eliminate countries from lengthy scrutiny when they clearly do not have any debt problems. However, as for what happens with the others, this cannot yet be stated in any detail since, apart from the fact that external shocks are to be given greater consideration in projections, we learn only that:

- the debts of local authorities below the level of central government as well as those of public companies are to be given more coherent consideration;
- generally, greater transparency is to be created and also required by governments; and
- in the future, MAC DSAs will be referred to as MAC-SRDSF: *Sovereign Risk and Debt Sustainability Framework for Market Assess Countries.*

The first new MAC DSAs are likely to be published at the beginning of 2022. At that time, we will be able to assess whether and, if so, how, the reforms are actually generating more meaningful results. Of course, there will be a particular focus on those MACs intermittently suspending payments and obliged to negotiate debt restructuring arrangements on the basis of the new analyses. Lebanon, Belize, Suriname and Laos are just some of the countries against which the worth of the new rules and parameters will be measured.

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[8] IMF (03.02.2021): 'IMF Executive Board Reviews Debt Sustainability Framework for Market Access Countries', press release 21/31, https://www.imf.org/en/News/Articles/2021/02/02/pr2131-imf-executive-board-reviews-imf-debt-sustainability-framework-for-market-access-countries.

6. Vulnerability indices: What alternative calculations are possible?

Any meaningful consideration of the quantitative dimension of debt sustainability and shock resilience naturally depends on countries being basically able to access debt restructuring, i.e. what was initially referred to as the qualitative dimension. In practical terms, this means overcoming the limitation on debt relief to countries that qualify based on their 'poverty' or other criteria that are actually irrelevant. In principle, if there are to be any inclusion or exclusion criteria at all, the question of the risk of debt distress must be at the forefront. However, discussions on how this might look in theory and how it would then be fleshed out in practice are still at a very early stage. Some of the indices proposed for determining the risk of debt distress as a result of climate change and/or the global recession driven by COVID-19 are set out below in the form of an overview.

Following a fundamental qualitative decision in favour of eligibility, the next question is that of the scope of the relief to be granted, based on the discrepancy between a sustainable level of debt, defined independently of an individual case scenario, and the actual debt indicators of the country in question.

Since such calculations cannot be undertaken without a precise knowledge of a country's existing payment liabilities and planned new debt, in most cases they can exclusively be undertaken by two stakeholders, namely the actual government of the country in question and the IMF, to whom all members have extensive reporting obligations with regard to their fiscal position and external economic relations. It is for this reason that, in the past, all other stakeholders, from the United Nations Development Programme (UNDP) to non-governmental organizations, struggled to propose 'alternative' sustainability calculations. In the first phase of the Millennium Development Goals, the Goals themselves were variously used as a basis for such calculations. However, the use of inadequate underlying data generally meant that the bottom line of these calculations ended up totalling the very sustainability level that had been input at the top by way of financing requirements for achieving the MDGs. Apart from some rhetoric on the part of the World Bank, for this reason, nowhere has such an approach led to any practical debt-relief policy.

In terms of dealing with external shocks such as hurricanes and cyclones or the economic consequences of the COVID-19 pandemic, the data situation has now improved somewhat, yet the calculations are no less complex. Nevertheless, in connection with the climate debate, there have been new attempts to incorporate the impact of shocks into sustainability calculations.

The following table presents four multidimensional indicators as alternatives for determining sustainability:

Name of Index	Published by	Aim of analysis	Most important content	Strengths	Weaknesses	Most significant conclusions
Multidimensional Vulnerability Index (MVI)	Assa & Meddeb, (February 2021): 'Towards a Multilateral Development Index'; UNDP[9]	More realistic consideration of climate vulnerability in relation to Small Island Developing States (SIDS)	Supplements the existing UN Economic Vulnerability Index (EVI) by way of a further 11 criteria that take account of environmental, financial and geographic vulnerability.	Covers a very broad spectrum of possible risks.	In mathematical terms, constructed on a very straightforward basis: arithmetic mean of 11 sub-indicators	With the exception of five countries, all SIDS are substantially more vulnerable than their income status would suggest.
Climate Disaster and Debt Risk Index	Brot für die Welt (Bread for the World), erlassjahr.de, Lutheran World Federation (March 2021): 'Climate Change, Debt and Covid-19'[10]	Identification of additional risks resulting from COVID-19 and climate change	Three indicators each with several sub-indicators (disaster risk (5), loss and damage risk (6), debt risk (5)) together yield classification as uncritical, slightly critical, moderately critical, critical or very critical.	Takes account of the consequences of COVID-19 under disaster risks; essentially builds on existing indicators, including those from the Global Sovereign Debt Monitor published by erlassjahr.de and MISEREOR[11].	Very simple calculation of final score	Four out of five middle-income countries taken as examples are categorized as 'critical', and one as 'slightly critical'.

[9] Assa, J. and R. Meddebb (2021): 'Towards a Multidimensional Vulnerability Index', UNDP Discussion Paper, file:///Users/elisekopper/Downloads/UNDP-Towards-a-Multidimensional-Vulnerability-Index.pdf.

[10] Brot für die Welt and erlassjahr.de (2021): 'Climate Change, Debt and Covid-19', https://erlassjahr.de/produkt/studie-climate-change-debt-and-covid-19/.

[11] erlassjahr.de and MISEREOR (2021): 'Global Sovereign Debt Monitor 2021', https://erlassjahr.de/en/publications/.

EIB COVID-19 Vulnerability Index	European Investment Bank (August 2020): 'The EIB COVID-19 Vulnerability Index'[12]	Calculates the economic consequences of COVID-19	Three sub-indicators: (1) Quality of healthcare and age of the population; (2) Structure of the economy; (3) Exposure and ability to respond to shocks	Broad incorporation of recognized economic parameters	Limitation to economic factors. With only three categories, very unsophisticated final score.	Vulnerability is inversely correlated to income.
World Risk Index	Bündnis Entwicklung hilft[13]	Annually updated definition of a processable index analysing a country's vulnerability	Susceptibility + coping capacity + adaptive capacity taken together yield the vulnerability of a country; exposure is calculated from this based on total population number. The Index is then based on the product of exposure and vulnerability.	Sophisticated quantification builds largely on existing and uncontroversial sub-indices.	The weighting of individual parameters between and within sub-indices cannot of necessity be entirely unbiased.	The WRI correlates with poverty, but MICs too are some of the most affected; SIDS are highly vulnerable.

[12] EIB (2020): 'The EIB COVID-19 Economic Vulnerability Index – An analysis of countries outside the European Union', https://www.eib.org/attachments/thematic/the_eib_covid-19_economic_vulnerability_index_en.pdf.

[13] Bündnis Entwicklung hilft (undated): 'World Risk Index', https://weltrisikobericht.de/english/.

The first three indices produce a result that can only be interpreted in qualitative terms, i.e. they conclude that a country ranks in one of a small number of problematical categories, the criticality of which varies in degree, without setting out in detail how acute a particular crisis is. For any debt relief process, this means that the scope of any debt restructuring cannot be derived from such a source. However, this does not mean that the index in question is of no benefit. After all, before debt relief is granted, a binary question arises, the answer to which may in part be found in just such an index, namely: debt relief, yes or no?

For example, with each of the three indices, it is possible for a decision to be made on access to an automatic moratorium in the event of a natural disaster involving a predefined level of damage. This means that countries in a higher category of vulnerability are able to benefit from an immediate moratorium even with a relatively low level of damage, while with countries that are less vulnerable, 'only' a more serious disaster would trigger the same extent of entitlement. A moratorium, in turn, has the capacity to offer the time and fiscal scope for a more comprehensive analysis of debt sustainability, when dealing with a disaster that has just occurred, with the potential outcome of genuine debt cancellation.

Here, however, it is already evident that such a mechanism would itself need to be based on a mechanism which is independent of both creditors and debtors; this, regrettably, does not yet exist. Due to the question of independent decision-making having been a central topic of debate since as long ago as the so-called 'Third World Debt Crisis' of the 1980s and 1990s, here it is however at least possible to refer back to a whole series of proposals outlining in concrete terms how the requisite independent institutions given the role of assessing debt distress and implementing any debt restructuring arrangements could be shaped.[14]

With regard to calculating the scale of debt relief needed, the fourth index, the World Risk Index, could then also have a role to play. Here, a possible parameter could for instance consist in determining the financial requirements of a country, including the costs of disaster aid, reconstruction and revival of economic activity. If this turned out to be higher than the likely available financial framework in the form of public revenues and a positive balance of payments, then ongoing debt service payments for the coming years – and, derived from this, also the level of debt – would be the dependent variable which, based on circumstances, would require modification in order to balance the capacities of a disaster-affected country and its expenditure, in the interests of the country's own population and those of external lenders.

7. What if?

As technical as the question of how to interpret debt sustainability may appear at first glance, it actually conceals an eminently political decision: who is to determine what is to be considered as a sustainable level of debt, both generally and on a case-by-case basis? The fact that a discussion has now been initiated on technical reforms in regard to defining vulnerability is a welcome development. However, if this technical dimension is considered and settled in isolation from the question of politically-based decision-making powers, then countries which have now fallen into a situation of unsustainable debt as a result of COVID-19 and/or climate change will end up in the same cycle of debt distress and perennially-inadequate debt relief as 30 or 40 years ago.

[14] For a discussion of different options and a possible synthesis of such options, see: UNCTAD (2015): 'Sovereign Debt Workouts: Going Forward. Roadmap and Guide', https://unctad.org/system/files/official-document/gdsddf2015misc1_en.pdf.