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The new (old) debt architecture

Unlike individuals or companies, states cannot rely on a uniform process based on the principles of the rule of law in the event of an unsustainable debt situation. Instead, debtor nations must negotiate debt restructurings with different creditors in various bodies and according to different rules. The creation of the G20 Common Framework has not fundamentally changed this.

Hence, while there is no universally binding international legal agreement outlining how sovereign debt restructurings should be conducted in the event of repayment difficulties, a de facto standard process has emerged – not least due to creditor interests and pressure.

- In this process, the main official bilateral creditors convene in informal bodies and jointly negotiate the terms of debt relief (in the form of debt cancellations, interest rate cuts and/or maturity extensions of repayments). At the moment, the Paris Club comprises 22 primarily Western creditor states. Under the Common Framework established in 2020, the Paris Club member states coordinate with the other G20 nations, including China.

- Not all critically indebted countries are eligible for negotiations under the Common Framework. For political reasons, their number is limited to the 73 countries with the lowest income. This means that countries not eligible for negotiations under the Common Framework have to negotiate separately at the bilateral level with creditor governments outside the Paris Club, such as China or India. Otherwise, however, similar rules apply to these negotiations (see below). Only Sri Lanka – actually not eligible for negotiations under the Common Framework – is currently an exception, as bilateral official creditors have formed an official creditor committee with Paris Club members and other relevant G20 nations such as India.[1] However, this has done little to change the outcomes or to achieve the goal of restoring sustainable debt levels.

- The Paris Club and Common Framework member states require debtor nations to initiate an IMF loan programme and implement the policy conditions formulated in this programme as a precondition for negotiating debt relief. Without an IMF programme, no negotiations take place.

[1] The G20 member nation China, however, only participated as an observer.

- Hence, the IMF plays a central role in debt restructuring negotiations. It calculates the amount of debt relief needed and thus determines how the costs are distributed between the debtor nation's population (through domestic measures like spending cuts) and the external creditors (through debt relief). The IMF does not carry out a binding human rights impact assessment when calculating the necessary debt relief.

- The calculation of necessary debt relief varies depending on the country's income level.
    - For low-income countries, the IMF has determined the following standard: The aim of the debt restructuring is to reduce the risk of debt distress to a 'moderate risk.' This means that, in a development scenario the IMF considers realistic over the next three to five years, debt indicators stay below the debt sustainability thresholds it sets for a 'moderate risk of debt distress.'[2]
    - There are no such targets for countries that are not considered to be low-income countries and are thus assessed by the IMF under a different debt sustainability framework. This means that sustainability targets can be designed more flexibly and more creditor-friendly. This becomes apparent in the differing treatment of Zambia and Sri Lanka: while the countries share broadly similar characteristics, they are assessed under different sustainability frameworks (see case studies).

  The bilateral official creditors in the Paris Club and in the Common Framework state that they base their decisions on the amount of debt relief to grant to a debtor nation on the IMF's calculations. However, there is no binding commitment to actually grant the debt relief deemed necessary by the IMF.

- Equal treatment clauses are included in debt restructuring agreements between bilateral official creditors and debtor nations that require the debtor nations to demand comparable concessions from other bilateral official and private creditors. This is based on the idea that the debt relief granted from official creditors should not serve to cross-finance profits made by private or other official creditors. However, the definition of "comparability" remains contentious and has been discussed time and again, for example during the Global Sovereign Debt Roundtable established by the G20.

[2] More specific IMF rules for its staff from August 2024 included the goal to make debt relief comprehensive enough to create 'room for shocks', so that only really extreme shocks – for example, natural disasters – will lead to the debtor nation exceeding the thresholds for a moderate risk of debt distress. The underlying idea is that the further a country remains below these thresholds, the greater its capacity to absorb external shocks without risking another debt crisis. However, this reasonable rule was not referenced in a subsequent publication released just a few months later, suggesting that the IMF's Executive Board and, by extension, the affected member states involved in negotiating claims with debtor nations, could not find a consensus. Once again, this shows the IMF's conflict of interests as both a body issuing directives and one that is dominated by creditors.

- Sometimes, agreements between bilateral official creditors and debtor nations include clauses intended to increase pressure for equal treatment; for example, requiring the country to remain in default towards its private creditors until comparable concessions are secured.[3]

- However, the debtor nation does not have any legal or political basis to enforce participation of uncooperative creditors. Hence, the responsibility to persuade private creditors of comparable participation is unilaterally shifted from the bilateral official creditors to the debtor nations. Even G20 reform efforts, for example, in the framework of the Global Sovereign Debt Roundtable, have not altered this and debtor nations still lack corresponding legal, financial or political instruments. For this reason, it has often been impossible to secure comparable concessions from private creditors in the past.[4]

- Multilateral debts (for instance to the World Bank) are normally not subject of negotiations, as they are excluded on principle due to the claimed "preferred creditor status".

Within the debt architecture described above, the IMF in principle plays a central role in detecting and resolving debt crises in the Global South. Even though the IMF has no monopoly on debt sustainability analyses under any (international) legal framework, it holds a quasi-legal monopoly, as bilateral official creditors make entering into an IMF loan programme a precondition for debt restructuring negotiations. When a debtor nation applies for a loan programme, the IMF's debt sustainability analysis is decisive, as it determines whether the loan is granted or not and as IMF funds are involved.

According to its Statutes, the IMF cannot lend if it believes that the debt is unsustainable – that is, if the country is unlikely to be able to repay the IMF. However, the IMF is often accused of conflicts of interest. First it is a lender itself and second its policies are heavily influenced by its major shareholders that happen to be the most powerful creditors themselves. This means that, contrary to what would be necessary in cases of critical debt situations, its loan programmes are not consistently tied to debt restructurings. By approving loan programmes despite a clearly unsustainable debt situation – and without tying those programmes to debt restructuring negotiations – the IMF and its powerful member states which approve the loan programmes effectively encourage the avoidance of restructurings that would actually be necessary. Moreover, the IMF often glosses

[3] See 'Global Sovereign Debt Roundtable Cochairs Progress Report', 12 October 2023.
[4] See for example the IMF statistical update on the realisation of the HIPC initiative from August 2019: 'Nonetheless, creditors representing about 43 percent of the total expected debt relief from non-Paris Club creditors either did not provide debt relief or provided less than 40 percent of the expected amount under the HIPC Initiative. Commercial creditor participation in the HIPC Initiative has been weak.', see IMF (2019): 'IMF Policy Paper: Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) – Statistical update'.

over the debt situation with optimistic forecasts and a comprehensive fiscal consolidation, thereby calculating lower levels of debt relief for the creditors.[5]

[5] See, among others, Rehbein, K. (2023): 'Dare to take more responsibility. The role of the IMF in delaying debt crisis resolution', in: Global Sovereign Debt Monitor 2023, Misereor and erlassjahr.de.