Staying Claims: Debt Moratoria Beyond the Debt Service Suspension Initiative

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'We are in this together. If there is anyone that hasn't quite gotten it, please wake up'. This was the plea from the Managing Director of the International Monetary Fund (IMF), Kristalina Georgieva in an interview with the *Financial Times* on Tuesday, 30 June 2020 as she revealed that unless prompt and urgent action was taken to stabilise economies in Africa, the continent is facing 'the heaviest hit' since the 1970s due to the COVID-19 pandemic. Her stark warnings come on the back of the most recent forecast by the IMF of the sub-Saharan African (SSA) region that showed a sharp deterioration in economic conditions since the fund's last regional report in April 2020.

The IMF is now projecting the SSA regional economy to contract by 3.2 percent in 2020, double the contraction forecasted in April due to global economic shocks and that the impact of the crisis is likely to extinguish almost ten years of progress in social and economic development. In April 2020, the IMF and the United Nations Conference on Trade and Development (UNCTAD) estimated that developing countries, including African countries, would require at least US$2.5 trillion to mitigate and recover from the financial and economic shocks of the pandemic. The IMF now estimates that African countries will have additional external financing needs of over US$110 billion to fund immediate health mitigation measures, short-term social and economic relief measures and long-term economic recovery programmes, of which US$44 billion have yet to be financed.

At the same time, developing countries are facing an unyielding debt crisis, with 40 countries, notably in SSA, entering the pandemic in or high risk of debt distress. Countries are spending much more of their income on debt service than any time after the global financial crisis in 2008-09. The service of long-term public and publicly guaranteed debt constituted an average of 6.5 percent of government revenues in 2012 but 10.3 percent in 2018, with many countries in SSA paying more than a quarter of their revenues out as debt repayments. Of particular concern is a rapid accumulation of private debt in all developing countries, including in Africa since the global financial crisis of 2008-09. Over the last decade the issuance of Eurobonds – bonds denominated in a currency other than that of the issuer – has risen sharply in Africa, passing US$100 billion in value in 2019, a US$27.1 billion increase from the previous year. Just less than half (49 percent) of Africa’s public external debt between 2012 and 2017 was concessional, compared with 58 percent from 2002-2007. The rating agency Fitch has predicted that the median of government debt-to-GDP for the 19 sovereigns it rated in SSA would rise to 71 percent by end-2020 from 26 percent in 2012, while the median debt ratio across other emerging markets is expected to climb to 57 percent. If African countries were to implement the same immediate fiscal policy measures as the largest EU economies so far, the OECD estimates that all other conditions remaining equal, Africa’s government debt-to-GDP ratio would increase from 57.6 percent in 2019 to about 85 percent this year.

The global community, including international financial institutions (IFIs) such as the IMF and World Bank, regional development banks (MDBs), bilateral and multilateral donors, have made significant commitments to scale up aid, credit and debt relief to developing countries to meet the financial challenges faced by African economies and other developing countries across the global south. There have also been initiatives to tackle the urgent sovereign debt crisis of developing countries both in emerging markets, which have seen capital outflows of more than US$100 billion in a matter of weeks and in low-income countries.

To date, there have been two significant international initiatives aimed at reducing the debt burden of low-income countries: the debt service relief under the IMF's Catastrophe Containment and Relief Trust (CCRT) and the Debt Service Suspension Initiative (DSSI), involving the G20 and Paris Club creditors and a limited number of private creditors. Both initiatives tackle the repayment of debt service: the former programme constituting grants from a donor-funded trust that repays debt owed by eligible countries to the IMF which is falling due within the agreed time period (initially six months); the latter committing official creditors and participating private creditors (on a voluntary basis) to a time-bound suspension of debt service (currently up to 31 December 2020) to eligible countries that request such forbearance.

There have been significant criticisms of both schemes. First, both schemes are limited in eligibility to countries deemed eligible for concessional debt relief from the IMF and the International Development Association) of the World Bank and this would cover 76 low-income countries and exclude middle-income developing countries. Second, the CCRT and DSSI deal only with debt service rather than debt stock which means that there is no write-down of the overall debt owed, just enabling some fiscal space for reprioritisation of expenditure for COVID-19 needs. Third, the schemes are reliant on the political will of official creditors and donors, with the CCRT dependent on donor contributions to fund grants for debt service and official creditors likely to fund CCRT contributions and bilateral debt service relief from existing aid budgets, thereby reducing the availability of concessional resources for countries for other needs. And third, the schemes do not adequately target private creditors who hold a significant amount of debt owed by developing countries, including many countries in

Africa. While a separate commitment was made and terms of reference were set by the Institute of International Finance (IIF) to support private creditor participation in DSSI, this arrangement remains voluntary. Further, there has been reluctance by highly indebted countries to take up offers of debt service suspension from official and private creditors for fear of credit rating downgrades and sending the ‘wrong’ signals to the market about their fiscal position or fearing the triggering of cross-defaults on debt contracts.

Statutory Moratorium on Debt Enforcement

In response to some of the challenges posed by a lack of private creditor participation in the DSSI, we proposed a legislative solution in English law to what is effectively a creditor holdout or refusal to participate in official debt relief arrangements. Our proposal aims to give legislative effect to the DSSI with respect to private creditors by granting a statutory standstill to all DSSI-eligible countries on qualifying debt owed by the country that is governed by English law. The proposal covers sovereign bonds, and those qualifying debts correspond to 90 per cent. of the bond contracts owed by countries covered by the DSSI. The proposal is based on the content of and rationale that underpinned the Debt Relief (Developing Countries) Act 2010, which prevented creditors of beneficiary countries of the Heavily Indebted Poor Countries Initiative (HIPC) Initiative from recovering an amount of debt in excess of that consistent with the HIPC Initiative.

Our argument is that continuing debt service to commercial creditors at this time diverts resources provided through official debt relief (from example through the DSSI and the CCRT) that is intended to free up resources for countries to support health, humanitarian and social and economic measures during the COVID-19 pandemic. We are proposing a temporary standstill that would be voluntary so that debtor countries would have an option, not an obligation, to rely on it. But where a debtor chose to do so, it will have the effect of staying any legal proceedings brought against it by a creditor before an English court or arbitral tribunal in respect of a qualifying debt.

In this regard, it is worth noting that the moratorium on enforcement would in no way release the debt of the country, nor amount to a waiver or forbearance on the part of the creditor. The proposed legislation does not directly intervene in a contract to suspend debt payments, and as such, it is still open to creditors to declare a default under the relevant contract. Instead, the legislation mirrors existing insolvency legislation in suspending the link between contractual default and the execution and enforcement of contractual rights, including with the aid of the English courts.

We believe that a statutory standstill on debt repayments is necessary to protect resources of low-income countries, especially highly indebted countries, from being diverted to debt service to commercial creditors. Previous experience with the HIPC Initiative and other Paris Club restructurings have demonstrated that without enshrining debt standstills and/or cancellation into law, private creditors are unlikely to participate fully and give effect to multilaterally organised debt relief initiatives. Despite the voluntary arrangement brokered by the IIF, question marks remain over the efficacy of a voluntary agreement covering a disparate class of creditors because nothing stops recalcitrant private creditors from refusing to participate and pursuing aggressive litigation tactics against a state.

Reliance on a purely voluntary arrangement may also generate collective action problems in which a group of private creditors would seek to benefit from the increased repayment capacity of eligible countries, generated by the official debt standstill, in order to keep obtaining debt repayment in full during this challenging time. The current situation poses the classic free-rider problem, in which some creditors may not engage in the initiative in the hope that they can free ride on the concessions offered by other creditors. This would create a strong incentive for otherwise cooperative creditors to refuse participation in the DSSI, thus undermining the arrangement as a whole.

Since most potentially eligible private debt is governed by English law, this situation has significant legal and political implications for the UK. If the DSSI is not accompanied by a statutory standstill for private debt, English courts (more than any other jurisdiction) could end up enforcing the debts of private creditors free-riding on the DSSI, CCRT and other debt relief measures funded by the UK taxpayers.

This could give rise to the same situation which provided the impetus for the aforementioned 2010 Act, i.e. the purchase of distressed debt on the secondary markets by speculative investors with the aim of recovering the full-face value at a later date. The aforementioned 2010 Act was introduced to prevent this free-rider problem and together with similar legislation in other jurisdictions, such as Belgium and France, has successfully prevented predatory behaviour that is jeopardising multilateral collective action on sovereign debt and development.

Foreclosing Crisis in Debt Markets

Reliance on contract law provisions to give effect to the DSSI and other debt relief measures are also inadequate. For example, reliance on *force majeure* clauses or the doctrine of frustration to set aside contractual debt service obligations leaves too much uncertainty as to what constitutes a reasonable circumstance under which to vary or set aside the contract and does not necessarily deal with events. The difficulty with leaving negotiation of force majeure to private parties is that this places an onus on those parties to identify exactly that which they did not expect to occur and to rationally weigh and assume the risks of what can be macroeconomic events.

Only specialist insurance markets are equipped to negotiating in advance a coordinated response to the pandemic. The average finance contract does not contain an explicit *force majeure* clause at all. The contractual burden of events such as the pandemic falls almost entirely on the side of borrowers. Only when a borrower is forced to default does risk even begin to pass to creditors. The only way to deal with these gaps in the law as it stands is through legislative intervention. A temporary standstill in the enforcement of debt contracts, in this case, serves the role of completing incomplete debt contracts. The temporary standstill legislation would establish the unenforceability of performance in ways that the reasonable contracting parties would have wanted should they had been able to predict this contingency.

Additionally, legislation would also bring some certainty to the enforcement of debt contracts under English law. It would, contrary to common concerns, support rather than undermine debt markets. Research shows that public interventions to suspend debt payments do not automatically undermine credit markets or undermine freedom of contracting. Instead, they can have the opposite effect in some cases. By temporarily suspending the debt payments, the risk of an outright default is reduced and reassures anxious creditors anticipating widespread default. The effect of the stay of enforcement in no way releases the debtor from the liability to pay, nor does it constitute a waiver of the debt or other forbearance by the creditor. The debt remains in place, and interest continues to accrue; all the standstill does is suspend the right of creditors to execution and enforcement for a specified period.

In suspending the right to enforce legal claims, our legislative proposal foresees a continued role for the parties to bargain in the shadow of the law. The proposed standstill amounts to a variation of the balance of negotiating power between the parties, removing the 'nuclear option' of legal proceedings from the table for a short period. We do not, however, expect parties to do nothing; in the changed circumstances, parties should, and very likely will negotiate a route through this crisis. By certifying through legislation that the COVID-19 crisis is a highly unusual and extraordinary event which the parties could not have reasonably described in the contract, the UK Parliament would ensure that no floodgates will be opened in English law to modify contract terms unless absolutely necessary.

We believe that the proposed legislation complements the DSSI as it relieves pressure on debtor countries by blunting private creditor threats to sue. We believe that enshrining a standstill into the law in jurisdictions where the majority private debt is contracted (i.e. the major financial centres which are also major creditor states and bilateral donors), the global community can demonstrate solidarity in facing the global crisis of the pandemic. This is an opportunity for global financial centres to reinforce their commitment to ensuring low-income countries have access to all the financial resources they need to contain COVID-19 and recover from this unprecedented health, social and economic crisis.

We recognise that the current proposal is limited in resolving the longer-term debt burden of developing countries. The stay of enforcement does not introduce any changes in the substantive obligations contracted by the parties. Thus, the standstill will only temporarily suspend the execution and enforcement of eligible financial obligations during the designated period. Meanwhile, interest on the principal will continue to accrue. The proposal is also meant to be used as a 'shield' rather than a 'sword', i.e. the stay will only be triggered as a defence by the sovereign debtor in the event of a claim against it by a private creditor. While this will hopefully stave off opportunistic litigation, it does not act as an automatic standstill in the way that is envisaged by proposals for a sovereign insolvency mechanism whereby creditors are automatically barred by statute from initiating legal proceedings or seeking enforcements of awards on claims. Due to its mirroring of the DSSI framework, the proposal is also limited to debt service rather than debt stock and will be time-bound in accordance with the terms of the DSSI.

The proposal does not also address the broader systemic issues relating to unsustainable debt burdens in developing countries and the gaps in regulation of the international financial architecture that enable the accumulation of such debt burdens. However, we believe that a standstill in the primary governing jurisdiction of private debt to sovereigns will be an important component of the toolkit for dealing with the global debt crisis. It is hoped that this will serve as an emergency measure to enable breathing space for countries to deal with the immediacy of the pandemic and pandemic-related economic shocks while more comprehensive and sustainable mechanisms are being developed. This will include the establishment of comprehensive sovereign debt restructuring processes that have the authority to deal promptly and equitably with indebtedness of sovereign states while ensuring that developing countries continue to have access to adequate external financing to meet domestic resourcing needs. Finally, there is also a need to consider the structural asymmetries in the international economic system that are preventing more comprehensive and effective responses to the problem of sovereign debt and the capacity of developing countries, including African countries, to mount an equitable and people-centred response to the financial fallout and social and economic dislocations of the COVID-19 pandemic.

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Economy (GLOBE); Karina Patricio Ferreira Lima is PhD Candidate and Modern Law Review Scholar at Durham Law School, University of Durham and Chris Tassis is PhD Candidate at Warwick Law School, University of Warwick. This article is drawn from the Proposal for Debt Suspension Legislation developed by the authors to support initiatives by civil society groups, led by Jubilee Debt Campaign UK and Oxfam GB, to find urgent solutions to the sovereign debt crisis in developing countries precipitated by the COVID-19 pandemic. The authors are working under the auspices of The IEL Collective Law and Finance Working Group. A crucial objective of the Working Group is to support the translation of critical research in the field to the general public, with a particular focus in influencing progressive policy-making either at national, regional or international levels. You can find out more about our debt suspension proposal here.

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