# Shared Responses, Shared Responsibility: Reinforcing Responsible Sovereign Financing Practices

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**Introduction**

Recent global crises have driven elevated borrowing levels among low-income and developing countries, prompting valid debt sustainability concerns. Between 2010 and 2022, the external debt stock for low- and middle-income countries (LMICs) more than doubled in nominal terms from $1.5 trillion to $ 3.1 trillion, reflecting an increase from about 11% of GDP in 2010 to 15% of GDP in 2022 (Merling et al. 2024). In particular, Africa will pay out $163 billion just to service debts in 2024-- a more than double uptick from $61 billion paid in 2010. Beyond the data, recent defaults illustrate the real implications of this issue. Across Africa, Zambia, Ghana, Ethiopia, and Chad have defaulted on their debt obligations, necessitating debt restructuring under the G20 Common

Framework. Between Zambia's default on its $42.5 million bond payment during the COVID-19 pandemic in 2020 and the eventual conclusion of negotiations with bilateral lenders to restructure about $6.3 billion of an outstanding $12.8 billion debt after almost four years (Grigorian et al., 2024), the World Bank-IMF Debt Sustainability Framework for Low-Income Countries (LICs) categorized the country's overall debt carrying capacity as 'weak' and its debt level as 'unsustainable'.

Similarly, Ghana had faced severe inflationary and balance of payments headwinds which led to its default in December 2022. Its debt fundamentals were also somewhat concerning, and according to the International Monetary Fund (IMF), the country channelled nearly half– or 47 cents, of every dollar raised by the budget in 2022 toward repaying interest on public debt. Following its default, it embarked on a restructuring that was wrapped up after 20 months in October 2024, following an agreement with more than 90% of bondholders to exchange about $ 13 billion in external debt (Reuters, 2024; Grigorian and Vessereau, 2024). Despite the Ethiopian government, on the other hand, ramping up concessional borrowing, it was still flagged at risk of external debt distress in 2017 due to increased borrowing to finance infrastructural and social investments. In December 2023, the situation culminated in the government defaulting on a $ 33 million coupon payment on its international bond.

Similar macroeconomic challenges have also impacted debt servicing obligations for other countries that may not have reached this point but have apparent debt vulnerabilities that affect investment in sustainable development goals. This may arise from fluctuating commodity prices, which these countries primarily depend on for cash flow. To illustrate, a report by the Centre for Economic and Policy Research highlights that in Ninety-Two LMICs', external public debt service is projected to surpass non-climate-related Sustainable Development Goal needs. Of these 92 countries, 61 have been identified by the IMF and other credit rating agencies as being at risk of debt distress. Additionally, more than half of the members of the G-24 were projected to spend more on debt servicing than SDG goals in 2024, indicating a concerning opportunity cost of development. Coupled with the relatively new and increasing participation of African countries in capital markets- where financing is offered on non-concessional terms, maturity periods are shorter, and interest rates are higher, debt unsustainability has become not just a looming threat but

one that requires innovative solutions. It is apparent, then, that brainstorming effective ways to implement viable, responsible borrowing and lending principles could not be more vital.

This essay will harmonize perspectives on responsible sovereign borrowing, re-emphasising the importance of shared responsibilities. It will commence by briefly examining the United Nations Conference on Trade and Development (UNCTAD) Principles on Promoting Responsible Sovereign Lending and Borrowing ("the UNCTAD Principles") and the Addis Ababa Action Agenda ("the Agenda"). Additionally, the proposals in the FfD4 Elements Paper, prepared by the co-facilitators of the FfD4 (Ambassadors of Mexico, Nepal, Norway, and Zambia) (hereinafter referred to as the FfD4 Elements Paper Proposals) on sustainable and responsible borrowing and lending and debt crisis prevention will be appraised. This analysis will consider the applicability of these principles within the specific context of African countries, considering economic, political, and social realities.

## Unpacking the UNCTAD Principles, the Addis Ababa Action Agenda ("the Agenda"), and the FfD4 Elements Paper Proposals

The UNCTAD Principles are considered the first set of internationally agreed principles aimed at preventing irresponsible sovereign financing. Equally, Paragraphs 93-102 of the Agenda, which addresses debt and debt sustainability, provide a more robust set of principles on responsible sovereign financing by explicitly acknowledging the rising vulnerabilities of many countries to debt distress and the significant increase in sovereign bond issuance. The FfD4 Elements Paper Proposals build on the Agenda as well as the Doha Declaration, under which member states agreed to co-operate with the private sector in intensifying debt crisis prevention efforts and find transparent, agreeable solutions by enhancing international financial mechanisms for crisis prevention and resolution. It also encapsulates the debt resolution principles under the Monterrey Consensus, which are to strengthen transparency and accountability, promote responsible borrowing and lending, improve debt management mechanisms, and foster equal treatment of all creditors. Hence, these are all interlinked and embody principles and proposals that are cardinal to achieving responsible borrowing and lending.

Moreover, all acknowledge that responsible borrowing discourse must employ balanced perspectives which recognise the roles of both borrowers and lenders. For instance, the Agenda acknowledges that while maintaining sustainable debt levels is the responsibility of the borrowing countries, lenders also have a responsibility to lend in a way that does not undermine a country's debt sustainability. The UNCTAD Principles reassert this and hold each side of a sovereign lending transaction accountable for its conduct in sovereign financing transactions. The FfD4 Elements Paper also adopts this mutual flavour, as its proposals outline the responsibilities that both the borrower and lender can assume in promoting responsible sovereign financing.

Principle 2 recognises that lenders have a duty to provide sufficient information to empower borrowers to make informed credit decisions and to clearly communicate the dynamics of the transaction and its implications to the borrowing party based on their degree of financial sophistication. This Principle aligns with the third proposal of the FfD4 Elements Paper on enhancing debt transparency by improving disclosure, reporting, and data reconciliation, and proposes a central debt registry which harmonises debt data reporting.

Additionally, the Agenda hinges on strengthening the analytical tools for assessing debt sustainability and prudent public debt management, mainly through utilising the IMF-World Bank debt sustainability analysis ("DSA") to determine appropriate borrowing levels. However, the DSA's methodologies may prove this difficult. For instance, it depends on debt-to-GDP ratios, which inextricably link growth and fiscal consolidation, resulting in projections that do not often translate. Furthermore, these fiscal consolidation mechanisms often entail higher taxes and decreased government spending, short-term solutions that lead to contractions in areas like unemployment and aggregate demand, thus undermining a holistic, long-term growth objective.

This is especially true for African economies that are largely informal and have yet to develop strong tax administration systems that are fit for purpose. Perhaps this underscores the significance of proposals in the FfD4 Elements Paper, such as capacity-building initiatives, which help developing countries manage their debts and efficiently allocate and invest borrowed resources. There is a pressing need for policymakers in these countries to be equipped with the tools that facilitate efficient debt management and the sound

economic management often needed to preempt unsustainable borrowing.

Lastly, while the Agenda acknowledges the potential for enhancing coordination between public and private sectors and between debtors and creditors, it highlights the difficulties posed by minority bondholders who may be non-receptive to debt restructuring efforts and disrupt overall progress as a result. Considering these limitations recognised under the Agenda, how can stakeholders improve debt sustainability outcomes?

**A Deep Dive into the UN DESA Proposals in the FfD4 Elements Paper**

The FfD4 Elements Paper Proposals advocate for a consolidated set of globally endorsed principles on responsible sovereign financing. It is worth highlighting that the Proposals emphasise that these principles should be collated in an inclusive manner, ensuring that the specificities of different economic contexts are captured. This would help harmonise the multiple Principles and guidelines on responsible sovereign financing, allowing players to have a universal frame of reference for financing transactions. In doing so, international financial institutions and national governments must prioritise the enforcement of these policy frameworks. These guidelines should also be holistic and attuned to modern financing trends, such as increased sovereign bond issuance and their accompanying challenges, such as holdouts, and require that private creditors at least participate in debt restructuring negotiations in a timely manner and on a good faith basis. It also acknowledges the need for a working group to monitor the sovereign debt lifecycle.

African regional initiatives such as the African Peer Review Mechanism (APRM), Specifically the economic governance and management and social development thematic areas, can be viable tools. Transparency is also crucial under the Proposals. Instruments such as confidentiality clauses in commercial debt contracts can hinder this, making it difficult for stakeholders, including other creditors, to accurately ascertain a borrower's true financial position, detect instances of preferential treatment, and effectively design debt crisis response policies. Moreover, citizens on both sides are unable to hold their governments accountable for secret debt obligations.

The Elements Paper proposes reporting and data reconciliation by streamlining existing debt databases of international financial institutions and creating a

central global debt data registry to harmonise debt data reporting. This is welcome, as improved disclosure obligations will help curb moral hazards, and transparency around debt obligations will discourage riskier lending practices. Additionally, a central global debt data registry should be introduced promptly and made universally available to all stakeholders online.

Capacity-building initiatives are also helpful because they assist developing countries in managing their debts and efficiently allocating and investing borrowed resources. This will equip policymakers with the tools that facilitate efficient debt management and sound economic management efforts, often necessary to preempt unsustainable borrowing.

The Elements Papers also propose mainstreaming state-contingent debt clauses (SCDC), which link debt repayment terms to certain conditions such as natural disasters, a rise or fall in commodity prices, etc. These instruments would permit incorporating provisions for debt standstills during global crises, which are not ordinarily covered by boilerplate force majeure clauses. They can help governments properly manage their finances in times of economic uncertainties and focus on more pressing needs, for example, during the COVID-19 pandemic, which might have included investments in social safety nets and wider healthcare coverage. However, these instruments have an added complication within an African context, particularly due to the risk perception premiums that African governments already face. Considering their novelty and relatively untested risk levels, SCDCs in commercial debt contracts could lead to higher debt costs. Hence, they must be closely monitored, and surrounding principles must be fleshed out to avoid such situations.

Local currency lending by official lenders is also ostensibly considered for its potential to cushion global economic shocks. However, official lenders and the government must do this as transparently as possible. This is illustrated by the abuse of the Ways and Means initiative in Nigeria, during which the Central Bank of Nigeria (“CBN”), in a bid to finance the federal government’s budget deficits, printed Naira (the country’s local currency) above the 5% revenue. This, among other things, spurred a rise in inflation, as there was a mismatch between the increased money in circulation and productivity/output levels. Hence, for local currency lending to be successful, there must be improved transparency and accountability around the entire process.

The FfD4 Elements Paper also proposes quicker, fairer and deeper debt resolution. This is relevant to the G20 Common Framework, which was created to facilitate timely and orderly debt treatment for low-income countries, with broad creditors' participation, including the private sector. However, African countries such as Zambia still experienced protracted delays and negotiations before finalising agreements. Explicit timelines and stages for debt restructuring negotiations under a refined Framework would be helpful in preventing this issue. This would also address the difficulties posed by minority bondholders who may be non-receptive to debt restructuring efforts, disrupting overall progress. Debtor countries can also be supported via tools such as the African Legal Support Facility during negotiations and financing structuring to ensure that appropriate clauses are incorporated in agreements to minimise the impact of hold-out creditors and permit collective action mechanisms.

Additionally, the Elements Paper proposes refining analytical tools for assessing debt sustainability and prudent public debt management. For instance, the IMF-World Bank debt sustainability analysis ("DSA"), which is used in determining levels of appropriate borrowing, is dependent on debt-to-GDP ratios that inextricably link growth and fiscal consolidation, resulting in projections that do not often align with actual economic realities, leading to inaccurate assessments of debt sustainability and counterproductive policy recommendations. Furthermore, these fiscal consolidation mechanisms often entail higher taxes and decreased government spending-- short-term solutions that lead to contractions in areas like unemployment and aggregate demand, undermining a holistic, long-term growth objective. This is especially true for African economies, which are largely informal and need to develop strong tax administration systems that are fit for purpose instead of merely increasing taxes.

In conclusion, sovereign financing necessitates a shared commitment to transparency, accountability, and sustainable debt practices by creditors and borrowers. Both parties have a crucial role in ensuring that debt transactions are conducted prudently and do not jeopardise the economic and social well-being of the borrowing country. Improved stakeholder coordination towards enforcing responsible borrowing principles is critical for effective debt crisis prevention and resolution. The establishment of comprehensive and enforceable international guidelines for responsible financing, along with robust

mechanisms for monitoring and enforcement, are crucial to addressing the growing challenges of sovereign debt. By all stakeholders fostering a culture of transparency and accountability and prioritising sustainable development objectives, sovereign debt financing can contribute to economic growth and social progress rather than hinder it.

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