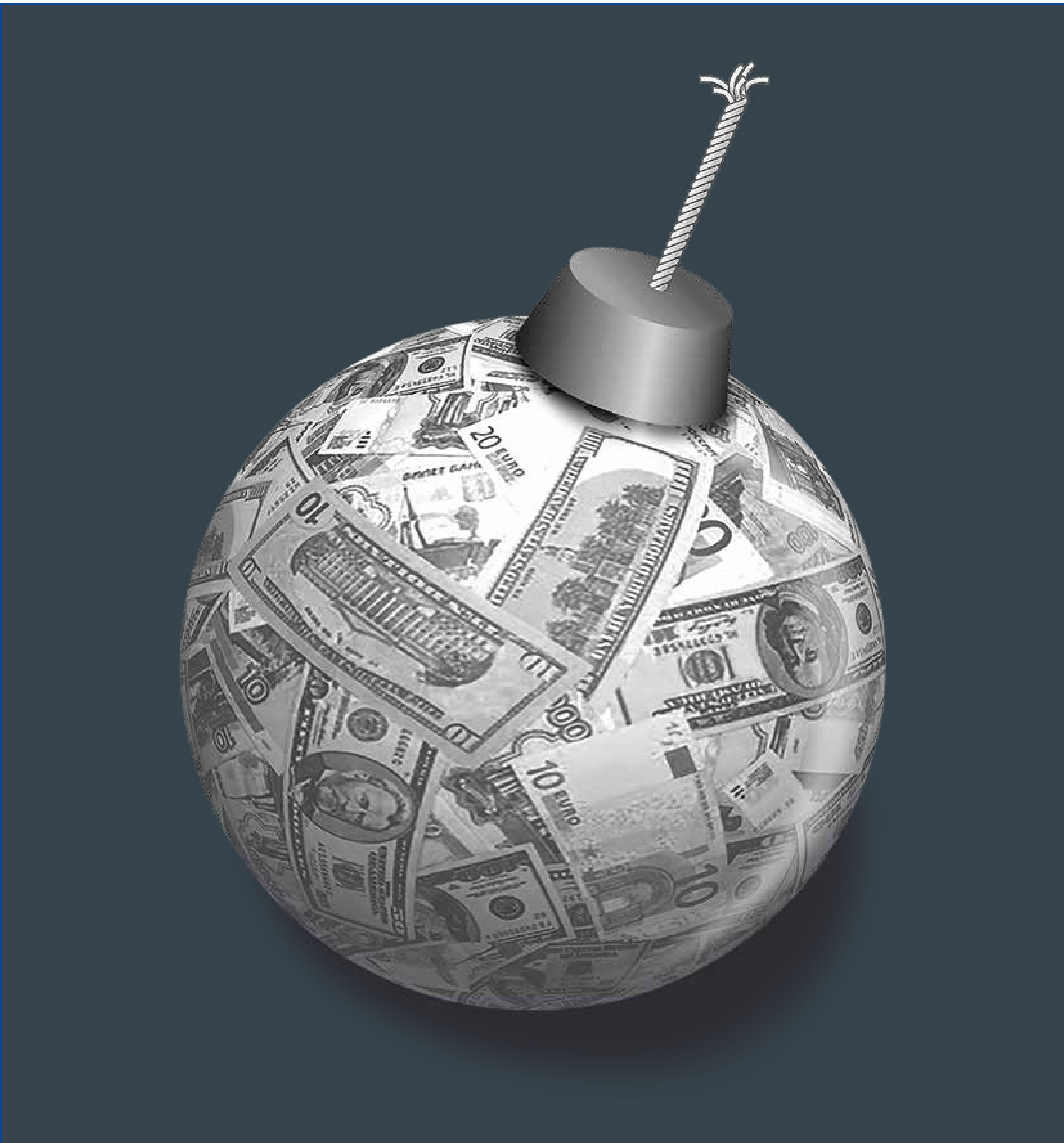
european network on
debt and development

The new debt vulnerabilities

10 reasons why the debt crisis is not over

By Bodo Ellmers and Diana Hulova



Acknowledgements

This report was written by Bodo Ellmers and Diana Hulova, with the support of Maria Kozlowska, Jeronimo Ruiz Victoria and Konstantinos Todoulos. Useful inputs and feedback on earlier drafts were provided by Antonio Gambini, Jesse Griffiths, Tim Jones, Jürgen Kaiser, Isabel Ortiz, and Maria José Romero. All remaining errors are the authors' own.

Vicky Anning and Julia Ravenscroft edited the report.

Design: studio@base-eleven.com

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Acronyms

AFRODAD	African Forum and Network on Debt and Development
DAC	Development Assistance Committee
DFI	Development Finance International
DFID	Department for International Development
DSA	Debt sustainability analysis
DSF	Debt sustainability framework
ECB	European Central Bank
EFTA	European Free Trade Association
EIB	European Investment Bank
EU	European Union
GDP	Gross domestic product
GNI	Gross national income
HIPC	Heavily indebted poor country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IIF	Institute of International Finance
IFI	International financial institution
IMF	International Monetary Fund
LIC	Low-income countries
MDRI	Multilateral Debt Relief Initiative
MIC	Middle-income countries
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PPP	Public private partnerships
PV	Present value
TJN	Tax Justice Network
UNCTAD	United Nations Conference on Trade and Development

Executive summary

This Eurodad report looks at the new debt picture in the sixth year of the global financial crisis. Debt vulnerabilities have changed, but overall they have not been substantially reduced. The good news is that the number of bank failures has dropped since the height of the European financial crisis. However, the downside is that governments have paid a high price to stabilise the financial sector, and sovereign debt levels have surged. Attention must still be paid to the volatility and bursting speculative bubbles in middle-income countries, and ever riskier debt profiles in low-income countries. Unsustainable and illegitimate debt is still a risk to financial stability and, ultimately, to the economic and social fabric of our nations.

Eurodad believes that the debt crisis is far from over, and here are ten reasons why:

1. **Economic imbalances continue to boost external debt:** The world remains divided into surplus and deficit countries. International institutions are imposing austerity policies on deficit countries but no pressure is put on surplus countries. The collapse of trade at the peak of the global financial crisis made surpluses and deficits temporarily narrow. However, since 2010, imbalances have increased again. Global current account divergences accounted for 2 per cent of the world's gross domestic product (GDP) in 2012, which is not much below the peak of 3 per cent in 2006 that triggered the worldwide financial crisis.

2. **Capital is moving around the globe in an uncontrolled way:** Recent data suggests that middle-income countries (MICs) are the next victim of absent or limited measures to regulate international capital movements. Lax monetary policies in rich countries since the crisis started have sent waves of speculative capital to the global south. In 2010, 70 per cent of global capital outflows originated from the USA and Europe. Developing countries' capital controls were too weak to stop foreign money from flowing in, appreciating their currencies and causing speculative bubbles. Now it is flowing back, making the currencies of MICs such as Brazil and Turkey drop by a quarter of their value.

3. **Private debt is on the rise:** Excessive private debt triggered the crisis in the USA and Europe six years ago. Now private debt in middle- and low-income countries is surging. In developing countries, external debt has doubled over the past decade to reach US$4.5 trillion in 2011. Private borrowers were the major driver.

4. **Sovereign debt is higher than ever in some places:** Rich countries have defused their private debt problem through public bailouts. As early as 2009, the International Monetary Fund (IMF) estimated that advanced economies had already provided headline support to the financial sector to the tune of half of their GDP. As a consequence of bailouts and the economic crisis, sovereign debt in rich countries has surpassed the threshold of 100 per cent of their GDP, reaching its highest levels since the Second World War. A new wave of sovereign debt workouts appear to be due.

Debt vulnerabilities have changed, but overall they have not been substantially reduced.

5 **Sovereign debt is riskier than ever in other places:** Low-income countries (LICs) receive less concessional funding. Their new debt is riskier overall and comes increasingly from private sources, at higher costs and shorter maturities. Several LICs are starting to issue bonds on financial markets for the first time, but the financial crisis has proved that investors' appetite to invest in developing country bonds is very fragile. The yield for the Ghanaian bond issued in 2007, for example, surged from less than 8 per cent in 2008 to more than 20 per cent in 2009, falling back to less than 5 per cent in 2012. It is uncertain if investors will make fresh money available when current bonds mature and need to be refinanced.

6 **The time bombs that are contingent liabilities could detonate at any time:** A badly regulated banking sector and public-private partnerships still contain hidden debts that amount to several times the annual GDP in some countries. The fiscal costs of recent banking crises in Cyprus, Greece and Ireland are estimated to exceed 60 per cent of these countries' GDP. These can be direct costs through recapitalisation of banks and public guarantees, or indirect costs through foregone tax revenue and the harmful economic impact of crises. Effective firewalls to protect the public side from taking on contingent liabilities still do not exist.

7 **Tax evasion and avoidance, and aid cuts, are undermining public income:** Endemic tax evasion and avoidance threatens public finances everywhere. According to research by the US think tank, Global Financial Integrity, developing countries lost $859 billion in illicit capital outflows in 2010. More money was lost through tax evasion than through crime and corruption combined. Recent aid cuts also pose a challenge to the poorest countries. The gaps are being filled through new borrowing, driving debt levels up.

8 **Debt limit policies are subject to political manipulation:** Debt limits such as those set by the IMF should keep new borrowing and lending within sustainable limits and signal to governments and donors that they should seek new assistance only in the form of grants. In practice they are being lifted or ignored whenever it is politically expedient.

9 **Responsible financing standards are rarely followed:** Although the buzzword 'responsible financing' is rhetorically high on the agenda of United Nations (UN), European Union (EU) or the G20, in practice there is little compliance with responsible financing standards. Export credits for the arms trade are just one example of this. Recently, UK-made military hovercrafts were exported to heavily indebted Pakistan, guaranteed by the UK Export Finance Agency. In the same month, the IMF had to approve a $6.6 billion Extended Fund Facility loan to Pakistan to boost the country's liquidity and avoid defaults, stating that: "Pakistan faces slow growth, declining reserves, increasing fiscal deficit".

10 **Effective debt workout mechanisms do not exist:** Six years into the global financial crisis, there is still no standing and effective mechanism that could tackle unsustainable debt before crises come to a head. Unless new global initiatives bear fruit, muddling through remains the default approach. It might get even worse: HIPC – the semi-structured debt relief initiative for the heavily indebted poor countries – is coming to an end and will not be followed up. And the current non-system of voluntary restructurings by coalitions of willing creditors is under massive attack by court rulings that favour vulture funds litigation and open the doors to free-rider behaviour.

“ Eurodad is calling on governments and international institutions to take the necessary steps to deal comprehensively with the debt crisis.

All of these debt vulnerabilities are due to two simple facts. Since the crisis began:

Debt has not been cancelled or paid off, it has simply been shifted from one balance sheet to another, and primarily from the private purse to public or government coffers.

The opportunity to use the financial crisis for fundamental reforms in national and international debt management and debt crises prevention and resolution has largely been wasted.

Recommendations

The striking governance gaps are, in essence, all known to decision-makers. Six years into the crisis, Eurodad is calling on governments and international institutions to take the necessary steps to deal comprehensively with the debt crisis:

Resolve ongoing debt crises and reduce legacy debt: Introduce an orderly insolvency regime for states. As stated in Eurodad’s debt workout principles, a new debt resolution mechanism for sovereign debtors must be independent from creditors; be transparent in decision-making; and take the developmental needs of indebted states and the human rights of its citizens into account when decisions are made.

Prevent future crises caused by unsustainable and illegitimate debt: Agree on a comprehensive and binding set of responsible financing standards and ensure compliance of all creditors and debtors, private and public. The Eurodad Responsible Finance Charter can provide valuable guidance and inspiration for decision-makers in this process.

1 Economic imbalances continue to boost external debt

Trade imbalances between countries remain high. The natural consequence of some countries running persistent deficits – by importing more than they export – means they have to borrow to finance them, resulting in an increase in external debt stocks. Deficit countries in Europe have made some progress since the start of the crisis, but much of this has been accompanied by damaging cut-backs in public spending, with the poorest paying the highest price. Yet overall current account imbalances remain high at around 2 per cent of global GDP.

Paying the price for adjustment has been one-sided, as the international financial architecture lacks instruments to put pressure on surplus countries such as Germany or China. Consequently, the necessary reduction of imbalances has not materialised, as only a few can be forced to adjust – the countries that are undergoing IMF-led structural adjustment programmes.

Euro Area: From internal imbalances to beggar-thy-neighbour policies

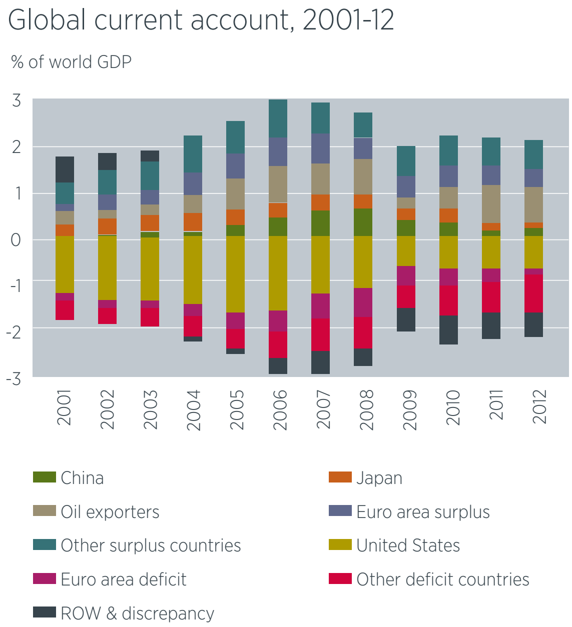
Economic imbalances – particularly current account deficits, and the external debt they create – were the key triggers of the Eurozone crisis. Countries on the European 'periphery' had run large and increasing current account deficits in the years leading up to the crisis. The current account is a measure of a country's imports and exports of goods and services. Those countries in deficit import more than they export, and have to finance these extra imports, largely through external borrowing. The European periphery deficits were made possible by lending from the EU 'core' zone's banks. This predictably unsustainable credit-driven boom collapsed in 2007 when credit flows dried up. Most of the current account deficits were due to the private sector's unregulated economic activities. The lesson learnt is that "the argument that a private-sector generated current account deficit should not be a concern for policy-makers is incorrect".[1]

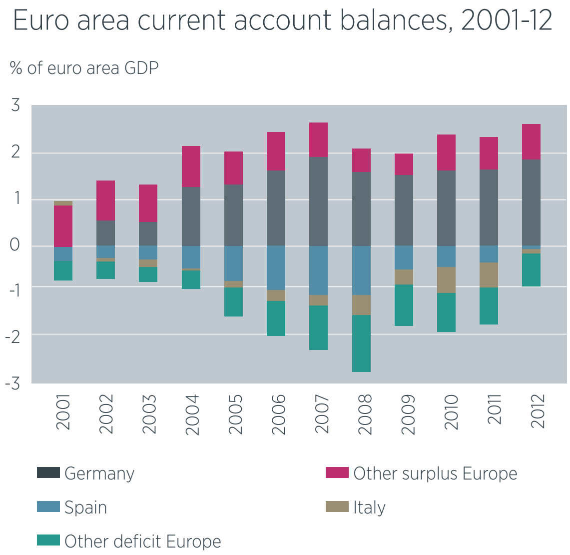
IMF data shows that trade imbalances are still not fully under control (see Graph 1). The collapse of trade at the peak of the global financial crisis narrowed surpluses and deficits temporarily, but since 2010 imbalances have increased again. Some countries – such as China, Germany, the Netherlands, Japan and the major oil exporters – continue to run large surpluses. As they export more than they import, they have used the surplus capital they earn to increase their overseas lending. Deficit countries such as the USA and Greece, Italy, Spain and Portugal continue to run deficits and build up external debt by borrowing from abroad. Global current account divergences accounted for 2 per cent of global GDP in 2012. This is not far below the peak of 3 per cent in 2006 that triggered the global financial crisis.[2]

Meanwhile, adjustment measures to try to reduce debts and borrowing in deficit countries have been unprecedented, particularly in Euro crisis countries, due to the harsh austerity measures imposed on these countries by the Troika of the IMF, the European Central Bank (ECB) and the EU. Spain's current account deficit, for instance, dropped from 10 to 1 per cent of GDP between 2007 and 2012, massively reducing the need to borrow from abroad.[3] But the adjustment is one-sided. While deficit countries carry the burden of adjustments, surplus countries such as Germany contribute little to solving their share of the problem.

The Eurozone managed to moderate their internal imbalances between core and periphery countries, but since the 'German model' to increase competitiveness by real wage cuts has now been imposed on the whole Eurozone by the Troika, it started to run a trade surplus with the rest of the world. In 2008, the Eurozone ran a current account deficit of -0.71 per cent. That was turned into a surplus of 2.2 per cent by the second quarter of 2013. This will enable some Eurozone countries to reduce their external debt. At the same time, it poses massive risks to the export-led growth model that had lifted most of the developing world up over the last few decades. The United Nations Conference on Trade and Development (UNCTAD) warned already in 2012 that "the whole [Euro] region is ... trying to export

Graph 1: Current account imbalances globally and in the Euro area





Source: IMF

> Substantial debt reduction to make debt manageable needs to go hand in hand with collective efforts to enable debtor countries to generate the surpluses they need to remaining debt.

its way out of the crisis. This could exert an enormous drag on overall global growth and worsen the outlook for many developing countries."[4] The times when the high export revenues that made foreign borrowing overall unnecessary and enabled developing countries to build up currency reserves that shielded them from debt crises might soon be over.

International institutions are aware of the risks that global economic imbalances cause to financial stability. The IMF warned in its recent *External Sector Report* that imbalances need to be tackled.[5] Unfortunately, the IMF's current mandate and instruments imply that pressure to adjust is placed solely on deficit countries, which have to comply with harsh austerity conditionality attached to the exceptional crisis loans they receive. No effective pressure can be put on the surplus countries.[6] The result is a race to the bottom in which different countries try to improve their competitiveness position vis-à-vis each other through beggar-thy-neighbour policies. The poor and most vulnerable are paying the price. Oxfam estimates that austerity measures in Europe will drive an additional 15 to 25 million Europeans into poverty[7]

The original design proposal of the Bretton Woods System, as proposed by John Maynard Keynes, foresaw that both sides should adjust in the case of balance of payment imbalances – the surplus countries by increasing their imports. However, the necessary institutions and enforcement mechanisms to make this happen were never developed.[8]

Historical examples of successful debt workouts explicitly acknowledged this need for both surplus and deficit countries to adjust. The 1953 London Debt Accord that relieved and restructured Germany's post-war debt was built on the principle that creditors and debtors adjust simultaneously, and explicitly linked Germany's repayment obligations to the balance of payments. Debt service could be suspended when there was no export surplus. At the same time, Germany's debt stock was greatly reduced to make it actually repayable without strangling economic development.[9] The lessons from the London Debt Accord – which was one of history's few examples of a successful sovereign debt workout – have unfortunately been ignored in current approaches. Substantial debt reduction to make debt manageable needs to go hand in hand with collective efforts to enable debtor countries to generate the surpluses they need to repay the remaining debt.

Developing countries: Dollar accumulation as alternative crisis insurance

Imbalances can also persist because the USA, the world's largest deficit country, does not need to adjust. Because the US dollar is the global reserve currency, the USA can run persistent deficits and finance them cheaply, essentially by printing new money. This works as long as other countries are willing to lend vast sums to the USA, by buying US debt, which they do in order to build currency reserves to protect themselves from future crises. Given the IMF's track record to impose harmful conditionalities on crisis countries, developing countries choose this crisis-insurance option although it is a welfare loss. Investing their scarce resources in US bonds certainly has less return than investing these sums in their own development.

Over the past decade, developing countries – particularly emerging markets – have stockpiled huge quantities of government reserves in order to protect their economies and their currencies from financial and economic turbulence. According to a recent report by the UN Secretary General, "From 2000 to 2012, global foreign exchange reserves increased by 468 per cent, from $2.1 trillion to $11.7 trillion, with emerging and developing countries holding an estimated $7.7 trillion and accounting for 66 per cent of the total."[10] The initial trigger for this unprecedented reserve accumulation was the disastrous experience by many Southeast Asian countries during the financial crisis of the late 1990s. During that period, Asian countries learned not to trust the IMF, which provided crisis assistance too late, and with damaging strings attached.[11]

These two issues are linked together. As the UN notes, "around 62 per cent of reserves [are] currently held in US Dollar treasury securities."[12] In other words, the US is able to abuse its position as issuer of the global reserve currency to finance massive deficits cheaply, while developing countries are encouraged by the preponderance of crises and the lack of mechanisms to protect themselves to use their surpluses to lend to the US on a massive scale, tying up resources that could be better used elsewhere. While imbalances cause debt crises, debt crises force countries to implement policies that lead to new imbalances.[13]

2 Capital is moving around the globe in an uncontrolled way

Big waves of speculative foreign capital were a key factor in all the recent crises. If it is not well regulated, foreign capital fuels speculative bubbles when it flows in, which then burst and cause major disruptions to the whole economy as soon as speculators discover a more attractive place and suddenly move their money to a different location. Currently, MICs like India or Brazil, which had been swamped by speculative monies since the crisis began in 2007, are most vulnerable to such a sudden retreat of capital back to the global north. Several countries have seen their exchange rates and asset prices crash already.

'Larger picture' analysis of financial and debt crises observe that they are foreshadowed by a boom of debt-creating capital inflows. Over time, these flows pile up to mountains of debt that become unsustainable. Kindleberger and Aliber identify four big waves of crises in different regions of the globe over the past few years and find that "the likelihood that the four waves of bubbles ... were unrelated events is low". All the crises were triggered by a credit boom that inflated asset prices and led to bubbles that finally exploded. As this happened, capital moved on to another place.[14]

Currently, it is mainly the MICs that are affected by volatile capital flows and the vulnerabilities they create. In 2010, 70 per cent of global capital outflows originated from the USA and Europe. MICs such as South Africa, India and Brazil had demanded better regulation of global capital flows and more sensitive policies from the global north to stop the 'tsunami' of foreign capital flowing to their country. Several Latin American countries such as Argentina, Brazil and Costa Rica even introduced unilateral defence measures such as taxing foreign purchases of stocks and bonds, and foreign short-term lending. For countries like Brazil, the measures were too weak to stop foreign money from flowing in, appreciating their currencies and causing speculative bubbles.[15]

As early as 2012, the South Centre had warned that: "The conditions driving the recent boom in capital flows and commodity prices are not sustainable, and they are likely to be followed by a sharp downturn. The major recipients are all exposed to the risk of a sudden stop and reversal – and, hence, to balance-of-payments and/or financial-market instability." [16]

The boom in capital flows was driven by northern states' policy response to the crisis: decreasing interest rates and providing additional liquidity through central banks. The policy of monetary easing in USA, Japan and the EU have literally flooded the globe with cheap money. Due to the lack of investment opportunities in the global north in times of austerity and sluggish growth, and low interest rates on 'safe' government bonds, this money has leaked from USA, Japan and Europe to developing countries where yields are higher. The lack of capital controls that were, in many cases, abolished to comply with international financial institution (IFI) conditionality means that developing countries did not have the necessary 'floodgates' to stop such speculative and debt-creating inflows that could be repatriated back north at any time.

Cheap credit from abroad has supported high economic growth in emerging and developing countries over the past few years, similar to the Eurozone periphery's credit-driven boom before the crisis started in 2007. However, it might be similarly less sustainable. The Institute for International Finance recently warned, under the headline 'Watch for accidents!': "A global environment of weaker supply of external financing can easily amplify country-specific vulnerabilities. Countries with large external financing needs are particularly exposed to a potential retrenchment of foreign capital flows. If external financing dries up, borrowers (both sovereigns and private sector entities) could find themselves in liquidity and solvency difficulties."[17]

The summer months of 2013 showed the first signs that these difficulties are coming true, as investors on financial markets anticipate that the USA's ultra-easy monetary policy is coming to an end, that the American central bank will increase interest rates again, making investments in the USA more attractive. Some heavyweights of the developing world were particularly affected by massive capital outflows. As illustrated in Graph 2 (overleaf), the exchange rates of Brazil, India and Turkey plummeted by about 25 per cent from 2011 until mid-2013, when their central banks finally stepped in to defend them, using debt swaps and currency reserves. The value of local currency bonds and stocks dropped too. Graph 3 (see overleaf) shows that net flows on both bonds and equities were negative.

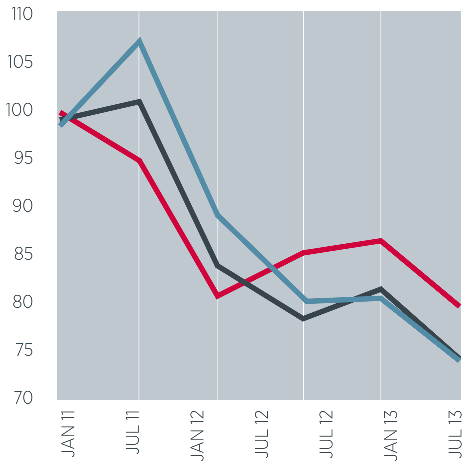
For 2013 and 2014, the Institute of International Finance (IIF) predicts a further drop in private capital inflows and lower growth rates in emerging economies. This would affect both domestic tax income and (re-)financing conditions for sovereign debtors, posing severe threats to public debt sustainability.

Private debtors are affected by the reverse of capital flows too. Much private debt in emerging and developing countries is denominated in foreign currency, while their assets and income are mostly domestic. This implies that their debt is more costly to service when exchange rates fall, a challenge to the solvency of private debtors. The fact

> “ The conditions driving the recent boom in capital flows and commodity prices are not sustainable, and they are likely to be followed by a sharp downturn.
>
> South Centre (2012)

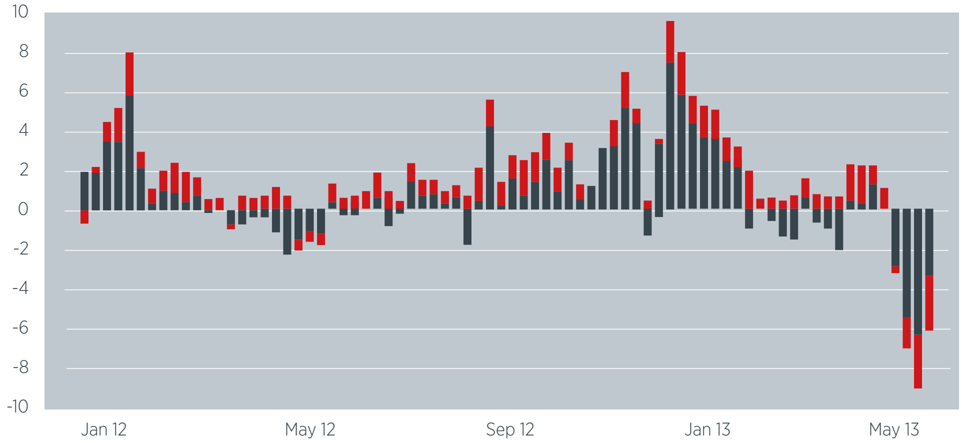
> We are…seeing a lethal combination of private capital flows leading to credit booms…leading to large scale socialization of the costs.

Graph 2: Exchange rates in selected emerging markets; January 2011 - July 2013



Source: Institute of International Finance

Graph 3: Emerging market net equity and bond fund flows



Source: Institute of International Finance

that foreign investors might in future prefer to lend and invest elsewhere is a liquidity risk. It means that it will be difficult to roll over existing debt with new loans once it matures.

LICs are less affected by volatile capital flows than MICs because most of them are still not deeply integrated in global financial markets. However, trouble for the MICs means trouble for the LICs too. Much of their recent growth and debt service capability depended on high export revenue caused by the commodity boom that was driven by high demand from MICs. UNCTAD's commodity price index reached an all-time high of 330 in February 2011 but has been on a downward trend since then, dropping to 253 in July 2013.[18]

Policy-makers had underestimated the debt vulnerabilities that volatile capital flows create, which is one of the reasons why the necessary institutions to mitigate and control them are not in place. The mood seems to be changing now, however. The United Nations' Panel on Facilitating International Adjustment through Timely Debt Resolution warned that "we are now increasingly seeing a different origin of the crisis – a lethal combination of private capital flows leading to credit booms … leading to large scale socialization of the costs". It was also critical that "the IMF has not raised enough of a 'red flag' in warnings of possible excessive borrowing" and the panel saw an "important role for the public sector to avoid surges in capital inflows".[19]

Yilmaz Akyuz, the chief economist of the developing country think tank South Centre, has already pointed to the fact that developing countries collectively "have been running a current-account surplus, and they do not need capital from advanced economies for external financing… The current headaches produced by unstable capital flows and commodity prices show once again that the international monetary and financial system needs urgent reforms. Ways and means should be found to prevent major reserve-issuing countries from pursuing beggar-thy-neighbor monetary and exchange-rate policies and creating destabilizing impulses for others."[20] In particular, Akyuz argues that: "Controls over both inflows and outflows should be part of the arsenal of public policy, used … in the areas and doses needed, rather than introduced as ad hoc temporary measures, as advocated by the IMF".[21]

3 Private debt is on the rise

The last financial crisis that began in 2007 was primarily a private debt crisis. It started with the crash of asset-backed securities – subprime mortgages – and credit default swaps in the USA, then spread primarily to countries with high levels of private debt and highly leveraged private banks. In advanced economies, the vulnerabilities coming from private debt seem to be contained for now. This is at a high cost to the public sector that funded the bailouts that reduced private debt, turning private debt into public debt. However, private debt levels are now rising in emerging and developing countries.

This indicates that the private debt-induced crisis of 2007 might not be the last of its kind. It was definitely not the first one. The economists Eichengreen and Mitchener called the Great Depression of the 1930s "a credit boom gone wrong".[22] The beginnings of the long "Third World debt crisis" in the 1970s were characterised by a boom in private lending to developing countries, the petrodollar-recycling that was intermediated by banks in the global north. Private lending and borrowing also played a key role in triggering the Asian debt crisis of the late 1990s, where credit booms fuelled real estate market bubbles, as we have seen more recently in Ireland and Spain. The IMF sees common patterns in recent crises too: "commonality among these crises is a substantial rise in private sector indebtedness, with the infected sectors besides banks being the household sector (as in the current US crisis and the Nordic crises of the nineties), the corporate sector (as in the case of the 1997–98 East Asian financial crisis), or both".[23]

There is no reason to think that the private debt bomb has been fully defused. The total debt stock is currently higher than ever. In developing countries, external debt has doubled over the past decade to reach $4.5 trillion in 2011. As Graph 4 shows, private borrowers were the major driver. In Europe, private debt surged in particular in Central and Eastern European countries. In Bulgaria, it quadrupled over the past decade.[24]

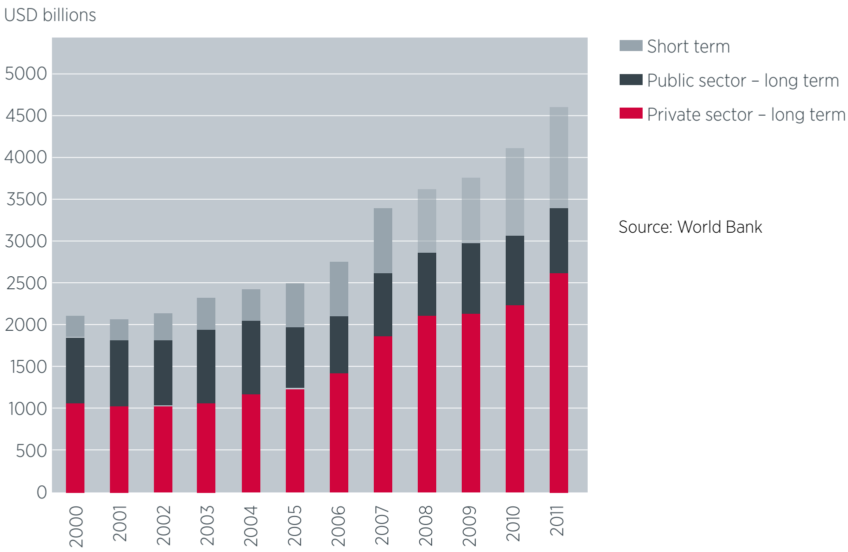
Economists such as Alan Taylor warn that "there is much more private debt out there than public debt".[25] Rejecting views that the financial folly of governments causes financial crises, he finds that "financial crises can be traced back to developments in the financial sector itself, namely excess credit ... Private credit has always been the only useful and reliable predictive factor".[26]

The risks arising from private debt in the major economies of the global north may have been contained over the past few years, mainly due to massive bailout programmes that transferred private debt to governments' balance sheets. However, in developing countries, private debt is on the rise and contributes increasingly to surging debt levels. In 2011, developing country corporate bond issuance accounted for 19 per cent of external debt inflows, compared to 12 per cent a decade earlier.[27]

Data on private borrowing is patchy, especially for LICs. It is not systematically monitored and reported. This implies that the actual magnitude of private debt and the related risks are not even known to regulators and decision-makers. The current financial crisis proved, when it started with the credit default swaps crash in the USA, that even the most sophisticated regulation systems can be taken by surprise. In developing countries with relatively weaker institutions and capacities, the uncertainty is even higher.

For half of LICs, there are no figures on external debt owed by private companies. In

Graph 4: Stock of external debt in developing countries



Source: World Bank

> "There is no reason to think that the private debt bomb has been fully defused.

> “ The private lending and borrowing boom is taking place in a largely unregulated environment.

those that release data, the average ratio of privately owed foreign debt is over 15 per cent of GDP. Private sector foreign debt payments have increased from 4 per cent of export earnings in 2000 to 10 per cent in 2010, thus reaching double those of the public sector.[28]

Generally, private debt in LICs and private external borrowing seems less relevant. Private debt (publicly guaranteed and non-guaranteed) in LICs was $10 billion at the end of 2011, up from $5.9 billion in 2000. However, these figures could be misleading as the World Bank's International Debt Statistics contain specific data on non-guaranteed debt for only five countries, which means that the magnitude of vulnerabilities could be largely underestimated.[29] Research by the Foreign Private Capital Monitoring and Analysis Capacity Building Programme found much higher figures for private external debt than the World Bank, and high volatility.[30]

The recent private debt boom in developing countries is a worrying sign. The key reason why developing and emerging economies could largely protect themselves against contagion from the US and Euro financial crisis was – besides the safety cushion provided by the more than $7 trillion of currency reserves they built up – the lower level of financial depths (i.e. private debt) in their economies.[31] The 'credit crunch', the temporary drop in private capital net transfers and the 'flight to safety' caused limited damage, because private debt levels were lower and thus the need to roll over loans with short maturity was lower too.[32] This might be changing now as private debt and thus overall financial depth are both increasing.

The private lending and borrowing boom is taking place in a largely unregulated environment, and is essentially uncontrolled. Very few countries are following successful examples, such as those of Malaysia, where the Central Bank has decreed that domestic companies can only borrow in foreign currency for projects that earn foreign exchange to repay the debt. This is a regulation that was key to protecting Malaysia from the debt trap into which its neighbours Thailand, Indonesia and South Korea fell in the late 1990s.[33]

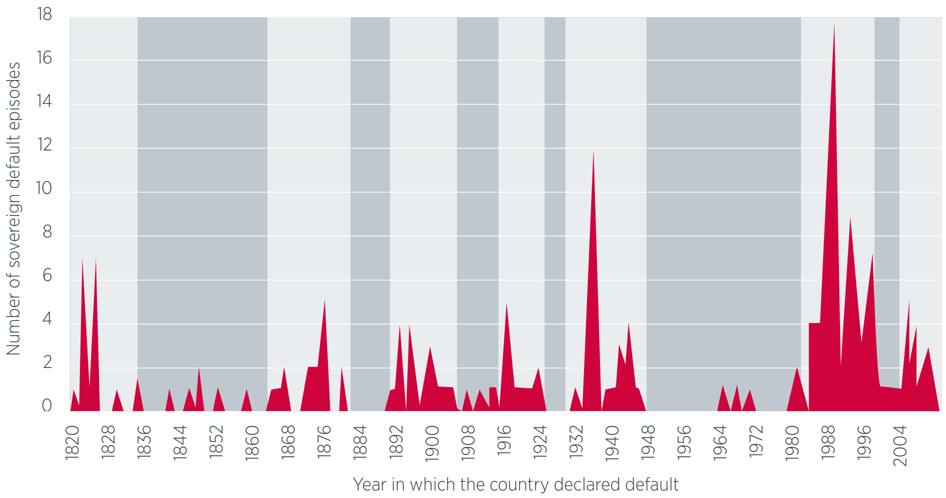
The consequences of the private lending and borrowing boom for the public sector and the national economies' financial stability could be severe. Most of the sovereign debt build-up that was witnessed, especially in advanced economies over the past few years and that will burden citizens and taxpayers for decades to come, was due to the bailout of private actors that basically went bankrupt.

4 Sovereign debt is higher than ever in some places

Bailouts of the private sector – in particular bank bailouts – have led to a situation in which the next big debt crisis might be once again a sovereign debt crisis. Sovereign debt levels in high-income countries are higher than they have ever been in times of peace. Even in LICs, sovereign debt is rising again, driven by concessional lending.

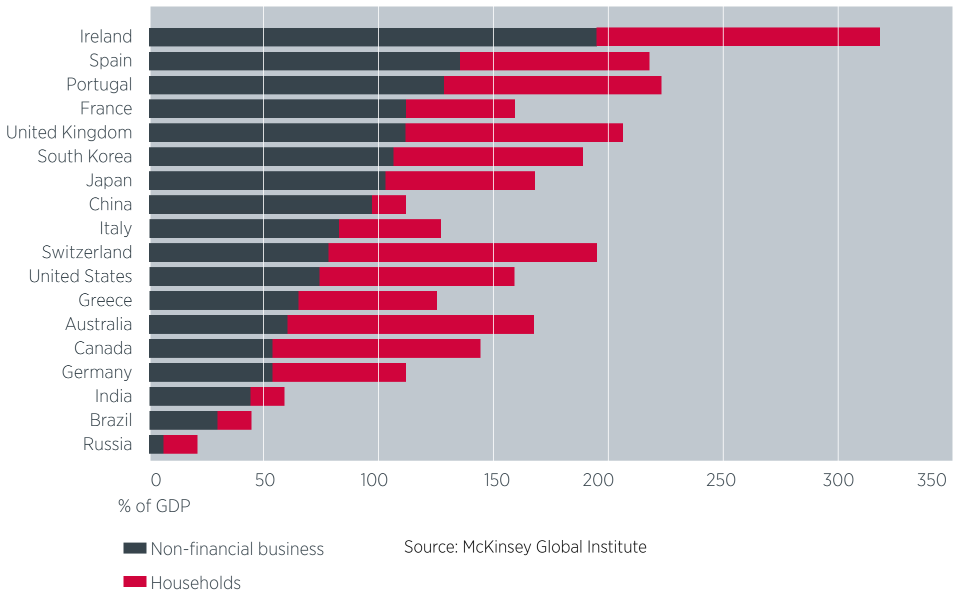
Ironically, while most media attention is focused on sovereign debt issues, the financial crisis since 2007 has not yet led to major sovereign debt defaults and restructurings, with the exception of Greece and a number of mostly small island states. However, the debt build-up that was evident over the past few years was so enormous that it is just a question of time until decision-makers acknowledge its unsustainability and launch the new cycle of defaults and restructurings. As the Inter-American Development Bank warned recently, sovereign debt defaults come in bunches.

Graph 5: Sovereign debt defaults 1820-2004



Source: Inter-American Development Bank

Graph 6: Private sector leverage potentially impacting sovereign debt levels



Source: McKinsey Global Institute

The amounts of money that sovereigns made available to bail out private banks are gigantic. As early as 2009, the IMF estimated that advanced economies had already provided headline support to the financial sector to the tune of 50 per cent of their GDP.[34] According to the European Commission, EU member states approved €4.5 trillion in state aid to the financial sector between October 2008 and October 2011, which is equivalent to 36.7 per cent of EU GDP.[35] Irish debt campaigners calculated that the financial sector bailouts in Ireland have reached more than €64 billion already, a third of the annual GDP. The money was partly taken from the National Pension Fund, essentially expropriating the workers' savings.[36] In Spain, just the recapitalisation and liquidity provided to failed banks accounted for more than €275 billion. An additional ECB credit line – mostly guaranteed by the Spanish government – of €357 billion, and other measures could bring the total costs to €1.4 trillion.[37]

In many countries, the worst is yet to come as there are huge amounts of 'hidden debts' or contingent liabilities in the private sector – especially in the financial sector – which may ultimately end up on governments' balance sheets and boost sovereign debt levels.[38] According to the McKinsey data used for Graph 6, contingent liabilities still account for more than 300 per cent in Spain, and more than 200 per cent in Ireland and Portugal.

Independent analysis of the use of exceptional crisis loans, for instance in Greece, shows that the vast majority was used to bail out private creditors and recapitalise failed banks, rather than enabling the government to stimulate growth and fulfill its human rights obligations towards citizens.[39]

The attempt to bring sovereign debt levels down through austerity has proven ineffective. Drops in GDP of more than 25 per cent since the beginning of the crisis, such as those in Greece, make debt levels appear less and less sustainable. A vast share of European countries has become stuck in a low growth, high debt trap, from which austerity policies cannot provide a way out.[40] However, the collateral damage of austerity to the European population is tremendous. A recent study by Oxfam finds that current

> Sovereign debt levels in high-income countries are higher than they have ever been in times of peace.

austerity policies could increase the number of Europeans living in poverty by 15 to 25 million over the next few years, adding to the 120 million Europeans who were already living in poverty in 2011.[41]

The result of generous financial assistance to private debtors combined with failed austerity policies is that sovereign debt levels in the global north are extremely high. According to IMF figures, the sovereign debt as a percentage of GDP has crossed the magical 100 per cent threshold already (see Graph 7). The World Bank's debt management experts concluded: "The magnitude of public liabilities incurred and the uncertainty surrounding the exit from unprecedented discretionary fiscal stimulus programs have become sources of concern about a future crisis".[42]

EU government debt reached 85.9 per cent of GDP in early 2013. The Eurozone is performing worse than average, with government debt levels of 92.2 per cent of GDP.[43] Of the four countries with the highest government debt to GDP ratio, four already receive exceptional crisis funding from the Troika. This situation already ties up the major share of IMF resources. The loans given by the IMF to European countries, in particular Greece, broke all records for IMF loan to IMF quota share – a special treatment that would never be offered to developing countries.

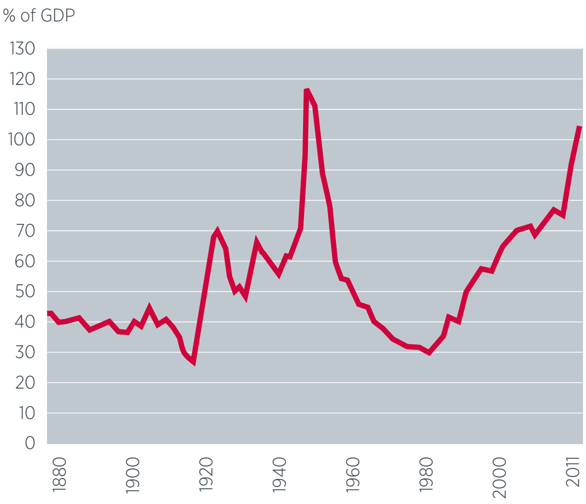
Nevertheless, the bailouts in Cyprus, Greece, Ireland and Portugal are simply made possible by the fact that these are relatively small economies. The existing bailout instruments of the EU or the IMF could not cope with a debt crisis in one of the major European economies, which leaves few alternatives to debt defaults and debt restructurings with private sector involvement if debt becomes unsustainable.

With some exceptions, sovereign debt levels in MICs and LICs appear low when compared to Europe. Many LICs have benefitted from debt relief through the HIPC/Multilateral Debt Relief Initiative (MDRI), taking both sovereign and external debt to lower levels. IMF analysis is that the number of countries at risk of debt distress fell over the past few years.[44] Remaining countries in debt distress are mainly small island states such as Jamaica or Grenada, which were not eligible for HIPC/MDRI debt relief for different reasons. This situation might quickly change, however. The HIPC initiative is about to expire. Currently no successor is foreseen, which puts a big question mark over how debt workouts are supposed to work in future when they are needed.

They might be needed soon. The World Bank estimates that at least eight countries that have benefitted from HIPC debt relief currently have unsustainable borrowing strategies, and are filling up the new borrowing space provided by HIPC quickly.[45] Moreover, debt management experts from the World Bank and UN find that the new post-HIPC debt composition of LICs is significantly riskier than it used to be.

Graph 7: Historical debt levels in advanced economies

Historical debt levels in advanced economies



Source: IMF

Debt to GDP ratios for selected economies in 2011

Source: IMF

5 Sovereign debt is riskier than ever in other places

Just because there are lower sovereign debt levels in developing countries, this is no reason to rest on our laurels. The debt composition in developing countries has changed for the worse in terms of risk. The share of concessional long-term finance from public institutions in total debt is shrinking. Developing country governments, including in LICs, are increasingly turning to financial markets instead to satisfy their financing needs. Domestic debt is also surging, as is short-term debt. Average interest rates across the loan portfolio are higher, and the loans from private borrowers that are increasingly relied on often come with shorter maturities. Creditor fragmentation makes it increasingly difficult to survey and regulate debt, and to prevent debt crises through coordinated actions.

Public borrowing goes private

A rapidly increasing number of developing countries started to issue bonds on international capital markets.[46] As Graph 8 shows, 11 new sub-Saharan sovereigns have started to tap international bond markets for the first time since 2007. None of these bonds has matured yet, or needed to be repaid or refinanced. Large bond issues lead to maturity concentrations, a large pile of debt that may account for several per cent of the concerned countries' GDP needing to be refinanced at the same time.

It is uncertain whether investors would be willing to provide fresh money at that time. The financial crisis has proved that investors' appetite to invest in developing country bonds is very fragile. African bond yields are very volatile. The yield for the Ghanaian bond issued in 2007, for example, surged from less than 8 per cent in 2008 to more than 20 per cent in 2009, just to fall back to less than 5 per cent in 2012.[47]

Borrowing cost increases

Borrowing from private creditors – domestic or foreign – is generally more costly for the sovereign since it comes on market terms, while official creditors often provide concessional loans. The average interest rate on debt from private creditors to developing countries over the period of 2005–2011 has been around 5.5 per cent, compared to average interest rate on debt from official creditors at 2.8 per cent.

Table 1: Interest payments on debt from private and official creditors to developing countries

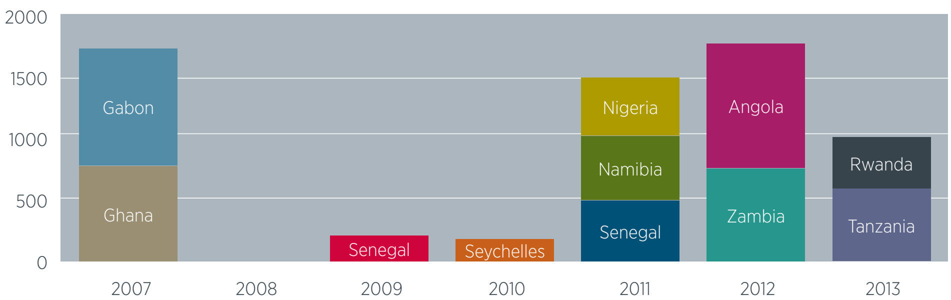
In million USD

Years	2000	2005	2006	2007	2008	2009	2010	2011
Interest payments	**94.082**	**83.319**	**92.578**	**108.004**	**116.760**	**107.741**	**110.441**	**127.435**
Public and publicly guaranteed	63.419	60.624	56.056	61.079	59.327	54.989	56.160	59.981
Official creditors	**25.959**	**23.885**	**19.685**	**20.195**	**19.002**	**16.949**	**16.572**	**17.120**
Multilateral	15.219	10.542	11.643	12.865	12.311	10.532	8.911	9.585
Bilateral	10.740	13.343	8.042	7.330	6.691	6.417	7.661	7.535
Private creditors	**37.460**	**36.739**	**36.370**	**40.884**	**40.325**	**38.040**	**39.588**	**42.861**
of which: Bonds	25.105	30.308	28.841	31.707	30.675	29.165	31.482	36.460
Commercial banks	8.677	4.880	5.988	6.393	6.467	5.874	4.153	4.418
Private non-guaranteed	30.663	22.695	36.523	46.925	57.433	52.752	54.280	67.453
of which: Bonds	7.776	7.994	12.488	13.461	11.346	11.788	14.099	19.524

Source: World Bank

Graph 8: Sub-Saharan sovereigns entering the international bond market

New bond emissions in mn. USD



Source: Standard & Poor's

“ Debt levels that can be considered sustainable fall when interest rates go up.

The trend towards borrowing from private creditors is thus a drain on public budgets and (if they are external loans) on the economy as a whole. Moreover, it is questionable whether borrowers can sustain debt service over the long term. Higher interest rates imply that borrowing countries need to generate and use much more income to pay off the similar large nominal debts. All other things being equal, debt levels that can be considered sustainable fall when interest rates go up. If they do, it implies high opportunity costs for all other public spending, including public services, general development and poverty reduction measures.

Short-term debt is volatile

In 2011, the last year for which comprehensive data is available, short-term debt inflows remained the most important component of financing from private creditors to developing countries, accounting for 44 per cent of net inflows. Short-term lending is volatile over time and differs between different regions and countries. In 2011, the net inflow of short-term financing fell 27 per cent to $189 billion while there was a strong return of medium-term financing, which rose to $122 billion, up from $48 billion in 2010.

Short-term debt flows are primarily trade related and were highly concentrated with about 75 per cent of short-term debt inflows in East Asia and Pacific ($145 billion) of which 90 per cent went to China. Latin America and the Caribbean recorded a net outflow of $3 billion, mainly due to a turnaround in flows to Brazil. Here the short-term financing was replaced with long-term lending by commercial banks.[48]

Overall, there is no clear trend, but individual countries show worrying surges. In Bangladesh, short-term debt as a share of external debt increased from 2.9 per cent to 7.3 per cent in just one year, between the end of 2011 and the end of 2012.[49]

Short-term loans often take the shape of ‘bridge funding’ for developing countries. They are taken out to cover the financing needs of unforeseen events and shocks, such as natural disasters or oil price hikes. In some cases, developing countries advance funding for projects and activities that donors and IFIs do not want to fund, or that require cumbersome and time-consuming approval. In Bangladesh, this includes the construction of a nuclear power plant, for instance.

The trend towards short-term financing is linked to the private lending boom. Loans from private creditors (even if classified as ‘long-term’ by the World Bank) come with shorter maturities than official loans. Table 2 demonstrates that the average maturity over the period 2005–2011 has been 15 years for private loans, compared to 23 years for official loans.

The short maturity rates of developing country borrowing from private lenders imply high rollover risks. Relatively short phases of ‘credit crunch’ can lead to defaults, because it is uncertain whether investors will always be willing to make fresh money for new loans available when the old loans expire. This problem is aggravated by the fact that the volume of individual bond issues is enormous. It can account for several per cent of GDP (4 per cent in Rwanda). It is unforeseeable whether capital markets will provide sufficient fresh money to rollover when such bonds mature and payment is due.[50]

Domestic debt is on the rise

Domestic capital markets in developing countries are now more highly developed, and they are deeper. The possibility for governments to raise private capital on domestic capital markets is increasingly complementing external donor and development bank funding. Domestic debt is on the rise. However it still receives little attention from international surveillance agencies, although it contributed to two of the largest sovereign defaults in recent times – those of Russia in 1998, and Argentina in 2002.[51]

Reliable domestic debt data is difficult to obtain for many developing countries. IMF staff estimates are that domestic debt has reached about 30 per cent of total government debt in 2010. Thus the share doubled over the past decade.[52] A thorough case study conducted by the African Forum and Network on Debt and Development (AFRODAD) on Tanzania outlines the trends seen in many other countries. Domestic debt reached 35 per cent of total government debt in 2012, up from less than 10 per cent in

Table 2: Average terms of new commitments (2000 and 2005-2011)

	2000	2005	.2006	2007	2008	2009	2010	2011
Official creditors								
Interest (%)	4.8	3.5	3.9	3.6	2.8	1.9	1.9	2.1
Maturity (years)	20.2	22.1	23.1	23.3	23.5	21.2	23.3	23.1
Grace period (years)	5.1	5.6	6.3	6.5	6.6	6.3	6.9	5.5
Private creditors								
Interest (%)	8.1	5.9	6	5.9	5.6	5.5	4.4	5
Maturity (years)	11.4	13.6	12.9	13.9	13.4	14.4	16.9	19
Grace period (years)	8.5	8.1	9.2	8.2	7.4	7.1	8.1	9.3

Source: World Bank

> Larger numbers of creditors simply makes finding consensual solutions more difficult.

2003. Domestic debt therefore contributed disproportionately to Tanzania's massive surge in the debt stock, since the country received debt relief under the HIPC/MDRI initiative. Tanzania's debt stock increased by 470 per cent from September 2002 to 2012. Over the same period, interest payments on domestic debt surged from less than 2 per cent to 10 per cent of government revenue, far exceeding the payments on external debt, which is mostly on concessional terms. However, these doubled over the last two years too, to reach almost 4 per cent of revenue in 2012.[53]

The trend towards domestic borrowing has a lot of advantages. It eliminates the exchange rate risks that are associated with taking out foreign currency loans. It also improves sovereignty, as foreign creditors – in particular the IFIs – tend to attach harmful policy conditionality to their loans. Last but not least, it boosts ownership, given that foreign official creditors often earmark loans for specific projects or sectors – while domestic loans are essentially general budget support for the government that borrows.

But AFRODAD points to the fact that surveillance of domestic debt is much patchier and weaker than for external debt. There are no established internationally agreed thresholds for domestic debt sustainability, which makes it difficult for debt managers to assess what volume of domestic borrowing can be considered sustainable and responsible. Moreover, the lion's share of domestic debt is held by local banks. This means sovereign defaults would send shockwaves through the financial system and the domestic economy.[54]

The risks of domestic borrowing increases further when inflation-linked or foreign currency-linked financial products are used. This means that, especially in bad times when exchange rates fall and inflation surges, the costs of debt service go up, making a default ever more likely.[55]

Creditor fragmentation: more players enter the field

The number of creditors to developing country governments has increased compared to earlier periods. This is a trend that was mainly triggered by the private borrowing and lending boom, but also by the increasing relevance of new official creditors such as China or Brazil on the international stage. This diversity has advantages too, as more players imply less dependence on each individual borrower, more 'liquidity' in capital supply, and less power of individual creditors to impose harmful conditionalities on the debtor. However, it leads to massive surveillance problems, and in particular to coordination and collective action problems when debt restructuring is attempted.[56]

It is predictable that future debt restructurings will face massive problems of 'holdouts' by private creditors that refuse to stick to collective agreements. Experiences made throughout the HIPC initiative is that participation of private creditors is very difficult to secure. Cumbersome negotiations with dispersed private creditors can delay a debt restructuring process for years. It may shift its launch to a moment that is 'too late' to prevent a major crisis, and to a debt relief outcome that is 'too little' to be sustainable. In practice, the debt relief under HIPC could often only be completed when public money was used to bail out the private creditors. The World Bank has set up the International Development Association (IDA) Commercial Debt Reduction Facility for this purpose.[57]

The experiences of developing countries in terms of attempts to restructure private debt are shocking. It takes on average a decade to conclude defaults on debt to private creditors. Creditors lose 40 per cent of their claims and – most worryingly – debtors end up more highly indebted than when they entered default. In LICs, the process was even more time-consuming than average. Creditor committees or bank collusion might help against free-riding, argues a World Bank study. However, in general, there is a "classic free-rider problem" due to the "public good nature of debt relief".[58] Larger numbers of creditors simply make finding consensual solutions more difficult.

The surge of official creditors that are not members of the mainly Organisation for Economic Co-operation and Development (OECD) countries' Paris Club has some challenges too. As the team from the HIPC Capacity Building Programme argued, "there is no formal multi-creditor mechanism for restructuring debts owed to non-Paris Club bilateral creditors, unless they decide to participate in Paris Club meetings, [and] no forum for sharing information about the terms non-Club creditors have given to debtor."[59]

6 The time bomb of contingent liabilities could detonate at any time

The grey zone between private debt and public debt are contingent liabilities: private debt that comes with an explicit or implicit government guarantee. A government's contingent liabilities can account for several times the volume of their actual public debt, or even several times the whole nation's GDP (see Graph 9). Many sovereigns in Europe have been affected by contingent liabilities that fell due – in particular those from failed banks that were bailed out. More nations will face debt crises if such contingent liabilities are not adequately controlled, or floodgates raised to shield the public sector and ultimately citizens and taxpayers from them.

Contingent liabilities take many forms (see Box 1). Current or expected guarantees to the banking system are perhaps the most prominent and dangerous contingent liability. Sovereign debt levels in crisis-struck countries primarily exploded due to bank bailouts, and state aid to the banking system. An increasingly costly and dangerous form is public-private partnerships.

What actually represents a contingent liability is not clearly defined in practice, which makes surveillance and precaution very difficult. There is a strong political dimension. In most cases, governments are not legally obliged to take over private debt on their balance sheets when private debtors go bankrupt. The very different approaches to dealing with failed banks taken in Ireland, where the government essentially funded a full bailout, and Iceland, where the government refused to fully bail out banks and let their (foreign) depositors and creditors foot the bill, prove that there is a large menu of options available.

Bank debt and bailouts

The sovereign debt vulnerabilities caused by the reckless lending and borrowing of banks – facilitated by loopholes in their regulation – are receiving increasing attention from policy-makers. The Euro Area Summit stated in June 2012: "We affirm that it is imperative to break the vicious cycle between banks and sovereigns".[61] For good reason: the fiscal costs of recent banking crises in Cyprus, Greece or Ireland are estimated to exceed 60 per cent of GDP (see Graph 9). These can be direct costs through the recapitalisation of banks and public guarantees, or indirect costs through lost tax revenue and the harmful economic impact of crises.[62]

Fiscal costs could be much lower if governments refrained from bailing out failed banks. However, in the past, this has rarely happened. Case studies conducted by Jubilee South indicate that developing country governments "under the guidance of the IMF" were pressured to fund bank bailouts in full. Thailand, for instance, set up the Financial Institutions Development Fund during the late 1990s financial crisis. The fund covered the losses of failed banks and finance institutions, and was the key reason for surging sovereign debt levels.[63] The Eurocrisis has raised new awareness about the need to improve control over the contingent liabilities coming from the financial sector.

Not much has happened since, however. The G20 process did not lead to any global-level agreement on banking resolution that would protect citizens and taxpayers from the costs of failed banks. The Council of the European Union tabled the 'Proposal for a directive establishing a framework for the recovery and resolution of credit institutions and investment firms' in early 2013. The proposal establishes a cascade model in which shareholders, bondholders and large depositors would be held to account for losses made by 'their' bank, rather than putting the burden on the taxpayer.[64] There are, however, numerous exceptions to the EU's new 'no bailout' approach. In any case, the new directive would not address the huge amounts of legacy debt that has already ended up on governments' balance sheets due to previous bailouts. The European Parliament has demanded strengthening the directive.[65]

Academics share the European Parliament's view. Ashoka Mody argues that "the task of resolving banking problems is far from finished. Banks throughout the euro area remain in varying degrees of distress and create significant contingent liabilities for their governments ... In the grip of this dynamic, the most vulnerable countries create a drag on other European economies. And with Europe slowing down, the drag extends to the world economy – Europe's internal problems are no longer its own."[66]

Hidden fiscal deficits: Selected contingent liabilities

Public bank financing

Public-private partnership arrangements

Public pension schemes

State-owned enterprise's borrowing

Debt arising from privatisation programmes

Lawsuits (e.g. vulture funds)

Subnational borrowing

Tariff guarantees

Insurance schemes

Opportunistic politicians

Ecological issues.

Source: Based on a compilation by Baba Y. Musa (WAIFEM).[60]

Public-private partnerships

Public-private partnerships (PPPs) continue to surge as the state withdraws from public service provision. They are increasingly used in all world regions, particularly in infrastructure financing. In LICs and MICs, the amount lent or used to buy equity in infrastructure through private participation has increased from $9 billion in 1991 to $162 billion in 2010. South Asia and sub-Saharan Africa have the highest percentage private participation among the developing regions, while in East Asia and Pacific region public provision is still better secured.[67]

Northern donors and the IFIs exercise enormous political pressure on poor countries to use PPPs, which might explain why in particular the world's poorest and most donor-dependent regions are now vulnerable to the risks and costs that PPPs incur. The Counter Balance the EIB network reports that the European Investment Bank

> “It is imperative to break the vicious cycle between banks and sovereigns.
>
> Euro Area Summit, June 2012

(EIB) has “been a relentless promoter of ‘structural reform’ via PPPs”.[68] The EIB itself states that, after the Arab Spring, it “launched an ambitious programme of technical assistance to encourage the use of public-private partnership contracts in the Mediterranean”.[69] The United Kingdom’s Department for International Development (DFID) funded and thus enabled pro-PPP campaigns by business-friendly lobby groups in developing countries.[70]

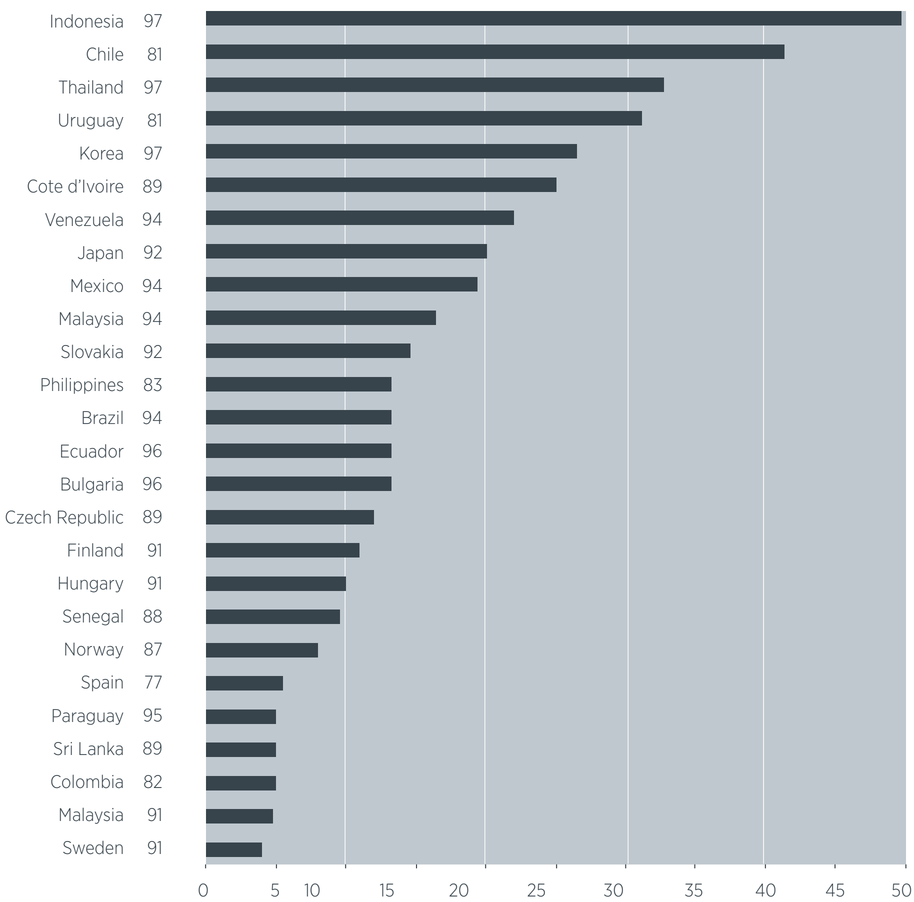
There is no overall economic rationale for preferring PPPs over traditional public service delivery. The EIB itself calculated that PPP-funded road schemes are 24 per cent more expensive than publicly procured projects.[71] A comparative analysis of different financing options for infrastructure conducted by Development Finance International (DFI) found PPPs to be the most expensive of all.[72]

The development charity CAFOD argues that the contract terms of PPPs can create debt bondages of governments to private firms. Looking at the Bujagali dam project in Uganda, the World Bank’s inspection panel assessed “that the greatest share of economic risks lies with the power purchaser… [whilst] the lenders especially but also the investors are held harmless against all or most eventualities”.[73]

Unbalanced risk sharing is the key characteristic across PPP projects. The potential costs to the public purse include lost budget revenue for decades to come, beyond the direct debt service that PPPs imply.[74]

The crisis potential of PPPs is high, which Europe has already witnessed. The Eurozone countries that experienced the highest surge in sovereign debt over the past few years are also those that had the largest PPP projects. An analysis of the EIB finds that the five countries where PPPs had the largest macroeconomic significance are Greece, Portugal, the UK, Spain and Ireland.[75]

Graph 9: Fiscal costs of banking crises



Source: World Bank

Four of these countries are now receiving major bailout loans by the IMF and/or EU institutions as their public balance sheets went totally out of control.

Portugal was one of the major abusers of excessively expensive PPPs until – perhaps to everyone’s surprise – the IMF came to the taxpayers’ rescue. The December 2011 Memorandum of Economic and Financial Policies between Portugal and the IMF forces Portugal to review its PPP contracts. Portugal, “Committed not to enter in new PPP contracts depending on the results of the study and, looking ahead, we will revise our current PPP framework in order to ensure a fiscally prudent model. We will ensure that the same commitments apply for regional PPPs, and that local governments do not enter into any PPP contracts.”[76] The IMF’s debt experts are aware that PPPs are debt sustainability’s worst enemy.

7 Tax evasion and avoidance, and aid cuts, are undermining public income

Given that both a government's future borrowing needs and its capability to sustain and repay past 'legacy debt' depends on its income or cash flow, attention needs to be paid to the income side too. It is worrying that public income is still undermined by excessive tax evasion, tax avoidance and capital flight. Moreover, low-income countries still rely to a large extent on foreign aid flows to fund public expenses, as well as suffering from recent aid cuts and persistent failures by donors to improve the quality of aid.

If governments are unable to raise sufficient income to fund the desired level of expenses, debt crises are unavoidable in the long-run. The alternative to persistent fiscal deficits is to effectively fight tax evasion and avoidance, and for rich countries to honour their commitment to deliver 0.7 per cent of their GDP in official development assistance to developing countries. Country case studies such as those of AFRODAD on Tanzania prove that borrowing is often simply governments' 'last resort' when other sources of income are not available. Lending picked up massively from 2009 when foreign sources of financing dried up.[77]

Tax evasion and capital flight: Much talk, little action

Tax evasion and capital flight are high on the agenda of all international policy-making processes, whether the G20, UN, EU or the IFIs. Unfortunately, besides rhetoric, not much has come of this so far. With tax evasion and capital flight continuing at the current scale, there is little chance for heavily indebted countries to sustain current levels of legacy debt, and for better-off countries to avoid high debt levels in future. The sums of illicit financial flows are gigantic. According to research by the Global Financial Integrity Initiative, the developing countries lost $859 billion in illicit capital outflows in 2010, stemming from crime, corruption, and primarily from tax evasion. From 2001 to 2010, developing countries lost almost $6 trillion to illicit outflows, a multiple of what they received in official development assistance over that period.[78]

According to Eurostat, the average tax rate in the EU was 38.8 per cent of GDP in 2011, with labour contributing the major share.[79] With the exception of Hungary, all EU member states that did not manage to weather the financial crisis without bailout funding from IMF and/or the EU score in the lower half of the EU's tax-to-GDP statistics, proving a close correlation of tax income and sovereign debt sustainability.

While on an upward trend since 2003, low-income countries mobilise just 15 per cent of tax income in gross national income (GNI), less than half of high-income countries' average rate.[80] The IMF states that developing countries' ability to raise taxes is constrained by their development status. Countries with a higher share of agriculture in GDP usually raise a lower level of taxes because the sector is per se hard to tax, or benefits from exemptions.[81]

Thus, developing countries often depend on other sorts of government revenue, such as import tariffs and royalties on natural resources. Here, the IMF is part of the problem as IMF advice and conditionality often lead to tariff cuts where no alternatives for raising public income were available. UNCTAD identified a "considerable decline in revenues from direct taxation as a share of GDP" due to neoliberal structural adjustment programmes since the 1980s and concludes that "fiscal reforms in developing countries in the 1980s, together with the loss of tariff revenues resulting from trade liberalization also led to a reduction of public revenue."[82] The borrowing needs and aid dependency of poor countries increased accordingly.

The Tax Justice Network (TJN) surveyed tax evasion and capital flight from 139 low- and middle-income countries and found that, since the 1970s, private elites had accumulated between $7.3 trillion to $9.3 trillion of unrecorded wealth hidden in offshore centres by 2010. This compares to the country groups' gross external debt of $4.08 trillion in 2010. TJN argues that "the problem here is that the assets of these countries are held by a small number of wealthy individuals while the debts are shouldered by the ordinary people of these countries through their governments". TJN concludes that the dramatic increase in unrecorded offshore assets and the build-up of developing country debt since the 1970s are intrinsically linked and positively correlated. The situation is now being repeated in the developed world. TJN concludes that "in terms of tackling poverty, it is hard to imagine a more pressing global issue to address."[83]

Official development assistance falls

UNCTAD also finds that developing countries' fiscal space is influenced by the amounts of official development assistance (ODA) they receive. Historically, cuts in public services began, and debt started to mushroom when ODA first stagnated in the 1980s, followed by a dramatic fall in the 1990s.[84] Both poverty and debt levels fell in the 2000s when ODA went up.

However, the times of scaling up ODA are over. Development assistance by member states of the OECD's Development Assistance Committee have also been affected by the crisis. As rich countries chose to use their resources for bank bailouts, the poor were short changed. ODA fell by 4 per cent in 2012, following a fall of 2 per cent in 2011. The EU's drop was disproportionately high, at minus 7.4 per cent. Crisis-affected EU countries such as Spain (-49.7%), Italy (-34.7%) and Greece (-17.0%) have seen the most severe cuts in 2012, and have basically ceased to be bilateral donors. Most of their remaining ODA is made up of compulsory contributions to the EU's financial instruments and to international organisations.[85]

According to political declarations, innovative finances such as financial transactions or carbon taxes should supplement ODA from rich countries' core budgets. However, in practice the introduction of such innovations is taking longer than desired due to political blockades, and the share that goes to developing countries is expected to be meagre in any case.[86]

Consequently, the OECD's Development Assistance Committee (DAC) donors provided just 0.29 per cent of their GNI as ODA, less than half of the 0.7 per cent target that is committed for more than 40 years under the UN and that would be, according to calculations by the UN's Millennium Project, necessary to reach the Millennium Development Goals. That said, developing countries have little choice

> Debt is back in development finance. That given, it is just a question of time until the next debt crisis strikes the world's poorest countries.

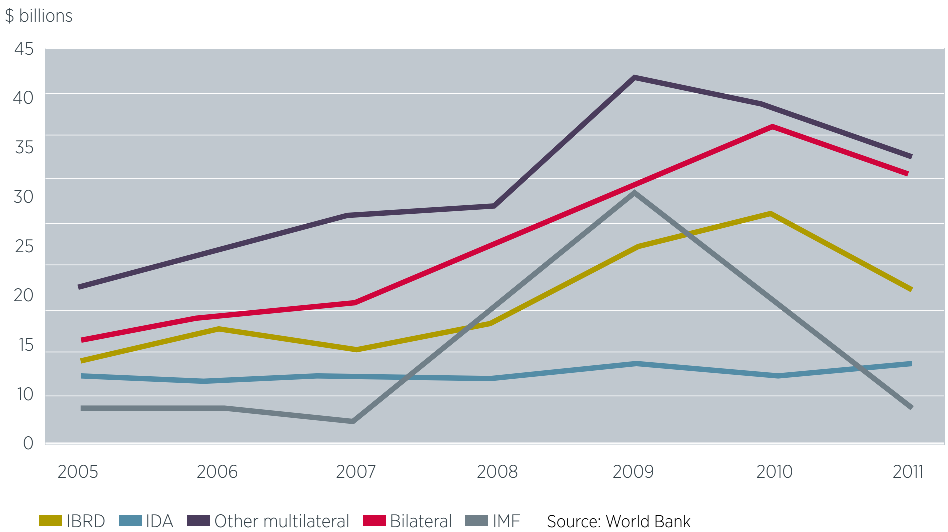
besides borrowing to implement ambitious development plans and urgent poverty alleviation measures. This applies in particular to LICs where ODA still accounts for more than 10 per cent of GDP, and a large share of government spending.

A worrying trend on top of the aid cuts is donors' desire to provide more ODA in form of concessional loans rather than grants. France for instance, increased the share of loans in total bilateral ODA from 14 per cent in 2005 to 40 per cent in 2012, and plans to continue this trend.[87] The whole European Union is increasingly using 'blended' financing instruments. The shrinking ODA grants that Europe is still willing to provide to poor countries are mixed with loans, and thus become debt-creating finance for the recipient countries.[88]

On a global level, the picture is not much better. UN agencies have warned that "low-income countries have limited ability to sustain debt but need external resources ... the ideal solution would be to increase aid flows to these countries."[89] The World Bank however – scared of losing influence and relevance as donors seem unwilling to fully replenish the International Development Assistance facility – proposed cutting grant aid to poor countries and providing more loans instead.[90] This new announcement comes on top of the reckless lending boom of the World Bank and other multilateral development banks that was triggered by the huge capital increases they got by order of the G20 in 2009 (see Graph 10).[91]

Debt is back in development finance. That given, it is just a question of time until the next debt crisis strikes the world's poorest countries.

Graph 10: The MDB lending boom:
Gross inflows from bilateral and multilateral creditors to developing countries



8 Debt limits are subject to political manipulation

Debt limits such as those set by the IMF should ensure that sovereign debt levels in developing countries stay within sustainable boundaries. Heavily indebted countries should only receive grants from donors and IFIs. In practice, however, debt limits are often violated as governments and IFIs chose the short-sighted approach that excessive borrowing and lending is the politically easier approach compared to grant transfers. Debt limit policies and thus long-term financial stability are frequently sacrificed.

This is true also of the institutions that set them. When the financial crisis started, donors' willingness to provide financial assistance to developing countries in the form of grants diminished even further. The G20's approach to 'assisting' poorer countries to weather the crises and make further (albeit unsustainable) progress towards reaching developing goals was based on new lending. The IMF and the multilateral development banks received enormous capital increases that enabled them to scale-up lending massively.[92]

Inappropriately, the IFI's own debt sustainability analysis (DSA) constrained new lending to many countries. The DSA should be a risk-mitigating assessment tool. Under order of the G20 and driven by the desire to 'get the money out', the IFIs simply reformed the debt sustainability analysis in 2009. The new methodology permitted counting migrant remittances towards a countries' debt service capacity and excluding the debts of state-owned enterprises, which are contingent liabilities. The prudent approach was replaced by a more 'flexible' approach. Essentially, the debt limits of poor countries had been lifted, new lending was made possible. Eurodad judged back in 2009, "it seems the 'cautious' approach has been squarely relegated to the bin".[93]

The 2009 DSA reform enabled the IFIs and other creditor institutions to provide new concessional loans to countries that had previously been only eligible for grant assistance. Not surprisingly, a recent background paper for the upcoming reform of the IMF debt limits policy finds: "In countries that reached the completion point under the HIPC Initiative several years ago, concessional borrowing has been the main driver of recent debt accumulation"[94] (The borrower perspective is an irony, it was creditor-driven concessional lending, by the IMF itself and in particular by the World Bank, its sister organisation next door).

In the words of the World Bank and IMF, the purpose of the DSA is to "help detect potential crises early so that preventive action can be taken [and to] provide guidance for creditors' lending and grant allocation decisions to ensure that resources are provided to LICs on terms that are consistent with both progress toward their development goals and long-term debt sustainability."[95] But obviously these purposes are secondary when the self interest of creditor countries and institutions is concerned.

Moreover, although it is now evident that the debt vulnerabilities from public and external debt has lost relevance, the DSA continues to exclude private debt and domestic debt.[96] There are no internationally agreed benchmarks for domestic debt. The consequences are, as AFRODAD put it, that "no clear guidelines exist on what poor countries should do with their domestic debt markets".[97]

Independent groups such as the advisory group Development Finance International (DFI) have calculated heavily indebted poor countries' historically unsustainable debt levels for both domestic and external debt. The total debt sustainability threshold for domestic debt service is 28 per cent of domestically generated budget revenue. For external debt service it is just 12 per cent.[98] These thresholds are substantially lower than those set by the IMF and World Bank (see Table 3), which indicates that debt defaults and crises occur at debt levels considered sustainable by the IFIs – and at which the IFI's debt limits policies still permit new lending and borrowing.

The IFIs' actions are inconsistent. This is a consequence of their multiple roles that incur conflicts of interest. In their function as surveillance agencies, World Bank and IMF conduct regular debt sustainability analyses and impose debt limits on developing countries, with the aim of keeping volume and the risk of borrowing manageable. In their function as banks, the multilateral development banks have scaled up lending during the crisis and are under continuous pressure 'to get the money out'. Last but not least, in their role as creditors, the IFIs expect debtor nations to fully service their debt even in cases when their own DSA finds that debt levels are unsustainable – and consequently full debt service would deplete the debtor country's capital stock and would be anti-developmental in effect.

Such obvious conflicts of interest indicate that it would be better if lending and surveillance were separated, and the latter be done by an independent institution. The debt thresholds calculated by DFI indicate that debt restructurings should be initiated at an earlier time. The too generous debt limits indicate why their debt restructurings usually come 'too little-too late'.

Table 3: Debt burden thresholds under the Debt Sustainability Framework

Type of Policy	PV of debt in percent of			Debt service in percent of	
	Exports	GDP	Revenue	Exports	Revenue
Weak Policy	100	30	200	15	18
Medium Policy	150	40	250	20	20
Strong Policy	200	50	300	25	22

Source: IMF

9 Responsible financing standards are rarely followed

It is increasingly acknowledged that, for loans to make an effective and sustainable contribution to public finances, both debtor and creditor need to act prudently and responsibly. If all borrowers and lenders complied with responsible finance standards, debt crises should not happen. Responsible financing is an evolving concept in international public and development finance. International organisations, as well as the private sector and civil society organisations, have developed new sets of standards over the past years. Prominent examples include the UNCTAD Standards for Promoting Responsible Lending and Borrowing, the Institute of International Finance's Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets,[99] the Eurodad Responsible Finance Charter[100] and the AFRODAD Borrowing Charter.[101] Unfortunately, in practice, responsible finance standards are rarely followed. And since no set of standards is legally binding yet, there is no chance of enforcing compliance or sanctioning their violation.

The EU analysis in its 2013 Accountability Report on Financing for Development states that the "lack of globally agreed rules and regulations guiding sovereign financing have contributed to irresponsible sovereign borrowing and lending to sovereign countries."[102] It acknowledges that the new UNCTAD principles did some gap filling in this area. The communication of the European Commission on the same subject "underlines the need for all actors to apply responsible lending and borrowing principles to ensure debt sustainability."[103] When it comes to implementation in the EU, there is not much to write home about, however. The EU Accountability Report's traffic light assessment ironically gives the EU a 'green light' for the box that includes promoting responsible lending practices.[104] But this judgement is simply based on an IMF report that found "broad compliance" of EU lending with the IFI's Debt Sustainability Framework, which implies that EU donors/creditors largely stick to the DSF's debt threshold and adjust the concessionality level of their financial assistance accordingly.

Modern responsible financing standards such as the Eurodad Charter and the UNCTAD Principles go much further, however, beyond the simple criteria for debt level thresholds. The UNCTAD principles, for instance, contain standards for due authorisation, data disclosure and the readiness to engage in good-faith debt restructurings when needed. Under the headline "avoid incidences of overborrowing", the UNCTAD principles are that sovereign borrowers "should seek a sovereign loan if it would permit additional public or private investment, with a prospective social return at least equal to the likely interest rate". However, the purposes for which governments seek loans include those for which no social or economic returns whatsoever are to be expected.

A particularly striking example is arms purchases, which are often financed through export credits.[105] A recent example is the export of UK-made military hovercrafts to heavily indebted Pakistan that was financed by the UK Export Finance agency.[106] In the same month, the IMF had to approve a $6.6 billion Extended Fund Facility loan to Pakistan to boost Pakistan's liquidity and avoid defaults, stating that "Pakistan faces slow growth, declining reserves, increasing fiscal deficit."[107] That is obviously no surprise when looking at the government's spending priorities, and European creditors' lending priorities.

The EU's leading crisis state of Greece had military spending that was double the EU average in the years that led up to the crisis. Costs included large purchases of military equipment from other EU member states, in particular Germany and France. The high and unproductive military spending contributed to the debt build-up, and ultimately to the debt crises. When the Troika of EU, ECB and IMF finally approved a €110 billion bailout loan in May 2010, it came with political pressure that, in return for the loan, previously cancelled orders for warships, submarines and tanks worth €3 billion were honoured.[108]

Thus, the green light that the European Commission gave for member states' efforts to promote responsible lending practices seems a little optimistic. The EU and other governments still have a long way to go when it comes to responsible lending and borrowing, and their commitment to moving forward seems limited. By September 2013, only 12 nations had endorsed the UNCTAD principles, including only three European nations (Germany, Italy and Norway).[109] Of these three, only Norway showed visible signs of implementation and a willingness to comply. In August 2013, Norway released a debt audit report that assessed a share of its outstanding loans to developing countries against the UNCTAD Principles.[110] However, even Norway has not yet cancelled the loans that were found non-compliant.

No responsible financing standards are currently legally binding and enforceable. Non-binding standards incentivise irresponsible lending because the burden – in the case of defaults – is usually shared among all creditors. So there is an incentive for creditors to engage in risky and often dodgy high-yield activities that offer more

“ If all borrowers and lenders complied with responsible finance standards, debt crises should not happen.

> Establishing the rule that illegitimate loan contracts will be systematically annulled would deter lenders and borrowers from engaging in irresponsible financing activities in the first place.

profits than responsible lending options – while the potential loss is the same for responsible and irresponsible lenders alike.

The agency principle in public finance, another pillar of the UNCTAD principles, implies that government officials involved in sovereign lending and borrowing transactions are acting as agents of citizens. Lenders have a co-responsibility to determine whether financing has been appropriately authorised. When looking at EU lending in the run-up to the Arab Spring, however, the list of borrowers reads like the 'who's who' of the Arab world's authoritarian regimes. Lending helped authoritarian regimes to stay in power, including by financing the oppression of their own population. A report by the UK parliament's arms export controls committee reads diplomatically: "Both the present government and its predecessor misjudged the risk that arms approved for export to certain authoritarian countries in north Africa and the Middle East might be used for internal repression".[111]

The multilateral development banks (MDB's) know that debt sustainability is not just an economic concept as their debt sustainability framework suggests. It is as much a political and ethical concept. The willingness to pay matters as much as the ability to pay.[112] Countries such as Ecuador have started to default on their debt because a thorough debt audit found that the claims were illegitimate. Ecuador is a landmark case because the ability to pay was given but played no role in the government's decision to default.[113] This is a practice that could soon spread to the Arab world. Why would citizens of young democracies want to see their taxes used to pay off loans that former dictators took out to oppress them?

Illegitimate debt must therefore be cancelled immediately and without condition. Not just for ethical reasons, or because it is financially unsustainable, but primarily because only establishing the rule that illegitimate loan contracts will be systematically annulled would deter lenders and borrowers from engaging in irresponsible financing activities in the first place.

10 Effective debt workout mechanisms do not exist

Debt crises could be prevented or at least mitigated if a build up of unsustainable debt was addressed as soon as it became evident. In practice this rarely happens. Both debtors and creditors suffer from a procrastination problem. For a number of reasons – including creditors' unwillingness to take a 'haircut' and debtors' fear of taking the political responsibility for debt restructuring – the solution is often delayed. When sovereign debt restructurings happen, the haircut – or relief – is often insufficient so that debt sustainability cannot be maintained in the medium- and long-term. Debt restructurings as we know them are 'too little-too late'. The lack of effective state insolvency or sovereign debt workout mechanisms is perhaps the central reason why debt crises happen in the first place and cause unnecessarily high damage once they erupt.

A recent investigation by IMF staff entitled *Sovereign Debt Restructuring – Recent Developments and Implications for the Fund's Legal and Policy Framework*, looked at the experiences of IMF-managed sovereign debt restructurings since 2005. Three countries – Jamaica, Grenada and Dominican Republic – needed new IMF emergency assistance programmes just a few years after their last restructuring.[114] Looking at Europe, the Greek debt restructuring of 2012 was the largest ever. Still, very few observers would think that – with a projected government debt-to-GDP ratio of more than 170 per cent of GDP for 2014 – the country is back on the path to debt sustainability. This ratio equals almost three times the debt limit that the EU set for its member states in Maastricht. It is obvious that it is just a question of time until the next cycle of debt default and debt restructuring is due.[115]

The Greek case also points to an additional problem of the current sovereign debt restructuring regime, the limitations to making private sector involvement happen. The Troika loans have facilitated the exit of private creditors. They have been used de facto to fund the capital flight of private creditors who left the country. Troika loans enabled the Greek government to pay off debt to private creditors and bondholders, using taxpayers' money to bail out private investors and speculators. But why would a private investor abstain from reckless and risky lending when he can expect that the international community essentially guarantees his investments, however dodgy they may be? Such wrong incentives and moral hazards encourage reckless lending. They make sure that debt crises occur in the first place, become even more severe when they happen, and are more costly and difficult to solve.

The Treaty of the European Union (TFEU) includes a 'no bailout policy', in articles 123 and 125. In the Euro crisis, and to the joy of reckless lenders, the TFEU has been handled quite flexibly. Analysts of the Euro crisis stress the urgent need for reform. Ashoka Mody, for instance, argues: "If the original intent of no official bailout is to be achieved, private creditors must be forced to significantly reduce their claims on the sovereign. An orderly mechanism of sovereign default (including on quasi-sovereign bank debt) needs to be in place. The status quo is untenable."[116]

For developing countries, the need is similarly urgent. The main debt workout procedure for LICs – the cumbersome and creditor-driven HIPC-Initiative that very few people will actually miss – is now expiring without successor. That given, no orderly mechanism at all to deal with the next crisis is in place. Processes to develop orderly debt workout mechanisms have already been initiated at the UN.[117] The actual implementation of their proposals should not be taken for granted, however.

The current regime to restructure sovereign debt might become even more dysfunctional in future. US courts have recently ruled in favour of two vulture funds that sued the government of Argentina for full payment of $1.3 billion of holdout debt.[118] After the large debt crisis of the early 2000s, which required a restructuring of the country's unsustainable debt, Argentina had offered a debt swap proposal to its creditors that 92 per cent of creditors accepted. The IMF finds that the "litigation against Argentina could have pervasive implications for future sovereign debt restructurings by increasing leverage of holdout creditors … the ongoing Argentina litigation has exacerbated the collective action problem". The US court decision would undermine future debt restructuring as it gives new leverage to holdout creditors suing for full payment. In consequence, "holdouts will multiply and creditors who are otherwise inclined to agree to a restructuring may be less likely to do so due to inter-creditor equity concerns".

The implication is that the current non-system, in which successful debt restructurings depend on voluntary participation of coalitions of willing creditors, would collapse because there would be such a strong incentive to 'free ride' that consensual agreements would become virtually impossible. Without fundamental reforms of the international financial architecture, the next debt crisis will cause even more harm than the last.

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Conclusion and recommendations

The debt crisis is far from over. Debt has not been cancelled, it has been shifted from one balance sheet to another, and the opportunity to reform national and international debt management mechanisms has largely been missed. Despite good news on growth in the Euro zone at the end of 2013 – and reports from the IMF that the number of poor countries in debt distress has fallen – unsustainable and illegitimate debt still poses a huge threat to our financial stability.

This paper has shown that different country groups are facing different debt vulnerabilities in the aftermath of the financial crisis:

The high-income countries (HICs) of the global north (or the advanced economies) that suffered from the private debt-induced financial crisis over the past few years have seen a shift of the debt vulnerabilities to the public sector. Private debt remains an issue, but it has been reduced in many countries. The financial sector has deleveraged – at tremendous costs to the public purse. The sovereign debt bubble that resulted from bank bailouts and recession has reached more than 100 per cent of their GDP. It is the largest the world has witnessed beyond the two world wars. It will be hard to sustain when interest rates return to normal, or just at the cost of massive redistribution of money from taxpayers to creditors. The growing number of European countries that are receiving bailout funding from the Troika and the USA's 'shutdown' of public spending when it was close to reaching its legal debt limit are just two indicators showing that this bubble has reached a critical size. Moreover, the policies that economic powers of the global north have introduced to overcome their financial crisis were essentially 'beggar-thy-neighbour' policies. Europe's recent economic gains come at the cost of other regions' pain.

Middle-income countries (MICs) were flooded with foreign capital when central banks in richer countries responded to the various crises with lax monetary policies. With investors expecting the USA's central bank to raise interest rates – forcing Europe to follow suit – several MICs (including the heavyweights Brazil, India and South Africa) started to struggle throughout 2013, as capital flows reversed and speculators' money flew back north. In the absence of effective capital controls, they were neither able to defend themselves from the speculative inflows in recent years, nor from the outflows they are facing now. Currency crises may follow, and since much of their debt – both sovereign and private – is denominated in foreign currency, it is becoming more costly and thus less sustainable when exchange rates fall. In any case, the times when MICs could easily borrow cheap money from abroad or roll over existing debt seem to be over.

In low-income countries (LICs), debt distress as measured by the IMF may have fallen in recent years. However, this was not due to improved economic conditions, but – as the IMF itself stresses – it was "thanks mainly to debt relief from the HIPC and Multilateral Debt Relief initiatives".[119] The HIPC initiative is about to expire now without a successor. No new country can qualify for debt relief. This is happening at a time when LICs are facing numerous new debt vulnerabilities. Their new debt composition is significantly riskier than it used to be.

LICs have diversified their financing sources over the past few years, with positive and negative consequences. While multilateral development banks such as the World Bank remain important creditors, their dependence on official finance provided by bilateral creditors and international financial institutions in the north has been greatly reduced, which is good news. External finance is now increasingly provided by new official creditors such as the BRICS countries (Brazil, Russia, India, China and South Africa). Many LICs have started to borrow from private sources, issuing bonds on financial markets as they are suffering from donors' reluctance to provide grants. Domestic borrowing is also becoming more prominent as local financial markets develop.

However, this comes with new vulnerabilities too. The new debt structure of LICs is generally more costly and risky. Average interest rates are higher and average maturities are shorter when compared with the concessional long-term finance that IFIs usually provide. LICs are also suffering most from recent aid cuts and still have little capacity to fight tax evasion, avoidance and capital flight. In the absence of sufficient tax income and foreign aid grants, borrowing is often the only option to fund poverty eradication and development projects. Debt levels in post-HIPC countries are increasing again as LICs make use of the new borrowing space.

> The international financial architecture is still not up to the task when it comes to preventing debt crises, or resolving them in the most efficient manner when they occur.

The international financial architecture is still not up to the task when it comes to preventing debt crises, or resolving them in the most efficient manner when they occur. UNCTAD summarised the desolate state of international financial system reforms as follows: "The G-20 process established in 2008 to enhance global macroeconomic and financial coordination has lost momentum ... It now seems that the moment of opportunity has passed – the advice to never let 'a serious crisis go to waste' has gone unheeded."[120] The EU has pursued some insufficient reforms since the crisis started. Given the implementation delays and their piecemeal character, the President of the European Parliament judged that "rather than breaking the vicious circle of bank debt and sovereign debt once and for all, the link has merely been weakened".[121]

If all lenders and borrowers acted responsibly, debt crises should not occur. Responsible financing standards should regulate the quality of borrowing so that loans are used productively and effectively, and generate a return that makes their repayment possible. However, this paper shows that, in practice, these standards are rarely followed – either by borrowers or lenders. Debt limits should regulate the quantity of borrowing so that it is kept within sustainable levels. However, we have found that such limits are simply shifted when it seems politically opportune, including by the institutions that set them.

Orderly sovereign debt workout mechanisms (or insolvency regimes) should resolve unsustainable debt. They should take debt down to sustainable levels once it becomes obvious that they are not sustainable. However, in practice, such mechanisms do not exist. The policy response to the financial crises has not cleaned the slates. Total debt levels are higher than ever. They have just been moved around from one country to another, or one balance sheet to another. And that is why the debt crisis is far from over.

The striking governance gaps are, in essence, all known to decision-makers. Six years into the crisis, Eurodad is calling on governments and international institutions to take the necessary steps to deal comprehensively with the debt crisis:

- **Resolve ongoing debt crises and reduce legacy debt:** Introduce an orderly insolvency regime for states. As stated in Eurodad's debt workout principles, a new debt resolution mechanism for sovereign debtors must: be independent from creditors; be transparent in decision-making; and take the developmental needs of indebted states and the human rights of its citizens into account when decisions are made.[122]
- **Prevent future crises caused by unsustainable and illegitimate debt**: Agree on a comprehensive and binding set of responsible financing standards and ensure compliance of all creditors and debtors, private and public. The Eurodad Responsible Finance Charter can provide valuable guidance and inspiration for decision-makers in this process.[123]

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Eurodad pushes for policies that support pro-poor and democratically-defined sustainable development strategies. We support the empowerment of Southern people to chart their own path towards development and ending poverty. We seek appropriate development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development.

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This report has been produced with the financial assistance of the European Union and Brot für die Welt – Evangelisches Werk für Diakonie und Entwicklung. The contents of this publication are the sole responsibility of Eurodad and can in no way be taken to reflect the views of the European Union.

Contact

Eurodad

Rue d'Edimbourg 18-26
1050 Brussels
Belgium

Tel: +32 (0) 2 894 4640
www.eurodad.org

www.facebook.com/Eurodad
twitter.com/eurodad

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debt and development