Final Statement on Addressing the debt and development crises in countries from the South in the year of the Jubilee

A group of academic experts in finance, practitioners, finance ministers, policymakers, authorities from international financial institutions, religious leaders, and experts from civil society organizations met at the Pontifical Academy of Social Sciences (PASS) in the Vatican City on June 5, 2024, to discuss the current *debt situation*, especially in the Southern Hemisphere. His Holiness Pope Francis addressed the participants of the meeting on the *debt crisis in the Global South*. Observing *that in the wake of mismanaged globalization, and in wake of the pandemic and wars, we find ourselves faced with a debt crisis that mainly affects the countries of the global South, causing misery and distress, and depriving millions of people of the possibility of a dignified future,* Pope Francis reminded the meeting that *ecological debt and external debt are two sides of the same coin that mortgages the future*, and called for the creation of *a multinational mechanism, based on the solidarity and harmony of peoples*.

After a brief welcome address by the Chancellor, the PASS President Helen Alford, PASS Academicians Professor Martin Guzman from Columbia University School of International and Public Affairs and Professor Joseph E. Stiglitz of the same University, moderated and chaired the proceedings of the workshop for the day.

A summary of the debt situation in the South

1. There is a debt and development crisis in many countries in the Southern Hemisphere. The

prevailing view that if a country does not default there is not a debt crisis is flawed: debt distressed countries are defaulting on economic development as they prioritize debt payments over critical public investments in education, health, the environment (including those necessary to mitigate and adapt to climate change) and infrastructure, jeopardizing the development and wellbeing of their people. Current debt and economic policies in many debt-distressed countries are serving financial interests rather than people.

2. The continent worst affected is Africa, although there are significantly different realities across African countries.

3. The numbers are striking. Data from UNCTAD shows that more than 54 countries spend more than 10% of their tax revenues on interest payments on their debt. The average interest burden as a share of tax revenues for developing nations increased by more than 50% percent with respect to 2015. 3.3 billion people live in countries that spend more on debt service than on health, and 2.1 billion people live in countries that spend more on debt service than on education. Against this backdrop, these countries are unable to make investments necessary for the green transition. This is not a path to equitable global human and social development.

4. The current situation is one more example of a well-known asymmetry in the global financial markets: capital flows are pro-cyclical for developing economies and countercyclical for advanced economies. This means that capital flows from advanced economies to developing economies in good global times, but the flows revert when there are negative global shocks.

5. Private capital flowed from the Western private sector to low and low-middle income countries (LLMICs) following the US government's bailout of the American banking system in the aftermath of the investment bank Lehman Brothers's collapse in 2008. In a context of zero interest rates in advanced economies, private capital managers searched for yields elsewhere, and provided financing at high interest rates with short-term maturities to less developed nations. Governments in developing countries were also eager to borrow. Those flows, however, did not facilitate greater pro-development investment; for that to have been the case, they would have needed to have been more stable, cheaper, and with longer maturities. For instance, investments in education eventually result in higher economic productivity but it takes longer than a decade or two for those results to be visible.

6. The Covid-19 pandemic and the war in Ukraine were two destabilizing shocks for indebted developing nations. The contractionary monetary policy, including high interest rates, implemented by advanced nations' central banks worsened the financing conditions for those countries.

7. Beginning in 2022, capital began flowing out of low and low-middle income countries. Since then, there has been a massive transfer from those countries to the private sector (greater than USD 50 billion in 2022), essentially financed to a large extent by International Financial Institutions

(IFIs), which increased their lending to those distressed countries. The mandate of those multilateral institutions is to finance development, anti-poverty policies, and macroeconomic stabilization policies; instead, the funds they provide are being used to bailout the creditors of those countries. This essentially means that the taxpayers of the world are bailing out private financiers. This is a highly regressive and anti-development policy.

8. While some believe that the existing institutional arrangements might be able to adequately address what the debt/development/environmental crisis, the prevailing view among experts is that more has to be done, and that at the minimum, the outflow out of low- and middle-income countries in distress had to be arrested. Not every participant of the conference shares this view.

A proposal

9. Arresting the outflow means that there should be no net transfers from debt distressed countries to the private sector or bilateral official creditors, and there should be positive transfers from multilateral development banks to debt distressed countries. This necessitates some form of debt restructuring/re-profiling in debt distressed countries. The objective should be to reduce debt burdens today and restore debt sustainability.

10. While there are some common features that debt distressed countries share, such as paying high interest rates on their debt, an increasing debt service burden, and no access to credit markets, given that each country has a different situation, there will need to be different approaches for different countries. In all cases, the principle defined in the previous paragraph should be respected.

11. If a country has debt to GDP levels such that even if it were able to extend debt maturities at a relatively low rate, such as the World Bank's interest rate, its public sector would need to achieve budget surpluses that were "too high", in the sense that such a level of surplus would precipitate a downturn, or, if the country was already in a downturn, not allow for a short-term economic recovery and be inconsistent with long-term development, the country will need a debt restructuring that includes reduction of the debt principal.

12. On the other hand, if a country's debt to GDP ratios is low enough such that the extension of maturities at the World Bank interest rate entails enough relief to enable strong economic performance in the short and long term, then a simple re-profiling would suffice, with no need to include reductions of the debt principal. The interest rate on the new bonds should be close to the World Bank's interest rate because, by definition, debt reprofiling would be sufficient for restoring debt sustainability, so there should not be a risk premium. But for this to be successful, *all* bonds, not just those that are coming due, would have to accept this lower interest rate; and it is right that they should, because the reprofiling (with possibly injection of new funds, on the condition of the reprofiling restoring sustainability) has lowered the risk of default, for which they were earlier being

compensated.

13. The necessary length of the extension of maturities depends on the expectation about how long it will take for debt distressed countries to recover access to international private credit markets *at sustainable interest rates.* Given the procyclical nature of global capital markets for developing economies, it will probably take a long time for them to recover market access, suggesting that maturity extensions should be long (10 to 20 years).

14. In assessing whether the present discounted value of exchange bonds is equivalent to that of the original bonds, one should discount future cash flows at a low interest rate, reflecting the low risk (e.g. the World Bank interest rate), not the high rates often used by private creditors.

15. It may be difficult to get the private sector to accede to this, and correspondingly, to the lower interest rates in the exchange bonds reflecting the lower risk. In such situations, the IMF should not provide funds, for such funds would amount to a bail-out and/or to lending into an unsustainable debt situation, in violation of their rules. The private sector's recognition of this as a firm stand of the IFI's would enhance their participation in a meaningful restructuring. More broadly, the IMF should define its policies in a way that encourages *meaningful* creditors' participation in debt operations. IMF's financing should in no case be used to bail-out private creditors; this may entail imposing constraints on capital flows and other constraints on the government's debt policies.

16. "Access to credit market" has to be properly defined. "Access" at exorbitant interest rates only "kicks the can down the road," decreasing the odds of an eventual resolution of the crisis and harming the prospects for social development. Kenya's recent debt issuance is a very visible example of this situation.

17. The IMF's debt sustainability analyses (DSAs) should (i) recognize that key variables in the analysis, such as future output, and foreign exchange and tax revenues, are endogenous, and depend on the nature of the policies undertaken and debt relief provided; (ii) use appropriate discount rates, recognizing that if debt has been made sustainable, risk is low and so, accordingly, should the interest rates being used; and (iii) account for the realization of climate shocks.

18. Debt relief should be sensitive to the pervasive problem of "too little and too late": Too little debt relief results in another debt crisis down the road; too late imposes unnecessarily high costs on the debtor country, as the underlying problems only mount.

19. The IMF should not push policies intended to reduce imports to create revenues for foreign-exchange debt payments in times of debt distress. Austerity in times of recessions impedes growth, poverty reduction, and climate action. On the contrary, IFIs should contribute to counter-cyclical and pro-growth programs.

20. The IMF lending rate policies were widely discussed. The recent reform of the IMF's basic lending rate and surcharge rate policy is a step in the right direction and should serve as the basis of further reforms that are consistent with the IMF's mission of contributing to the stability of the global economy.

21. New York State and England are the main jurisdictions for the issuance of developing nations' debts in foreign currency, and the legal frameworks should be amended to improve efficiency and equity in sovereign debt crisis resolution. There is a need for changes in legislation to tackle vulture funds' behavior (defined as the purchase of defaulted debt with the intent of litigating against the debtor), and for reducing the pre-judgment rate that compensates debts in default at the rate of 9%. That high rate was set in 1981, when the inflation rate in the US was 8.9%, and kept in place in part as the result of lobbying from vulture funds. It incentivizes delays in debt restructurings. A recovery cap on private creditors to ensure comparable treatment with official creditors would also incentivize meaningful participation in debt restructurings by the private sector.

22. Debtors should pursue responsible lending policies, aiming at inter-generational social justice, and refrain from opportunistic behaviors that seek for short-term political payoffs.

23. Legislation to improve sovereign debt management practices and ensure greater transparency for borrowing, giving more involvement to Parliaments in debtor countries and encouraging broader public discussion of increases in public indebtedness, would likely improve debt policies.

Conclusions

24. The resolution of a macroeconomic debt crises entails a distribution of losses, a process generally associated with conflict. The process for resolving conflict differs if it is among countries (like with Heavily Indebted Poor Countries Initiative for debt relief) or between a country and the private sector.

25. Under the current deficient international financial architecture, with no international mechanism for sovereign debt restructuring, matters are typically resolved in a sub-optimal way. The private sector uses fear of default as a bludgeon to negotiate for self-serving terms but that often prove unsustainable for the country and impose high costs on the debtor country, costs often borne by those least able to do so.

26. When the country defaults, conflicts among the creditors and between them and the debtor often result in situations where all are worse off than they would be with a more smoothly organized debt restructuring.

27. The alternative, that is, continuing to pay unsustainable debts that were issued at high interest rates (that both recognize and create the risk of default), is generally the worst of all possible options.

28. It is clear that contractual improvements, like collective action clauses that facilitate the aggregation of creditors in processes of sovereign debt restructuring, while helpful, are largely insufficient to resolve the conflicts that need to be addressed in debt crises.

29.. The IMF's stance (its DSA and its debt policies) affects the bargaining power of the different sides and is thus a main determinant of debt outcomes. Such a stance is generally influenced by the power that is exercised through its shareholders.

30. In his address, Pope Francis called for an international mechanism for sovereign debt restructuring, "based on the solidarity and harmony of peoples, that takes into account the global nature of the problem and its economic, financial and social implications".

31. In the current situation, and with the current deficient IFA for sovereign debt crisis resolution, a sense of solidarity of the most powerful will be an important determinant of whether it will be possible to achieve debt resolutions that allow the citizens of distressed countries to regain hope in the year of the Jubilee. In his address, Pope Francis reiterated that "it is the principles of justice and solidarity that will lead to finding solutions. On this path, it is essential to act in good faith and with truth, following an international code of conduct with ethical standards that can guide dialogue between parties".

32. It is essential to reform the international financial architecture, not only to facilitate just and efficient debt resolutions, but also to provide greater access to the funds that are essential to growth and development in ways that reduce the frequency and depth of the recurrent debt crises that have plagued the world.

© Fri Jun 20 01:22:15 CEST 2025 - The Pontifical Academy of Social Sciences