

Towards HIPC 2.0?

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addressing current debt problems

Dennis Essers
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Institute of Development Policy

Postal address:	Visiting address:
Prinsstraat 13	Lange Sint-Annastraat 7
B-2000 Antwerpen	B-2000 Antwerpen
Belgium	Belgium

Tel: +32 (0)3 265 57 70
Fax: +32 (0)3 265 57 71
e-mail: iob@uantwerp.be
<http://www.uantwerp.be/iob>

WORKING PAPER / 2021.02

ISSN 2294-8643

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Dennis **Essers***

Danny **Cassimon****

July 2021

* Dennis Essers, Economics and Research Department, National Bank of Belgium, Brussels, Belgium; Institute of Development Policy (IOB), University of Antwerp, Antwerp, Belgium; email: dennis.essers@nbb.be

** Institute of Development Policy (IOB), University of Antwerp, Antwerp, Belgium.

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Dennis Essers* & Danny Cassimon**

Abstract: When the COVID-19 pandemic added to already elevated debt vulnerabilities in low-income countries, the G20 launched the Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond the DSSI, which have provided limited relief so far. For several countries, deeper and more wide-ranging debt treatments will likely be needed to secure future debt sustainability. This paper looks at the Heavily Indebted Poor Countries (HIPC) initiative, the largest and most comprehensive debt relief effort for low-income countries to date, as a potential reference point for the 2020s. While the HIPC initiative appears to have been a qualified success, its replication in the current context would be infeasible and undesirable. Creditor base heterogeneity justifies a more flexible, differentiated approach to debt restructuring. Yet, the HIPC experience holds valuable lessons. “Delay and replay” tendencies should be avoided. Involving commercial creditors is a real challenge, requiring carrots and sticks. And imposing extra conditionality on debt relief proceeds could be helpful but should not be overdone. Even if the Common Framework is unlikely to suffice in case of a systemic debt crisis, its inter-creditor dialogue could perhaps serve as the basis for a more inclusive advisory body or forum for debt restructuring.

JEL codes: F34, F63, H63

Keywords: public debt, debt relief, Heavily Indebted Poor Countries initiative, Debt Service Suspension Initiative, G20 Common Framework, real options

Acknowledgements: *The views expressed in this paper are those of the authors and do not necessarily reflect the views of the National Bank of Belgium or the Eurosystem. We thank Ugo Panizza and Andrea Presbitero for inviting us to write this paper and are grateful to Silvia Marchesi and other workshop participants in an online seminar on sovereign debt for useful comments and suggestions.*

* *Corresponding author*, Economics and Research Department, National Bank of Belgium, Brussels, Belgium; Institute of Development Policy (IOB), University of Antwerp, Antwerp, Belgium; email: dennis.essers@nbb.be

** Institute of Development Policy (IOB), University of Antwerp, Antwerp, Belgium; Graduate School of Business, University of Cape Town, Cape Town, South Africa

1 Introduction

[D]eveloping countries cannot afford to go back to the days of HIPC where the Paris Club had to underwrite the cancellation of debts...[W]e certainly should not come back to Paris to speak of another HIPC. One HIPC is more than enough!

Akinwumi A. Adesina, President of the African Development Bank, at the Paris Forum on Debt and Development, 20 November 2015.¹

[We need a] HIPC on steroids.

Ken Ofori-Atta, Finance Minister of Ghana, Financial Times, 7 April 2020.²

Debt vulnerabilities have been on the rise for some time in most low-income and several middle-income countries, as evident from growing public and external debt stocks and debt service. The COVID-19 pandemic reinforced these vulnerabilities as economic growth faltered, export and tax revenues diminished while public spending needs increased, and local currencies depreciated on the back of capital outflows. More than half of low-income countries are now classified by the IMF and World Bank to be at high risk of or already in debt distress. Public external debt service often exceeds government spending on education and/or health (see e.g. Jones 2020, IMF 2021a, Munevar 2021, UNICEF 2021, World Bank 2021).

The international community responded to these debt problems with the provision of emergency financing, and the G20 in particular with the creation of the Debt Service Suspension Initiative (DSSI) in May 2020 and the Common Framework for Debt Treatments beyond the DSSI (henceforth the Common Framework) in November 2020. Fortunately, and thanks also to the large fiscal and monetary stimulus of advanced economies in response to the pandemic, global financial conditions have eased and a “systemic debt crisis” has so far been averted – to the extent that outright defaults remain limited to a limited number of relatively isolated country cases.

However, there is a growing recognition that for several low-income countries, and perhaps some middle-income countries too, deeper and more wide-ranging debt relief will be needed to secure debt sustainability further down the road (Clements et al. 2021). Various proposals to go beyond the debt relief that is currently on the table, i.e. case-by-case debt treatments under the Common Framework, have been advanced. Some of these proposals invoke, explicitly or implicitly, the Heavily Indebted Poor Countries (HIPC) initiative (or elements thereof), including campaigns by Eurodad, ONE and Oxfam.³ These references to HIPC, which until recently tended to be perceived as a one-off (cf. opening quote), should perhaps not come as a surprise. Together with its successor, the Multilateral Debt Relief Initiative (MDRI), the HIPC initiative remains the largest and most comprehensive debt relief effort ever launched for low-income countries, and is broadly regarded as a (qualified) success (Morris 2019).

This paper looks at the HIPC initiative's potential as a reference point for debt relief in the 2020s. We engage with three questions: (i) How exactly did the HIPC initiative work, and what have been its key results? (ii) What are the similarities and differences between the HIPC initiative and current debt relief initiatives, i.e. the DSSI and Common Framework? And (iii) what can we learn from HIPC, and from the DSSI and Common Framework, for future debt relief?

¹ See <https://www.afdb.org/en/news-and-events/keynote-address-delivered-by-dr-akinwumi-a-adesina-president-of-the-african-development-bank-at-the-paris-forum-on-debt-and-development-organized-by-the-paris-club-and-the-g20-on-november-20-2015-15032>. The citation is borrowed from Le Gouguec (2016).

² See <https://www.ft.com/content/89c6d60f-5fe9-4b72-b327-4a6eb267a9c9>.

³ See e.g. Munevar (2020); <https://www.one.org/international/blog/gleneagles-new-debt-deal-covid19>; and <https://www.oxfam.org/en/press-releases/imfs-gold-holdings-soar-nearly-20-billion-start-coronavirus-pandemic>.

Our main conclusions are the following. While the HIPC initiative and MDRI indeed appear to have been successful on some fronts, a copy-paste replication in the current context would be both infeasible and undesirable. The increased role of non-traditional creditors in low-income countries, notably China and commercial creditors, complicates finding consensus on large comprehensive debt relief on similar terms for a broad set of countries. New large write-offs of multilateral debt do not seem to be on the cards for now either. Greater creditor base heterogeneity across debtor countries justifies a more flexible and differentiated approach to debt restructuring than under HIPC, one that may include middle-income debtor countries too. Yet, the experiences with the HIPC initiative do hold valuable lessons for the future. The “delay and replay” tendencies of (pre-HIPC) debt restructuring should be avoided. Involving commercial creditors is a real challenge which may require a combination of carrots and sticks. And imposing extra conditionality on the spending of debt relief proceeds could be helpful but should not be overdone. Finally, even if the Common Framework is unlikely to be sufficient in case a systemic debt crisis would occur, the inter-creditor dialogue it entails could perhaps serve as the basis for a more inclusive advisory body or forum for debt restructuring.

The paper is structured as follows. In section 2 we start out by clarifying what we mean by “debt relief” and discuss some of the key dimensions it involves. Section 3 deals with the past: it describes the set-up of the HIPC initiative and the MDRI, and summarises their main results by means of a literature review and illustrative graphs. Section 4 jumps from the past to the present: we describe the set-up of the recent DSSI and Common Framework and point to their similarities and differences compared to the HIPC initiative. We also show how debtor countries’ decision to participate in the DSSI can be conceptualised using a real options framework and validate this empirically. Section 5 addresses the future: it formulates some lessons that can be drawn from the HIPC initiative, and from experiences with the DSSI and the emerging Common Framework, for improving upon current debt relief practice. Section 6 concludes.

2 Debt relief: Conceptual clarifications

Debt relief can mean many things. It comes in multiple shapes and colours (Cassimon and Essers 2017), ranging from piecemeal debt service restructuring operations involving only one creditor (or creditor class), to large-scale, comprehensive debt stock cancellations, involving all creditors (classes) according to coordinated common restructuring terms. Debt relief may also involve various types of conditionality (“strings attached”) that the debtor country needs to comply with. And debt relief operations may be used to serve multiple, potentially overlapping purposes. In this section we provide some short conceptual clarifications. These will help us to classify different types of external debt relief operations; to discuss, in a more structured manner, both the HIPC initiative/MDRI and the current initiatives (sections 3.1, 3.2 and 4.1); and to tease out the key differences between them (section 4.2). We will also refer back to the concepts introduced here when we draw some, more normative lessons from past and recent debt relief initiatives for the future (section 5).

We consider six dimensions: (i) the extent to which debt relief interventions restore the (external) debt sustainability of the recipient debtor country; (ii) the extent to which they lead to more resource availability for the debtor, directly and/or indirectly; (iii) the extent to which they realise broad creditor involvement and adequate burden-sharing between creditors; (iv) the extent to which they apply adequate conditionality; (v) the extent to which they are sufficiently attractive for the debtor to participate (as a consequence of the previous elements); and (vi) from a more systemic perspective, the extent to which they constitute an adequate ex ante framework for sovereign debt workouts in the future.

Before touching upon each of these aspects, we need to establish a common definition of “debt relief”. As debt obligations are of an inter-temporal nature, they are typically measured in a present value (PV) sense. *Sensu stricto*, debt relief refers to any type of change in the original debt service schedule of a loan/security that leads to a reduction of its PV, where future repayments are

discounted using an appropriate (usually market-based) discount rate. PV reductions can be achieved through a rescheduling of interest or principal payments over time at below-market terms; and/or partial or full cancellation of such payments; or even a cancellation of outstanding debt stocks. PV-based measures of debt relief allow for the assessment of comparable treatment of debt across debtor countries and across debt claims held by different creditors.

(i) Restoring debt sustainability

Obviously, helping to restore debt sustainability is often one of the key aims of a debt relief intervention. For low-income countries, the main reference point are the debt sustainability analyses (DSAs) under the IMF-World Bank's Debt Sustainability Framework (LIC DSF), which uses threshold debt (service)-to-GDP/exports/revenue ratios and a composite indicator for debt-carrying capacity to score countries according to their level of risk of debt distress (see IMF 2017).⁴ From this perspective, debt relief is most relevant and effective if it is accessible to countries with high risks of debt distress and if it is engineered in such a way that it brings down debt to "sustainable" levels, at which there is no immediate risk of default. For countries with severe debt problems, piecemeal debt (service) relief operations will not do; larger-scale operations, ideally involving as much as possible all (relevant) creditor classes (see (iii)), would be needed. Reinhart and Trebesch (2016) empirically show that debt crises are more effectively resolved by "decisive" debt relief operations, with (deep) debt write-offs. Historically, however, default episodes have often been characterised by multiple, consecutive debt restructurings, typically involving limited relief. This tendency to "delay and replay" has been linked to factors such as creditors' loss aversion, inter-creditor disputes, debtor government instability, over-optimistic assumptions about future growth and fiscal balances, and unexpected shocks (Graf von Luckner et al. 2021).

(ii) Increasing resource availability

It is often assumed that debt relief will automatically translate one-for-one in increased resource availability for the debtor (government), i.e. create "fiscal space"; resources otherwise spent on debt service can now be diverted to alternative uses, say to support the economy throughout the COVID-19 pandemic or to attain the Sustainable Development Goals (SDGs). But two important caveats apply here. First, the current cash-flow effect of debt relief may be minimal if it involves mostly debt service due in the more distant future. Second, and more importantly, when dealing with debt levels that are highly unsustainable, it is likely that debtors would not be able or willing to service all debt due, defaulting on part or all of it. Cancelling claims that would not have been repaid by the debtor anyway does not increase resource availability at the debtor level. From a resource availability perspective, it is thus more effective to provide debt relief on claims that would have been effectively serviced. By this logic, debt relief that reduces unsustainable debts to sustainable levels may not result in much genuine debt service savings, whereas debt relief that goes beyond what is needed to restore sustainability should result in extra fiscal space; it becomes similar to the provision of development (grant) aid (Cassimon and Essers 2017). The key question is then whether and when such debt relief is the best way of increasing available resources for the debtor country.

Even if the direct cash-flow gain from debt relief is limited, there could be indirect effects on resource availability. According to the debt overhang concept (Krugman 1988), unsustainable debt burdens create all kinds of disincentives in the debtor economy to invest, reform and eventually grow, as part of the fruits of investment and reform efforts would leak away to creditors under the form of increased debt service. Debt relief, if substantial, could then remove these disincentives (Bulow and Rogoff

⁴ The IMF uses a separate framework for other, so-called "market access countries" (recently rebaptised as the Sovereign Risk and Debt Sustainability Framework for Market Access Countries, MAC SRDSF). This framework performs more elaborated risk assessments over near-, medium- and long-term horizons. A general definition of public debt sustainability, which arguably also applies to low-income countries, is that "*public debt [is] regarded as sustainable when the primary balance needed to at least stabilise debt under both the baseline and realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level*" (see IMF 2021b, 6).

1991), leading to positive indirect effects on investment, growth and hence resource availability. This would give such debt relief an edge over the provision of grants or new loans. Another set of indirect effects to consider relates to the impact of debt relief on the availability to the debtor of other external flows, be it from official or private sources. Several substitution and complementarity effects may be at play. For official (bilateral and multilateral) creditors that are also donors of development aid and that consider debt relief as one of several possible interventions, a fixed aid budget would imply substitution between debt relief and other forms of aid (at the level of all recipient countries together). Debt relief on claims owed to private creditors could also result in lower resources later on, due to reputation and market access losses (especially in post-default debt restructurings; see Asonuma et al. 2019). Furthermore, for both categories of creditors, during a debt crisis build-up, some part of new lending or granting may be “defensive” (Birdsall et al. 2003, Marchesi and Missale 2013), i.e. provided to allow recipient countries to stay current on their debt servicing rather than for other, more productive purposes. Debt relief may put an end to such “loss of selectivity” and undesired lending/granting practices. Finally, on the other hand, to the extent that debt relief improves debt sustainability materially and removes debt overhang, it should make countries more attractive for new lending, both from official and private creditors, and for non-debt-creating flows such as FDI and portfolio equity. Which of these effects dominates in particular situations is ultimately an empirical question.

(iii) Creditor involvement and burden-sharing

External debt is typically owed to a diverse array of creditors, that can be categorised into a number of broader creditor classes. On the official creditor side, we have the “traditional” bilateral creditors organised in the Paris Club, an informal group for the coordination of debt treatments across (advanced economy) creditor countries; the traditional multilateral creditors, mainly the IMF, World Bank and regional development banks; as well as “non-traditional”, non-Paris Club bilateral creditors, China being the most prominent one; and “plurilateral” creditors, i.e. smaller multilateral organisations with a more limited membership. On the non-official/private creditor side, we find commercial banks, international bondholders, and multinational enterprises including suppliers and commodity trading companies. Sometimes the dividing line between official and private creditors is blurred, as in the case of bilateral export credit agencies (ECAs), development finance institutions (DFIs), banks with a hybrid ownership status, or if lending occurs through a syndicate of lenders.

Resolving debt problems has clear public good characteristics. Whenever a particular creditor (or creditor class) contributes to the solution by providing debt relief, it increases the probability for other creditors (or creditor classes) to be paid in full, giving rise to free-riding opportunities. Engineering concerted and comprehensive interventions, involving as many as creditors as possible is thus preferable over stand-alone operations, not only to solve the problem effectively, but also to reach fair burden-sharing between and within creditor classes. An ex ante well-established framework would in principle be able to provide guidance and coordinate debt relief interventions once a crisis emerges, but while some creditor classes have functioning fora – most notably the Paris Club – an overarching sovereign debt restructuring mechanism to assure broad creditor involvement and appropriate burden-sharing does currently not exist (see (vi)). Most official debt relief granted by Paris Club creditors does entail the obligation for the debtor country to seek a comparable, at least as favourable debt treatment from its other official bilateral and private creditors, but the Paris Club has no legal means to enforce this “comparability of treatment” clause. Multilateral creditors typically do not participate in debt relief operations, referring to their “preferred creditor status”. This de facto (rather than de jure) status protects multilaterals’ favourable credit ratings and low market financing costs (in case of the World Bank and regional development banks) and/or allows them to fulfil their role as international lender of last resort, i.e. to provide cheap financing during the harshest of crises (most relevant for the IMF). Commercial creditors, especially if they do not represent a large share of claims on the debtor, may try to hold out from debt restructurings, hoping that official creditors providing debt relief will let them off the hook. Inter-creditor coordination may also be hampered by a lack of transparency on the claims (and/or on their terms) of particular creditors.

(iv) Appropriate conditionality

Debt relief almost always comes with some conditionality attached. In most official as well as private debt restructurings, this includes having an active IMF-supported programme, which serves to reassure creditors that the debtor has committed to sound policies aimed at resolving debt problems and facilitates the monitoring of progress. Creditors may also employ additional ex post conditionality to earmark the use of debt relief savings to particular purposes, be it narrowly defined projects or broader development strategies, or even ex ante conditionality, requiring certain reforms to be implemented before debt relief is granted. Again, some caveats apply. While conditionalities may increase the buy-in of creditors, they may also add to transactions costs (say in the case of stringent reporting requirements) and undermine debtor country ownership, if the debtor's own policy preferences and/or its own institutions and systems for decision-making, implementation and monitoring are disregarded (Cassimon and Essers 2017). Moreover, similar to most development aid, debt relief is fungible; without a clear baseline, it is not always easy to establish whether the proceeds from debt relief imply additional resources for the earmarked purposes or merely displace the debtor government's own spending on those purposes. Finally, an extensive use of ex ante conditionality risks to slow down the whole debt restructuring process.

(v) Attractiveness to debtors

Ultimately, debtor countries will only agree to debt relief operations that they believe to improve their welfare. As the foregoing suggests, this may not be guaranteed. Indeed, large-scale debt relief may restore debt sustainability, lead to increased resource availability, and through removing debt overhang create all kinds of indirect benefits. Even short-term debt restructurings that imply no genuine debt relief (in a PV sense) may be beneficial, if the debtor is "impatient" (i.e., its subjective discount rate is higher than the market discount rate). But these benefits could be offset by certain costs. If commercial creditors are "forced" to provide debt relief they may be less willing to lend (or only at higher cost) in the (near) future. Debtor countries may also find the adherence to certain conditionalities attached to debt relief to be too cumbersome or not well aligned with their own preferences. Furthermore, the benefits and costs of debt relief are typically subject to uncertainty. In section 4.3 we will illustrate this using a real option approach.

(vi) Preparedness for the future

As mentioned, there is currently no encompassing sovereign debt restructuring mechanism that can be readily activated once a debt crisis emerges – despite multiple attempts and various proposals to introduce such mechanisms (see e.g. Cassimon et al. 2018, Alonso 2018, and G30 2021 for recent overviews). As such, with every new crisis, problems have to be solved in a rather ad hoc manner. Although this allows for more flexibility in adjusting to the specific nature of the crisis, it also adds to uncertainty and makes it difficult to tackle recurring problems such as the "delay and replay" tendencies and strategic holdout behaviour in debt restructuring.

3 The past: HIPC initiative and MDRI

3.1 Set-up of HIPC initiative and MDRI

In the 1970s and early 1980s, the oil crisis, a global recession, and a commodity price boom and bust led to severe balance of payment problems and were followed by a surge in requests for debt relief from developing countries. The Paris Club initially responded with offering short-term debt service rescheduling at market-based interest rates. Commercial banks too, organised in special advisory committees often referred to as the "London Club", engaged in short-term rescheduling of their claims. Only from the late 1980s onwards, Paris Club debt treatments began to include elements of genuine debt relief for low-income countries. In 1989, the World Bank's International Development Association Debt Reduction Facility (IDA-DRF) was set up, providing grants to sponsor low-income

countries in buying back their external debts from commercial creditors at (deep) discounts (Gamarra et al. 2009).⁵

By the mid-1990s, it had sunk in that traditional debt relief operations by bilateral and commercial creditors would not suffice to solve the systemic debt problems that were still present in many low-income countries, in part because of increasing multilateral debt. In September 1996, the IMF and World Bank together launched the HIPC initiative, with the aim of reducing overall external debt burdens to manageable levels for poor countries that bore particularly high debts but also showed commitment to macroeconomic and structural reforms. The HIPC initiative was soon adopted by the Paris Club, which devised new “Lyon terms” that allowed for a reduction in HIPCs’ bilateral debts (not classified as Official Development Aid or ODA) of up to 80% in PV terms. Such PV debt relief was achieved by lowering either principal or interest repayments and by rescheduling them over a period of up to 40 years.⁶ Eligibility for the HIPC initiative was restricted to poorer countries that could only borrow from the World Bank’s International Development Association (IDA) and were faced with unsustainable external debt after the application of traditional debt treatments (from the Paris Club and others). “Unsustainable” debt levels were defined with respect to empirically derived thresholds: a debt service-to-exports ratio in excess of 20-25%; a debt stock-to-exports ratio above 200-250%; and/or (for open economies making efforts to generate fiscal revenues) a debt-to-revenue ratio of more than 280%, all expressed in PV terms.

The HIPC initiative followed a two-stage process. First, eligible countries needed to successfully implement IMF and IDA-supported reform programmes for three years in order to reach their HIPC “decision point”, at which the required amount of debt relief to regain sustainability would be determined by a IMF-World Bank DSA. Second, to attain their HIPC “completion point” and receive full and irrevocable debt stock relief, countries had to go through another three-year period of programme implementation, conditional upon meeting country-specific reform targets (Boote and Thugge 1997). Debt relief costs under HIPC were to be shared among Paris Club and other bilateral creditors, multilaterals, and commercial creditors, all in proportion to their respective exposures (applying a “common reduction factor”). As such, the HIPC initiative marked the first-ever instance of comprehensive multilateral debt relief, a major departure from past practice (Easterly 2002). It is important to emphasise, however, that to preserve multilateral institutions’ resources, they were largely compensated for their debt relief by grant contributions of member countries, i.e. bilateral creditors; with some exceptions: the IMF used investment income from a revaluation of some of its gold holdings to fund part of its HIPC relief, whereas the World Bank financed its relief partly out of earnings on loans to middle-income countries (Cosio-Pascal 2008).

Slow and insufficient progress under the original HIPC initiative, together with mounting pressure from civil society organisations such as the Jubilee 2000 movement (Roodman 2010), led to a revision in 1999. The so-called “enhanced” HIPC initiative introduced three key changes (Gautam 2003). First of all, debt sustainability thresholds were lowered, e.g. the PV debt stock-to-exports ratio from 200-205% to 150%. This was meant to widen country eligibility and deepen debt relief. Accordingly, Paris Club creditors substituted their Lyon terms by new Cologne terms, allowing for up to 90% PV relief (or more if necessary). Second, the fixed three-year interim period between decision and completion point was replaced by a floating completion point, which would be reached upon the

⁵ Meanwhile, also in 1989, the creditor community established the Brady plan (named after the then US Treasury Secretary), under which commercial banks were strongly encouraged or even coerced to exchange their claims for tradable bonds (partly collateralised by US Treasuries). Creditors participating in these Brady deals could choose from a menu of debt stock- or service-reducing operations: typically, an exchange of the original loans for bonds with reduced principal; an exchange at par with lower interest rates; and a “new money” option, whereby banks received new bonds with better terms conditional upon lending additional money (Claessens and Diwan 1994). Unlike the IDA-DRF, the Brady plan was geared towards middle-income countries.

⁶ ODA credits were to be rescheduled at a more concessional interest rate, or sometimes (partly) forgiven by individual Paris Club creditors. The Lyon terms for HIPC debt treatment replaced earlier Toronto terms (from 1988), London terms (from 1991) and Naples terms (from 1994) for low-income countries, which offered up to 33%, 50% and 67% in PV debt reduction, respectively (see Gamarra et al. 2009).

fulfilment of structural reforms and social sector objectives. Creditors also received more discretionary power to provide debt relief during the interim period. Third and most notably, debtor countries' progress under the HIPC Initiative was attached to a poverty-reduction strategy paper (PRSP), elaborated in consultation with external development partners. In order to attain their HIPC completion points, countries had to satisfactorily implement their PRSP strategies for at least one year. Hence, an explicit link between debt relief and development and poverty reduction was established. At this stage, the HIPC initiative seemed to go beyond achieving debt sustainability per se and became more concerned with increasing resource availability – even though eligibility remained based on narrow debt service and stock ratios rather than on fiscal needs for development. The increased attention towards resource availability and development/poverty reduction led to increased tracking of public spending in HIPC countries, sometimes using separate budget lines or even off-budget vehicles to follow debt relief proceeds (IMF and World Bank 2001).

In the years following the enhanced HIPC initiative, most Paris Club creditors decided to voluntarily top up their relief at HIPC completion point to 100% of the claims concerned (hence going beyond Cologne terms). In 2005 the IMF, IDA and African Development Fund followed suit and established the MDRI, joined in 2007 by the Inter-American Development Bank. Under the MDRI, these multilateral creditors committed to forgiving all remaining claims of post-completion point HIPCs without imposing extra conditionality. Even more so than the enhanced HIPC initiative, the MDRI was seen as a mechanism to free-up additional resources for debtor countries, in particular in support of the Millennium Development Goals (MDGs), rather than simply accomplish debt sustainability. In contrast to HIPC, the MDRI did not prescribe parallel debt relief from bilateral and commercial creditors or other multilaterals. Again, however, the costs of MDRI relief were largely borne by contributions from bilateral donors/creditors.

3.2 Results of HIPC initiative and MDRI

At the moment of writing, 36 countries had reached their HIPC completion point (the last one being Chad in 2015), two more found themselves between decision and completion point (Somalia and Sudan), and one remained eligible but had not yet reached decision point (Eritrea). Currently, the initiative is effectively closed to new entrants. The latest official estimates put total (committed) HIPC plus MDRI debt relief for the 36 post-completion point countries at almost US\$125 billion in nominal terms (IMF and World Bank 2019). Paris Club creditors and multilaterals, which represent 37% and 48% of the HIPC debt relief costs (in PV terms), respectively, have fulfilled quasi 100% of their commitments under the initiative (and have tended to go beyond that; cf. above). Non-Paris Club bilateral creditors, accounting for 8% of HIPC costs, have only provided about half of what is expected from them, but this masks great variation between individual creditors. For example, China, Kuwait and the United Arab Emirates had all delivered more than 80% of their assigned debt relief shares, while India, Libya, Taiwan, and several poorer creditor countries had delivered much less (or nothing). The participation of commercial creditors in the HIPC initiative, accounting for the remaining 6% of costs, has been very weak (IMF and World Bank 2019). And it would have been weaker still without the support for commercial debt buybacks from the IDA-DRF, which became explicitly linked to the HIPC initiative in 2004 (Landers 2020). Moreover, commercial creditors have brought several lawsuits against HIPCs, sometimes successfully and with several cases still ongoing.

Obviously, because of the sheer size of debt relief, the HIPC initiative and MDRI made a big dent in the debt stocks and debt service of those countries completing the process. Empirical studies have also tried to shed light on the impact of HIPC and/or MDRI on overall resource availability, fiscal space and poverty-reducing expenditures, debt overhang elimination and investment promotion, economic growth, and governance. It appears that these large-scale schemes have met at least part of the expectations (see Cassimon and Essers 2017, and Ferry and Raffinot 2019 for more extensive overviews). Powell and Bird (2010) claim that post-2000 debt relief has complemented rather than substituted other aid interventions in Sub-Saharan Africa, whereas Dömeland and Kharas (2009) argue that the HIPC initiative may have simply prevented a decline in net resource transfers to

HIPCs. Claessens et al. (2009) find evidence of a decline in defensive lending due to the HIPC initiative, with bilateral donor aid becoming more responsive to recipient countries' policy and institutional quality and less to high debts. Using more recent data, Ferry et al. (2021) suggest that HIPC/MDRI completion leads official creditors to reduce the concessionality of their new loans but also allows broader access to international financial markets. With respect to fiscal space, Cassimon and Van Campenhout (2007, 2008) and Cassimon et al. (2015) find that HIPC and MDRI debt relief have increased government recurrent primary spending and domestic revenues. Like Djimeu (2018), they also find that enhanced HIPC (but not MDRI) debt relief has increased public investment, in accordance with debt overhang theory (see also Raddatz 2011, for more indirect support). The IMF and World Bank (2019) themselves showcase an increase in social, poverty-reducing expenditures in the immediate aftermath of HIPC/MDRI relief, but when Duggan et al. (2021) evaluate this in a difference-in-difference set-up, the relation becomes less clear. Studies by Depetris Chauvin and Kraay (2005), Presbitero (2009) and Johansson (2010) fail to uncover a clear debt relief-growth nexus. However, accounting for debt restructuring heterogeneities, Cheng et al. (2019) and Marchesi and Masi (2021) both find that Paris Club debt treatments involving (large) nominal haircuts tend to be associated with positive growth in the following years. That notwithstanding, establishing strict causality from (deep) relief to multi-year growth remains difficult. Finally, some studies uncover a link between HIPC debt relief and improvements in recipient countries' quality of governance (Depetris Chauvin and Kraay 2007, Freytag and Pehnel 2009), but again it is hard to demonstrate causality (Presbitero 2009).

To further illustrate how (post-completion point) HIPCs have fared since they benefited from large, comprehensive debt relief, in Figure 1 we conduct a simple event study-like exercise. More specifically, we track a number of variables of interest around each HIPC's country-specific year of reaching HIPC completion point or of receiving MDRI relief (whichever comes latest).⁷ Figure 1 plots the evolution of the cross-HIPC average, median and interquartile range for each of these variables. To put things in perspective, Figure A1 in Appendix shows time series graphs of the same variables for non-HIPC, DSSI-eligible countries. These are mostly low-income countries that did not qualify as HIPCs at the time because their external debt was deemed to be sustainable or because they were not IDA-only borrowers; we discuss DSSI eligibility and come back to HIPC-DSSI country sample differences in sections 4.1 and 4.2.

Panel A of Figure 1 confirms that the public external debt reduction due to the HIPC initiative and MDRI has been very pronounced. In most post-completion point HIPCs, there has been no immediate re-accumulation of large external debts and, compared to pre-HIPC values, overall external debt ratios remain low. Of course, there have been a number of notable exceptions to this trend, Mozambique being one example (other outliers are not shown). Panel A of Appendix Figure A1 shows that there has not been such a drastic decline in the external debt stocks of non-HIPC, DSSI-eligible countries. In the latter group, external debt ratios are somewhat more heterogenous in recent years. The composition of external debt has clearly changed over time. The share of debt owed to Chinese official and non-official creditor agencies has steadily increased in ex-HIPCs, but generally to a lesser extent than in non-HIPCs. However, in some ex-HIPCs, like Cameroon, the presence of China has indeed grown spectacularly (Panels B of Figure 1 and Appendix Figure A1). Also the share of external debt owed to commercial creditors has increased for ex-HIPCs, albeit from a very low base and more so in recent years than in the immediate aftermath of the HIPC initiative. Countries which have issued multiple large international bonds, notably Ghana, Senegal, and Zambia, stand out. In non-HIPCs, the commercial creditor share has remained relatively stable on average (Panels C). Ex-HIPCs' external debt service was significantly reduced under the HIPC initiative and remained relatively low for years, before increasing again to pre-HIPC levels more recently (as countries, including Ghana, switched to more expensive commercial debt). Non-HIPCs saw a similar evolution in external debt service, but with less of an intermediate dip (Panels D). The COVID-19 pandemic has further worsened debt service-to-revenue ratios in low-income countries

⁷ Note that some HIPCs did not receive MDRI relief because of a lack of remaining multilateral claims. We adopt a 20-year event window, from six years before HIPC completion point/MDRI to up to 13 years after, since for most countries the base year is 2006 and our data runs until 2019.

(Jones, 2020). Both economic growth and the quality of governance, the latter proxied by the World Bank's Country Policy and Institutional Assessment (CPIA) ratings, seemed to increase in the run up to the completion of HIPC/MDRI for the average ex-HIPC. However, these average trends in growth and governance mask large cross-country variation and are broadly similar to the evolutions observed for non-HIPCs (Panels E and F).

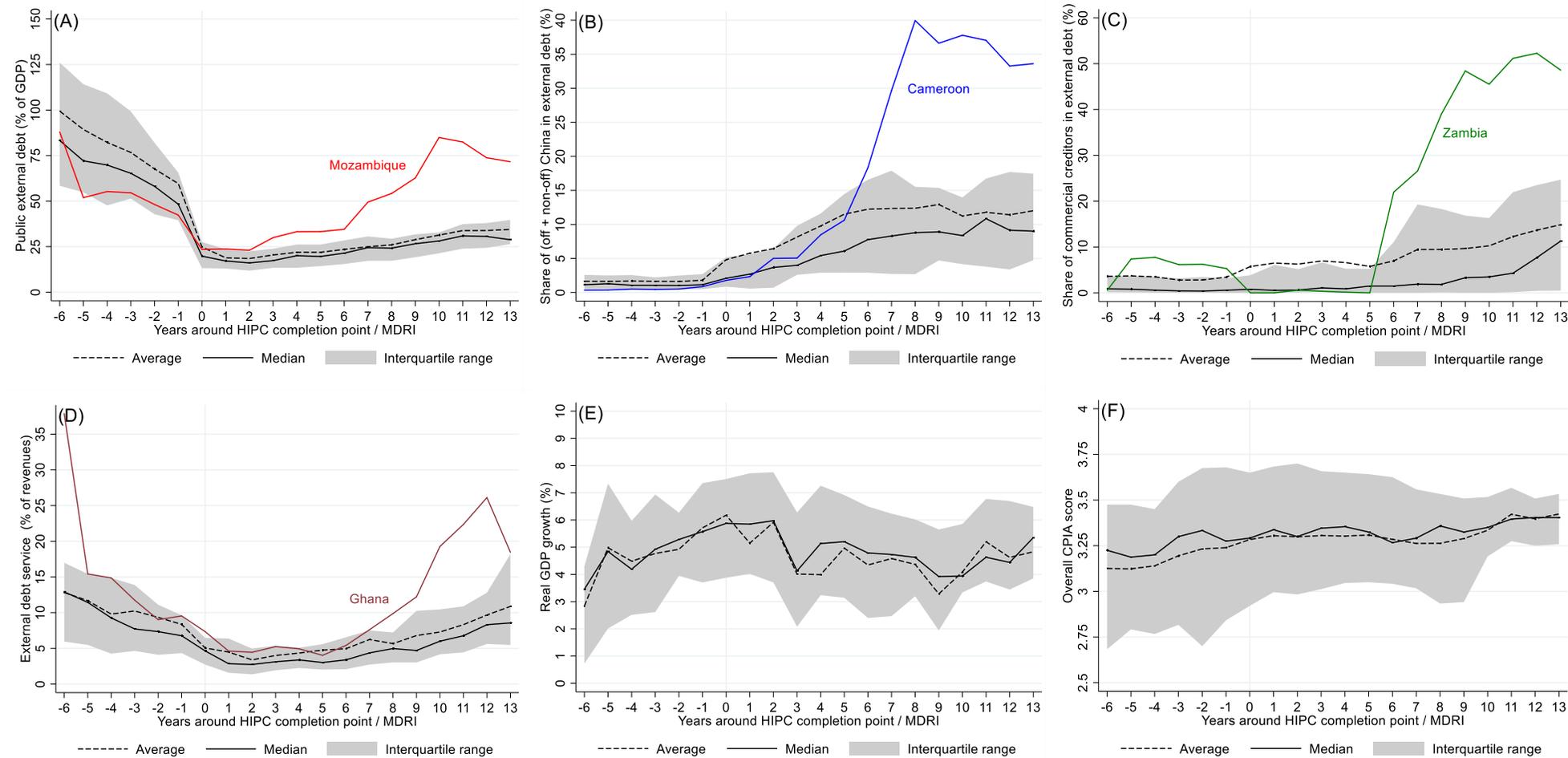


Figure 1: Evolution of external debt ratio (A), of Chinese creditors' share in external debt (B), of commercial creditors' share in external debt (C), of external debt service (D), of real GDP growth (E), and of CPIA scores (F); for post-completion point HIPCs.

Sources: IMF, World Bank, authors' calculations.

Note: Panel D excludes outlier Liberia.

4 The present: DSSI and Common Framework

4.1 Set-up of DSSI and Common Framework

Fast forward to 2020. In response to the economic repercussions of the COVID-19 pandemic for the world's poorest countries and urged by the IMF and World Bank, on 15 April 2020 the G20 launched the DSSI, which entered into force on 1 May. The DSSI provides a temporary and PV-neutral suspension of debt service payments on claims owed to all official bilateral creditors. Therefore, strictly speaking, it does not constitute debt relief (cf. section 2). Originally, the DSSI only suspended the debt service due between May and December 2020, which was to be repaid over three years after a one-year grace period. In November 2020, the initiative was extended to also cover debt service from January to June 2021, to be repaid over five years (again after a one-year grace). A final extension, for debt service through December 2021, was granted in April 2021. The DSSI is open to all IDA countries and least developed countries (LDCs, as defined by the United Nations) that have no arrears vis-à-vis the IMF or World Bank. In practice, this amounts to 73 eligible countries, i.e. 72 IDA countries plus Angola (an LDC). In order to benefit from the DSSI, eligible countries need to make a formal request to their creditors and be involved in, or at least have made at request for an IMF financing arrangement, including the IMF's emergency facilities (which do not entail a full-fledged reform programme). DSSI beneficiaries commit to use the free-up resources to combat the COVID-19 crisis, subject to IMF-World Bank fiscal monitoring; to disclose their public debt; and to respect IMF and World Bank limits on contracting new non-concessional debt during the suspension period.

The G20 also called upon commercial creditors to participate in the DSSI "on comparable terms". While the initial response of commercial creditors, represented by the Institute of International Finance (IIF, a 450-member financial sector association), to the DSSI proposal seemed cautiously positive, by the end of May commercial creditors had made their strong reservations about the initiative very clear. The IIF stressed that private sector participation in the DSSI should be entirely voluntary, with respect for fiduciary duties and other contractual and legal obligations, and with sufficient freedom to tailor the exact modalities of any debt service relief (see Bolton et al. 2020, IIF 2020 for details). Multilateral development banks were kept outside of the DSSI perimeter but were asked by the G20 to further explore options for the suspension of debt service, while maintaining their advantageous credit rating and low cost of funding. The IMF decided to complement the DSSI with debt service relief on its own claims for 29 of the poorest and most vulnerable countries hit by COVID-19. Through its Catastrophe Containment and Relief Trust (CCRT), fully financed by voluntary contributions from official bilateral donors, the IMF has provided grants to pay for the debt service it is owed by the 29 eligible countries (in three tranches, covering the period April 2020 - October 2021, at the time of writing).

As of mid-March 2021, 46 eligible countries had made requests to be included in the DSSI. In 2020, 43 participants benefited from an estimated US\$5.7 billion of suspended debt service owed to official bilateral creditors and the China Development Bank (CDB, which China considers to be a commercial creditor but is, at best, a hybrid policy-commercial bank; Brautigam 2020). The first six-month DSSI extension through June 2021 was expected to result in an additional US\$7.3 billion of suspended debt service (IMF and World Bank 2021). Ultimately, commercial creditors did not participate in the DSSI, since very few debtor countries that opted to join the initiative requested such participation, mostly for fear of negative implications for their credit ratings and financial market access (see section 4.3). Even if several countries that requested DSSI support did see their credit ratings being put on negative watch, in and of itself the official debt service moratorium under the DSSI has not triggered severe adverse market reactions.⁸ On the contrary, Lang et al. (2021) find that sovereign bond spreads significantly *decreased* for eligible countries, especially for those with greater amounts of

⁸ The major credit rating agencies – Standard and Poor's, Moody's and Fitch – clarified that the suspension of official debt service alone would unlikely impact credit ratings. However, they also noted that countries' DSSI requests raised the risk that commercial creditors would eventually be drawn in and incur losses, which could justify a rating downgrade (Kearse 2020).

(potential) debt service relief and weaker fiscal positions, suggesting the beneficial effect runs through the DSSI's easing of near-term liquidity problems. A less benign reading of these results is that the relative increase in bond prices is due to the DSSI's implicit subsidy from official bilateral creditors (temporarily waiving their claims) to commercial creditors (which continued to be paid in full).

Together with the DSSI's first extension and with the approval of the Paris Club, in November 2020 the G20 also introduced the Common Framework for Debt Treatments beyond the DSSI. The Common Framework aims to facilitate timely and orderly debt treatments for DSSI-eligible countries on a case-by-case basis and, again, at the request of the debtor country. The need for a debt treatment and the required restructuring/financing envelope is determined based on the parameters of a full-fledged IMF-supported programme including conditionality, on the accompanying IMF-World Bank DSA, and on the collective assessment of the participating official bilateral creditors, which coordinate among themselves and negotiate with the debtor country under the form of an ad hoc creditor committee. In principle, the Common Framework can be used to implement anything from a short-term debt reprofiling up to a deep debt restructuring with large PV reductions or nominal debt write-offs, in case that would be needed to restore debt sustainability. However, the Common Framework's term sheet restricts such debt write-offs to "the most difficult cases" and notes that due consideration must be given to creditors' domestic approval procedures. Similar as under the DSSI, the debtor country must disclose all necessary information on their public debt, "while respecting commercially sensitive information".

In order to promote broad creditor participation and fair inter-creditor burden-sharing, a debtor country that agrees to the key parameters of a debt treatment with its official bilateral creditors that participated in the negotiations is bound by the usual "comparability of treatment" clause. Under the Common Framework, comparable treatment is not simply encouraged as under the DSSI, but rather a formal requirement, for which the debtor country bears responsibility. Again in line with the DSSI, multilateral development banks are not expected to participate in the Common Framework debt treatments (for now) but asked to explore how best to help meet the longer-term financing needs of developing countries while protecting their current credit ratings and low cost of funding. Also IMF claims are excluded from the Common Framework. IMF debt forgiveness efforts are limited to fundraising for additional donor resources to extend the duration of CCRT debt service relief.

At the moment of writing, G20 and Paris Club creditors had received three requests for debt treatments under the Common Framework, by Chad, Ethiopia, and Zambia. While negotiations on debt treatments were still ongoing, it is already clear that these three countries differ significantly in terms of creditor and debt instrument compositions and hence may need different debt restructuring solutions. According to World Bank (2021) data for 2019, Chad's largest official creditors are Libya and China, followed at a distance by France and India. However, about half of the country's (non-IMF) external debt is owed to commodity trading company Glencore, whose claims were already part of two debt restructurings, most recently in 2018. Part of Glencore's claims on Chad is syndicated with claims of other commercial creditors, and part is collateralised by oil revenues (G30 2021). The success of any Chadian debt restructuring hinges on how Glencore's claims will be treated.

Ethiopia owes a relatively large share of its external debt, more than 40%, to the World Bank and African Development Bank. Its most important official bilateral creditor is China, good for about a quarter of total external debt. Commercial external debt, which includes one Eurobond, amounts to another 25%. Following Ethiopia's Common Framework request, all three major credit rating agencies downgraded the country. Preliminary assessments by the IMF and World Bank indicate Ethiopia would need only a debt service reprofiling to lower the risk of debt distress from high to moderate.

Zambia's external debt is relatively heavy on commercial debt, which represents almost 50% of the total and comprises three Eurobonds as well as other claims by private creditors (including again collateralised borrowing from Glencore). Official bilateral debt, almost all of it owed to China, accounts for just over 30%, and multilateral debt for the remaining 20%. In late 2020, Zambia

negotiated short-term interest payment holidays with Chinese lending agencies but then defaulted on a Eurobond payment after discussions with bondholders on a potential payment deferral under the DSSI broke down over demands to obtain more information on Zambia’s debt to China (G30 2021).

4.2 Key similarities and differences between HIPC and current initiatives

There are a number of similarities between the HIPC initiative on the one hand, and the DSSI and Common Framework on the other hand. First of all, eligibility for these initiatives is not universal but based on a pre-selection of countries, including on their IDA borrowing status (IDA-only in the case of HIPC) – which depends primarily on countries’ GNI per capita relative to a (annually updated) threshold. This explains why there is substantial overlap in (potential) beneficiaries between HIPC and the DSSI/Common Framework, as shown in Figure 2.⁹



Figure 2: Classification of countries based on IDA borrowing status, HIPC eligibility and DSSI/Common Framework eligibility.

Sources: IMF, World Bank, authors’ construction.

Notes: Countries in bold are actual participants in the DSSI as of mid-March 2021. * indicates HIPC-eligible countries that have not yet reached their decision point (Eritrea) or completion point (Somalia and Sudan).

Another parallel is that the Common Framework draws heavily on the Paris Club, which played a central role in the HIPC initiative. In fact, the Common Framework extends the Paris Club’s set of official bilateral creditors with G20, non-Paris Club creditors, such as China, India, Turkey and Saudi Arabia, and attempts to replicate some of the Paris Club’s key procedures and principles.¹⁰ Just like in the Paris Club’s debt treatments under HIPC, participation in the Common Framework requires involvement in an IMF programme; debt treatments are informed by inputs from the IMF and World Bank on debtors’ macroeconomic situation, debt sustainability and the required restructuring envelope; and official bilateral creditor coordination and negotiation with the debtor country takes place through a creditor committee and results in a memorandum of understanding (to be implemented bilaterally). The Common Framework also explicitly adopts the Paris Club’s comparability of treatment principle. Notwithstanding these similarities, the Common Framework lacks some of the Paris Club’s institutional features, such as a standing secretariat (operated by the French Treasury), as well as its long-time experience with information-sharing and creditor

⁹ Bolivia, Moldova and Mongolia were no longer classified as IDA countries in fiscal year (FY) 2021, having graduated from IDA in FY2017, FY2020 and FY2020, respectively. Angola’s eligibility for the DSSI is based on its LDC status (cf. section 4.1).

¹⁰ The Paris Club continues to operate in parallel, in a coordinated fashion with the Common Framework.

coordination. It thus remains to be seen how closely the Common Framework will stick to Paris Club modalities in practice.

Obviously, the DSSI/Common Framework approach differs in many other aspects from the HIPC initiative. Unlike for HIPC, country eligibility for the DSSI and Common Framework is not based on any criteria of debt sustainability, which explains the larger country coverage of the latter (see Figure 2).¹¹ The Common Framework prescribes no common terms for debt treatments, such as the (enhanced) HIPC initiative's Lyon (Cologne) terms. The explicit case-by-case approach of the Common Framework, whereby the debt treatment is tailored to the individual debtor country's situation, resembles much more the Paris Club's Evian approach, which it introduced in 2003 to deal with the debts of non-HIPCs (Munevar, 2020). Moreover, the Common Framework does not entail any multi-stage process conditionality like with the HIPC's set-up of decision and completion points, nor an explicit link to poverty reduction as under the enhanced HIPC initiative and MDRI. Another important difference with the HIPC initiative is that the Common Framework does not expect any participation of multilateral creditors in debt treatments (similar to pre-HIPC debt relief initiatives).

Finally, under the DSSI/Common Framework, the decision to participate lies squarely with the eligible debtor country, which needs to file an explicit request. The participation decision is based on the debtor's own assessment of the trade-off between benefits in terms of temporarily lower debt service (in case of the DSSI) or a debt reprofiling/reduction (in case of the Common Framework), and potential costs, such as reputational harm or a temporary loss of market access. Arguably, participation in the HIPC initiative was much less of an active decision on the part of the eligible debtor countries. Admission to HIPC was (quasi-)automatic upon the debtor meeting the qualification criteria and after IMF-World Bank Executive Board approval.¹² To the extent that debtors needed to confirm their willingness to participate in HIPC, it was almost a "no-brainer", with large debt relief benefits and small reputational costs, given the repeated debt restructurings that many of them underwent in the years before HIPC and because of most countries' limited market access at the time.

In the next section we elaborate on countries' decision to participate in the DSSI (and Common Framework), showing how it can be conceptualised using a real options framework and testing empirically some of the underlying drivers of this decision.

4.3 Participation in the DSSI from a real option perspective

When decision-makers are confronted with choices that entail uncertain costs and/or benefits, the real option approach shows that such decisions are best characterised as exercising a dividend-paying call (stock) option (McDonald and Siegel 1986, Dixit and Pindyck 1994, Trigeorgis 1996). In case of some flexibility in timing these decisions, the real option approach will cause optimal timing of execution to divert from the traditional net present value (NPV) rule of investment analysis: rather than deciding to invest whenever benefits exceed costs, uncertainty may lead to postponement (waiting behaviour), even when net benefits are currently positive – in the hope of acquiring more information about the risky future to make a better-informed decision later on, and with the aim of not getting trapped in a loss-making situation when the adverse risks do materialize. More specifically, decision-makers will compare the value of going ahead now (i.e. the NPV or net benefit, equal to benefits V minus costs I) with the current value of the option (C , indicating the value of waiting now in order to potentially execute later), and will only proceed *now* whenever the former exceeds the latter ($V - I \geq C$). Otherwise, they will prefer to *wait*.

¹¹ Pre-completion point HIPCs Sudan and Eritrea are excluded from the DSSI/Common Framework due to their arrears with the IMF and/or World Bank. The same holds for non-HIPC IDA countries Syria and Zimbabwe.

¹² We are aware of only a few HIPC-eligible "opt-outs". Ghana (which eventually did join HIPC), Bhutan, Kyrgyz Republic, Lao PDR, Nepal and Sri Lanka indicated that they did not wish to avail themselves of HIPC assistance, in part because Japan (a key donor to those countries) threatened to forgo future concessional loans to HIPC participants.

Figure 3 (borrowed from Cassimon et al. 2016) illustrates the foregoing graphically. It plots the NPV and the option value C in function of the underlying asset value, i.e. the benefits V . An NPV approach would suggest going ahead with the decision once benefits V equal costs I , at point (a). However, in the presence of uncertainty/risk, the decision to go ahead would be postponed until the NPV exceeds the positive value of waiting, as from point (b) onward. Moreover, as higher uncertainty/risk increases option value C , shifting point (b) to the right, it leads to longer waiting. Instead, the presence of an opportunity cost of waiting (the dividend payment foregone in the case of a stock option), lowers option value C , with higher opportunity costs shifting point (b) to the left, and leads to earlier exercise.

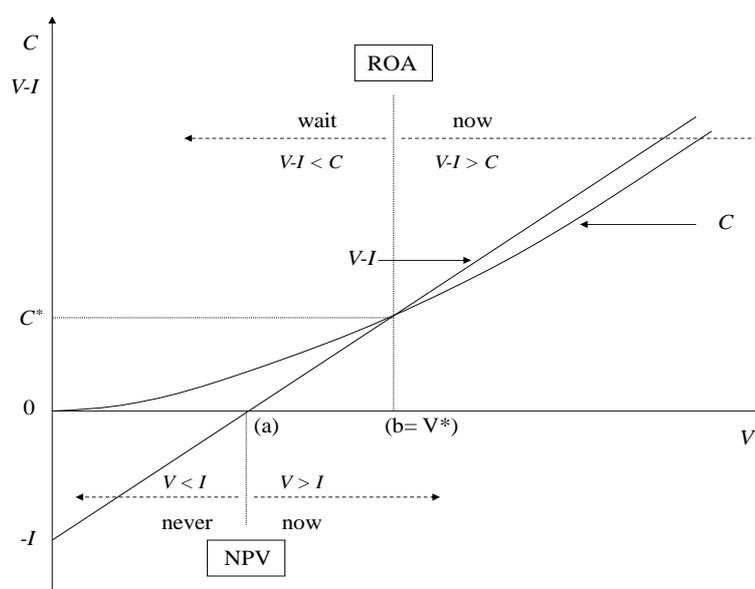


Figure 3: The real option approach versus the NPV rule.

Source: Cassimon et al. (2016).

Conceptually, this real option set-up appears to apply well to debtor countries' decisions on whether or not and when to enter into the DSSI and/or Common Framework. A debtor is likely to consider the benefits of participation, the costs of participation, the associated uncertainty related to benefits and/or costs, and the opportunity cost of waiting/postponing the participation decision. Each of these parameters can be further specified and linked to (proxy) variables. Let us focus here on the DSSI.

The main benefit of DSSI participation is obviously the temporary debt service suspension. As such, participation is more beneficial if these savings are substantial. This in turn depends on the composition of debt service: benefits increase with the scheduled debt service owed to (bilateral) creditors that have committed themselves to implement the DSSI. Arguably, to the extent that the DSSI eases liquidity pressures, benefits are also higher for debtor countries that experience greater risks of debt distress. The (perceived) costs of DSSI participation include potential reputational harm, possibly involving a credit rating downgrade and leading to higher future borrowing costs. Fears about adverse reputational effects were not far-fetched: some countries' credit ratings were indeed put on negative watch upon joining the DSSI, even without them signalling that they would seek debt service suspension from their private creditors. Such costs can be assumed to be higher for countries with larger commercial debts and more front-loaded debt repayment profiles (requiring an earlier return to the market for debt rollover). Stigma related to the DSSI-required request for IMF assistance may constitute an additional cost.¹³

¹³ See Scheubel et al. (2018) and Andone and Scheubel (2019) for a discussion of financial market and political stigma vis-à-vis IMF assistance.

Clearly, the DSSI participation decision is subject to uncertainties, especially at the start of the initiative. Uncertainty relates mainly to the (reputational) costs of the DSSI, but on the benefits side too, there were initial doubts about the exact terms and perimeter of the DSSI. Over time, the uncertainty for candidate DSSI participants decreased as (commercial) creditors and credit rating agencies clarified their positions, DSSI terms (including on the treatment of arrears, payments on syndicated loans, etc.) were further specified, and the experiences of actual DSSI-participating debtor countries could be observed. Finally, there are opportunity costs to postponing the decision to participate in the DSSI, since the suspension only applies to debt service due *after* the debtor's DSSI request; it is not applied retroactively to debt service paid before the request.

In order to empirically validate our real option framing of the DSSI participation decision, we consider a number of proxy variables for the just-mentioned potential benefits, costs/risks, and opportunity costs associated with DSSI participation and compare them across three buckets of DSSI-eligible countries: (i) countries who filed a request for DSSI support with the Paris Club before 1 June 2020 ("early DSSI participants"); (ii) countries who filed such a request only after 1 June 2020 ("later participants"); and (iii) countries who made no such request ("non-participants"). Note that for this exercise we focus on the initial stage of the DSSI, which provided relief on debt service between May and December 2020. The 1 June dividing line is chosen because of the clarifications about the DSSI that were made during its first month of operation, including through consultations of eligible debtor countries with their official creditors and with IMF staff, the publication of the IIF's terms of reference for voluntary private sector participation, and the first credit rating actions. These clarifications, together with the actual experiences of the first movers, reduced the uncertainty about the potential benefits and costs of DSSI participation. The 1 June division also allows us to have a reasonable number of DSSI-eligible countries in both the "early participants" and "later participants" groups (23 and 13 countries, respectively).¹⁴

Panel A of Figure 4 shows that DSSI-eligible countries that decide to participate tend to be those with higher potential debt service savings, i.e. higher potential benefits. Early participants have the highest median debt service savings, in line with the interpretation that a higher debt service due may imply higher opportunity costs of waiting. Panel B further indicates that DSSI participants typically had a higher risk of debt distress (before the DSSI was initiated) than non-participants, signalling the DSSI's perceived benefit of debt risk reduction. And panel C shows that DSSI participants, especially early participants, were more likely to already have an IMF arrangement in place (sometimes under the form of COVID19-related emergency financing, sometimes a full-fledged arrangement pre-dating the COVID19 pandemic). Arguably, countries with a pre-DSSI IMF arrangement faced lower costs, as they did no longer have to worry about the potential stigma of requesting IMF support.¹⁵

¹⁴ Another 30 countries are classified as non-participants (including Kyrgyz Republic and Vanuatu, which withdrew their initial DSSI participation request). Seven countries are classified as DSSI participants but did not file a request with the Paris Club (mostly because they directed their request to single Paris Club creditors on a bilateral basis and/or to non-Paris Club creditors only). For the latter countries we have no information on the timing of their DSSI participation request.

¹⁵ Of course, if an IMF arrangement was already in place, there was no need for the debtor country to negotiate one and this may have brought the country's DSSI request forward a couple of weeks.

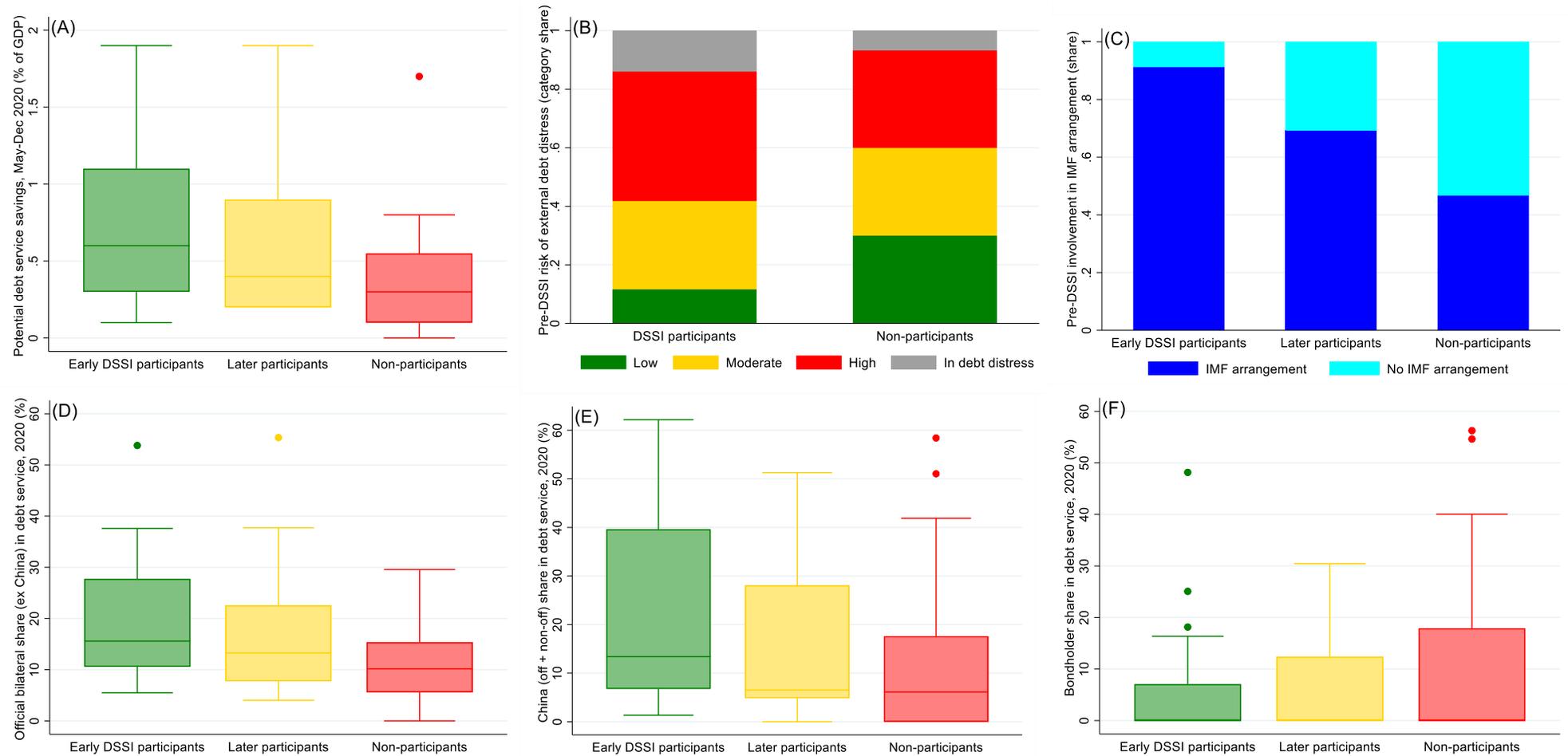


Figure 4: Potential debt service savings (A), risk of external debt distress (B), involvement in IMF arrangement (C), and creditor composition of external debt service (D, E, F); by DSSI participation status.

Sources: IMF, World Bank, authors' calculations.

Notes: Participation status is based on whether and when DSSI-eligible countries filed a request with the Paris Club to join the original DSSI (running from May 2020 to December 2020). Early (later) DSSI participants are countries that filed a request before (after) 1 June 2020. Panel A excludes outlier Bhutan. Panel D excludes outliers Bhutan and Haiti.

Moreover, as evident from panels D, E and F of Figure 4, the three groups of DSSI-eligible countries differ notably in terms of creditor composition of external debt service. Countries that decide to participate (earlier) tend to owe higher shares of their debt service obligations to official bilateral creditors (excluding China) as well as to Chinese official and non-official agencies, and lower debt service shares to bondholders. Higher exposure to official bilateral creditors implies higher benefits from DSSI participation; as does higher exposure to China, given that the DSSI is the first coordinated debt relief initiative to which China has explicitly committed itself. Lower exposure to bondholders reduces the perceived risks that DSSI participation may lead to reputation loss, negative rating actions and/or a worsening of market access.

There is also more anecdotal evidence supporting our real option framework. For example, in May 2020 Kenyan Treasury Secretary Ukur Yatani was quoted as saying: *“We fear we might unnecessarily create a crisis...The G20 debt relief initiative does not offer optimal benefit given the structure of Kenya’s debt portfolio...Kenya is taking a cautious approach of seeking debt relief from bilateral creditors to safeguard its sovereign credit rating”*.¹⁶ By November 2020, however, Mr. Yatani had changed tack: *“We have been reluctant in the past because of the attendant unintended consequences in terms of those holding private debt...But now after getting a bit of assurance that it is a matter that can be managed, we are now strongly considering joining the arrangement”*.¹⁷ In January 2021 Kenya actually joined the DSSI. The above quotes give an indication of why Kenya switched from non-participation in the first leg of the DSSI to participation in the second leg. At first, Kenya deemed the debt service savings from participating not sufficiently large to go ahead, in view of a potential credit rating downgrade, and decided to wait. Later, Kenya decided to participate after all, because of “assurances” on the DSSI’s market access effects (likely obtained through observing the experiences of earlier DSSI participants and talking to creditors and IMF staff). Moreover, between May and November 2020 Kenya’s financial situation had deteriorated and its credit rating had been placed on negative watch by the three main rating agencies, making reputational damage less of an issue. Kenya’s decision to join the DSSI only at a later stage implies that it missed out on some temporary debt service savings in 2020.

In future work, a similar real option-inspired analysis could be performed to test the drivers of participation in the Common Framework. A priori, there seems to be some overlap but also important differences with the parameters we have proposed for the DSSI. For example, the potential benefits appear to be much broader, in terms of improved resource availability through debt (service) relief or ultimately even the regaining of debt sustainability. At the same time, the reputational costs of a deeper debt treatment are likely to be more severe. Above all, especially at the current juncture, there is much more uncertainty surrounding the benefits and costs of participation in the Common Framework.

5 The future: How to improve upon current debt relief practice?

So where does the foregoing leave us? What lessons can we draw from the HIPC initiative, and from experiences with the DSSI and emerging Common Framework, to improve upon current debt relief practice? We again structure our discussion along the six dimensions identified in section 2: (i) restoring debt sustainability; (ii) increasing resource availability; (iii) creditor involvement and burden-sharing; (iv) appropriate conditionality; (v) attractiveness for debtors; and (vi) preparedness for the future.

¹⁶ See <https://news.trust.org/item/20200515125658-ef81f>. The citation is borrowed from Lang et al. (2021).

¹⁷ See <https://news.trust.org/item/20201118112615-ohp5f>.

(i) Restoring debt sustainability

First of all, the modalities of any debt treatment should be informed by a thorough DSA, based on realistic macroeconomic baselines and shock scenarios. This is no sinecure, as a DSA is an inherently forward-looking exercise that implies forming expectations about countries' future debt repayment capacities and involves a good dose of judgement (Guzman and Heymann, 2015).¹⁸ It also requires transparency on the size and nature of public and publicly guaranteed debt.

To facilitate a robust return to debt sustainability, debt treatments should be “deep enough”, i.e. they should provide sufficient relief so that debtor countries have the time to tackle the structural issues underlying their debt problems and retain some headroom in case of external shocks. The temporary debt service suspension under the DSSI may have eased short-term liquidity pressures for some countries but is obviously inadequate to address situations of unsustainable debt. Debt treatments under the Common Framework should avoid the tendency to “delay and replay” (Graf von Luckner et al. 2021). Also the deep debt relief under (and beyond) the HIPC initiative – which has contributed to longer-term debt sustainability in most of its beneficiaries (cf. section 3.2) – was preceded by a long run-up of multiple, successive reschedulings with gradually increasing concessions (larger PV reductions) by Paris Club creditors.¹⁹ At least on paper, the Common Framework currently seems to be biased against deep debt treatments, as debt write-offs are said to be reserved for “the most difficult cases”, increasing the risk of undershooting.

The heterogeneity in debt instruments and creditor bases of debtor countries has grown considerably since the 2000s (cf. Figure 1, and World Bank 2021), justifying a more flexible and differentiated approach to debt restructuring than under HIPC. In that respect, the case-by-case set-up of the Common Framework may be helpful (cf. the very different cases of Chad, Ethiopia and Zambia in section 4.1). Moreover, it seems untenable to keep restricting debtor countries' access to the Common Framework solely on the basis of IDA eligibility, i.e. income criteria. As the IMF (2021c) points out, several middle-income countries that are not eligible for the DSSI and Common Framework have elevated external debt vulnerabilities and broadly similar debt compositions. They too may need debt treatments at some point. It would be more efficient to bring those treatments under the umbrella of the Common Framework too than to organise the negotiations in the Paris Club and with (individual) non-Paris Club creditors separately. At the same time, acknowledging that creditor resources for debt relief are finite, they may need to be prioritized for low-income countries.

(ii) Increasing resource availability

While the original HIPC initiative was, above all, conceived as a mechanism to restore debt sustainability, the enhanced HIPC, and more so the MDRI and beyond-HIPC debt relief provided by Paris Club creditors, became more focused on generating additional resources to support debtor countries' progress towards the MDGs. The available evidence suggests some success in the creation of fiscal space by the latter initiatives, although it remains unclear how much of this has contributed to additional MDG-related spending (cf. section 3.2). The Common Framework seems again much more geared towards resolving debt sustainability problems but could in theory be used to channel extra resources to debtor countries to support their fulfilment of the SDGs – if debt treatments go beyond writing off arrears and short-term debt reprofiling, of course.

However, one needs to take an holistic view here. In order to realise truly additional, positive net transfers, debt relief under the Common Framework will need to complement rather than replace grants and (concessional) lending by bilateral and multilateral donors/creditors.²⁰ It is also important

¹⁸ The application of judgement in DSAs is inevitable and necessary to take into account country-specific characteristics but may introduce bias (Lang and Presbitero 2018).

¹⁹ Zambia, for example, was involved in seven Paris Club debt treatments between 1983 and 1999, before it reached its HIPC decision point in 2000.

²⁰ Several commentators have argued that the granting and lending response to the COVID-19 crisis of multilaterals such as the World Bank and IMF has been far too weak (G30 2021, Sandefur 2021).

to consider potential second-round resource effects. Whether or not deep debt relief is an appropriate vehicle to increase resource availability depends on the importance of debt overhang effects and on the consequences of the relief for the private market access of debtor countries. Back in the HIPC days, debt overhang was indeed an issue and market access was very limited. This time is different, and debtor country specifics will need to be taken into account.

(iii) Creditor involvement and burden-sharing

To increase the impact of debt treatments on debt sustainability and/or resource availability, and to come to a fair burden-sharing, it will be key to involve as many as creditors possible. To the extent that the Common Framework is the very first constellation that brings together Paris Club and non-Paris Club creditors to jointly deliver on debt treatments, it is an important milestone. However, whether the Common Framework will actually smooth coordination and increase solidarity among the various bilateral creditors remains to be seen. Free-riding by creditors outside of the Common Framework, most notably commercial creditors, should be prevented. The experience under the HIPC initiative already showed this is a hard nut to crack, as many commercial creditors did not participate in the debt relief, or only indirectly, through sponsored debt buybacks. The enforcement of the Paris Club's (and now Common Framework's) comparability of treatment principle has now become more important as well as more challenging, due to the much-increased role and greater fragmentation of commercial creditors (including many bondholders) in several debtor countries. The total abstinence of commercial creditors from the DSSI suggests that an entirely voluntary approach will not work. Incentives will need to be changed, likely through a combination of carrots and sticks.

G20 governments could use moral suasion and regulatory tools such as tax incentives and supervisory requirements to steer commercial participation in debt restructurings, like the United States and European countries have done in the past (Volz et al. 2021). Also doubling down on debt transparency at the debtor and creditor side could help to expose some free-riders. Since different types of (commercial) creditors are likely to have heterogeneous preferences (due to differences in tax and financial regulations, investment horizons, etc.), it may be useful for debtor countries to offer them a tailored menu of debt restructuring options, as was done in the Brady deals of the 1980s and early 1990s (Claessens and Diwan, 1994). Some of the options on the menu could be made more attractive to creditors by means of "sweeteners", including cash payments, the provision of collateral, debt buybacks, guarantees and other credit enhancements (see e.g., Stiglitz and Rashid 2020, and Volz et al. 2021 for proposals). These sweeteners would be paid for by the debtor and/or official creditors. However, as the IMF (2021d) demonstrates, the conditions under which debt operations with sweeteners can be expected to deliver significant efficiency gains over standard debt restructurings are relatively narrow, and may be hard to pin down in practice. Offering cash/collateral or a buyback could make sense if there are clear indications that creditors underprice the original debt instruments, or if the costs of a debt restructuring are deemed to be very elevated (due to the prospect of protracted negotiations or high reputational costs). In any case, one should avoid that private creditors play hardball and hold out for a better deal because they know that sweeteners are forthcoming. Moreover, officially sponsored sweeteners may lead debtor countries to act strategically and reduce their efforts in clinching a debt restructuring deal.

For now at least, involving multilateral institutions in debt write-offs as under HIPC and MDRI is not envisioned under the Common Framework and appears to be (politically) difficult. As always, the behaviour of multilaterals crucially depends on the views of their shareholders, which would need to provide compensation or agree on the use of the multilaterals' own resources (Morris 2019). It is far from assured that bilateral donors-creditors stand ready to foot the bill again, on top of the debt relief they provide on their own claims. To be able to use gold sales to finance debt relief, the IMF would need to assure a majority of 85% of total votes in its Executive Board. Increasing net transfers to debtor countries through additional grants and concessional loans from multilaterals, potentially boosted by an SDR allocation, seems a much faster and more promising avenue, especially if aimed at tackling a near-term shock like the ongoing COVID-19 pandemic (Morris 2020).

(iv) Appropriate conditionality

Debt relief should continue to be conditioned on debt transparency commitments by the debtor, as currently under the DSSI and Common Framework. It could also be useful to establish a greater link between debt relief proceeds and desirable spending, say through more attention to SDG-related expenditures in the IMF programme accompanying the debt treatment. This would not only benefit debtor country citizens but may also help to increase bilateral creditor buy-in for deeper debt treatments. There is likely to be some lingering debt relief fatigue from the HIPC initiative among Paris Club creditors. Providing creditors with extra assurances that the money freed-up through debt relief would be well spent could make them less reluctant. One interesting avenue that should be appealing to creditors, in principle, would be to use conditionality to steer debt relief proceeds towards financing global public goods, such as COVID-19 vaccination campaigns or investment in climate change mitigation in the debtor country (Volz et al. 2020) (again if debt relief is deemed to be a good vehicle to increase resource availability).

However, it would be wise not to overuse conditionality, as this adds to transaction costs, may slow down the debt restructuring process and risks to undermine country ownership. We should not go back to the time-consuming two-stage set-up of the HIPC initiative nor to the micro-level (and sometimes off-budget) tracking of expenditures it applied in some countries.

(v) Attractiveness to debtors

Debtor countries, even those with unsustainable debts, may not want to come forward to apply for a debt treatment in the Common Framework, or at least not initially, because of the large uncertainty surrounding the benefits and costs of such debt treatments. This problem can be attenuated by changing the “real option value” of participation for those debtor countries, to keep with the terminology we have used in section 4.3. Like in the case of the DSSI, uncertainty about the benefits and costs of the Common Framework can be reduced by means of clarifications with respect to the exact perimeter of treated debt (issues with guarantees, arrears, collateralisation, etc.) and the likely effects of participation on credit ratings and market access. Moreover, even if the Common Framework explicitly operates on a case-by-case basis, an effective handling of the first few cases by bilateral creditors, the IMF and the World Bank may have positive demonstration effects, increasing other debtors’ confidence in applying.

(vi) Preparedness for the future

Finally, the current architecture for sovereign debt restructuring – which includes the DSSI, Paris Club and Common Framework, contractual provisions, and some limited statutory tools (such as the anti-vulture fund laws of the United Kingdom, France, and Belgium) – is likely insufficient should a (COVID-19-related) systemic debt crisis materialise (IMF, 2020). The Common Framework’s case-by-case approach for official debt relief and the contract-by-contract negotiated debt workouts with commercial creditors may be too slow and inefficient to deal with multiple-country debt crises. Hence, some proposals for legislative or executive actions, have been advanced, mostly to be used as last-resort measures. For example, Bolton et al. (2021) introduce the notion of “legal air cover”, i.e. temporary legal protection to debtor countries during which they can divert resources from (commercial) debt service to, for example, funding the health care costs of the COVID-19 pandemic, without the need for debtors to file a request. Bolton et al. (2021) argue that such a stay on debt repayments could be based on a UN Security Council resolution (as was used in the 2003 debt restructuring for Iraq) or on an Executive Order by the US President (as was also used for Iraq and, more recently, for Venezuela).

Ideally, however, debt relief interventions should be guided by an ex ante mechanism or clearly defined set of rules allowing for an orderly, predictable, and speedy restructuring process. A full-fledged sovereign debt restructuring mechanism (SDRM) like the one that was proposed by the IMF but ultimately abandoned (Krueger 2002), may not see the day of light any time soon because of the opposition of major creditors and debtors. But perhaps the inter-creditor dialogue in the Common

Framework can serve as a stepping stone for what the G30 (2021) refers to as a “standing consultative mechanism”. Such a mechanism would include representation from all major stakeholders (i.e., the different creditor classes, debtor countries, the international financial institutions, credit rating agencies) and could be given the mandate of promoting transparency, consistency, and even-handedness across the Common Framework’s cases, as well as an advisory role.

6 Concluding remarks

This paper has described the set-up and surveyed the main results of the HIPC initiative and the MDRI, which to date remain the largest and most comprehensive debt relief effort ever launched for low-income countries. We have also discussed the recent DSSI and the emerging Common Framework, pointing out key similarities and differences with HIPC/MDRI. Based on this comparative analysis we have tried to shed some light on how current debt relief practice could be improved.

We conclude that, whereas the HIPC initiative and MDRI appear to have been rather successful – most clearly in reducing large debt stocks and debt service significantly and allowing them to remain low for some time, in the average HIPC – a copy-paste replication of HIPC in the current context would be both infeasible and undesirable. The landscape in terms of debt instruments and creditors has changed considerably for most low-income countries, and has become more heterogeneous across countries, since the 2000s, partly because of HIPC itself. The increased role of China and other non-Paris creditors as well as commercial creditors complicates finding consensus on large comprehensive debt relief on similar terms for a broad set of countries. Moreover, large write-offs of multilateral debt, a key feature of HIPC and MDRI, appear to be politically difficult for now, and the provision of additional grants and concessional loans seems more promising. Greater cross-debtor country heterogeneity justifies a more flexible and differentiated approach to debt restructuring than under HIPC, with more attention paid to what kind of debt treatment would be needed to restore debt sustainability and/or to increase resource availability in a specific country, including a closer look at potential consequences for market access. In this more flexible approach, there should be room to include middle-income debtor countries.

Despite that this time *is* different, we believe there are still valuable lessons to draw from the HIPC initiative, some reinforced by the experience with the DSSI. First of all, the “delay and replay” tendencies of (pre-HIPC) debt restructuring should be avoided; if debts are clearly unsustainable a sufficiently deep debt treatment may be the only way out. Second, the enforcement of the “comparability of treatment” principle, in particular the involvement of commercial creditors, is a real challenge, and has become even more challenging. Achieving it may require a combination of carrots, such as a menu approach to debt restructuring (possibly with “sweeteners”), and sticks, like moral suasion by creditor governments or regulatory tools. Third, imposing extra conditionality on the spending of debt relief proceeds may be helpful, also for creditor buy-in, but should not be overdone.

While the Common Framework has been an important step in rallying Paris Club and non-Paris Club bilateral creditors behind the idea of jointly delivering on debt treatments, it is unlikely to be sufficient in case a systemic, multiple-country debt crisis would occur. Whereas a full-fledged SDRM still seems like a far-off frontier, the inter-creditor dialogue in the Common Framework could perhaps serve as the embryonic basis for a more inclusive body or forum with advisory powers on debt restructuring.

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Appendix

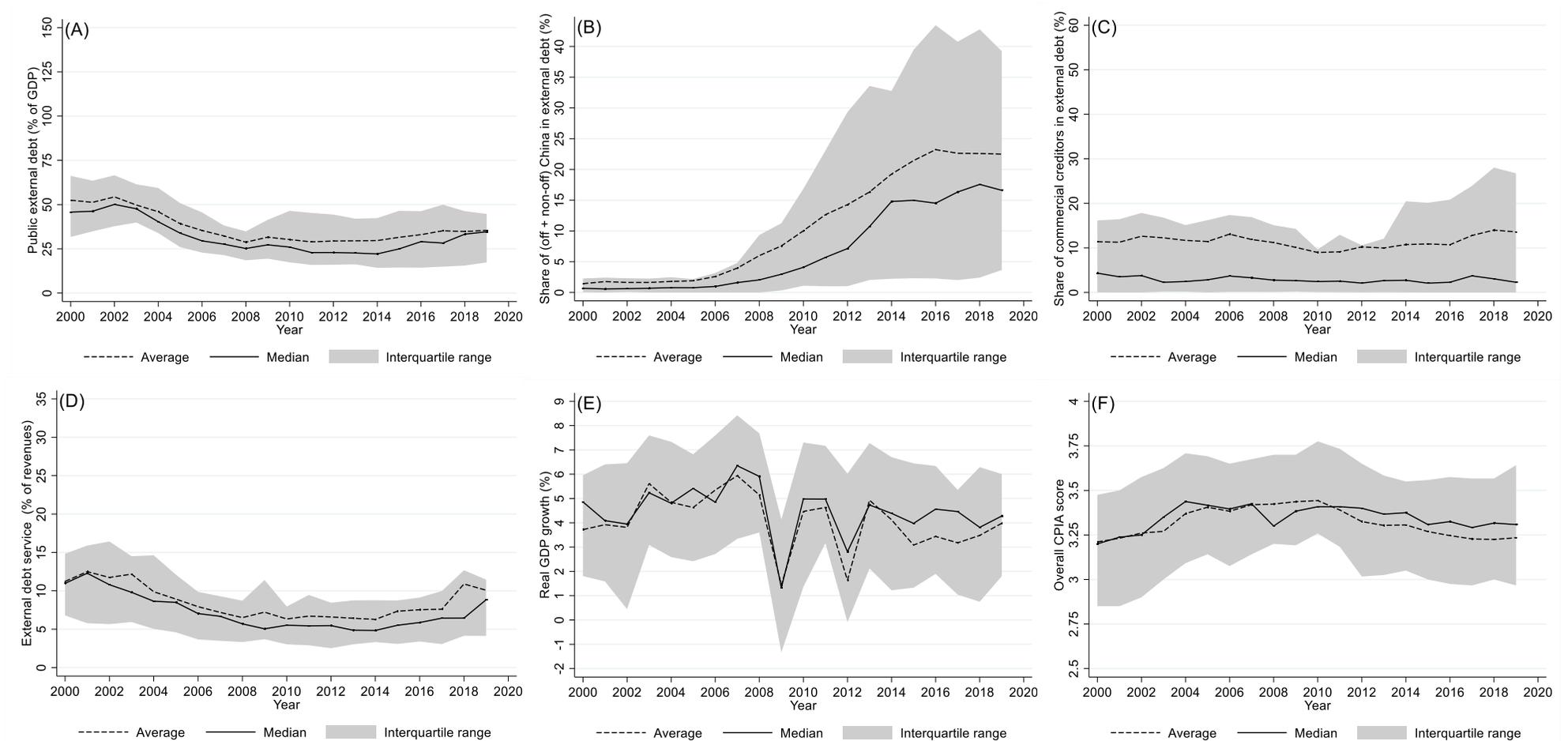


Figure A1: Evolution of external debt ratio (A), of Chinese creditors' share in external debt (B), of commercial creditors' share in external debt (C), of external debt service (D), of real GDP growth (E), and of CPIA scores (F); for non-HIPC DSSI-eligible countries.

Sources: IMF, World Bank, authors' calculations.



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