

WORKING PAPER #186

UNPACKING DEVELOPING COUNTRY DEBT PROBLEMS

SELECTED REFORMS TO THE
INTERNATIONAL FINANCIAL
ARCHITECTURE

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Unpacking developing country debt problems: Selected reforms to the international financial architecture

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Executive summary

Entering 2024, multiple forums are debating reforms to the international financial architecture to resolve developing country debt problems. These forums should start by identifying the different problems that need to be solved. In this paper, we argue that there are four distinct debt-related questions that developing countries are confronting, each of which merits its own response: (i) how to meet current debt service obligations; (ii) how to open fiscal space for debt-financed sustainable infrastructure and other priority development investments; (iii) how to best use debt in responding to natural disasters; and (iv) how to improve debt transparency to better the overall functioning of global capital markets.

Problem 1: How to meet current debt service obligations

In 2020, the nominal dollar value of developing country exports fell by almost 10%, just at the time when external debt service was rising and when global capital was rushing to advanced country safe havens. Developing countries owed 10% of total GDP in external debt service.¹

A G20-led Debt Service Suspension Initiative (DSSI) helped alleviate the liquidity problem in the lowest-income countries. Surges in lending from the International Monetary Fund (IMF) and multilateral development banks also helped.

In 2022, central banks in the major advanced economies started to raise interest rates, with significant impact on interest payments owed by developing countries in 2023. Meanwhile, the DSSI had expired, and net financial transfers from official multilateral agencies declined steeply in 2023. No International Development Association (IDA)-eligible country was able or willing to issue a bond on global capital markets in 2023. Many countries faced severe shortages of foreign exchange.

At the start of 2023, officials at the IMF, World Bank, and U.N. had warned that 60% of low-income countries were either in, or at high risk of, debt distress.² This triggered calls for systemic change to streamline the G20 Common Framework for Debt Treatments into a speedy, efficient mechanism for debt resolution that could also be applied to middle-income countries.

During 2023, only Ghana applied for relief under the Common Framework auspices. Nevertheless, the feared systemic spread of debt crises did not materialize. Most developing countries were able to muddle through and meet their external payment obligations, albeit at considerable cost of cutting needed social programs and investments. Ethiopia was the only developing country to default in 2023, missing a late December bond payment.

Total debt service due in 2024 is now estimated to be lower in sub-Saharan Africa and the Middle East regions, while exports are rising.³ From 2025 and onward, debt servicing should be manageable in most cases without resorting to exceptional measures, such as blanket debt relief. It is important for developing countries to retain hard-won access to global capital markets.

Two lessons should be learned from the experience of the past few years. First, reliance on private sector financing carries high liquidity risks, complicates reprofiling of debt service, and so cannot easily substitute for official financing. Second, private lenders have been shielded from the consequences of their overlending. There is moral hazard in global capital markets that now needs to be rolled back.

The Common Framework should have a separate window, open to all countries, that is limited to a debt reprofiling exercise, with haircuts taken off the table. This window will need new money packages or restructurings from official creditors, conditioned on priority investments but with reduced structural conditionalities.

Problem 2: How to open fiscal space for debt-financed sustainable infrastructure

Emerging economies in sub-Saharan Africa, Latin America, and developing Europe have investment rates that average between 20-22% of GDP.⁴ These rates are lower than in 2015 when the international community agreed to pursue ambitious sustainable development goals and to refresh the global framework for development financing.⁵ Since Addis, the need for higher investment and more financing in emerging economies has risen, to meet commitments to invest more in global public goods and challenges: climate action, pandemic surveillance, and nature preservation.

President Ruto of Kenya, along with other leaders, has called for a new energy pact for Africa to finance and realize energy projects, while tackling governance, environmental and labor issues.⁶ The problem is that many governments lack fiscal space and cannot access new project finance due to the overhang from existing debt.

When countries have high debt, policymakers face a dilemma: cut back spending to reduce the rate of debt accumulation or accelerate investment in high-return projects to grow out of debt problems. At present, creditors tend to favor the former while borrowers argue for the latter. The empirical evidence as to which strategy better averts debt problems is mixed and heavily dependent on context and time.⁷ In contrast, the empirical evidence on which strategy is needed to better address climate change and sustainable development is strong: a big push on investment.⁸

A big push investment strategy should be effective in most developing countries. The World Bank estimates its projects have had a median *ex post* 17% rate of return in developing countries of all types—middle-income and low-income, and in every geography.⁹ It has documented “200 windfall-producing investment booms—episodes in which per-capita investment growth accelerated to 4 percent or more and stayed there for more than six years” as periods of income growth, higher productivity, and reduced poverty.¹⁰ Such evidence corroborates modeling simulations done by the IMF that find a large public investment push would be beneficial for borrower governments and their populations, as well as for new and existing creditors.

Such microeconomic evidence on high rates of return to public investment is treated with skepticism in some quarters because of the possibility of selection bias, or the difficulties of scaling up in the face of possible Dutch Disease and adverse macroeconomic effects of high investment.

A mindset change is needed for such evidence to be taken seriously. The presumption that public sector debt insolvency reflects economic mismanagement, waste, and corruption needs to be overcome. Historical evidence suggests that wars and revolutions are more frequent causes of insolvency than economic mismanagement.¹¹

For those who view debt as unsustainable because of wasteful spending in the past, a solution may lie in debt write-offs. This can, in principle, resolve the debt problem. It is unlikely, however, to resolve the

problem of inadequate investment and growth. For this, new money is needed, and a bad track record will reduce access to funds.

Hence, we suggest an alternative strategy to manage the debt overhang. Let multilateral development banks (MDBs) lend more for specific public and private investment programs.¹² MDBs enjoy preferred creditor treatment and have a proven track record of high returns on the development projects they finance. They also provide additional benefits in the form of policy advice, project origination, and long-term affordable loans. MDBs can coordinate a bridge between new money, investment, and policy reform, along the lines suggested by President Ruto and by academics.¹³

MDB lending to support country platforms should be the initial entry point for their scale-up. Figuring out how to expand the quantity of high-quality projects and enhance design and implementation capability is not a simple matter. Country-owned and country-led transformation platforms are novel institutional mechanisms to do this. These have been piloted in energy transition and other sector programs that seek to achieve specific results over a specified time period.

Country platforms also provide a mechanism for partnering with private creditors. Ultimately new private creditors will only participate at scale if they are able to reduce their risk, either implicitly via a “halo” effect from engagement with MDBs or explicitly through a guarantee from a AAA-rated entity such as an MDB.

To encourage private sector activities in non-investment grade developing countries, finance for green investments in designated country platforms should be treated in the same way as trade finance and exempted from future negotiations on debt rescheduling. The added advantage of reducing risk in this way for global-priority investments is that the interest rate that commercial banks charge on green infrastructure projects would also be driven down, raising financial returns.

Of course, this approach should be implemented in a measured and selective way to keep the level of senior debt manageable and to strengthen fiscal solvency over time. New tools and mechanisms to assess public solvency in a nuanced fashion are needed. The MDBs should modernize their debt sustainability assessments (DSAs) to focus on public solvency, leaving the assessment of liquidity and rollover risk to the IMF. There are useful programs for international technical assistance to strengthen public debt management and these could be given greater priority. Official creditors could also support the establishment of independent fiscal councils and public net worth accounting in developing countries, both of which could provide better controls on the appropriate level of public investment than the debt and debt service ratio threshold criteria embedded in DSAs and other MDB creditworthiness assessments.

Problem 3: How to best use debt in responding to natural disasters

When developing countries are hit by natural disasters, they borrow to cushion the effect of the shock. This is a sound use of borrowing capacity, but it has its limits. When there is a sequence of natural disasters destroying capital that then needs to be rebuilt before being destroyed by the next disaster, borrowing becomes ineffective. Debt simply mounts, while domestic assets do not grow. Many Caribbean countries have fallen victim to this cycle. The IMF estimates that the cost to the Caribbean

from natural disasters has averaged 2.4% of GDP each year between 1980-2020.¹⁴ One in ten disasters causes damage and loss of more than 30% of GDP in small countries.¹⁵

There are now 68 member states in the V20 group of vulnerable countries faced with the risk of a cycle of disaster-rebuild-repeat, or a single disaster that is very large compared to the economy.

Debt relief can help in these cases, but it is the second-best solution. Seychelles and Belize restructured their debts after major catastrophes. Grenada and Barbados have pioneered automatic disaster-relief clauses in their debt contracts. Such clauses should become standard practice in new bond contracts. The International Credit Market Association has developed appropriate standardized contracts that can be used in private debt contracts. Similarly, the World Bank has expanded its climate-resilient debt clauses for selected borrowers. Other official lenders should follow suit.

A preferred solution is more and better insurance but the insurance gap in developing countries remains enormous. According to SwissRe, 60% of global insurable crop production was unprotected against natural disasters and accidents, and 76% of global exposure to catastrophes was unprotected.¹⁶

Catastrophe bonds are now available for individual countries. However, premiums can be exorbitant, and the preexisting condition of a country's geography can create a market failure. In such situations, it would be just and equitable for the international community to bear a portion of the underlying risks by subsidizing insurance premiums through donor-funded mechanisms like the Global Risk Financing Facility. The newly established loss and damage fund also directly provides subsidies to countries hit by natural disasters and could potentially be used to buy down insurance premiums. But these and other examples of subsidized insurance facilities must be adequately resourced to be impactful at scale.

Problem 4: How to improve debt transparency

Without debt transparency, global credit markets cannot work efficiently. Risk rises and with it the cost of capital to developing countries. Aggregate credit limits, used by lenders to limit moral hazard and adverse selection, only work if data is reliable, up-to-date, and verifiable.

Only one IDA-eligible country, Burkina Faso, has been judged as fully transparent in its debt reporting. A raft of initiatives to improve reporting is ongoing, in the IMF, World Bank, and the Organisation for Economic Cooperation and Development (OECD). However, there is little evidence of progress, and incomplete information complicates and lengthens debt negotiations, as exemplified by the Zambia case. Efforts to encourage countries receiving debt relief under the debt service suspension initiative to improve their reporting have so far been unsuccessful.

Elevating the priority of debt transparency is a prerequisite to any sustainable treatment of developing country debt. An institutional strengthening component for debt reporting should be included in all debt relief packages.

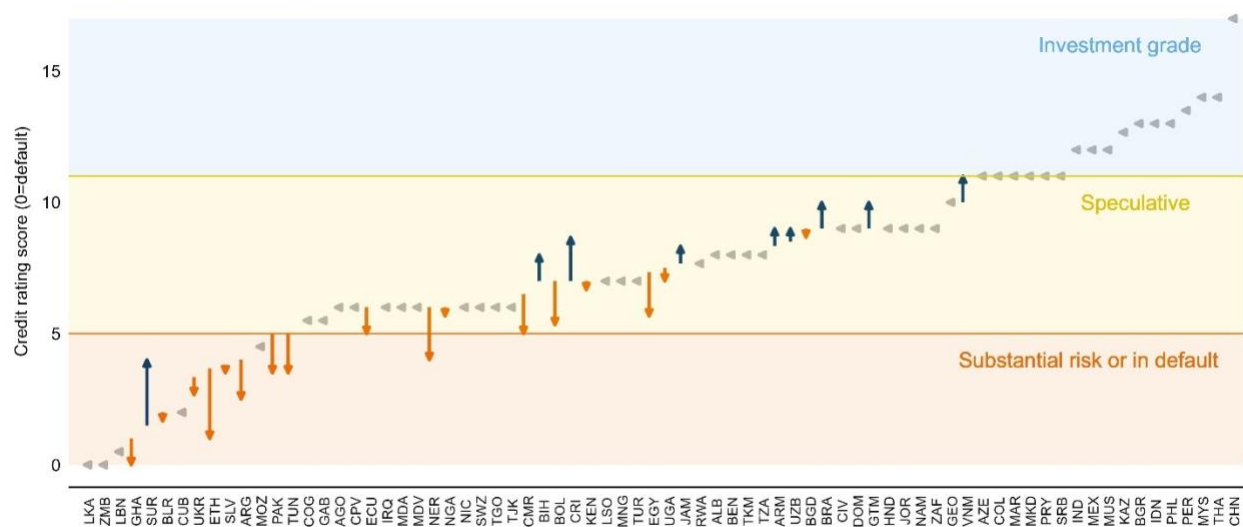
I. Introduction

In early 2023, there was considerable concern that many developing countries could face acute difficulties with servicing their external debt. Ten developing countries had already defaulted on their sovereign debt payments between 2020 and 2022, raising concern that contagion and/or the worsening of the global economy—slowing growth, polycrises, rising interest rates, and tighter credit markets—would lead to multiple additional casualties.^a

However, Ethiopia was the only country to default during 2023, missing its December bond payment. Other countries, like Bolivia, Pakistan, and Tunisia, did see their creditworthiness deteriorate but managed to stave off default. They are, as Figure 1 shows, more the exception than the rule. Only a handful of developing countries actually had a major downward revision in their credit rating during 2023 despite the onslaught of bad global economic news.^b

Figure 1. Changes in developing country sovereign credit ratings in 2023

Sovereign credit ratings Jan 2023 versus Jan 2024



Note: Vertical axis measures average credit rating of 3 major agencies: S&P, Fitch, Moody's with ratings converted to a 0 (default) to 21 (best rating) scale. Credit risk is classified as Investment grade (<=21 & > 11), Speculative grade (<=11 & >5), and Substantial risk or in default (<=5). Source: Author estimates from scraping of Trading Economics 03/29/2024 and Fitch ratings 01/12/2024. Arrows indicate change from January, 2023 to January, 2024.

Entering 2024, the rhetoric on the risk of a systemic debt crisis has abated.^c Nevertheless, the questions of what to do about sovereign debt—how to manage the obligations due on existing debt and how to

^a Argentina, Belarus, Ghana, Ecuador, El Salvador, Lebanon, Suriname, Sri Lanka, Ukraine and Zambia. Additionally, Chad entered into discussions with creditors in 2021 to restructure its debts, although it was able to make payments to private creditors on schedule, thereby avoiding default, thanks to windfall receipts from oil exports.

^b As another indicator, the JP Morgan EMBI+ index was flat during 2023. Source: Bloomberg Terminal.

^c For example, see [IMF Managing Director Kristalina Georgieva](#), October 12, 2023. However, the potential for a coming debt crisis remains a central part of the narrative, see [A. Krueger, 2023](#).

think about future borrowing strategies—remain at the forefront of international debate on reform of the international financial architecture. Meeting or pre-emptively reprofiling debt service obligations in the short term is one problem but there are others: financing important public investments in developing countries; managing natural disasters; and creating better debt transparency.

Something needs to be done. The debt of many countries is large in absolute terms, so how debt is treated has a material impact on economies. The World Bank reports the public and publicly guaranteed (PPG) debt of low- and middle-income developing countries, excluding China, which is a large net creditor country (henceforth LMYxC). At the end of 2022, this stood at \$3 trillion (of which \$0.6 trillion was owed by 75 IDA-eligible countries). LMYxC governments paid \$371 billion in 2022 to service their external public and publicly guaranteed debt. By 2024, this will rise to \$421 billion, the highest level in history.¹⁷ U.N. Secretary-General Guterres argues that “52 developing countries—almost 40% of the developing world—are in serious debt trouble” and that “the existing architecture is plagued with inequities, gaps and inefficiencies.”¹⁸ He calls for an apex sovereign debt authority to enhance the coherence of the system.

The U.N. is not alone in calling for fresh approaches. There are many other initiatives. A Ministerial-level Sustainable Debt Coalition focused on African countries has been set up following the Egyptian COP27. Ghana is leading an Emergency Debt Coalition for the V20 group of vulnerable countries. The G20, IMF, and World Bank have launched a series of global sovereign debt roundtables to improve the Common Framework. An expert review on debt, nature, and climate, spearheaded by France, Colombia, and Kenya was formed at the Paris Summit in mid-2023.

This proliferation of debates partly reflects dissatisfaction with the existing G20 Common Framework – a set of norms about how to restore debt sustainability in low-income countries (LICs) in a fair and speedy way. The Common Framework has been roundly criticized for its narrow application to only four countries and for its failure to resolve a single case as of the end of 2023 (although Zambia’s three-year negotiations appear to be nearing a conclusion). An additional criticism is that the Common Framework only applies to LICs, while the largest debt problems have emerged in middle-income countries where *ad hoc* approaches remain the norm.

The difficulty faced by the Common Framework and other initiatives is that the problem they are trying to solve is not well-defined, nor are the objectives commonly shared among stakeholders. The treatment of debt can serve many different purposes—international NGOs advocate for debt relief as an instrument to increase resource transfers to poor countries and poor people. Climate and nature activists see debt swaps as a way of achieving a scale-up of mitigation, adaptation, and conservation. LMYxC governments look for debt relief to recapture fiscal space to deliver for their people. Vulnerable countries view debt relief as implicit insurance against large external shocks. Bilateral and multilateral creditors use debt negotiations to extract promises of economic reform from debtors, for poverty, sustainability, macroeconomic stability, human rights, or other causes. Debt has become a geostrategic issue with the emergence of China and Chinese-based banks as large creditors. Each of these sub-texts introduces its own objectives and governance/institutional arrangements into the debates, usually in an implicit rather than explicit way.

The purpose of this paper is to unpack “developing country debt problems” to better understand what needs to be done. Given the complexity of multiple creditors and borrowers, along with multiple objectives, we believe that a debt framework must be flexible. Indeed, perhaps one reason for

dissatisfaction with the existing system is that the same framework is the starting point in all contexts. This is generating confusion, inefficiency, and unmet expectations.

In this paper, after a brief overview of the current state of debt service obligations, we identify four distinct issues: (i) how to meet current debt service obligations; (ii) how to open fiscal space for debt-financed sustainable infrastructure and other priority development investments; (iii) how to best use debt in responding to natural disasters; and (iv) how to improve debt transparency to better the overall functioning of global capital markets. We then propose technical and organizational solutions for each problem.

Problem 1: How to meet current debt service obligations. A government's ability to service external debt can be compromised by a dollar shortage when the ability to roll over debt in global credit markets is curtailed. From 2022 to 2024, LMZYC payments for external debt service reached record levels. The problem is how to manage the observed hump in debt service obligations without crippling the economies of borrowers.

Problem 2: How to open fiscal space for debt-financed sustainable infrastructure. There is a particular urgency today for fiscal space to raise public investments to meet an array of challenges, some with global spillovers such as climate action, pandemic surveillance and nature preservation, and some reflecting national priorities, such as education, health, jobs, and anti-poverty programs.

Currently, because many developing countries have sub-investment-grade credit ratings, private lenders are unwilling to lend more, while official lenders are reaching sustainable lending limits. The problem is that fiscal space for non-investment grade countries has fallen below what is economically efficient and desirable from the perspective of developing country governments and the world more broadly.

Problem 3: How to respond to natural disasters. A higher frequency and severity of natural disasters has revealed a gap in the international financial architecture. Private insurance markets for natural disasters are expensive and increasingly inaccessible, especially for countries susceptible to repeated events, and there is a growing case to be made on the grounds of fairness, justice, and equity that members of the international community responsible for climate change should subsidize the premiums. A secondary problem is to speed up immediate access to bridge finance, given that insurance payouts may be delayed until on-the-ground assessments of losses are finalized.

Problem 4: How to improve debt transparency. Because the operations of sovereign debt markets depend on aggregate credit limits, transparency is crucial for the market to operate properly. This applies not just to the aggregate level of indebtedness, but also to the terms of borrowing and the nature of collateral or other contractual conditions that can favor one creditor over another. The provision of comprehensive debt information is a public good that benefits both borrowers and creditors. Yet data on debt obligations is opaque, especially from private lenders. Some analysts estimate that half of Chinese overseas bank lending may be unreported to the IMF and World Bank.¹⁹

All four types of debt problems have emerged in recent debt crises. In the case of Chad, for example, the first country to apply for debt relief under the Common Framework in 2021, the recovery of oil prices in the middle of 2022 to over \$100/barrel meant that Chad was able to conclude its negotiations with no haircut but with a reprofiling of major private sector debts—a liquidity rather than solvency solution.²⁰

Chad's example differs markedly from that of Zambia where there is agreement that a solvency problem exists, but differences between the extent of haircuts being offered by private and official creditors continue to derail final agreement on how fiscal space and debt overhang issues should be resolved. Inter-creditor comparability of treatment has been hard to achieve in practice.

Pakistan suffered a major downgrade in creditworthiness during 2023 because it lacked any insurance against massive floods that caused an estimated damage of 8% of GDP.²¹ Pakistan was able to borrow heavily from multilateral banks to respond to the disaster, but the shock has reduced its limited fiscal space even further. Ongoing political and structural reforms, as well as debt treatment, are required to reestablish Pakistan's ability to meet its debt payments and invest adequately to restore sustainable development. Meanwhile in Pakistan, as in many other countries, the emergence of China as a major creditor means that the overall size and terms of debt is opaque.

These examples highlight the fact that the mechanics of treating individual country debt problems must be understood in the context of broader reforms that govern the operation of sovereign credit markets.

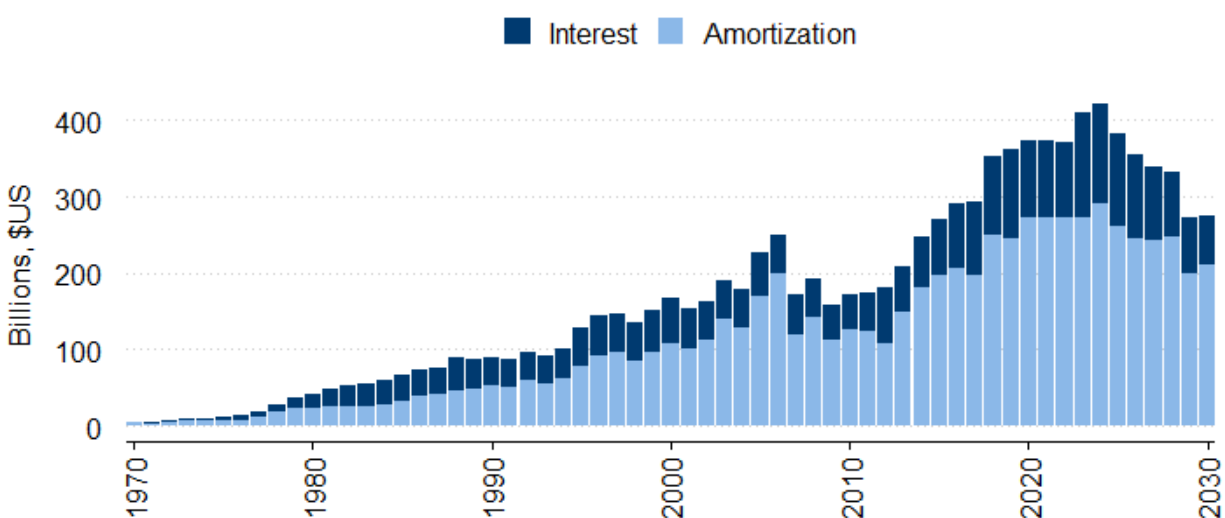
II. How to manage current debt service obligations

The World Bank's *International Debt Statistics* report provides the most comprehensive coverage of developing country debt and debt service obligations.²² To this, we have added repayments and charges to the IMF even though they are not technically debt service payments, in order to arrive at a full picture of public external financial obligations. Figure 2 below provides a summary of all LMYxC.^d It shows that debt service on public and publicly guaranteed debts of LMYxC has doubled compared to a decade ago.

The hump in debt service that is clearly visible in Figure 2 reflects two factors: bunched repayments of principal, largely on private bonds and, since 2023, sharply higher interest payments on the variable-interest-rate debt that dominates developing country borrowing.

Figure 2: The developing country debt service bulge

Debt Service 1970 to 2030



Source: World Bank International Debt Statistics, 2/29/2024. PPG debt service, current \$US.
Notes: Excludes China.

Much of the increase in debt service after 2018 was predictable in advance and initially not thought to be a major problem. When the debt was contracted, current account deficits were sustainable, exports were growing, and access to global capital markets at low nominal interest rates provided liquidity. Then, in 2020, the nominal dollar value of developing country exports fell by almost 10%, just at the time when external debt service was rising and when global capital was rushing to advanced country safe havens. Developing countries owed 10% of total GDP in external debt service that year.²³

A G20-led Debt Service Suspension Initiative (DSSI) helped alleviate the liquidity problem in the lowest income countries. Surges in lending from the IMF and multilateral development banks also helped.

^d China is excluded in this analysis because its role as a creditor is more important for understanding debt issues than its role as a borrower. Because China is so large, aggregate statistics that include China can disguise the situation facing most other developing countries.

In 2022, central banks in the major advanced economies started to raise interest rates, with significant impact on interest payments owed by developing countries in 2023. Meanwhile, the DSSI had expired, and net financial transfers from official multilateral agencies declined steeply in 2023, turning negative for the IMF. No IDA-eligible country was able or willing to issue a bond on global capital markets in 2023. Overall, \$161 billion and \$151 billion were paid to private bondholders by LMYxC excluding China, in interest plus amortization in 2022 and 2023, respectively. Many countries faced severe shortages of foreign exchange.

At the start of 2023, officials at the IMF, World Bank, and U.N. warned that 60% of low-income countries were either in, or at high risk, of debt distress.²⁴ This triggered calls for systemic change, largely in the workings of the G20 Common Framework for Debt Treatments.

The Common Framework process, however, has been unsatisfactory and loaded with too many issues. It has considered both debt reprofiling and debt reductions. It has been difficult to organize multiple creditors. It has a complex sequencing of commitments between official and private creditors. It does not address middle-income countries. It can trigger a market signal of a default. It is a last-resort response to a debt service crisis rather than a pre-emptive mechanism for avoiding a crisis.

The Common Framework should instead focus on pre-emptive debt reprofiling and new money commitments. Pre-emptive measures are in fact the norm for debt restructurings. An IMF database of debt restructurings covering over 700 episodes in developing countries between 1950 and 2021 shows that almost 60% of all debt restructuring events have been pre-emptive, and in 80% of cases, there has been cash flow relief without face value reductions.²⁵ However, this history largely reflects a time when most restructuring related to official debt obligations. A complication today is that Paris Club debt, where coordination structures are well-developed, is no longer the most important part of debt service obligations.

A further complication is that developing countries are a mixed group, mostly with sub-investment grade credit ratings. Of the 117 LMYxC in the IDS database for whom March-2024 public long-term credit ratings are available or can be readily inferred, only 12 have an investment grade credit rating (accounting for 33% of the total debt service due in 2024), and 69 are classified as “speculative” (owing 45%). The remaining 36, mostly low-income countries, are either in debt distress or at substantial risk of default.^e They account for 21% of total LMYxC debt service obligations.

This paper is not concerned with investment-grade developing countries.

Looking at disaggregated data on who owes what (see Appendix I), the following major points emerge:

- Most of the debt service hump comes from large repayments falling due on bonds—LMYxC paid \$200 billion more in total debt service in 2022 than in 2010, of which \$100 billion is due to higher payments on bonds.
- The debt service hump is concentrated in lower middle-income countries—upper middle-income countries are already seeing a decline in their debt service after a peak in 2020.
- The problem is particularly acute in sub-Saharan Africa where PPG debt service will peak in 2024 at \$65 billion, almost \$40 billion more than in 2017.

^e These rankings are based on publicly available ratings for long-term (approximately 10 years) sovereign bonds, supplemented by modelled ratings inferred from macroeconomic and institutional data for other countries.

- Encouragingly, 2024 PPG debt service due in the most seriously debt-distressed countries will fall substantially compared to 2023 levels. It is speculative grade countries that face the largest absolute increases in debt service obligations in 2024.

The IDS data reflects a significant change over time in the composition of borrowing by developing countries toward private bank and bond markets and away from official bilateral and multilateral institutions, exposing countries to larger rollover risks and higher interest rates.^f In 1990, debt service to private banks and bond creditors represented half of all LMYxC PPG debt service and was concentrated in investment-grade countries. By 2020, this share had grown to three-quarters. Since then, however, debt service on private debt has fallen, as these creditors have reduced exposure in developing countries. In 2024, debt service to private creditors will be back down to 55% of total debt service.

Over the last few years, private creditors have been largely replaced by multilateral lenders: the MDBs and the IMF. This has important implications as the international financial institutions (IFIs) enjoy preferred creditor status and traditionally have not participated in any debt relief or rescheduling activities.^g Under current trends, the share of preferred creditors in debt service, which had been as low as 20% in 2010, could rise to 30% in 2024 and to 34% by 2030. Less debt will be eligible for restructuring in the future.

What to do now?

There are three priorities:

- Enhance liquidity so developing countries can manage debt payments on their own
- Encourage countries to seek assistance earlier from the IMF to pre-emptively forestall crises
- Shift accountability back to private creditors to avoid moral hazard.

Enhance Liquidity

The simplest and most efficient solution to a liquidity problem is to expand liquidity! In August 2021, the IMF issued \$650 million worth of new Special Drawing Rights (SDRs) to member countries. Unlike an IMF financing arrangement, there were no restrictions on the use of these additional SDRs.^h Most developing country governments converted a portion into hard currency for external debt service and imports or used them to expand fiscal space.²⁶ The policy was widely applauded, with the only concerns being the skewed allocation of SDRs toward rich countries that did not need additional liquidity. Just \$233 billion of the new issue went to emerging market and LMYxC, of which only \$21 billion was allocated to low-income countries.²⁷

To offset this misallocation, large countries (initially the G7, later the G20) agreed to recycle \$100 billion of SDRs into two IMF facilities, the Poverty Reduction and Growth Trust (PRGT) and the newly created Resilience and Sustainability Facility (RSF). While most of the funds have been received by the IMF (except for a [\\$21 billion pledge](#) from the United States that is awaiting approval by the U.S. Congress),

^f There is still debate about whether to classify Chinese state-owned banks as “bilateral” creditors or private creditors. The data here use World Bank classifications.

^g MDBs did offer debt relief through the Multilateral Debt Relief Initiative (MDRI), but this was fully funded by bilateral official creditors.

^h When an SDR is issued, it is held as an asset by a member country central bank that can then expand a local currency counterpart liability to the government that can be used for domestic budget purposes.

disbursements to developing countries have been slow, partly due to cumbersome conditions and conditionalities in the management of these two facilities. In 2023, net disbursements from the RST and PRGT amounted to only SDR 608 million and SDR 2.4 billion respectively.²⁸ These recycled SDRs, then, have added very little to developing country liquidity, unlike the original issuance of SDRs.

There should be a structured, rules-based provision of SDRs to developing countries. Because the August 2021 issuance of SDRs was allocated through a generally accepted, long-standing formula of quotas, governments could plan and budget with confidence, amplifying the development impact. Prime Minister Mia Mottley and academics such as Ted Truman have, therefore, advocated for a regular issuance of SDRs.²⁹ Truman suggests maintaining the share of SDRs in total global reserves, which are about \$12 trillion. If reserves and SDRs were to grow at the same rate as nominal GDP or nominal imports (about 6% per year), then annual allocations of SDRs of \$72 billion equivalent should be considered. Of this, LMYxC could be expected to get \$20 billion per year based on current quotas, but much more if SDR recycling by rich countries becomes mainstreamed and passed through with less cumbersome processes, or if quota shares are revised. There is already a mechanism in place for periodically reviewing the need for new SDR issuance. Unfortunately, the recommendation from the IMF Managing Director has typically been to refrain from expansion. This is a policy choice that should be changed.

Encourage early assistance from the IMF

During the Asian financial crisis in the late 1990s, professor Martin Feldstein worried that the expectation of politically costly reform programs could induce governments to delay approaching the IMF for assistance, permitting liquidity problems to foment.ⁱ He therefore proposed that the IMF should reduce its structural conditionality to mission-critical areas. The conditionality in financing programs would then be largely restricted to macroeconomic, balance of payment management issues designed to resolve short-term liquidity problems.

There is some evidence that countries try to avoid the IMF. For example, only 48 of 73 eligible low-income countries participated in the G20 [Debt Service Suspension Initiative](#) (DSSI), partly because of the requirement that countries should have, or should have requested, an IMF financing arrangement with its accompanying conditionalities.

Of course, the IMF has a responsibility to ensure that any money it lends to countries is well-spent. IMF staff should continue to provide its best judgment and advice to member countries on the structural reform of their economies. Yet, this can go too far in the minds of some analysts. In 2007, for example, the IMF Independent Evaluation Office found many cases where structural reforms had been intrusive and unrelated to the basic issue of how to generate enough foreign exchange to service external debt.³⁰

Reduced IMF structural conditionality would encourage countries to turn to the IMF earlier and to resolve macroeconomic problems before they become too deep. Had Sri Lanka taken this path, it would have had a far easier time dealing with the aftermath of the policy mistakes that plunged it into a debt servicing crisis.³¹ Of course, it was the government of Sri Lanka that chose not to approach the IMF in

ⁱ Countries may even postpone reforms so that they have something to include in the package of reform measures that is required for an IMF financing arrangement.

order to avoid pressure to take politically unpalatable reforms, but, with hindsight, the IMF, the government of Sri Lanka, and most obviously the people of Sri Lanka would have been better off had negotiations commenced earlier.

Shift accountability back to private creditors

Feldstein also famously suggested that the IMF should limit its role to temporary bridge loans during which time creditors could organize themselves.³² He warned that an expansive IMF lending-cum-conditionality approach could have adverse consequences in both the short term and in the more distant future. He argued that large IMF lending programs could promote moral hazard by providing a relatively easy exit for private creditors—indeed, IMF programs in the Russian debt crisis (1998), the Greek crisis (2010), and several Argentina programs among others have allowed many private creditors to get repaid in full without being held accountable for having overlent to these countries. In each of these cases, private lenders were able to exit with little pain, leaving the country's taxpayers with the bill to repay the IMF. As another example, no private lenders participated in the DSSI, despite jawboning from official creditors, implying that all official new money and forbearance under the program simply provided liquidity to reduce private creditor exposure.

Moral hazard is now an entrenched feature of the international system. Commercial creditors can pressure the IMF and other official creditors to provide significant new money packages through the Extended Fund Facility and program loans. Clarity that official lenders would only provide smaller, rule-based bridge finance programs would restore private creditor accountability. Legislation binding bondholders to majority decisions and prohibiting holdouts from claiming legal damages in a court, will also facilitate direct borrower/private creditor negotiations on debt restructurings.

With this, the IMF can also play a role in convening interested parties and providing objective financial advice on the short-term economic outlook, so that creditors and debtors can negotiate on the basis of a common understanding of the economic situation.

A corollary of this last observation is that efforts to crowd in MDB adjustment lending into liquidity resolution also complicate the agenda and should be discouraged. The job of the MDBs should be to encourage higher levels of public investment and overall growth, not to bail out private creditors.

These proposals cannot be immediately implemented. They represent an effort to change market expectations and processes, so should be implemented in a phased and orderly way. In the very short run, it will be useful for the IMF and other official lenders to provide liquidity to forestall default in 2024, buying time until debt service obligations start to fall, even if this means permitting bondholders to exit without penalty. The global sovereign debt roundtables, organized by the IMF, World Bank, and others to improve the functioning of the Common Framework, could be one forum where such a reset of expectations could be started.

III. How to open fiscal space for debt-financed sustainable infrastructure

Emerging economies in sub-Saharan Africa, Latin America, and developing Europe have investment rates that average between 20-22% of GDP.³³ These rates are lower than in 2015 when the international community agreed to pursue ambitious sustainable development goals and to refresh the global framework for development financing.³⁴

Governments can only undertake more investments if they also take on more debt. Since Addis, the need for higher investment and more financing in emerging economies has risen, to meet commitments to invest more in global public goods and challenges: climate action, pandemic surveillance, and nature preservation.

President Ruto of Kenya, along with other leaders, has called for a new energy pact for Africa to finance and realize energy projects, while tackling governance, environmental and labor issues.³⁵ The problem is that many governments lack fiscal space and cannot access new project finance due to the overhang from existing debt.

The current dilemma facing policymakers is whether to cut back spending to reduce the rate of debt accumulation or accelerate investment in high-return projects to grow out of debt problems. At present, creditors tend to favor the former course of action while borrowers argue for the latter. The empirical evidence as to which strategy better averts debt problems is mixed and heavily dependent on context and time.³⁶ In contrast, the empirical evidence on which strategy is needed to better address climate change and sustainable development is strong: a big push on investment.³⁷

What needs to be done?

The priorities to move forward are:

- Change mindsets to favor a big push, high-quality investment strategy to improve growth and creditworthiness.
- Recognize MDBs as the spearhead to coordinate new money, investment, and policy reform.³⁸
- Develop new tools for assessing public sector solvency.

Change mindsets to favor a big push, high-quality investment strategy

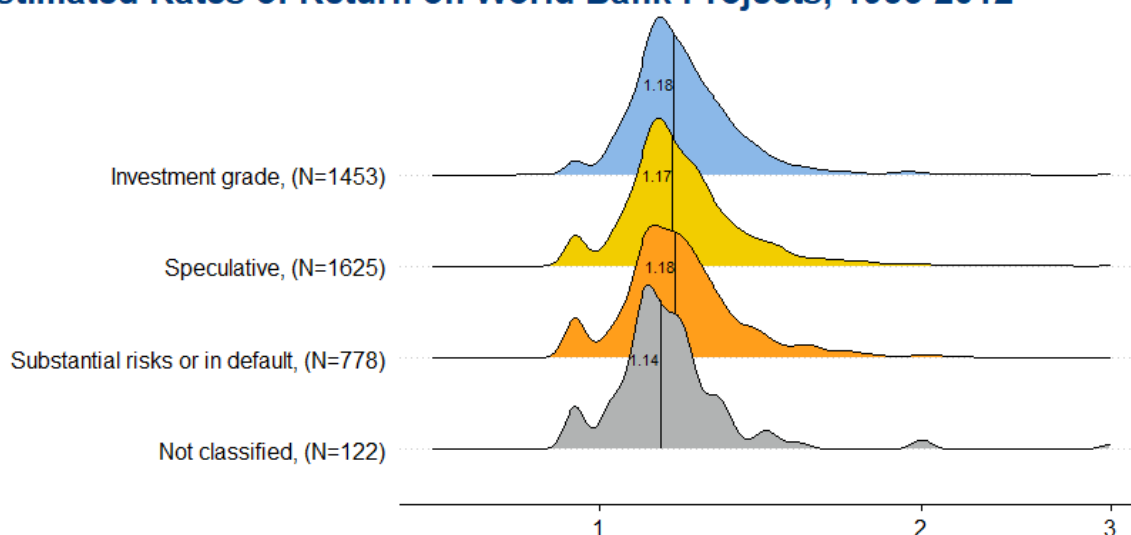
A big push investment strategy is only viable if it generates high economic rates of return.³⁹ Given the distortions in many developing economies, the burden of proof rests with government borrowers to show such returns exist and are the norm, rather than the exception. Every analyst with experience in public investment has anecdotes of successful projects as well as those where corruption and waste created “white elephants.”

Microeconomic analysis of *ex post* rates of return of completed public investment projects is one piece of evidence. The World Bank’s evaluation group reported *ex post* economic rates of return on almost 4,000 projects approved between 1956 and 2012 (almost 600 since 2000).⁴⁰ Four-fifths of projects are in 3 sectors: a third in agriculture and rural development, a fourth in transport, and a fifth in energy and mining.

The results are shown in Figure 3, grouped by countries according to their creditworthiness. Two conclusions emerge. First, the median return on all projects is a solid 17%. The number of projects with negative rates of return is low, some 5% of the total sample. 78% of projects have a return higher than 10%, a typical threshold return for a development project, and the standard discount rate used in calculating the economic rate of return. There is little difference across geographies or country income levels (Appendix III.), suggesting one key to project quality lies in staff identification and appraisal. This is consistent with earlier findings showing more variation in project outcomes within countries than between countries.⁴¹

Figure 3: Rates of return to public investments financed by the World Bank

Estimated Rates of Return on World Bank Projects, 1956-2012



Source: IEG World Bank Project Performance Ratings Dataset 2022. Trading Economics scores.

Notes: Y axis is density (# of projects). X-axis is (1 + estimated rate of return). Hence numbers less than one indicate negative rates of return. Values are shown on a log scale. Vertical lines indicate median rates of return for each group. Credit risk groups derived from Trading Economics scores and author's imputations: Investment grade (>50), Speculative grade (>20), and Debt distress (<=20). Not classified is largely comprised of regional projects.

The second conclusion, that returns are similarly high in most country contexts including in cases where the risk of default is high, is less intuitive. One might expect returns to be higher in low-risk countries. After all, these are countries with stronger institutions, less economic distortions, and usually higher income levels. But the actual results are very similar for investment-grade countries, speculative grade countries, and countries with a high likelihood of debt distress. There is little difference in either the median or the distribution of project returns. In fact, the highest return project in the database was a 2012 Zoonoses Control Project in Nepal, a country with one of the worst credit ratings. This project had a rate of return of 747%.

Qualitative results also support these conclusions. The World Bank's annual independent evaluation of its results and performance indicates that projects displayed a high degree of resilience to the difficult

economic climate associated with the COVID-19 recession. Those projects that were completed in FY20 and FY21 continued to enjoy the same relatively high impact scores as in previous years.⁴²

The point is not to claim that all public investments in developing countries have high returns. The World Bank only calculates rates of return on a quarter of its projects, so selection bias cannot be ruled out. However, a similar database from the U.S. Millennium Challenge Corporation also shows very similar results: a mean return of 15% and a median return of 13%, with only a few project failures (Appendix IV). Data from the Global Emerging Markets Risk Database shows 100% ultimate recovery on infrastructure finance in Africa and the Middle East and, in most regions, the recovery on infrastructure investments exceeds that in other sectors.⁴³

It is not straightforward to extrapolate from project analysis to macroeconomic outcomes. Large-scale investment could create underlying inflationary pressures or enlarge current account deficits, causing Dutch disease. In such cases, the cost of borrowing should also factor in a suitable rate of depreciation of the local currency, and cost-benefit calculations should factor in potential real wage increases.

For these reasons, evidence from the macroeconomic literature of the impact of public investment on income growth needs to be also considered. The findings are mixed. Warner (2014) finds little systematic causality, but Furceri and Li (2017) conclude that public investment can be a strong spur to short-term growth when properly managed.^{44,45}

In a suite of general equilibrium models designed to look at debt, investment, and growth, calibrated to reflect conditions in each of 65 individual developing countries, the IMF estimated that rates of return to public investment in developing countries remain high even after taking into account general equilibrium effects.⁴⁶

Similarly, the World Bank's comprehensive review of investment accelerations in developing countries found that countries "...reaped an economic windfall: output growth increased by about 2 percentage points and productivity growth increased by 1.3 percentage points per year. Other benefits also materialized in the majority of such episodes: inflation fell, fiscal and external balances improved, and the national poverty rate declined. Most accelerations followed, or were accompanied by, policy shifts intended to improve macroeconomic stability, structural reforms, or both."⁴⁷

The potential implication of these findings is profound. It suggests that the narrative that developing countries are running into debt difficulties because they have wasted (or stolen) funds is not generally true, at least where projects are properly designed and supervised by entities like the World Bank or the Millennium Challenge Corporation. Furthermore, if high returns are feasible in most developing country contexts, then it follows that public solvency and fiscal space are improved by expanding public investment. This is the conclusion drawn by the report of the Independent High Level Expert Group on Climate Finance and is an important underpinning for the argument that investment in clean energy (which can yield considerable savings in the use of fossil fuels, a tradable) is desirable in all countries, regardless of current levels of debt.⁴⁸

Accepting this evidence requires a change in mindset to recognize that high-quality, debt-financed sustainable infrastructure is part of the solution to public solvency, not part of the problem.

Recognize MDBs as the spearhead for scaled-up investments in sustainability

Scaling up high-quality public investment can best be done by expanding lending by multilateral institutions. Multilateral institutions have the expertise in project design and implementation to ensure sound returns. They can also lend more readily to finance these projects as they enjoy preferred creditor treatment, a status that makes any debt overhang less relevant for their internal creditworthiness assessments.

These considerations lie behind the recommendation of the G20 Independent Expert Group to triple the level of multilateral lending by 2030.⁴⁹ MDB lending to support country platforms should be the initial entry point for their scale-up. Figuring out how to expand the quantity of high-quality projects and enhance design and implementation capability is not a simple matter. Country-owned and country-led transformation platforms are novel institutional mechanisms to do this. These have been piloted in energy transition and other sector programs that seek to achieve specific results over a specified time period.

Country platforms also provide a mechanism for partnering with private creditors. Mobilizing and catalyzing private capital has two challenges. First, because the cost of private capital exceeds the cost of capital provided by multilateral organizations, the financial rates of return to projects financed by private debt can be low. In fact, if the costs of private capital are too high, the net return may turn negative.

The second challenge is that incremental private lending will be constrained by the debt overhang, regardless of the merits of new projects. Ultimately, private creditors will only participate at scale if they are able to reduce their risk, either implicitly via a “halo” effect from engagement with MDBs or explicitly through a guarantee from a AAA-rated entity such as an MDB.

Another option is for MDBs to offer participation agreements with the private sector in a manner like the International Finance Corporation (IFC) “B” Loan program. In that program, the borrower signs an agreement with IFC, which provides a portion of the financing on its own account and a portion through the B Loan arrangements. Other creditors benefit from IFC’s loan origination, risk mitigation, application of standards, and favorable treatment by regulators. By extension, participation in select programs with MDBs would also grant the private creditor preferred creditor status, thereby driving down the cost of capital, and relaxing Basel III rules for capital charges on infrastructure.

In effect, such a proposal would be akin to treating selected parts of private mobilized capital in the same way as trade finance is treated in debt reschedulings. Trade finance is typically excluded from debt treatments. Indeed, new trade credit lines are encouraged by borrowers and existing lenders because they add value to a country. Similarly, private finance for priority projects, for example, financing that is raised to implement a country’s energy transition plan, should be exempted from future debt reschedulings as an incentive for new lenders to participate in such high-priority programs.

Such an approach would, admittedly, dilute the MDB preferred creditor treatment, but, if investment programs are sound, the added risk to MDBs would be offset by an improvement in public solvency. This places a premium on ensuring that only those investments that yield high foreign exchange savings should be considered for such treatment.

Develop new tools for assessing public sector solvency

In principle, MDB-financed projects help grow fiscal space because project returns exceed project costs. There is, nevertheless, still a need to be sure that a responsible balance is maintained between debt-financed investment today and the impact of debt service on government expenditures in the future. In brief, a new toolkit for developing country borrowers is needed to ensure that MDB activity improves their public solvency and future fiscal space.

Existing toolkits are inadequate. About 51 developing countries have established fiscal rules to limit government borrowing, most since the 2000s, but in practice, these rules have been ineffective: overly restrictive at times, for example during COVID-19, and insufficiently nuanced to provide adequate early warning at other times.⁵⁰

Empirically, it does not appear that fiscal rules help prevent debt crises. Yet fiscal rules are the principal analytical instrument used to guide the IMF/World Bank Debt Sustainability Assessments. The DSA, as it stands, is a highly imperfect measure of public solvency. It was the basis for computing Heavily Indebted Poor Country and Multilateral Debt Relief Initiative debt relief packages, when almost all debt was official, but has been unable to prevent a recurrence of insolvency in some of those cases.

An alternative approach to assessing public solvency, which could be more effective, is to establish fiscal councils, non-partisan technical bodies with a mandate to monitor and publicly report on fiscal policies and medium-term programs. These have become more popular recently, especially in Europe and Latin America, but are not yet widespread in other developing countries. Only 14 developing countries have such councils in place.⁵¹ Properly run fiscal councils have the flexibility and technical capacity to inform widespread public debate about the appropriate level of public investment and spending. They transparently comment on these in the context of medium-term fiscal frameworks that also consider the rules and procedures for implementing annual budgets.

Fiscal councils should become key institutional counterparts for multilateral development banks as they shift toward programmatic financial assistance, or assistance to country-led platforms, such as the energy transition and climate adaptation platforms that have been announced in a number of countries. They could become important institutions in monitoring and conveying information on the benefits and costs of public investment in a way that holds governments accountable to a broader range of stakeholders.

Another institutional innovation to strengthen the understanding of public solvency is the adoption of public net worth accounting. At least 45 developing countries have published some estimates of public sector balance sheets, tabulating the assets and liabilities of the general government, public corporations, and pension funds.⁵² While these accounts are not updated annually and are painstaking to produce, they provide a sounder measure of fiscal solvency than debt ratios. They also highlight the importance of monitoring and properly managing public sector assets. Some calculations by the IMF suggest that much government property holding, in particular, is unreported and undermanaged, and could provide higher revenues of 1-1.5% of GDP annually for the public purse.⁵³

This thinking prompted Walter Wriston, former chairman of Citicorp, one of the largest sovereign lenders in the 1980s, to comment “countries don’t go out of business...their assets [infrastructure, productivity of people, natural resources] always exceed their liabilities which is the technical reason for

bankruptcy. And that's very different from a company."⁵⁴ The problem has always been that the construction of such accounts at the country level is far harder than at the company level.

It can be done. Successful public wealth funds across the world have used such accounting devices. Across East Asia, professionally run public corporations have managed infrastructure assets and associated liabilities using net worth accounting.

The World Bank and other multilateral development banks should take the lead in developing these new toolkits. They should develop, refine, and publish estimates of the public capital stock and of the return to public investments, based on their own activities and in consultation with national governments. Such information should be central to the assessment of investment needs that is made in Country Climate and Development Reports produced by the World Bank and in country strategy diagnostics prepared by other MDBs.

IV. How to respond to natural disasters

As the effects of climate change become more damaging, the insurance gap in developing countries is growing larger. Only one-quarter of global natural disaster exposure is protected by insurance, with even lower coverage in developing countries.⁵⁵ Sixty percent of global insurable crop production is unprotected against natural disasters.⁵⁶

When developing countries are hit by natural disasters, they borrow to cushion the effect of the shock. This is a sound use of borrowing capacity, but it has its limits. When there is a sequence of natural disasters destroying capital that then needs to be rebuilt before being hit by the next disaster, borrowing is ineffective. Debt simply mounts, while domestic assets do not grow.⁵⁷ Many Caribbean countries have fallen victim to this cycle. The IMF estimates that the cost to the Caribbean from natural disasters has averaged 2.4% of GDP each year between 1980-2020.⁵⁸ One in ten disasters causes damage and loss of more than 30% of GDP in small countries.⁵⁹

There are now 68 member states in the [V20 group of vulnerable countries](#) faced with the risk of a cycle of disaster-rebuild-repeat, or a single disaster that is very large compared to the economy.

There are two priorities:

- More insurance against catastrophes
- Speedy access to finance in the aftermath of a disaster

Insurance against catastrophes

Borrowing can help shift the cost of natural disasters over time, so it is a welcome strategy for an isolated event. But for repeated events in a single country, borrowing is not as useful. Insurance could provide a market solution to sharing the expected losses across countries but can be very expensive and is increasingly inaccessible for countries or places in specific zones prone to natural disasters. These countries suffer from the same type of insurance market failure as a preexisting condition in health insurance. In the case of health insurance, the solution is legislation that forces insurance companies to spread the costs of coverage of individuals with pre-existing conditions premiums to the whole population. In a similar vein, it would be just and equitable to spread the costs of climate-related catastrophes across countries, considering that everyone has contributed to GHG emissions.

Solutions of this kind do not currently exist internationally. The core idea of providing real resource transfers to “unlucky” people, however, is captured by the Loss and Damage Fund that compensates those who, through no fault of their own, are impacted by large natural disasters. Payments from this Fund could potentially be used to buy down premiums on insurance, for example through the African Risk Capacity Group.

Speedy access to finance in the aftermath of a natural disaster

The loss and damage fund and other insurance mechanisms such as catastrophe bonds or the World Bank’s Pandemic Emergency Fund bonds have a major drawback: they may not provide timely access to funds. Pay-outs typically follow on-the-ground assessments of damage that can take months to finalize. In the aftermath of disasters, however, rapid relief is paramount to reducing overall costs.

Grenada and Barbados have therefore introduced natural disaster relief clauses directly in their sovereign debt contracts. Such clauses piggyback on insurance—in these cases on the Caribbean Catastrophe Risk Insurance Facility. The insurance facility provides clarity on the triggering event in a matter of days—all that is required is a certification that the natural disaster is covered by the insurance and that damages exceed a pre-specified threshold. Once this certification is obtained, a government with disaster-related clauses in its bond contract has the option to defer principal and interest payments for a pre-determined period (up to two years in the case of Barbados).⁶⁰

The International Capital Markets Association is the body responsible for innovating bond contracts. It has successfully incorporated collective action clauses into bonds, permitting creditors to negotiate rescheduling more easily should the need arise. It has now developed model disaster-related clauses that should also be incorporated into such contracts, especially in small, vulnerable countries. There may be scope to evolve beyond natural disasters to also include pandemics and other large exogenous shocks.

Another tool that can be useful for climate-vulnerable countries is a debt-for-climate or debt-for-nature swap. At heart, such swap agreements are package deals. Creditors get to reduce their exposure to a country, either by receiving a new bond instrument with a portion of the repayment guaranteed by a third party, or by selling an existing bond at a discount-to-face-value market price. The borrowing country saves on its debt service while enhancing its natural capital stock or climate resilience. Third parties, such as mission-driven nonprofits like the Nature Conservancy, advance their impact by contributing grants to subsidize these deals.

V. How to improve debt transparency

Because the risk of any individual external loan to a developing country depends on the size, terms, and conditions of other loans, a well-functioning international debt market depends on the quality of information on external indebtedness. *Ex post*, in the event of a restructuring, details on individual debts are needed to assign fair treatment across creditors. In many developing countries, this information base is incomplete. For example, significant amounts of previously undisclosed debts were uncovered during Zambia's debt negotiations.

There are a number of efforts to identify weaknesses in debt transparency. USAID puts out an annual [Debt Transparency Scorecard](#) covering 14 indicators for 103 low- and middle-income developing countries. They find that countries are only reporting 60% of the information that they should. They also find that information is updated sporadically. Some countries with good reporting in 2020 failed to report adequately in 2021 and conversely, some bad reporting countries improved their scores.

In a similar vein, the World Bank [Debt Reporting Heat Map](#) indicates that as of 2022, most IDA-eligible countries have incomplete disclosure. Only one country, Burkina Faso, was scored as having full debt transparency. The least well-covered indicators in the World Bank heatmap are for recently acquired debt, annual borrowing plans, and contingent liabilities.

Part of the reason for poor debt transparency is the difficulty in compiling data across a growing number of public agencies, each borrowing from multiple creditors, including some private creditors with nondisclosure clauses designed to protect the bargaining power of creditors and debtors in future negotiations. For example, some analysts estimate that half of overseas lending by Chinese entities is not reported to the IMF and World Bank.⁶¹ Information on private-sector lending and state-owned enterprise debts are also areas with significant gaps.

In principle, all external debt should be reported to the World Bank and IMF and reflected in the World Bank's International Debt Statistics. In practice, however, there are discrepancies between what debtors say they owe and creditors' claims, even for official debt.

There is a long history of efforts to improve debt transparency. Among noteworthy recent programs is the 2020 IMF and World Bank launch of the Multi-pronged Approach to Address Debt Vulnerabilities (MPA) as a capacity-building and technical assistance initiative. With training and debt reporting assistance from these two institutions, Burkina Faso was able to achieve full debt transparency through an improved country debt database and quarterly Statistical Debt Bulletin containing details on the terms and conditions of each loan.⁶² The country has since benefited from decreased borrowing costs and longer maturities on bonds.

Other solutions have been suggested: an "International Loan Repository" to host records online for creditors and debtors and to automate the submission of information to debt databases, and direct incentives or penalties imposed by the IFIs to promote disclosure. Such efforts have not been met with success. For example, IFIs tried to condition country participation in the DSSI on improved, or on a commitment to improve, transparency but unfortunately there has been no difference between DSSI and non-DSSI countries on improvements in debt transparency.⁶³ The OECD has recommended a reform of nondisclosure agreements to permit data to be reported. They have also begun working with commercial banks to disclose more transaction-level data through the OECD Debt Transparency Initiative.⁶⁴ As Vasquez et al. (2024) argue, legal reforms have an important role to play—strengthening

reporting requirements and accountability mechanisms and regulating confidentiality arrangements, which can often be used to hide debt.⁶⁵

Despite these setbacks, data transparency and broader efforts to strengthen national debt management offices are ongoing priorities for strengthening the institutional underpinnings of external debt markets. The IMF, World Bank, and OECD efforts are commendable but should be given more teeth. Just as there are social and environmental safeguards for projects, there should be minimum reporting standards for indebtedness for clients and members of these institutions.

VI. Concluding comments

Eichengreen and Kenen (1994) succinctly summarized the problem with debt treatments: “an insolvent debtor must pursue a debt-reducing strategy, but an illiquid debtor should pursue a debt-raising strategy so as to make its interest payments and defend its creditworthiness.”⁶⁶ In the current environment, this needs to be revisited. Both illiquid and insolvent debtors need to pursue a strategy of raising sharply the amounts of debt from official sources to invest in high-quality projects.

A range of technical options is available that would address each of the debt-related problems we have identified. Small steps, led by different institutions in different forums, could make a big difference.

This is not the time to embark on broad-based debt relief initiatives, nor single international sovereign debt restructuring mechanisms. Instead, we recommend four distinct forms of action to address four respective problems:

Liquidity: Despite adverse credit market developments, almost all developing countries managed to muddle through 2023 without resorting to debt defaults. There is every reason to believe the same can happen in 2024, especially as the IMF still has considerable firepower that it did not use in 2023. After that, the wave of peak debt servicing will start to pass, and developing countries’ debt service difficulties will fade.

The IMF is the leading international institution for providing liquidity, through its own lending programs and through its role in issuing and allocating SDRs. It should accelerate disbursements from the PRGT and RST and, longer term, reconsider how and when to issue and allocate additional SDRs.

The IMF must also reset market expectations of its emergency financing role, to incentivize private lenders to take accountability for their own lending decisions and to discourage moral hazard. A well-functioning market will need smoother mechanisms for private creditors to reprofile their debt through direct negotiations with borrowers in the face of liquidity shortages.

Big investment push: Developing countries need new mechanisms to assist them with developing and financing a big-push investment strategy. Ample evidence exists that high-quality investment projects are available, or a pipeline could be developed. Implementing these can promote economic development and sustainability simultaneously.

MDBs should spearhead the scale-up of these investments by participating in country transition platforms. They should triple own-account lending and mobilize significant private flows. To be successful in mobilizing private debt, they must reduce the risk that such debt will end up having to be

rescheduled. Options are available, but the simplest and most relevant ones require MDBs to take on more risk and to accept a dilution of their preferred creditor status.

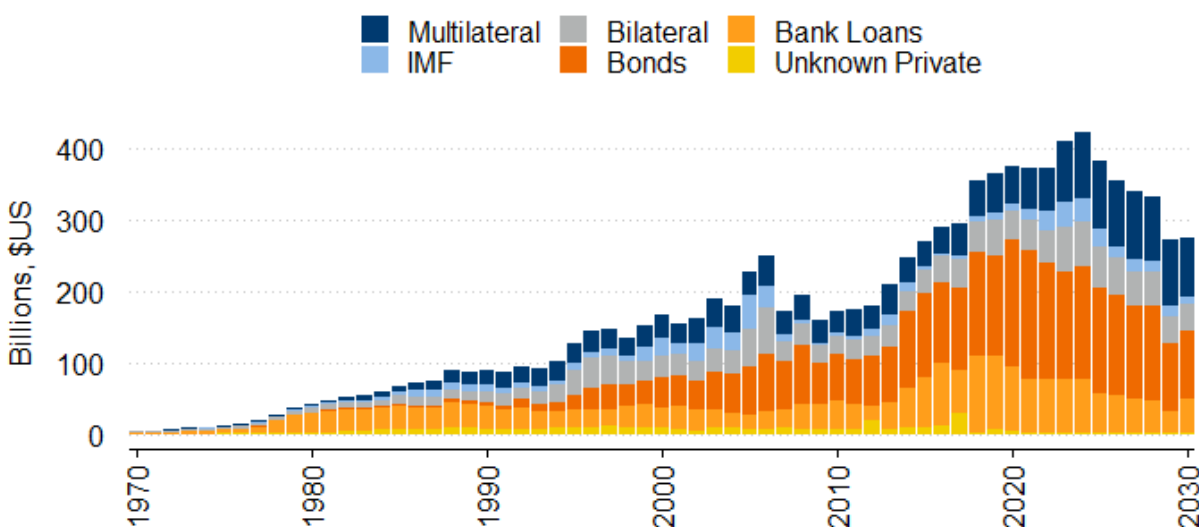
Institutional arrangements that explicitly measure public assets and liabilities should be developed to provide a sound basis for assessing trends in public solvency.

Insurance: Natural disasters are an increasing source of debt difficulties for vulnerable countries. Developing countries are massively underinsured and lag in risk mitigation. New, non-debt-creating instruments are needed to make insurance affordable. This should be pursued alongside natural-disaster debt relief clauses that have been developed and should be mainstreamed.

Transparency: All the problems above depend on a sound information base. Debt reporting is currently too weak in many countries to support a robust international capital market. Investments in debt transparency are a public good that the World Bank, the IMF, and the OECD should be mandated to address as a priority.

Appendix I. Debt Service

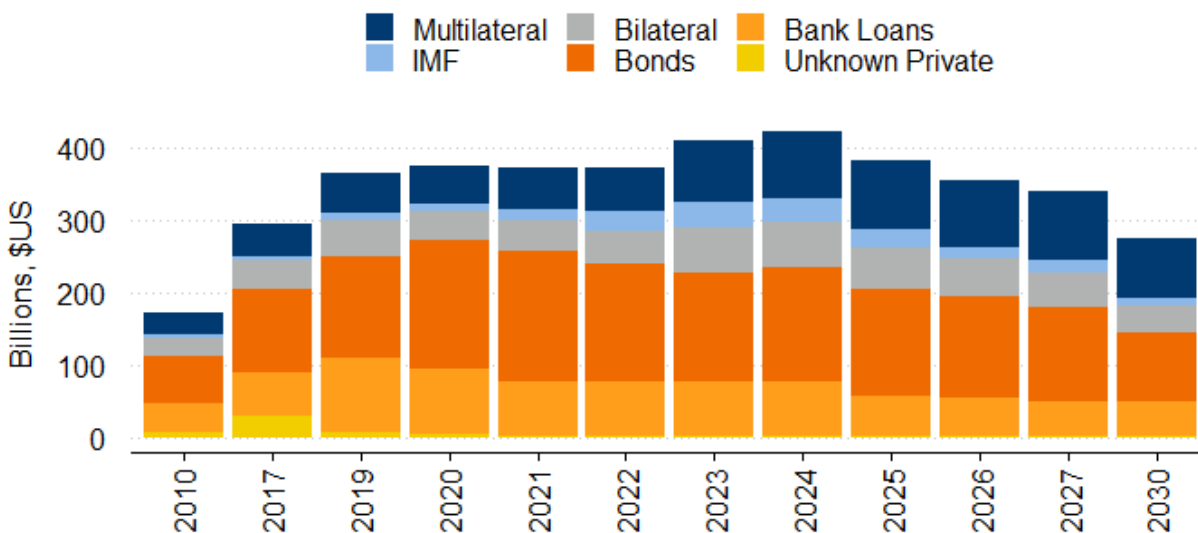
Debt Service 1970 to 2030 by Creditor



Source: World Bank International Debt Statistics, 2/29/2024. PPG debt service, current \$US.
Notes: Excludes China.

Creditor	1970	1980	1990	2000	2010	2020	2030
Bilateral	1.9	6.4	15.7	30.1	25.5	42.1	37.4
IMF	0.6	2.2	8.9	23.5	3.9	8.4	10.8
Multilateral	0.7	3.8	19.8	32.4	30.1	52.5	81.7
Bonds	0.2	1.2	5.1	43.7	63.4	175.8	94.6
Bank Loans	1.5	26.2	33.3	27.6	40.8	89.3	47.6
Unknown Private	0.8	2.6	6.3	9.3	7.4	5.5	2.1
Total	5.7	42.4	89.1	166.6	171.0	373.6	274.2

Debt Service 2010 to 2030 by Creditor

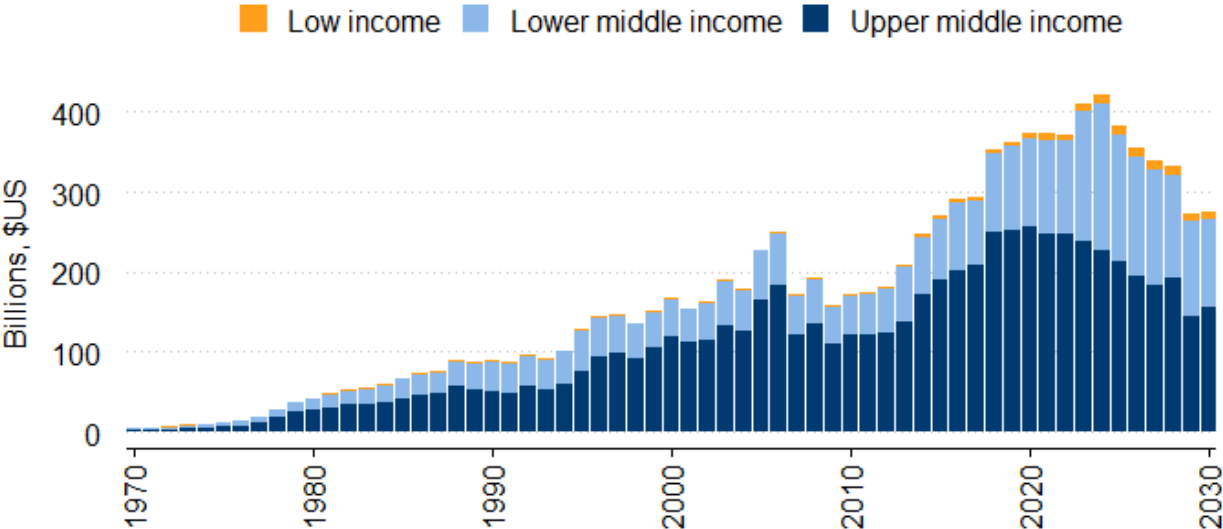


Source: World Bank International Debt Statistics 2/29/2024. PPG debt service, current \$US.

Notes: Excludes China.

Creditor	2010	2017	2019	2020	2021	2022	2023	2024	2025	2026	2027	2030
Bilateral	25.5	38.6	50.0	42.1	44.3	45.0	62.6	62.5	57.9	52.6	47.5	37.4
IMF	3.9	4.1	8.3	8.4	15.5	29.2	34.2	32.8	24.2	15.7	17.4	10.8
Multilateral	30.1	45.3	54.6	52.5	57.1	57.9	85.4	92.8	95.1	91.6	92.9	81.7
Bonds	63.4	116.0	140.7	175.8	177.7	160.8	151.0	157.1	147.1	140.9	131.0	94.6
Bank Loans	40.8	60.7	102.2	89.3	74.9	75.3	74.9	73.5	54.1	51.0	46.9	47.6
Unknown Private	7.4	28.8	7.2	5.5	2.9	2.4	1.9	2.6	3.1	2.6	2.7	2.1
Total	171.0	293.4	362.9	373.6	372.5	370.6	410.0	421.3	381.5	354.5	338.4	274.2

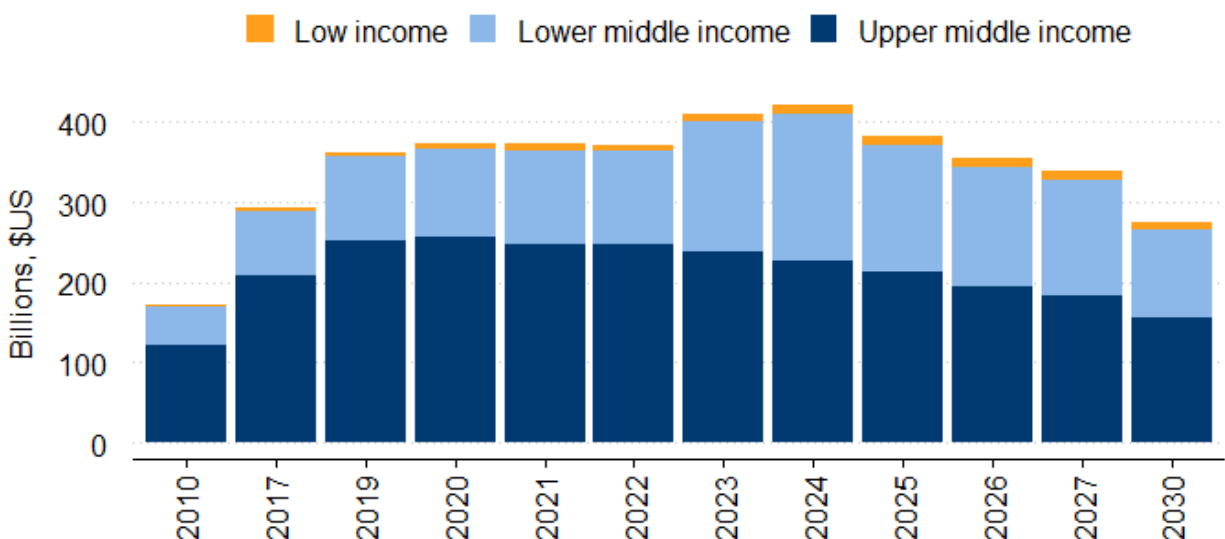
Debt Service 1970 to 2030 by Income Group



Source: World Bank International Debt Statistics, 2/29/2024. PPG debt service, current \$US.
Notes: Excludes China. World Bank income groups.

Income Group	1970	1980	1990	2000	2010	2020	2030
Low income	0.2	1.2	1.6	1.2	2.4	5.9	8.7
Lower middle income	2.7	14.4	36.3	45.3	46.0	111.2	109.2
Upper middle income	2.8	26.7	51.2	120.0	122.6	256.4	156.3
Total	5.7	42.4	89.1	166.6	171.0	373.6	274.2

Debt Service 2010 to 2030 by Income Group

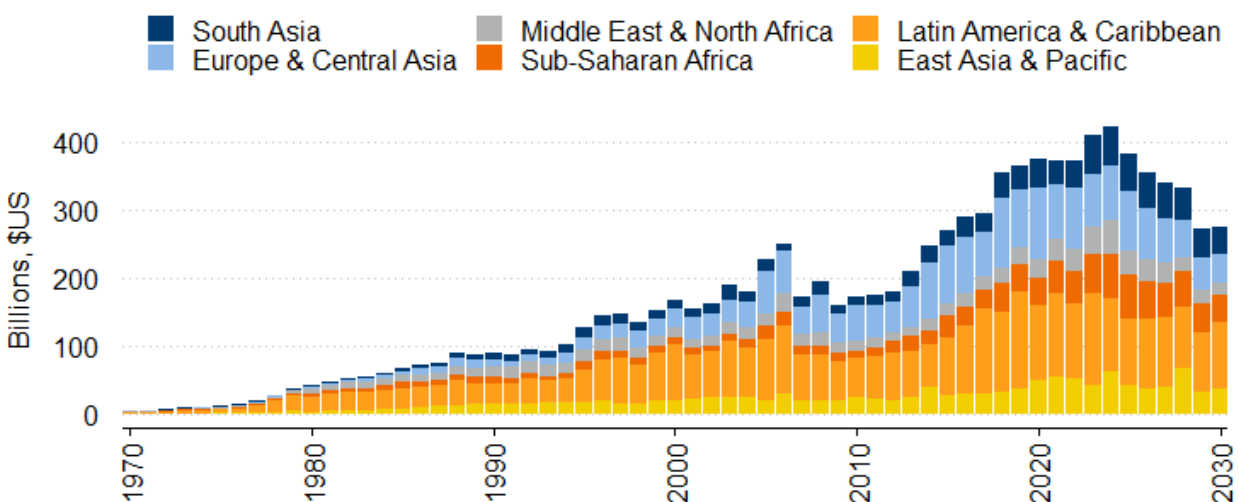


Source: World Bank International Debt Statistics 2/29/2024. PPG debt service, current \$US.

Notes: Excludes China. World Bank income groups.

Income Group	2010	2017	2019	2020	2021	2022	2023	2024	2025	2026	2027	2030
Low income	2.4	4.0	5.8	5.9	9.0	6.5	10.2	11.4	10.5	10.2	10.9	8.7
Lower middle income	46.0	80.8	105.5	111.2	116.3	116.7	160.5	181.9	158.8	148.9	143.7	109.2
Upper middle income	122.6	208.7	251.7	256.4	247.3	247.4	239.3	228.0	212.2	195.4	183.7	156.3
Total	171.0	293.4	362.9	373.6	372.5	370.6	410.0	421.3	381.5	354.5	338.4	274.2

Debt Service 1970 to 2030 by Region

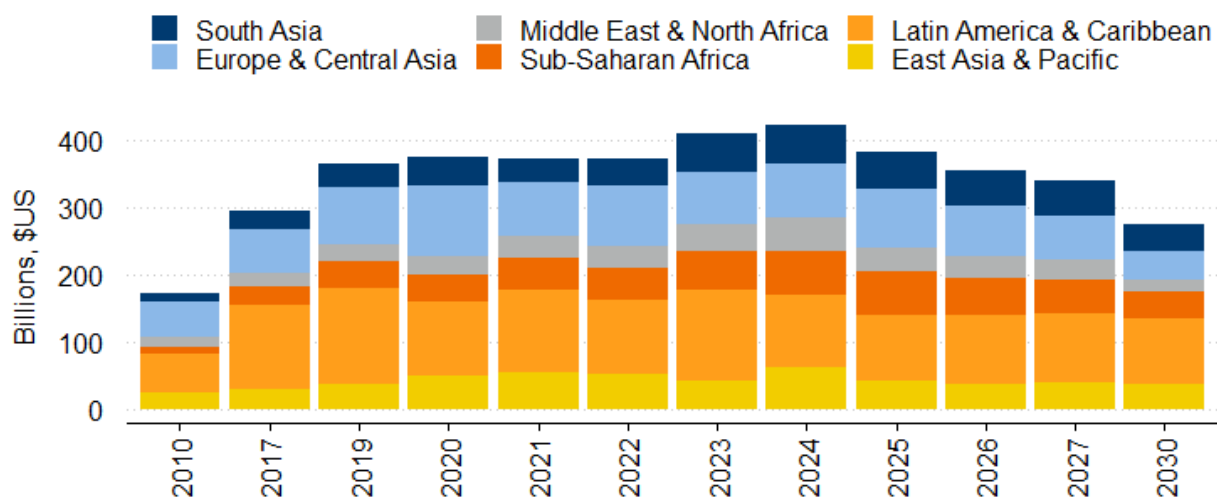


Source: World Bank International Debt Statistics, 2/29/2024. PPG debt service, current \$US.

Notes: Excludes China.

Region	1970	1980	1990	2000	2010	2020	2030
East Asia & Pacific	0.3	3.3	15.1	19.3	24.3	49.6	37.5
Europe & Central Asia	0.5	2.0	11.0	25.6	51.5	104.9	41.6
Latin America & Caribbean	2.3	22.6	29.3	82.3	58.6	110.8	98.0
Middle East & North Africa	0.5	7.7	15.3	15.2	14.5	26.0	18.5
South Asia	1.7	2.3	9.1	13.3	12.1	42.3	40.8
Sub-Saharan Africa	0.6	4.6	9.3	10.9	10.1	39.9	37.9
Total	5.7	42.4	89.1	166.6	171.0	373.6	274.2

Debt Service 2010 to 2030 by Region

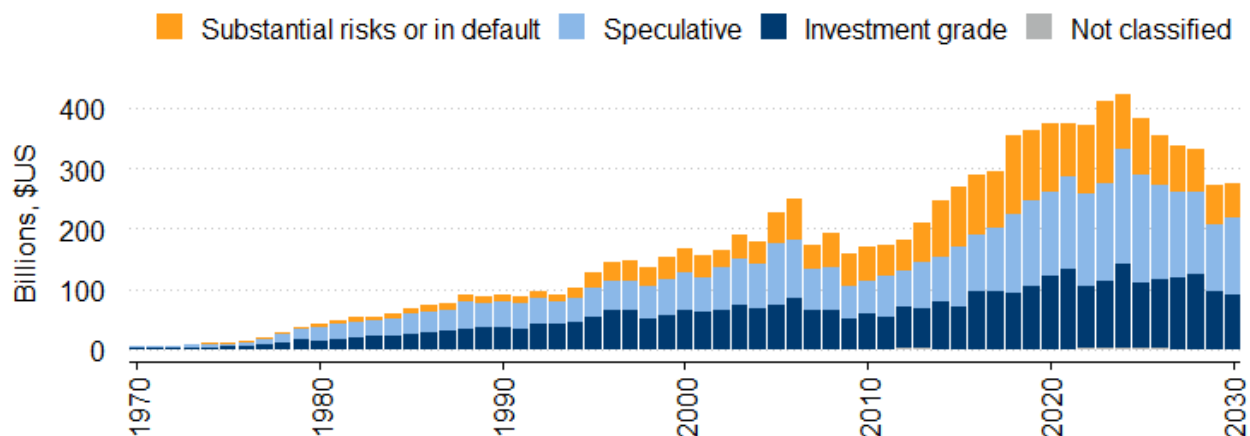


Source: World Bank International Debt Statistics 2/29/2024. PPG debt service, current \$US.

Notes: Excludes China.

Region	2010	2017	2019	2020	2021	2022	2023	2024	2025	2026	2027	2030
East Asia & Pacific	24.3	29.9	37.2	49.6	55.6	51.2	42.8	62.4	41.3	37.0	38.5	37.5
Europe & Central Asia	51.5	65.8	83.8	104.9	79.4	89.4	77.3	79.7	86.9	74.1	64.7	41.6
Latin America & Caribbean	58.6	123.9	142.1	110.8	120.9	110.5	135.1	108.0	98.6	103.1	102.5	98.0
Middle East & North Africa	14.5	20.5	25.2	26.0	34.2	33.3	38.6	48.4	36.8	32.9	30.3	18.5
South Asia	12.1	25.9	34.1	42.3	35.5	39.7	58.6	58.0	54.3	53.8	52.6	40.8
Sub-Saharan Africa	10.1	27.5	40.6	39.9	46.9	46.6	57.5	64.8	63.6	53.7	49.8	37.9
Total	171.0	293.4	362.9	373.6	372.5	370.6	410.0	421.3	381.5	354.5	338.4	274.2

Debt Service 1970 to 2030 by Credit Risk

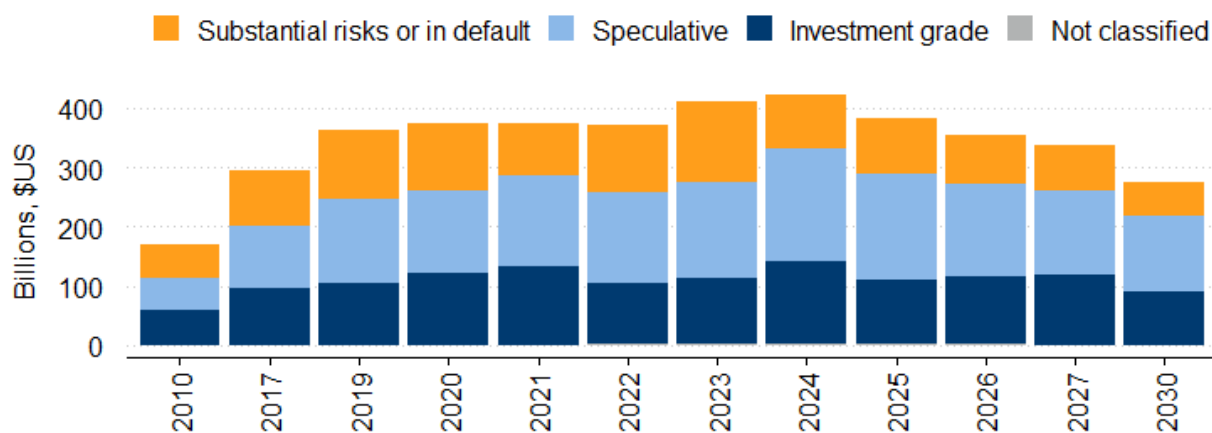


Source: World Bank International Debt Statistics, 2/29/2024. PPG debt service, current \$US.

Notes: Excludes China. Note: Includes countries with actual Trading Economics Scores and those imputed. Credit risk categories are simplified: Investment grade (>50), Non-investment grade (>20), and Debt distress (<=20)

Credit Risk	1970	1980	1990	2000	2010	2020	2030
Substantial risks or in default	1.1	5.5	11.4	38.7	57.5	113.6	57.3
Speculative	2.0	22.3	42.3	62.0	54.6	139.4	127.6
Investment grade	2.7	14.5	35.4	65.9	58.0	120.1	88.5
Not classified	0.0	0.1	0.1	0.0	0.9	0.5	0.8
Total	5.7	42.4	89.1	166.6	171.0	373.6	274.2

Debt Service 2010 to 2030 by Credit Risk



Source: World Bank International Debt Statistics 2/29/2024. PPG debt service, current \$US.

Notes: Excludes China. Note: Includes countries with actual Trading Economics Scores and those imputed. Credit risk categories are simplified: Investment grade (>50), Non-investment grade (>20), and Debt distress (<=20)

Credit Risk	2010	2017	2019	2020	2021	2022	2023	2024	2025	2026	2027	2030
Substantial risks or in default	57.5	92.9	116.4	113.6	86.7	111.6	134.5	90.3	93.2	81.4	78.4	57.3
Speculative	54.6	106.0	142.8	139.4	152.2	155.9	162.2	189.6	177.3	157.9	142.2	127.6
Investment grade	58.0	93.9	103.1	120.1	132.8	102.1	111.9	140.1	109.8	114.1	116.9	88.5
Not classified	0.9	0.7	0.7	0.5	0.8	0.9	1.3	1.3	1.3	1.1	0.9	0.8
Total	171.0	293.4	362.9	373.6	372.5	370.6	410.0	421.3	381.5	354.5	338.4	274.2

Appendix II. Country credit risk classifications

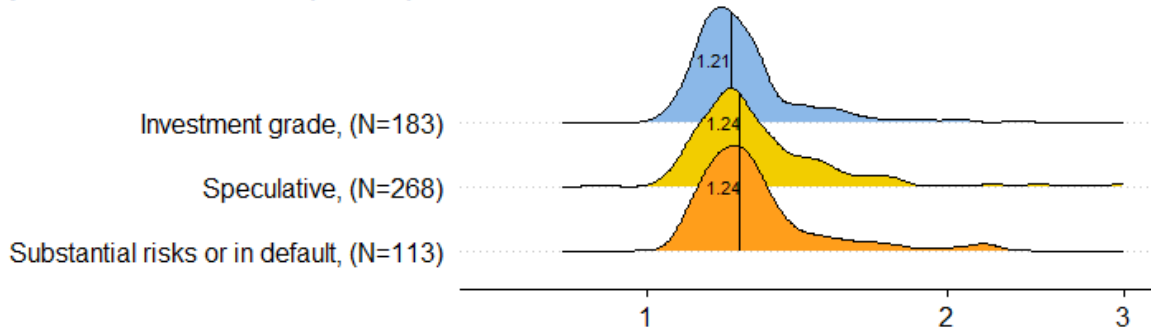
(Countries included in Figure 3)

Investment grade
<i>Bhutan</i> , Botswana, Bulgaria, Chile, China, Colombia, Croatia, Cyprus, Czech Republic, Estonia, Finland, Hungary, Iceland, India, Indonesia, Ireland, Israel, Kazakhstan, Republic of Korea, Latvia, Lithuania, Malaysia, Mauritius, Mexico, <i>Federated States of Micronesia</i> , New Zealand, Panama, Peru, Philippines, Poland, Portugal, Romania, Singapore, Slovak Republic, Slovenia, Spain, <i>St. Kitts and Nevis</i> , <i>Taiwan</i> , China, Thailand, Uruguay
Speculative
Albania, <i>Algeria</i> , Angola, <i>Antigua and Barbuda</i> , Armenia, Azerbaijan, The Bahamas, Bangladesh, Barbados, Benin, Bolivia, Bosnia and Herzegovina, Brazil, Cabo Verde, Cambodia, Cameroon, Democratic Republic of Congo, Costa Rica, Cote d'Ivoire, <i>Djibouti</i> , <i>Dominica</i> , Dominican Republic, Egypt, <i>Equatorial Guinea</i> , Eswatini, Fiji, Gabon, <i>The Gambia</i> , Georgia, Greece, <i>Grenada</i> , Guatemala, Honduras, Iraq, Jamaica, Jordan, Kenya, <i>Kiribati</i> , <i>Kosovo</i> , Kyrgyz Republic, Lesotho, Madagascar, <i>Malawi</i> , Maldives, <i>Mauritania</i> , Moldova, Mongolia, Montenegro, Morocco, Namibia, <i>Nepal</i> , Nicaragua, Nigeria, North Macedonia, Oman, Papua New Guinea, Paraguay, Rwanda, <i>Samoa</i> , Senegal, Serbia, Seychelles, Solomon Islands, South Africa, <i>St. Lucia</i> , St. Vincent and the Grenadines, Tajikistan, Tanzania, Togo, <i>Tonga</i> , Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Uganda, Uzbekistan, <i>Vanuatu</i> , Vietnam, Zambia
Debt distress
<i>Afghanistan</i> , Argentina, Belarus, Belize, Burkina Faso, <i>Burundi</i> , <i>Central African Republic</i> , <i>Chad</i> , <i>Comoros</i> , Republic of Congo, Ecuador, El Salvador, Ethiopia, Ghana, Guinea, <i>Guinea-Bissau</i> , <i>Haiti</i> , <i>Iran</i> , Laos, Lebanon, <i>Liberia</i> , Mali, Mozambique, Niger, Pakistan, Russian Federation, <i>Sao Tome and Principe</i> , <i>Sierra Leone</i> , <i>Somalia</i> , <i>South Sudan</i> , Sri Lanka, <i>Sudan</i> , <i>Timor-Leste</i> , Ukraine, <i>Republic of Yemen</i> , <i>Zimbabwe</i>
Not classified
Africa, Andean Countries, Aral Sea, Caribbean, Central America, Central Asia, East Asia and Pacific, Eastern Africa, Eritrea, Europe and Central Asia, Guyana, Latin America, Marshall Islands, Mekong, Middle East and North Africa, Myanmar, OECS Countries, Red Sea and Gulf of Aden, South Asia, Syrian Arab Republic, Tuvalu, Venezuela, West Bank and Gaza, Western Africa, Western Balkans, World, former Yugoslavia

Note: Countries are classified using [Trading Economics](#) credit rating scores that transform credit rating agency scores, financial market data, and economic indicators into a numerical scale from 0 (default) to 100 (riskless): Investment grade (>50), Speculative (<=50 and >20), and Substantial risk and in default (<=20). For those without a Trading Economics score, scores are *Imputed*, indicated by blue italics above. Not classified includes those where a Trading Economics score was unavailable and could not be imputed. This group is largely comprised of regional projects.

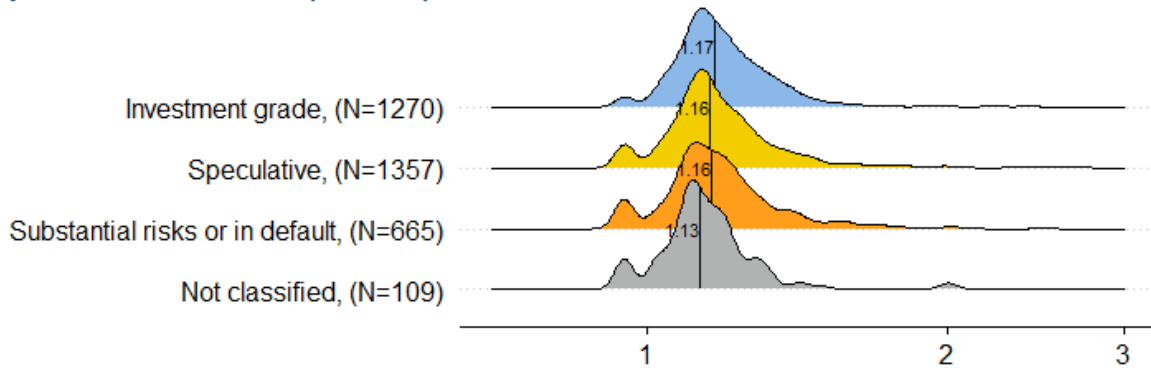
Appendix III. Sensitivity Analysis, Estimated Rates of Return on World Bank Projects

Approval FY 2000-2012 (N=564)

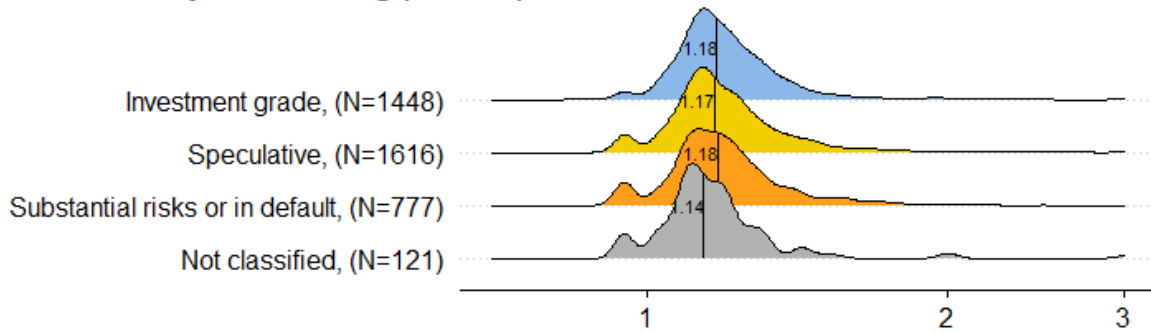


Note: Excludes "Not classified" due to insufficient sample size during this time range.

Approval FY 1956-2000 (N=3401)

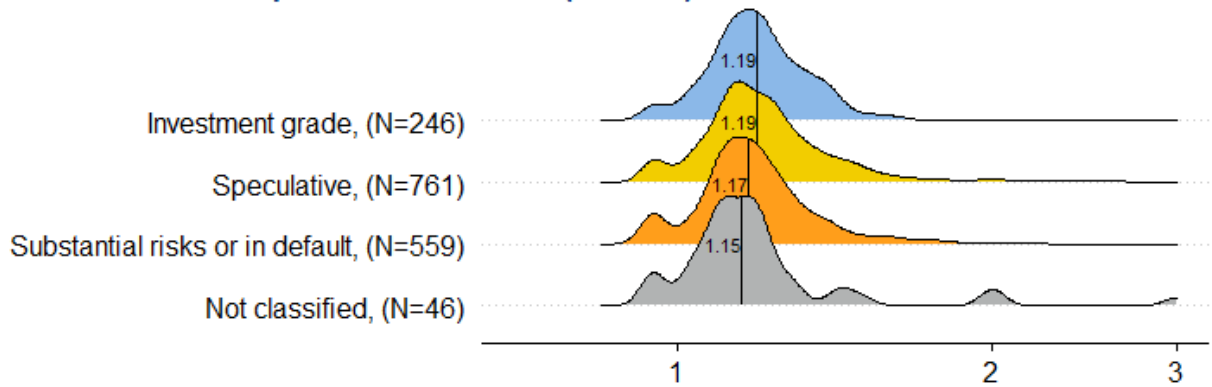


Investment Project Financing (N=3962)

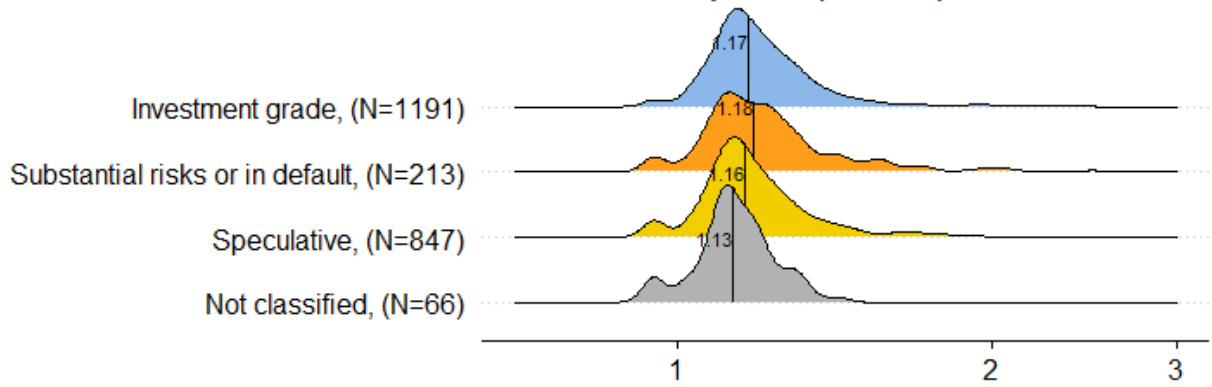


Note: Investment Project Financing (IPF) as opposed to Development Policy Financing

International Development Association (N=1612)



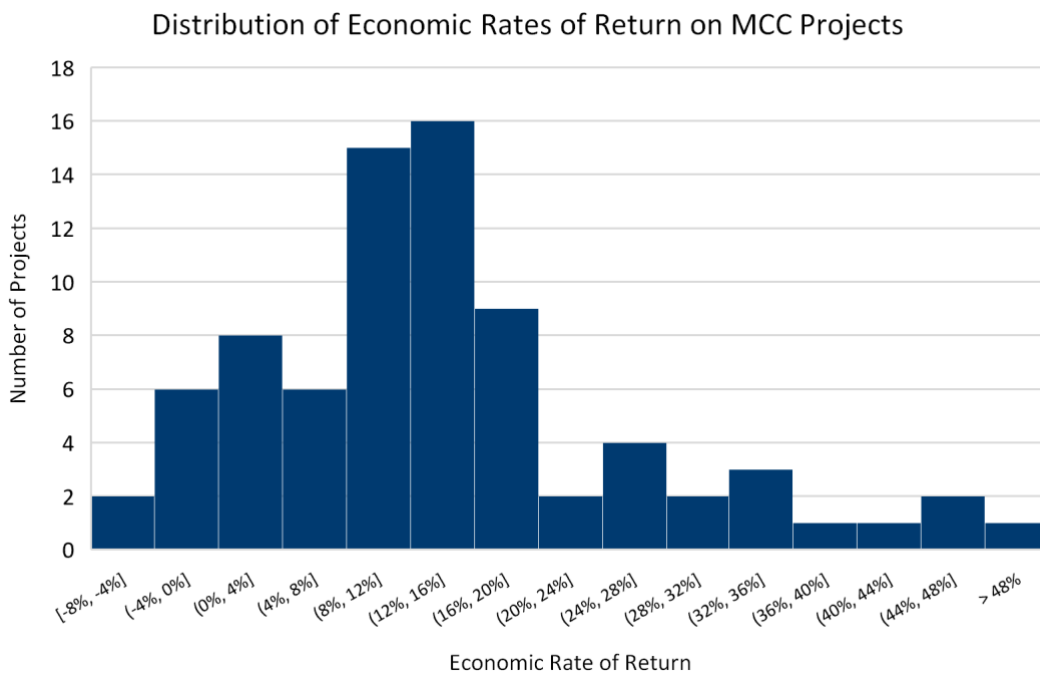
International Bank for Reconstruction and Development (N=2317)



Appendix IV. Millennium Challenge Corporation Rates of Return

The Millennium Challenge Corporation provides the [economic rates of return](#) for a collection of its projects. To be considered for investment, MCC projects must have an estimated rate of return of over 10%. This rate of return is revised throughout the project and a closeout rate of return is calculated when the project is complete. The histogram below shows the distribution of closeout rates of return for 78 MCC Projects across 24 countries, between 2005-2020.

As we saw with the World Bank rates of return, MCC projects have also performed well. Projects across all countries had a mean return of 15.1% (12.9% median), and those in sub-Saharan Africa had a mean return of 14.4% (12.3% median). There was, however, a slightly higher share of MCC projects with negative rates of return: about 9% for the MCC, versus around 5% for the World Bank.



Source: Millennium Challenge Corporation

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