DIPLOMACY, DEBT, AND CHANGE: THE INTERNATIONAL DEBT ARCHITECTURE AFTER THE COVID-19 PANDEMIC[1]

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The article argues that the response from the Group of Twenty (G20) and the Paris Club to the covid-19 pandemic in the field of sovereign debt marks a turning point in the international debt architecture. In articulating a new approach, G20 leaders and Paris Club creditors approved the Debt Service Suspension Initiative (DSSI), which seeks to provide fiscal relief to help low-income economies (LIEs) face the pandemic crisis. Thereafter, the G20 and the Paris Club endorsed the Common Framework for Debt Treatments beyond the DSSI (CFDT), a mechanism to tackle the solvency problems of LIEs through debt restructuring processes. The CFDT is the first mechanism since the Paris Club's creation in 1956 that brings together both its members and non-members on a permanent basis, and the first one that the G20 rather than the Group of Seven (G7) established. The CFDT's design takes into account the changes in the sovereign debt landscape over the last 25 years, but it also seeks to maintain the Paris Club's influence as the main forum for sovereign debt restructuring despite its declining importance.

Keywords: international finance; sovereign debt; G20; Paris Club; DSSI; Common Framework.

DIPLOMACIA, DÍVIDA E MUDANÇA: A ARQUITETURA INTERNACIONAL DA DÍVIDA APÓS A PANDEMIA DE COVID-19

O artigo argumenta que a resposta do Grupo dos Vinte (G20) e do Clube de Paris à pandemia de covid-19 no campo da dívida soberana representa ponto de inflexão na arquitetura internacional da dívida. Ao articularem nova abordagem, líderes do G20 e credores do Clube de Paris aprovaram a Iniciativa de Suspensão do Pagamento da Dívida (Debt Service Suspension Initiative – DSSI), que busca dar alívio fiscal aos países de baixa renda para que possam melhor enfrentar a crise pandêmica. Na sequência, endossaram o Acordo Quadro Comum para Tratamento da Dívida após a DSSI (Acordo Quadro), mecanismo desenvolvido para lidar com problemas de solvência enfrentados por países elegíveis à DSSI mediante processos de reestruturação. O Acordo Quadro é o primeiro instrumento criado, desde a formação do Clube de Paris em 1956, que congrega, em bases permanentes, membros e não membros do Clube de Paris, e o primeiro que foi estabelecido pelo G20, que assumiu funções do Grupo dos Sete (G7). O desenho do Acordo Quadro leva em conta mudanças na evolução da situação internacional da dívida soberana nos últimos 25 anos, mas também busca manter a influência do Clube de Paris como principal foro para reestruturação da dívida apesar de sua influência declinante.

Palavras-chave: finanças internacionais; dívida soberana; G20; Clube de Paris; DSSI; Acordo Quadro Comum.

1. The views and opinions expressed in this essay are the sole responsibility of the author and do not reflect the positions of the government of Brazil.

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DIPLOMACIA, DEUDA Y CAMBIO: LA ARQUITECTURA INTERNACIONAL DE LA DEUDA TRAS LA PANDEMIA DE COVID-19

El artículo sostiene que la respuesta del Grupo de los Veinte (G20) y del Club de París a la pandemia de covid-19 en el campo de la deuda soberana marca un punto de inflexión en la arquitectura internacional de la deuda. Al articular un nuevo enfoque, los líderes del G20 y los acreedores del Club de París aprobaron la Iniciativa de Suspensión del Servicio de la Deuda(Debt Service Suspension Initiative – DSSI), que busca garantizar alivio fiscal para ayudar a las economías de bajos ingresos (LIE) a enfrentar la crisis pandémica. Posteriormente, el G20 y el Club de París aprobaron el Marco Común para el Tratamiento de la Deuda más allá de la DSSI (CFDT), un mecanismo para abordar los problemas de solvencia de los LIE a través de procesos de reestructuración de la deuda. El CFDT es el primer mecanismo desde la creación del Club de París en 1956 que reúne a sus miembros y no miembros de forma permanente, y el primero que el G20 ha establecido, en lugar del Grupo de los Siete (G7). El diseño del CFDT tiene en cuenta los cambios en el panorama de la deuda soberana durante los últimos 25 años, pero también busca mantener la influencia del Club de París como el principal foro para la reestructuración de la deuda soberana a pesar de su importancia decreciente.

Palabras clave: finanzas internacionales; deuda soberana; G20; Club de París; Marco Común.

JEL: F34.

DOI: http://dx.doi.org/10.38116/rtm28art6

Data de envio do artigo: 7/12/2021. Data de aceite: 3/3/2022.

1 INTRODUCTION[3]

Problems that may be structural in origin ultimately emerge as policy issues.
Henry Kissinger

The covid-19 pandemic led the public sector to engage in unprecedented expenditure, which was needed to address the economic and health crisis it engendered. Without strong financial and social safety nets in place, lower-income and highly indebted countries were particularly hard hit. They lacked fiscal space to accommodate public spending and faced reduced access to adequate international financing in the short term. The alarming landscape of global sovereign debt, with more than 30 countries with unsustainable debt in 2019 (IMF, 2019), was substantially aggravated because of the pandemic-induced crisis. In the first six months of 2020, more than 100 countries resorted to International Monetary Fund (IMF) financing (Shalal and Lawder, 2020), and more than US$ 100 billion left financial markets in developing countries, three times the amount registered at the outset of the Global Financial Crisis (GFC) (Georgieva, 2020). According to IMF data, average deficits-to-GDP coefficients reached

3. The author is thankful to Caio Mario Renault, Henrique Choer, and Mari Carmen Rial Gerpe for their valuable comments on earlier drafts of this paper. Mistakes and omissions are solely the responsibility of the author.

11.7%, 9.8%, and 5.5% in developed, developing, and lower-income countries in 2020 (IMF, 2021a). Beyond that, the reduction in foreign direct investment globally, and exchange rate depreciations in many developing countries, further increased the cost of servicing foreign currency loans and added pressure to the difficulties faced, especially by poor countries (OECD, 2020; Bolton et al., 2020).

This extremely challenging environment induced varied responses at the international level. Financial diplomacy was of particular utility to decision-makers. This sub-set of economic diplomacy is a two-leg instrument that comprises the exercise of financial power, on the one hand, and the regulation of financial flows, on the other (Marfil, 2004). As the pandemic unfolded, there was increasing diplomatic coordination to formulate financial instruments that could help to tackle the crisis: not only did States and International Financial Institutions (IFIs) use their financial power to protect the economy and workers, but they also implemented measures to strengthen the Global Financial Safety Net and mitigate the uncertainty that affected markets (Segal, 2020). From swap lines by the United States Federal Reserve in favor of several countries, over increased concessional financing by the IMF, and the creation of special credit lines by Multilateral Development Banks (MDBs), financial diplomacy was a key ingredient in the policy mix used to face the crisis.

At the multilateral level, the Group of Twenty (G20) and the Paris Club were particularly active. They established the Debt Service Suspension Initiative (DSSI) to provide fiscal relief to lower-income economies (LIEs) during the second half of 2020 so that they could be in a better position to weather the pandemic. Since the economic and health conditions did not improve as fast as predicted, they also approved two term extensions for the initiative and the Common Framework for Debt Treatments beyond the DSSI (CFDT), the aim of which is to organize the debt restructuring process of DSSI beneficiary countries facing insolvency issues and debt distress. A significant change in the international debt architecture came about as a result of the pandemic. As this article shows, this change relates to the emergence of China as the world's largest sovereign creditor and to the new "geoeconomic order" that is taking shape due to China's growing influence on international economic governance (Robertson, Choer and Ferguson, 2019). But it is also influenced by different conditions in the global financial markets, the increasing role of private creditors, and the relative decline in concessional lending, which have altered the sovereign debt landscape during the last two decades (IMF, 2021c).

This article analyzes the roles of the G20 and the Paris Club in addressing the issue of global debt at the outset of the covid-19 crisis, both in the short term, with the DSSI, and the long term, with the CFDT. Moreover, the negotiations that led to the DSSI and the CFDT revealed unprecedented reform to the international debt architecture. For the first time since its creation in 1956, Paris Club members had to share the negotiating table, occasionally as a minority,

with non-members, notably China, and coordinate with them the restructuring of debt stocks of countries whose larger share of debt was, in the majority of cases, owed to non-members. Also for the first time, the G20, rather than the Group of Seven (G7), created this new debt restructuring mechanism, expanding considerably the universe of interested parties with a say in its implementation. This means that Paris Club creditors will no longer enjoy the major privilege and autonomy in negotiating debt treatments through previous instruments, such as the Highly Indebted Poor Country (HIPC) initiative and the Evian approach, causing the implementation of the CFDT to be much more fraught with disputes and more prone to failure. These elements, and the underlying changes that have been altering the sovereign debt architecture, further suggest that the singular power position of Western creditor nations since the 1950s has been greatly eroded, accompanied by the relative retreat of the Unites States hegemony in world politics and the rise of China. Whereas United States hegemony provided a stable configuration of power for those previous initiatives, great-power transition creates a highly unstable and indefinite playing field, where actors strive to build understanding and do not have a clearly defined framework for moving forward.

The article's main contention is that the process unlocked by the DSSI and the CFDT marks not only the first relevant initiative at the global level in the sovereign debt agenda since the GFC but also the beginning of significant changes in the international framework that regulates sovereign debt treatments. In this sense, the article offers a contribution to understanding how global financial governance is seeking to adapt to broader changes in world politics, such as the strategic rivalry between the United States and China triggered by the rise of the latter, as well as the fallout of the covid-19 crisis. It also builds on the assumption that public debts are both economic and political objects, and that they raise "issues about the distribution of power and resources within and across societies, revealing as well as enhancing transfers of liabilities between social groups and generations" (Barreyre and Delalande, 2020, p. v). In this definition, public debt is "an instrument of power, a social relationship, and a political arena in which interest and values collide" (idem, ibidem). Changes in the international configuration of sovereign debt will therefore reflect power dynamics, conflictive relationships among States, and different approaches as to what end sovereign debt should serve and as to what means, and informed for which values, should States address it. The CFDT, as will be discussed, is a simple and seemingly useful mechanism to address debt sustainability in the LIEs, but it leaves the majority of these questions unanswered. Indeed, the G20 consensus on which it rests is immensely more fragile than the one that underpinned G7 initiatives.

The article answers three main questions: what were the objectives pursued by the G20 with regard to the debt situation of the LIEs? Which instruments

were used to reach them? And were these instruments adequate to promote those objectives? Part 2 discusses the central international initiatives regarding sovereign debt from 1996 to 2020, compares the sovereign debt landscapes in 2020 and before, and shows why this is significant for any new debt restructuring process. Part 3 describes the creation of the DSSI and gives the main reasons why the initiative may not have succeeded, above all the posture of China and of the private sector. Part 4 begins with a conceptual analysis of changes in debt regimes and why they occur. Further, it explains why the CFDT represents a real change, despite its flaws, and does so by contrasting the traditional role of the Paris Club on the sovereign debt agenda with how the Paris Club will have to proceed from now on. The conclusion serves to summarize the answers to the three questions posed in the research and to signal the main challenges ahead for the CFDT.

2 SOVEREIGN DEBT AND DEBT CRISES: FROM THE G7 AND THE HIPC TO THE G20 AND THE COMMON FRAMEWORK (1996-2020)

Since the 1970s, there have been cyclical periods of sovereign debt accumulation, each marked by simultaneous events of debt distress in several countries and more or less coordinated processes of debt restructuring (Kose et al., 2021). These initiatives had clearly defined goals, such as poverty reduction, debt sustainability, regularization of relations with creditors, and growth (Callaghy, 2002; Cosio-Pascal, 2008). Their history tells the story of the consolidation of the Paris Club and the G7 as the main articulators of rules governing sovereign debt restructuring (Josselin, 2009; Rieffel, 1985, p. 1).

Emerging markets and LIEs saw substantial debt accumulation between the 1970s and the 1990s. In analyzing historical cycles of widespread debt growth, Eichengreen et al. (2020, p. 29) qualify this period as “The Great Accumulation”, which partially coincides with the years of relative decline in growth volatility and inflation in industrialized nations, defined as “The Great Moderation” by Bernanke (2004). In this period, favorable economic conditions in the advanced nations led to increased financing for the Third World. When these conditions waned and the debt-carrying capacity of debtors suffered a blow, notably due to inflation and recession in the developed world and sky-rocketing interest rates in the United States, emerging markets and LIEs benefited from international initiatives to alleviate their debt burdens. Although creditor countries were mostly the same in both cases, their approach to LIEs was more systematic than to developing countries. After the Mexican crisis (1994), this approach gained in organization as the G7 (France, United Kingdom, Germany, Italy, Japan, and the United States) decided to act in a more structured manner regarding the financial agenda. After its Halifax meeting in 1995, the group began a series of consultations to build the so-called “New Architecture of the International

Financial System" (IFA) (Peláez and Peláez, 2005). Recurrent financial crises, loss of confidence in markets, and sudden reversal of capital flows led the group to articulate proposals for reforms and present them to the IFIs. Their work covered a wide range of issues, from macroeconomic policy coordination and international codes to capital account liberalization, to developing supervisory and regulatory frameworks for banking activities.

In the field of sovereign debt, the G7 agreed on a comprehensive framework to help solve the issue of unsustainable debt in the LIEs, a decision taken as part of the general efforts to promote poverty reduction in the Third World. Under the topic of "reducing poverty", the 1995 G7 Halifax Summit Communiqué was critical in this process (Halifax..., 1995). It welcomed the Paris Club's response to the G7 encouragement the year before to improve the treatment of the debt of the poorest countries. In coordination with the IMF and the World Bank, the G7 and the Paris Club established in 1996 the HIPC initiative, which is still in place. Its main objective is to ensure that LIEs are not obliged to serve unsustainable debt. Since its inception, the HIPC initiative has benefited more than 37 countries and promoted US$ 76 billion of debt relief between 2001 and 2015 (IMF, 2019). Through debt pardon and better financial conditions for remaining debt, the HIPC initiative seeks to adapt debt stocks and payment conditions to make debt sustainable and conducive to economic growth (Badaró, 2016; Santarosa and Gerpe, 2017).

However, the G7 scheme did not prove sufficient to drive beneficiary countries into a virtuous track of debt accumulation in a manner consistent with longer-term debt sustainability. Moreover, shortly after the HIPC was launched, the international financial system began to face significant shocks. In a statement entitled *Toward a New Financial Architecture for a Globalized World*, delivered weeks before the G7 Summit of May 1998, then IMF Managing-Director Michael Camdessus (1998) stressed that central on the summit agenda would be "the issue of how to renovate the architecture of the international financial system in the face of the tremendous changes underway in the global economy". The context was the 1997 Asian banking crisis, whose tremendous effects and contagion capacity were felt worldwide. Absent in Camdessus' talk but key to financial stability was the issue of sovereign debt in the LIEs, which was addressed in a similarly entitled *Report by the Executive Committee on Economic and Social Affairs of the United Nations* (Ecesa) published in January 1999. The report underscored the rise in market volatility as a result of the "liberalization of financial flows among industrialized and some developing countries, floating exchange rates, financial innovations, and new communications techniques", and pointed out to the increase in external debt this process was yielding (Ecesa, 1999, p. 5). The report summarized the situation as one of an "enormous discrepancy that exists between

an increasingly sophisticated and dynamic international financial world, with rapid globalization of financial portfolios, and the lack of a proper institutional framework to regulate it" (Ecesa, 1999, p. 5). It also argued in favor of external debt service suspension through a coordinated approach between lenders and borrowers, with the IMF participating, and of debt restructuring mechanisms that could deliver a more adequate structure of debt maturity in situations of sudden shifts in market sentiment, disorderly capital flight, and financial distress (op. cit., p. 20). Suggestions in banking regulation, transparency, and financial supervision were also formulated. Though not all of them were endorsed, the world's largest creditors decided thereafter to amplify the HIPC initiative's terms and create complementary arrangements to attack the debt problem in the LIEs. For, as the paper noted, "accelerated implementation of the HIPC initiative is a world priority, but bolder debt relief initiatives should also be considered" (op. cit., p. 25).

The G7 moved ahead to adopt the "Cologne Debt Initiative" in June 1999, a few months after the Russian crisis in August 1998, which raised concerns about contagion effects throughout the world (Peláez and Peláez, 2005, p. 86). They and the IMF/World Bank added specific objectives to the HIPC framework and created the "Enhanced HIPC", with increased focus on poverty; substantially higher and quicker debt relief; more beneficiary countries; resource availability for priority needs; shortening of the performance criteria; and lowering of targets and thresholds (of debt-to-export ratios) (Blackmon, 2017, p. 43). The initiative called upon the IFIs to develop mechanisms that linked more effectively the stock reduction of debt to public spending in areas deemed essential, such as health and education (Callaghy, 2002, p. 12). To this end, countries would have to develop with the IMF/World Bank a Poverty Reduction Strategy Paper (PRSP) to guide their economic reforms. Creditors agreed to cancel up to 90% of debt stocks. Of the 41 countries considered eligible, 26 participated in the initiative.

But neither HIPC nor Cologne were seen as definitive answers to the lack of a bankruptcy regime for sovereign debt. They were of no use to solve the Argentinian debt crisis of 2001-2003 and the critical issue of holdouts and private sector participation. This led the IMF to formulate a proposal to members of a Sovereign Debt Restructuring Mechanism (SMDR) in 2001, which also failed to attract commercial creditors. Because it excluded Paris Club credits from operations, it was denounced as a device to protect the IMF and official claims at their expense. However, it served its purpose to ensure private sector consent to including collective action clauses in debt contracts (Josselin, 2009, p. 532).

Instead of supporting a comprehensive and permanent mechanism to treat sovereign debt, the Group of Eight (G8) established the Evian approach in 2003, with the Paris Club assuming the key role of implementing it (Cosio-Pascal, 2008,

p. 23). It was designed to help countries not considered eligible for HIPC, mainly low-middle income countries. Cheng, Díaz-Cassou and Erce (2017) argue that this decision was taken against the backdrop of a geopolitical necessity: after the Iraq war initiated by the United States-led coalition in that year, the financial community needed a mechanism to structure the cancellation of the "odious debt" that the Saddam Hussein regime had accumulated over the previous decades (Damle, 2007). By allowing the possibility of treating stock-of-debt rather than debt flow, it also brought official methods closer to private ones (Josselin, 2009, p. 533). Another issue was the G7 ambition to show its continuing contribution to the reform of the international financial architecture following the financial crises of the late 1990s. Considering that without comprehensive treatment of all debt categories countries would continue to come back to the Paris Club demanding restructuring, Evian shifted the focus from simple short-term relief and put emphasis on long-term debt sustainability (Cosio-Pascal, 2008, p. 24).

But, despite the substantial engagement of the international financial community with the issue of unsustainable debt during the last 25 years, the debt situation in the LIEs has worsened. Unsustainable debt continued to grow in the first decades of the 21st century. After the GFC, another wave of debt accumulation ensued in LIEs, without proportional gains in terms of productivity or product growth, with a few exceptions (World Bank, 2021). The high volatility of commodities prices, which fell abruptly from 2014-2016, did not help either (IMF, 2021c). In 2016, public debt had risen 15 percentage points of the world GDP between 2000 and 2015 (Okamoto, 2020). Sub-Saharan Africa, in 2020, faced a fiscal gap amounting to US$ 44 billion, and average debt-to-GDP ratios rose from 24% to 32% in the region between 2009 and 2018. The Debt Sustainability Analysis (DSA) conducted by the World Bank and the IMF in 2019 indicated that 51 percent of IDA countries were classified "as either in or at high risk of debt distress" (Okamoto, 2020). The interest burden continued to rise for LIEs: "The average interest to revenue ratio is expected to rise to 8.7 in 2019 up by 0.9 percentage points in 2017, extending the rise from 6.3 percent in 2013" (IMF, 2020c, p. 8).

This debt landscape differs markedly from those of preceding debt crises, when official lending by States, and the IFIs that lent on concessional terms, dominated the creditors' scene. Differences refer to changes in terms of countries' debt profile, the nature of creditor and the creditor base, the distribution of the volume of claims among the creditors, and the variety of credit instruments held by debtors.

Changes in the debt profile are tied to the exponential growth of two types of creditors during the last 25 years: the private sector, and China. The 1990s, as is well known, were marked by significant changes in the relationship between States and markets, leading to a relative consensus regarding the benefits arising from financial deregulation, capital market liberation, relaxation of banking supervision

rules and trade tariff reduction, among others. With this came an enormous injection of liquidity in the global financial markets, and the private sector increased its participation in financing not only businesses but also States. In 1999, around 50 percent of the HIPC debt was owed to bilateral creditors, while 13 percent was owed to private ones (Blackmon, 2017, p. 27). Although the share of official claims in sovereign debt portfolios is still higher (75% of the total debt of LIEs), the private sector share grows fastest (World Bank, 2019, p. 8): "[t]he fall in the share of bilateral loans in total external debt by 7 percentage points is broadly matched by the rise in the share of commercial borrowing by 8 percentage points" (IMF, 2020c, p. 6). The emission of sovereign bonds in the international markets by a growing number of developing countries, as well as the growing share of credit offered by the private sector and sovereign wealth funds, has reduced the percentage of official debt on the total amount of sovereign debt across the world (Santarosa and Gerpe, 2017, p. 251). This situation of increased fragmentation of the creditor base clearly poses a challenge to any process of coordinated action to restructure foreign debts (IMF, 2020b, p. 20). This is a first and significant face of the over-indebtedness process witnessed in several nations.

The second is the result of China's continuing economic growth and the enormous trade surpluses it has been registering since the late 1990s. This dynamic caused the country to accumulate gigantic reserve balances in strong currency that have been readily available to use as a foreign policy tool. In less than two decades, China became the world's largest creditor, outstripping by far the combined Paris Club members. In 2020, of the US$ 45 billion due in servicing sovereign debt, about US$ 6,2 were owed to the Paris Club's members, US$ 14,5 billion to the private sector, and not less than US$ 24,3 billion, almost half the total, to China (Watkins, 2020). These data convey the importance of Chinese claims when assessing world debt and the inescapable necessity of including China in any serious discussion about the international debt architecture in the 21st century. This increased Chinese presence on the debt agenda has parallels in other fields and institutions in the international economy, such as the World Trade Organization (WTO), the IMF (Wang, 2018), and the MDBs. This influence and the conflict it creates with other powers, notably the United States, will have a greater consequence for the governance of international regimes and in the pattern of interactions governing interstate behavior, causing a shift toward a "geoeconomic order" (Robertson, Choer and Ferguson, 2019). It is too early to confirm this shift for sovereign debt, but there is no doubt that the changes sketched in this section are closely related to this growing Chinese influence in numerous international arenas.

A third representative group of creditors is the MDBs. In 2017, MDBs accounted for 43% of the total long-term debt of the LIEs, a still highly significant share, but relatively smaller than the one it owned in 2008, 53% (World Bank, 2019, p. 8).

As to the diversity of credit instruments in the sovereign debt portfolio, countries have also been witnessing significant changes. These include diversity in instruments, including bonds, loans, collateralized debt contracts and repurchase agreements. While bank loans have declined, since only the largest and most developed countries can access international bond markets, non-bonded debt with public guarantee remains the major source of financing for LIEs (IMF, 2020b).[4]

This changing scenario suffered a major blow with the covid-19 pandemic. In contrast to 2008, when the economic crisis erupted due to factors originating from within the global capitalist system itself, the world economy had been experiencing relative stability and modest recovery in 2020. The IMF projected world GDP growth of 3.3% in that year, more than the 2.9% recorded in 2019, and less than the 3.4% expected for 2021(IMF and World Bank, 2021). This time, the crisis was essentially caused by an external shock, which was not only the pandemic but, most importantly, the restrictive measures needed to reduce its dissemination.

When covid-19 struck, virtually all conditions that generate debt and affect the debt-carrying capacity were combined in a short period. The world saw an increased need for public spending; decline in economic growth and in tax revenues; short-term difficulty to raise funds in the markets; an increase in the risk premium and in the cost of the debt; a drop in remittances; and currency devaluation, among other impacts. The IMF and the World Bank composite indicator that measures debt sustainability takes the majority of these factors into account, and their deterioration obviously led to worsening of debt classification. Furthermore, this time the crisis also hit developed economies. It would be impracticable to put another initiative like the HIPC in place. Even the G7 countries had to drastically expand their balance sheet and issue debt on a large scale to pay for the pandemic-related costs. Average discretionary fiscal response to the pandemic in advanced nations stood at around 17% of GDP (IMF, 2020d).

Although the pandemic did not trigger a new debt crisis, it certainly added increased pressure on the debt scenario in the LIEs and helped bring more attention from the international community to a situation that had been deteriorating and needed to be addressed. This critical conjuncture is addressed next.

4. It is worth emphasizing the differences between sovereign and multilateral lenders with respect to political economy issues. Because MDBs lend in concessive terms and have strong no-toleration of arrears policies, borrowers usually do not default on their debts to those institutions. Sovereign creditors, nevertheless, have been vocal in arguing that seniority should be given to their credits vis-à-vis multilateral loans, so that bilateral flows of debt service are given precedence when debtors face financial difficulties. In the long term, this would imply increased consumption of MDB's capital, a reduction in their capacity to borrow, and entail financial losses to middle-income countries, which are the biggest contributors to those institutions. Briefly, lower and middle-income countries would be sacrificed for the sake of large creditors.

3 IMPLEMENTING CRISIS RESPONSE POLICIES: THE DSSI AND THE "ELEPHANTS IN THE ROOM"

Despite its apparently declining influence in previous years (O'Neill, 2019), once again, as in 2008, it was not the G7 but the G20 that served as the definitive forum to organize and coordinate responses to the crisis (Delabie, 2009; Scandiucci Filho, 2018). The G20, born in 1999 after the Asian crisis as a mechanism of dialogue for Finance Ministers and Central Bankers, became a forum for leaders in 2008 to develop a joint response to the GFC, following the changes in the distribution of wealth and power in the world in previous years. After that, it established a working group to discuss the "International Financial Architecture" (IFA), similarly to what was done under the G7/8 in the 1990s (DT, s.d.). From discussions within this mechanism emerged the proposal to establish the DSSI in 2020.

On April 15th, the G20 endorsed an Action Plan (AP) and announced its intention to support a time-bound suspension of debt service payments for the poorest countries, to be implemented in coordination with the Paris Club (Communiqué..., 2020). It added that "[a]ll bilateral official creditors will participate in this initiative" and called "on private creditors" to participate on comparable terms. Thus was born the DSSI, an unprecedented arrangement between the Paris Club and G20, intended as "a short-term breathing space" for LIEs (IMF and World Bank, 2021; common framework). Beneficiary countries were expected to comply with three commitments: to use the resources to increase social, health or economic spending in response to the crisis; to disclose all public sector financial commitments; to contract no new non-concessional debt during the suspension period. According to the World Bank, by June 2021 the initiative had "delivered more than $ 5 billion in relief to more than 40 eligible countries" (World Bank, 2021b).

But the main drawbacks in the DSSI design were already producing effects before its completion. In November, a G20 declaration highlighted two main shortcomings. It stated that "[a]ll official bilateral creditors should implement this initiative fully and in a transparent manner", and "strongly" encouraged private creditors "to participate on comparable terms when requested by eligible countries" (Leader's..., 2020). In these sentences, it summarized the main constraints to fully implementing the DSSI, the two "elephants in the room": China and private creditors.

As the world's largest sovereign creditor, China was expected to have a central role to play in the DSSI. Nevertheless, its commitment to the G20 arrangement would have to be adjusted to the Chinese practice in terms of transparency. China has a weak record of information-sharing where its creditor position is concerned. The country is not a Paris Club member, and only occasionally joins its meetings as an observer. It has no obligation to comply with the "information sharing" principle that guides the Paris Club's work. The report *How China Lends*

has published some key findings in this regard after analyzing 100 Chinese debt contracts and comparing them to a benchmark of other bilateral, multilateral, and commercial contracts (Gelpern et al., 2021). Specifically related to the DSSI is the conclusion that "[m]any of the contracts contain or refer to borrowers' promise not to disclose their terms – or, in some cases, even the fact of the contract's existence" (op. cit.). In this context, China's unwillingness to share the complete picture of its foreign exposure would simply impede the full implementation of the initiative. Though China, as a G20 member, approved the DSSI, it is unclear whether it would publish data of contracts with clauses such as the ones mentioned and allow closer scrutiny of compliance with the instrument. Officially, the Chinese government says it suspended US$ 2,1 billion under the first phase of the initiative (from May to December 2020), whereas sub-Saharan African countries alone owe it approximately US$ 10 billion in 2021 (Qiu and Woo, 2020). China's role should have been bigger in the first phase.

The private sector's role would also have to be of great significance. Its share in the global sovereign debt landscape has been increasing rapidly in the last few decades. When the DSSI was launched, it included only a soft message in this respect: "[p]rivate creditors will be called upon publicly to participate in the initiative on comparable terms" (Communiqué..., 2020). Nevertheless, private sector participation was considered critical, since in some cases it accounts for the majority of the debt accumulated by the country, such as Chad's, which owes the mining company Glencore US$ 379 million, and US$ 778 million to other private, bilateral, and multilateral creditors (Soto and Hoije, 2020). But of all the groups of creditors, probably the private sector was the one which contributed the least to the DSSI. This happened mainly for two reasons: new money and debt sustainability.

Firstly, private sector entities argued that their involvement in the initiative would have counterproductive effects, mainly because it could impact country-risk analysis by commercial creditors and credit rating agencies, eventually making their financial position deteriorate. A higher risk premium could be required from the LIEs in the future, affecting their capacity to fill their Sustainable Development Goals (SDGs) funding gap. This line of argument, used by the Institute of International Finance (IIF), a global association of the financial industry, in a letter to the G20 in September 2020, pointed out the "impressive" recovery in debt markets since the beginning of the pandemic, with emerging and frontier market bond spreads narrowing significantly from their peak in mid-March. The gradual normalization of financial flows even risked facing interruption because of further DSSI extension, considering that the initial market reaction to the launch of the DSSI had been "spread widening and disruption to market access for DSSI-eligible countries" (Adams, 2020b).

Other issues mentioned relate to eventual collective action problems and delays in renegotiating debts with private creditors. Furthermore, it was argued that borrowers themselves, in conversations with commercial creditors, were voicing concerns that their request to suspend payments to the private sector might be read as default by credit rating agencies and lead to higher credit risk classification. Scholarly research refers to this issue as "reputational damage", which can imply sanctions by creditors, output losses and reduced access to international markets (Reinhart and Trebesch, 2016). After the DSSI was announced, the three major credit rating agencies (Moody's, Fitch, and Standard and Poors – S&T) suggested that they would not view suspension of payments to service commercial debt as a "rating neutral event" (Kearse, 2020). IIF even published the *Terms of Reference For Voluntary Private Sector Participation* in the DSSI, but there is no evidence of considerable adherence to it (IIF, 2020). Briefly, private sector participation was considered to prevent new money, which the financial industry was eager to provide, from finding DSSI-eligible countries.[5]

Lack of private creditor participation collides with the comparability of treatment principle, a cornerstone of Paris Club negotiations that require comparable burden sharing among creditors in debt initiatives. Private Sector Involvement (PSI) was avoided to impede losses for private creditors, and this is no surprise. In fact, there are two interrelated but distinct regimes of debt restructuring: one for official debts, centered on the Paris Club, and another for commercial debt, with the London Club at its center (Josselin, 2009). Their interaction is non-hierarchical and has been marked less by coordination than by mutual pressure. Historically, after debtors agreed on terms of restructuring with their Paris Club creditors, they proceeded to negotiate with another informal group, the London Club, which gathers the private creditors. The terms were presented, and comparability of treatment demanded. There was never "reverse comparability, that is, initial negotiation at the London Club followed by comparability by the Paris Club" (Peláez and Peláez, 2005, p. 190-192).

5. These private sector claims rest on much disputed grounds. There is no precedent or guarantee as to whether a LIE will face difficulties in obtaining financing in international markets in the future if it renegotiates its private debt, or if simply suspends payments in a coordinated way, such as the one provided by the DSSI (Bulow and Rogoff, 1989). In fact, on the contrary, debt relief seems to improve the economic conditions of creditors, in terms of GDP per capita growth, rating, debt to GDP ratio, and debt service burden, at least for emerging markets and advanced economies (Reinhart and Trebesch, 2016, p. 4). On the other hand, some authors criticize initiatives such as the HIPC because, after debt pardon and financial assistance, many countries return to a path of unsustainable debt accumulation. Large portions of debts that are forgiven originate in credit operations by Export Credit Agencies (ECAs). When the countries representing these ECAs participate in pardons and reschedules at the Paris Club, their commitment to writing off debts is implemented by channeling development assistance money to the ECAs whose claim was cancelled. Developed countries, such as the United Kingdom, classify this operation as Official Development Assistance (ODA), when in fact no new money is directed toward LIEs. Secondly, reschedules are often not followed by mechanisms that ensure sustainable debt accumulation: after the old debt is restructured, ECAs and developed countries provide new public and publicly guaranteed loans to LIEs and contribute to renewing long-term debt problems. Consequently, a vicious cycle is formed "whereby developing countries are stuck in a revolving door of debt, rescheduling and more debt" (Blackmon, 2017, p. 9, 10, 54 and 56).

Therefore, the private sector would hardly agree voluntarily to suspend payments in a coordinated manner as supposed in the DSSI, especially in a context like the pandemic in which they would also suffer a blow.

The hole this caused in the DSSI was significant: "[w]ithout the participation of private creditors and China, the debt service bill will be cut by just 14 percent – and many countries will still be paying far more on debt than they are spending on safety nets and health" (Watkins, 2020). Fresnillo (2020) further argues that the debt suspension provided by the DSSI covered only "3.65% of all debt service payments to be made in 2020 by all developing countries".

Secondly, the lack of PSI has to do with the issue of debt sustainability. The keyword here is "case-by-case". Both China and the private sector have indicated that the DSSI would only postpone debt restructuring processes for several LIEs eligible for the benefit. The private creditors, in the same mentioned IIF letter, criticized what was viewed as "across-the-board, one-size-fits-all solutions", invoking as justification their principles and working-methods. The proposed approach was therefore to differentiate specific country situations. Since market liquidity had been reestablished, and new money would continue to flow to LIEs in sustainable debt position, it would be more suited for those with debt distress to transition to debt restructuring negotiations, preferably accompanied by an IMF-supported policy program. Then it would be possible to ensure comparability of treatment and restoration of debt sustainability for those who needed it.

These disagreements regarding DSSI design and implementation were taken into account in the discussions that led to the extension of the initiative for two terms. In November, the same G20 "Riyadh Summit Leaders' Declaration" that extended payments for another six months already came forth with a suggested solution for the long term, announcing a consensus in favor of a "Common Framework for Debt Treatments beyond the DSSI".

4 THE COMMON FRAMEWORK: A FRAGILE CONSENSUS

This section intends to demonstrate that in 2020 the necessary factors converged to foster an alteration of the debt regime that had regulated sovereign debt treatment for the last 70 years. Barreyre and Delalande (2020, p. xi-xii) stress that the world underwent "successive public debt regimes since the eighteenth century", meaning a "stable, dominant configuration defined by a specific articulation between the distribution of capital and markets (...), the nature of the state power (...), and the shape of the political arena". The authors argue that such regimes might be hegemonic, but they coexist with alternative modes of treatment of the object they regulate. Moreover, it is precisely when crises occur that they are "challenged and redefined, through multiple negotiations, conflicts,

and reordering". While the previously mentioned structural and underlying factors, and the dynamics of China and private creditors' financing, had been reshaping the global debt configuration during the past twenty years, they only emerged in full intensity as policy issues in that eventful year.

In the same November 2020 "Riyadh Summit Leaders' Declaration", taking into account the "significant debt vulnerabilities and deteriorating outlook in many low-income countries", the G20 recognized that "debt treatments beyond the DSSI may be required on a case-by-case basis" and endorsed the CFDT, which was also endorsed by the Paris Club. In less than two pages, the document established the basic parameters of this innovative mechanism that was added to the international debt architecture (Club de Paris, s.d.). The CFDT addressed three topics: i) need for debt treatment and debt eligible to the treatment; ii) coordination among official bilateral creditors; and iii) comparability of treatment with other creditors. The text affirms that "all official bilateral creditors with claims on a debtor country" would participate in the debt treatment of such a country. The key parameters include: i) changes in nominal debt service; ii) where applicable, the debt reduction in net present value terms; and iii) the extension of the duration of the treated claims; and calls for comparability of treatment. In stark contrast to previous initiatives, it stated that "debt treatments will not be conducted in the form of debt write-off or cancellation" (Statement..., 2020).

The simplicity of the CFDT's terms might conceal the truly sweeping nature of the process they seek to address. They create a new mechanism for debt treatment, not only beyond the DSSI, but virtually beyond the Paris Club itself.

To understand what this means, it is useful to bear in mind basic aspects regarding the Paris Club. Since it came into being in 1956, it has concluded 473 agreements, amounting to US$ 589 billion of debt, with 100 debtor countries. The Paris Club, run from within the French Treasury's premises, has always been chaired and co-chaired by senior officials of the French Treasury, and its secretary-general, also a French public official, runs a team of other French officials. Thus from a political and administrative point of view, France holds a considerable privilege in managing the Paris Club's affairs. The Paris Club is formed by twenty-two permanent members, nineteen of them also part of the Organisation for Economic Co-operation and Development (OECD). It has been expanding its membership in an effort to maintain its influence by incorporating important creditors of the developing world. Israel became a member in 2014. In June 2016, South Korea joined the Paris Club, and Brazil in September of that year (The Paris..., 2016; Brazil..., 2016). Brazil's accession was hailed by the Paris Club as "a key step forward in the Paris Club's enlargement to emerging creditors, which strengthens the Paris Club's position as the principal international forum

for restructuring official bilateral debt". Other countries, such as India, China, and South Africa, have been participating in some Paris Club regular meetings, the so-called "Tour d'horizon", on an ad-hoc basis. In a way, by reaching towards developing countries, the Paris Club seeks to fragilize the narrative of debt as a contentious North-South issue, a narrative that was developed in the 1970s in the Group of 77 (G77) and United Nations Conference on Trade and Development (UNCTAD) (Rieffel, 1985, p. 23).

Paris Club membership is measured against its benefits. As the Paris Club's official website mentioned on the occasion of Brazil's accession, they include enhanced opportunity to influence the international financial agenda and to have a greater say in future negotiations of sovereign debt restructurings, as well as privileged access to data that would enable future risk assessments of debtors. Supporters of membership also argue that it would increase bargaining power in efforts to recover claims in arrears (Santarosa and Gerpe, 2017, p. 231). Another key benefit involves the Paris Club's relationship with the IMF. The Paris Club enjoys a unique and privileged status in discussions leading to IMF facilities. The fund's policy of non-toleration of arrears owed to official bilateral creditors (non-toleration of arrears policy – NTP) impedes fund lending to countries in arrears to Paris Club creditors unless there is an agreement by the creditors covering the claim or manifestation of consent by the creditors. Besides, it also means that the ECAs of developed countries (to which debt is often owed) will only provide new insurance or guarantees for new export loans once there is an agreement with the IMF, in what Blackmon and others refer to as the "subordination strategy" (Blackmon, 2017, p. 8). This policy was reformed in 2015 to give the fund more latitude in approving facilities and avoiding situations where an individual creditor country could block a program, but the Paris Club can still act together and object to specific negotiations in the fund (IMF, 2015). Thus, the traditional steps involved in Paris Club debt restructurings include IMF/World Bank DSA of the debtors' situation, clearance of arrears with IFIs (if existing), negotiations of facilities with the IMF (if deemed necessary), which may provide for bilateral arrears clearance, and agreement with the sovereign creditors. Only then can the debtor bring the agreed terms to the private sector and require comparability of treatment.

The whole process described above is informal. That is because there is no formal bankruptcy mechanism to solve sovereign debt problems, and therefore the approach has always been based on the contracts regulating the debts concerned (IMF, 2020d). As a consequence, sovereign debt negotiations generally require a consensus among four groups: creditors, debtors, IFIs, and the IMF. And, in the "absence of a bankruptcy mechanism, the four parties must solve a coordination problem" (Truman, 2020), with all the setbacks

traditionally associated with these arrangements, namely asymmetry of information, moral hazard, the possibility of hold-outs etc.

Those against membership note that it would prevent bilateral negotiations with debtor countries, and it would increase the pressure to conform to the Paris Club's principles, including sharing sensitive information regarding bilateral financing contracts (Santarosa and Gerpe, 2017, p. 230). As Rieffel (1984, p. 94) pointed, "there are two major aspects of preparations by the creditors: exchange of data on debts subject to rescheduling, and the formulation of negotiating positions. In these phases, members are expected to share the complete picture of their claims, and the Paris Club's secretariat often serves as the trustee of creditors in their engagement with debtors.

This raises the central issue of China. The previously mentioned report *How China Lends provided* some conclusions regarding Chinese behavior as a sovereign creditor that conflict with the Paris Club's practices and principles. Beyond innovating in financing contracts by blending standard and commercial lending terms, "China's contracts also contain unique provisions, such as broad borrower confidentiality undertakings, the promise to exclude Chinese lenders from Paris Club and other collective restructuring initiatives". Moreover, Chinese contracts seek to include investment-protection clauses to "climb the 'seniority ladder'" to gain advantages over other creditors in restructuring processes (Gelpern et al., 2021).

Thus, the first critical problem that the Paris Club creditors will have to face in implementing the CFDT is to engage with China in a transparent and equal manner. Take the case of Chad, the first country to ask for debt restructuring under the CFDT. As previously mentioned, Chad's foreign debt is owed mainly to private creditors and non-Paris Club members. The Creditor Committee convened by the Paris Club to negotiate a debt treatment for Chad includes four countries, only one a Paris Club member: France, China, India, and Saudi Arabia (Club de Paris, 2021a). It is the first time a Paris Club member has negotiated debt restructuring as a minority among creditors. As of June 11st, 2021, the committee had been able to reach a consensus regarding the support for an IMF upper credit tranche (UCT) program for Chad, and announced that a Memorandum of Understanding (MoU) would be negotiated with Chad to establish the basic parameters of the debt treatment (Club de Paris, 2021b). Chad's case also illustrates the challenges that the creditors will have to face concerning PSI. Just after the G20 endorsed the CFDT in November 2020, an IIF letter to the Saudi G20 presidency urged "that development and application of the Common Framework be a consultative process including the private sector" and communicated its intention to "convene a public-private sector group of experts and provide a forum for regular consultation", but so far this has not taken place (IIF, 2020). Much of the CFDT's

success seems to depend on the outcome of Chad's negotiations. As the first one, it will set a precedent for future treatments.

So far (September 2021), the group of countries that requested debt treatment under the CFDT remains limited. Besides Chad, only Zambia and Ethiopia have made formal requests for negotiations. The Paris Club has successfully been able to form the Creditor Committee for Ethiopia after months of dialogue, but it will face great trouble in restructuring the country's debt in a timely manner. Recall that this will be needed soon, since Ethiopia is benefiting from an IMF program and needs to reprofile its debt service obligations to lower the risk of debt distress and remain eligible for the benefit. The IMF itself is encouraging Ethiopia to have "more prudence in borrowing by state-owned enterprises" (IMF, 2021b), which is an indirect reference to state-owned enterprises (SOEs) that borrow from China. In this context, creditors will also face the question of the types of debt that will be treated in future negotiations, for example, whether SOEs with loans from Chinese entities without guarantee by Ethiopia's government will become subject to restructuring or not. Traditionally, all credits extended by official creditors or with their guarantee are subject to rescheduling, with some exceptions, such as short-term debts (Rieffel, 1984, p. 99). An additional challenge will be to negotiate with several Chinese institutions that lend overseas and to ensure that the Chinese government will be able to oversee the implementation of a possible agreement. The Paris Club's creditors have never yet dealt with something of this magnitude. There is simply no precedent to consult, and there will be no shortage of challenges on the road ahead.

5 CONCLUSION

By endorsing the DSSI and the CFDT, the G20 and the Paris Club intended to provide both short and long-term answers to the urgent debt problems confronting LIEs. Their multilateral objective, in the first case, was to provide short-term relief to countries and enable them to face the covid-19 pandemic with additional fiscal space. In the second, the objective was to put in place a comprehensive mechanism that could embrace restructuring negotiations involving the whole spectrum of DSSI-eligible countries, since the Paris Club structure could not support this process alone.

The instruments used present both benefits and shortcomings. The design of the DSSI ensured immediate relief. Countries were simply able to cease transferring resources to service their foreign-denominated debts and use them to meet domestic needs. Nevertheless, there has not been adequate monitoring of the use of the resources freed up by the initiative, despite discussions in the G20 with this aim. As a simple instrument to provide relief, the DSSI was certainly a welcome

initiative; as a well-designed tool to fund pandemic-related spending, it may not have delivered enough. The US$ 5 billion that the DSSI deferred to 73 countries bear no comparison to the new money that IFIs, for example, conceded to LIEs and emerging markets to fight the pandemic. For one, Brazil received more than US$ 10 billion, 40% of which was earmarked for pandemic-related costs (Brasil, 2020). Moreover, much of the debt that was deferred was composed of arrears registered before the DSSI, and the initiative served only to regulate this situation and the arrears to inflate its numbers. Zambia, for example, owed China US$ 200 million in arrears in 2020 (Cotterill, Wheatley and Stubbington, 2020).

The CFDT is the first SMDR that was added to the international debt architecture by the G20 rather than the G7. It is said that the evolution of sovereign debt treatment went from simple "debt collection", to forgiveness, and poverty reduction (Callaghy, 2002, p. vi). These objectives were announced when initiatives such as HIPC and Evian were established. The CFDT, however, lacks a major guiding objective. Restructuring debt will not be enough to restore macroeconomic stability and growth in the LIEs (Callaghy, 2002, p. vii; Rieffel, 1985, p. 85). The CFDT should be supplemented with G20 commitments regarding market access, financing for development and other growth-supporting initiatives.

The CFDT seems less flawed than the DSSI, but it still presents enormous challenges. Although the objective of the instrument is incomparably more ambitious than that of the DSSI, its structure seems sufficiently general and firm to accommodate the process it seeks to regulate, at least for now. But its success depends on the goodwill of the creditors, especially China. Lex Rieffel wrote in 1985 that the procedures for resolving international debt crises resembled a three-ring circus with the IMF at the center, followed by the bilateral and then the private creditors (Rieffel, 1984, p. 2). It is no overstatement to say that China represents today a fourth ring, rather than an addition to the second one. It is also significant that the G20 is traditionally less a regime builder than an influence group whose role is to press institutions and nations in one direction or another, for example, the reform of the IFIs (Delabie, 2009, p. 650). Large-scale initiatives such as the CFDT represent a completely new challenge for it. Plus, the country-cases to be treated under the CFDT already present several challenges within the Creditor Committees, where only official creditors participate. After negotiations take place in these fora and debt is restructured, comparability of treatment with the private sector will require so close a coordination that interested actors will have to devise unforeseen strategies to ensure it. Furthermore, the simple structure of the CFDT hides the fact the there is no underlying great consensus giving strength to its implementation. G20 creditors agreed only on the idea that some mechanism to restructure claims on countries with insolvency issues had to be devised, but they did not agree on what they would sacrifice to

achieve the results, and neither did they communicate ambitious policy objectives. This time, creditors had neither the money nor the capacity to deliver as much as they did with the HIPC initiative.

With the CFDT, the relationship of the Paris Club with other official creditors from the G20 will become virtually permanent, and the Paris Club creditors will have to reach a compromise in several areas of negotiation: from claims that will be restructured and the data that will be shared, to the institutions that will negotiate in the name of the country creditor, the production of working papers on the situation of debtors, the monitoring of compliance, among others. And, due to the number of member countries and their natural differences in many policy areas, the G20 format implies greater transaction costs and makes consensus more difficult than within the G7 (Delabie, 2009, p. 658). Furthermore, the IMF traditionally played the role of managing the interplay between the private sector and the Paris Club (Josselin, 2009, p. 528). But as an institution dominated by Western powers, major creditors such as China and India will find it difficult to accept the IMF as an honest broker in the CFDT negotiations. How this will play out remains an open question. More than anything, the Paris Club represents a set of procedures (Rieffel, 1985, p. 3). If the players do not comply, there is simply no adjudicating authority to enforce the rules.

Reforms on specific topics of the international debt agenda have indeed been advancing in recent years. The recent changes on debt limits in IMF-supported programs, the creation of the Catastrophe Containment and Relief Trust (CCRT) to provide debt relief through grants to poor countries, and the introduction of collective action clauses (CACs) in sovereign bonds demonstrate progress. But none of these amount to changes in the scale of the CFDT, nor do they have the potential to reframe the way sovereign debt negotiations take place. If the CFDT takes off, it will be the central mechanism that delivers sovereign debt restructuring in the coming decades, and, perhaps above all, a much more diverse, non-Western-dominated one.

The year of 2020 marks a critical moment in the history of the international debt architecture. Trends that were accumulating in previous years finally made it to the surface and imposed themselves as policy issues for the international community, with the G20, above all, rising to the task of responding to them. As the principal international forum to coordinate international responses to the covid-19 pandemic, the group revealed a capacity to act together. That resolve to address big issues must be matched by the commitment to delivering results, if the group is to remain relevant.

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