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OPINION | COMMENTARY

Stemming a Sovereign-Debt Crisis

Rising interest rates and slow economic growth will spur restructuring, but the procedures are inadequate for borrowers and lenders.

By William R. Rhodes and John Lipsky
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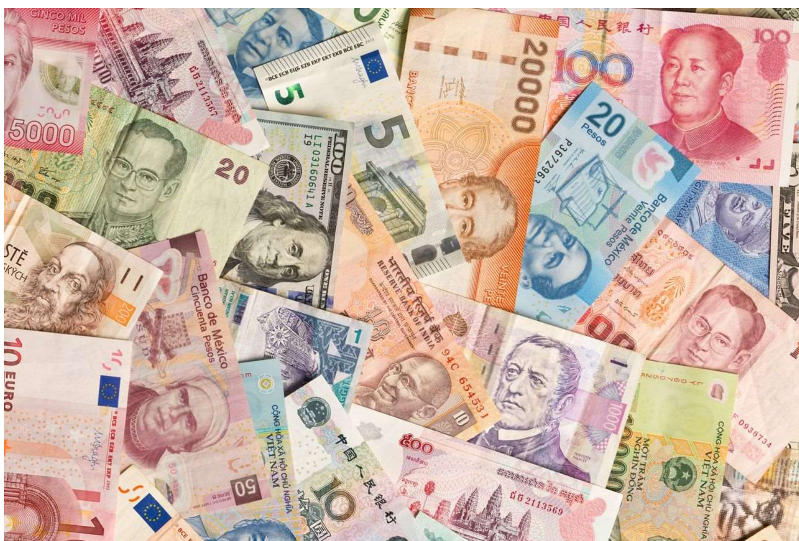

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Rising interest rates and slowing global economic growth likely will spur many low-income countries to try to restructure their sovereign debt. This is troubling because recent restructuring cases have produced extended stalemates between borrowers and lenders rather than resolution. Existing international mechanisms for dealing with sovereign-debt restructuring simply aren't up to the task. Market participants urgently need to make reforms to prevent a deepening debt crisis in developing economies.

The warning signs of a crisis are clear already: According to International Monetary Fund figures, interest payments on public debt as a percentage of public revenues are four times as high in low-income economies as in advanced economies, while the same ratio in emerging economies is twice as high. IMF data show that a decade ago this ratio was similar across all countries. According to the World Bank, 60% of low-income countries are either suffering from debt distress or at high risk of doing so.

Pre-existing international mechanisms for dealing with sovereign-debt restructuring—particularly the Paris Club, where a voluntary grouping of official lenders negotiate with debtor countries—have become muddled and ineffective. The lack of an efficient debt restructuring process creates market volatility and risk, damaging a broad range of financial market participants. As a result, urgent action to improve the current system should receive broad support from all participants.

Incomplete disclosure of the volume and terms of outstanding debt has complicated Group of 20-led efforts to craft agreement on what constitutes fair burden-sharing. Lenders and borrowers alike often want to keep key information confidential, and changes in funding sources, including China's emergence as the largest lender to low-income countries, have further complicated attempts to enhance transparency.

At present there is no international agreement over minimum standards of disclosure, formal mechanisms that create incentives to comply, or sanctions for noncompliance. In November 2020, G-20 leaders created the Common Framework for Debt Treatments and charged the Organization for Economic Cooperation and Development with establishing a debt-information depository. Nonetheless, meaningful progress has been disappointingly slow, though it has been in the right direction.

The Bretton Woods Committee's Sovereign Debt Working Group, which we lead, has been examining the challenges facing the sovereign-debt market in the interest of strengthening the market's efficiency and stability. The group's new report on debt transparency argues that meaningful progress will require a broad agreement on minimum disclosure standards, including what types of borrowing should be included and what degree of detail should be required.

The report includes model disclosure standards that the group deemed appropriate and effective while remaining plausible and practical. Successful reform must create incentives for borrowers and lenders to comply and include consequences for noncompliance. The group concluded that proposals exist already for practical and effective incentives and consequences, but they need to be agreed to and implemented.

International institutions like the IMF and World Bank could make adherence to disclosure standards a requirement for access to their financial support. Regulators could require lenders to disclose lending terms to foreign sovereigns, while debt-rating agencies could include compliance with transparency standards as a rating criterion.

In addition, the various parties involved in any sovereign-debt restructuring should know beforehand how the process will operate and be confident that their interests and point of view will get a fair hearing.

One weakness of the Paris Club process is that private-sector lenders often feel their interests are taken into account only at the final stage of discussions and that they aren't always taken seriously. The private sector deserves more formal engagement, perhaps through creditor committees, which would represent their interests in restructuring negotiations.

New challenges regarding sovereign-debt restructuring are looming, and the resolution processes currently in place are inadequate. To avoid a deepening crisis, new reforms are needed urgently. The coming G-20 Finance Ministers meeting would be an obvious place to begin making progress on this critical issue.

Messrs. Rhodes and Lipsky are co-chairmen of the Bretton Woods Committee's Sovereign Debt Working Group.

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