Sovereign Debt, Management, and Restructurings during the COVID-19 Pandemic

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The unprecedented contraction in global economic activity from the COVID-19 pandemic drew decisive domestic fiscal and monetary policy measures to ameliorate demand and supply implications, reduce systemic risks and maintain financial stability. However, medium-term vulnerabilities have risen because of these measures. In particular, sovereign and corporate debt levels have increased amid massive fiscal stimulus spending, contributing to explosive debt accumulation in advanced economies, emerging markets, and low-income countries. As a result, issues of risk and sustainability have emerged. The increase in public debt necessitates the development of careful debt management strategies to avoid risks and debt distress situations that could lead to sovereign debt restructurings.

I. Introduction

This special issue of the Multinational Finance Journal presents selected papers from a virtual conference on "Sovereign Debt, Restructuring and

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Risk Management in the Post-COVID-19 Era" that took place on February 26, 2021. The conference was jointly sponsored by Drexel University's LeBow College of Business and the Global Interdependence Center. At the conference, international financial organization experts, credit rating agency officials, financial advisors, and academics discussed recent developments and prospects for sovereign debt and addressed issues of sovereign debt management and restructurings linked to the increased risks in the global economy from the COVID crisis. In this context, they provided concrete recommendations in managing debt and dealing with debt resolutions in case of emerging preemptive defaults or post-default situations.

Global debt has increased dramatically since the Global Financial Crisis of 2007-2009. This increase covered both public and private debt and was observed in countries of all income levels. This global debt entropy was accelerated during the COVID-19 pandemic. Especially hard were hit Low-Income Countries (LICs), developing and Emerging Market (EM) economies, with a number of them becoming unable to service their sovereign debt and some being forced to sovereign debt default and restructuring. Amid these adverse developments, the G20 proceeded with two main debt relief initiatives for LICs, the G20 Debt Service Suspension Initiative (DSSI) and the Common Framework. These initiatives, however, have not been able so far to effectively contain the debt distress of the most vulnerable countries, let alone help resolve their massive accumulation of debt. This situation highlights the need of instituting prudent local debt sustainability and management policies, as well as concerted international actions to prevent more defaults and restructurings that disrupt capital-inflows and thus affect growth negatively in these countries.

To put the adverse global debt situation in perspective, it is worth mentioning that total global debt, consisting of general government, non-financial corporate, financial sector, and household debts, reached US$281 trillion at end-2020, the highest ever debt level, or close to 356 percent of global GDP, up from US$257 trillion or over 321 percent at end-2019, according to February 2021 data from the Institute for International Finance (IIF), based on 61 countries. By sector, general government debt reached more than US$83 trillion or more than 105 percent of global GDP in 2020, up from close to US$71 trillion or over 88 percent in 2019; non-financial corporate debt reached more than US$79 trillion or a little over 100 percent of global GDP in 2020, up from close to US$74 trillion or almost 92 percent in 2019; financial sector debt reached more than US$67 trillion or almost 86 percent of global GDP in 2020, up from close to US$65 trillion or almost 81 percent in 2019; and household debt reached almost US$51 trillion or over 64 percent of global GDP in 2020, up from a little over US$48 trillion or over 60 percent in 2019. These figures make evident that the general government debt had the biggest sectoral contribution in the increase of total global debt in 2020, namely more than 17 percent out of a total increase of about 35 percent of global GDP, mainly as a result of fiscal stimulus packages implemented to offset the economic fallout of the pandemic.

Further, from a country-income viewpoint, the debt of mature markets included in the IIF data reached US$205 trillion in 2020 or close to 419 percent of mature-markets GDP, up from US$183 trillion or more than 381 percent in 2019, while that of LICs/developing/EM countries rose to US$76 trillion in 2020 or over 250 percent of the corresponding countries GDP, up from US$74 trillion or over 220 percent in 2019. For mature-market economies, general government debt reached close to US$64 trillion or more than 130 percent of mature markets GDP in 2020, up from more than US$52 trillion or close to 110 percent in 2019; non-financial corporate debt reached US$48 trillion or a little over 98 percent of mature markets GDP in 2020, up from over than US$43 trillion or a bit over 91 percent in 2019; financial sector debt reached over than US$55 trillion or over 113 percent of mature markets GDP in 2020, up from close to US$52 trillion or a little over 108 percent in 2019; and household debt reached over US$37 trillion or close to 77 percent of mature markets GDP in 2020, up from close to US$35 trillion or over 72 percent in 2019.

For LICs/developing/EM countries included in the IIF data, general government debt reached over US$19 trillion or more than 63 percent of corresponding LICs/developing/EM economies' GDP in 2020, up from more than US$17 trillion or over 52 percent in 2019; non-financial corporate debt reached over US$31 trillion or over 103 percent of LICs/developing/EM economies GDP in 2020, up a bit from US$31 trillion or 93 percent in 2019; financial sector debt reached a bit over US$12 trillion or close to 40 percent of LICs/developing/EM economies GDP in 2020, up from close to US$12 trillion or about 35 percent in 2019; and household debt reached over US$13 trillion or close to 44 percent of LICs/developing/EM economies GDP in 2020, down from over US$13 trillion or over 40 percent in 2019.

These individual figures for mature markets' and LICs/developing

/EM economies' debt further show that the general government debt had the biggest sectoral contribution in the respective increase of debt in 2020, namely, more than 20 percent out of a total increase of over 37 percent of mature markets GDP and over 11 percent out of a total increase of 30 percent of LICs/developing/EM countries GDP. Further, these statistics point out to the disparity between mature markets and LICs/developing/EM countries in their total indebtedness, as more than half of the increase of mature markets' debt between 2019 and 2020 was due to the accumulation of general government debt (20 percent out of 37 percent) and only about one-third of the increase of LICs/developing/EM economies' debt originated in higher general government debt (11 percent out of 30 percent). This also reveals that the fiscal stimulus packages instituted during this period to cope with the direct and consequential adverse effects of the pandemic were bigger in mature markets.

From a global economic recovery standpoint, it is necessary that both developed (mature markets) and LICs/developing/EM countries develop appropriate debt management strategies to overcome their current sovereign debt overhung. In particular, the Covid-19 period has made obvious that LICs/developing/EM countries need international support to reduce their sovereign debt burden and ensure sustainable financing for their economies. For Africa, for example, building on and going beyond existing partnerships, such as the G20's joint effort with the Paris Club within the DSSI and its Compact with Africa, may be required, including the full scope of international financial instruments such as a new IMF Special Drawing Rights (SDR) allocation, to increase liquidity/restore debt sustainability and enhance positive growth prospects. Regarding issuance of new IMF SDRs, the G7 finance ministers in their virtual meeting on February 11, 2021 considered a proposal on a new US$500 billion SDR allocation to help LICs, while the G20 Finance Ministers and Central Bank Governors in their February 26, 2021 meeting supported a new IMF SDR allocation and asked the IMF to develop a plan for such allocation, without specifying an amount.

At an informal meeting on March 23, 2021, the IMF's Executive Directors expressed broad support for IMF staff to formulate a proposal for a general new SDR allocation of US$650 billion to increase reserves and support the global recovery from Covid-19 crisis. The proposal was presented to the IMF Executive Board (EB) on June 25, 2021 and concurrence was achieved on July 8, 2021. It was approved by the IMF

Board of Governors on August 2, 2021and the allocation took place on August 23, 2021 (approval required 85 percent majority of IMF's membership voting power, with SDR allocations being distributed across the IMF membership in proportion to IMF quota shares) (IMF, 2021a). This allocation provided US$21 billion worth of SDRs in liquidity support out of about US$275 billion to EM/developing countries/LICs, helping them to continue with Covid-19 spending needs and avoid debt problems. It seems that liquidity support will be needed until Covid-19-related expenditures subside and recovery returns. However, when global interest rates start rising, swift unwinding/withdrawing of fiscal stimulus measures may become imperative to avoid additional debt-servicing challenges especially of LICs with elevated debt levels.

The presenters and participants at the conference highlighted the gravity of the sovereign debt situation following the advent of the COVID-19 pandemic and critically discussed the undertaken G20 debt relief initiatives for LICs, including from a credit rating viewpoint. Subsequently, they outlined the sovereign debt management policies assumed during the COVID-19 period and emphasized the need for enhancement and adaptation of existing debt management practices going forward. Finally, they provided the salient features of some of the main restructuring episodes during the COVID-19 era, along with an overview of the prevailing sovereign debt restructuring framework and bond contractual elements promoting efficient debt resolutions, e.g., CACs. Summaries of their presentations appear in the next section by contributor.

II. Summary of Contributions in this Special Issue

This section is organized into three parts, each covering one of the three main topics in the "Sovereign Debt, Restructuring and Risk Management in the COVID-19 Era" conference agenda. The contributions reflect the views of some prominent experts specializing on sovereign debt developments, debt relief initiatives, sovereign debt management, and sovereign debt restructurings.

Sovereign Debt Developments and Debt Relief Initiatives

In this, first, paper, Michael G. Papaioannou and George Tsetsekos provide an overview of sovereign and corporate debt developments until end-2020. They argue that the unprecedented contraction in global economic activity from the COVID-19 pandemic drew decisive domestic fiscal and monetary policy measures to ameliorate demand and supply implications, reduce systemic risks and maintain financial stability. However, medium-term vulnerabilities were risen because of these measures. In particular, sovereign and corporate debt levels increased amid massive fiscal stimulus spending, contributing to explosive debt accumulation in advance economies, emerging markets, and low-income countries. As a result, issues of risk and sustainability have emerged. They maintain that the increase in public debt necessitates the development of careful debt management strategies and international support to avoid risks and debt distress situations that could lead to sovereign debt restructurings.

The second paper, by Elena Duggar, presents the G20 debt relief initiatives for low-income countries during the COVID-19 crisis. She mentions that the G-20 Debt Service Suspension Initiative (DSSI) was endorsed effective May 1, 2020, in the midst of an unprecedented fall in government revenues and rapidly rising public expenditure following the COVID-19 shock and resulting deep economic contraction. She states that by the end of 2020, 45 of the 73 eligible countries had participated in the initiative and by March 18, 2021, 24 countries had participated in the extended DSSI.

Further, the author argues that the G-20 DSSI initiative will alleviate liquidity pressures for participating countries, but in general the savings from debt relief under the DSSI are modest relative to the fiscal deterioration brought about by the COVID-19 shock. She stresses that countries eligible for the DSSI and the Common Framework for debt treatments differ greatly in terms of their debt-to-GDP levels, debt sustainability positions and credit risk, potential benefits from DSSI debt relief, and creditor universe, and argues that this diversity will necessitate tailored approaches to debt relief, taking into account country-specific circumstances.

Sovereign Debt Management Practices

In the third paper, Thordur Jonasson and James Knight offer some observations on debt and debt management, before, during and after the COVID-19 pandemic. They discuss the impact of the COVID-19 pandemic on global debt and on debt management practices, with a focus on the state of debt management prior to the pandemic, the responses of country authorities to the challenge, and how debt management is likely to change in the future. This paper discusses the sovereign debt and management challenges that emerged following the COVID crisis from an international financial institution perspective, while the Rafael Molina paper below presents these challenges from a financial advisor's viewpoint.

The fourth paper, by Rafael Molina, presents some enhancements and adoptions of sovereign debt management practices in the advent of the COVID-19 pandemic. First, he discusses the evolution of sovereign debt management over the past two decades, highlights the need for its further evolution in light of the continuous efforts to build sustainable debt and growth policies, and outlines some views on its future following the ensuing challenges from the Covid-19 pandemic. Then, he outlines some key lessons and considerations for sovereign debt restructurings that might emerge as a result of COVID-19-related sovereign debt distresses and concludes by highlighting the need of integrating sovereign debt management with fiscal and monetary policies.

Sovereign Debt Restructuring Experiences and the Role of Collective Action Clauses

In the fifth paper, Papaioannou and Tsetsekos examine the causes, processes, and outcomes of some prominent sovereign debt restructuring episodes that occurred during 2020-2021 in the context of the prevailing IMF sovereign debt restructuring framework and the G20 debt relief initiatives for LICs that were instituted as a result of the Covid-19 economic consequences. The paper presents, first, the central role of debt sustainability analysis in the IMF sovereign debt restructuring framework for both low-income countries and countries that maintain market access. Based on the observed salient features of the recent restructurings, the authors outline common traits in the behavior of involved stakeholders and draw lessons on facilitating sovereign and creditor attributes for efficient sovereign debt resolutions.

In the sixth paper, by Elena Duggar, Gabriel Torres, Claire Li, and Gabriel Agostini, presents the Argentina sovereign debt restructuring episode in 2020 and subsequent developments. It stresses that Argentina's 2020 debt restructuring was the second largest sovereign restructuring in history, after Greece's in 2012, and mentions that the sovereign's latest default was triggered by extending maturities on short-term debt in August 2019, followed by another postponement of short-term debt payments in December 2019 and long-term debt payments in February 2020. In August 2019, the government announced its intention to restructure its long-term debt as well.

In addition, it compares Argentina's sovereign debt crisis with prior sovereign bond defaults and sets forth Moody's view that significant challenges result in Argentina's creditworthiness remaining weak even after the debt restructuring and despite sizeable losses for investors. These challenges include Argentina's large share of foreign-currency debt amid its dependence on external foreign-exchange financing and limited domestic funding options, along with subdued economic prospects as the coronavirus pandemic deepened the country's multi-year recession and also affected Argentina's main trading partners.

In the seventh paper, Tamon Asonuma, Michael G. Papaioannou, and Takahiro Tsuda present the domestic sovereign debt restructuring, banking crisis and financial stability policies in Cyprus during 2012-2013. They state that the Cyprus 2013 domestic sovereign debt restructuring was undertaken in the context of the country's economic adjustment programs, when the government agreed to a € 9.0 billion program with the European Stability Mechanism on March 25, 2013 and a €1.0 billion program with the International Monetary Fund on May 13, 2013 (both programs were concluded at end-March 2016). They mention that, as part of the combined programs, Cyprus' second-largest bank, the Cyprus Popular Bank (CPB), was also agreed to be closed, and a one-time bank deposit levy (haircut) be imposed on all uninsured deposits of CPB and on 47.5 percent of uninsured deposits of the largest commercial bank, the Bank of Cyprus (BoC), while no insured deposit of Euro 100,000 or less would be affected.

Further, they maintain that the debt restructuring was successful in attaining substantial debt relief, reducing the country's debt-to-GDP ratio, and restoring financial stability, although at a high cost for some depositors. However, they point out that, while the bail-in of both resident and nonresident depositors helped mitigate the burden of bank recapitalization for the general public, a more targeted bail-in approach for deposits above a socially acceptable level would have lessened the cost to the public, as well as the erosion of the public's confidence to local banks.

In the final contribution, Kay Chung and Michael G. Papaioannou analyze the effects of the inclusion of enhanced collective action clauses

(CACs) in international (nondomestic law-governed) sovereign bonds on countries' borrowing costs, since their introduction in September 2014 and until March 2021. Using secondary-market bond yield spreads, they find that in the period September 2014 to February 2020, where no restructuring episodes have occurred, enhanced CACs are negatively associated with sovereign bond yield spreads and consequently lower borrowing costs. However, during the COVID-19 period of March 2020 to March 2021, when the Argentina and Ecuador sovereign debt restructurings occurred, they find that investors' bond pricing behavior was differentiated depending on the inclusion or not of enhanced CACs their inclusion is positively associated with yield spreads, perhaps due to the lack of flexibility of investors bound by the enhanced CACs provisions. The results obtained for September 2014 to February 2020 continue to hold when the sample is extended to March 2021.

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