A PROPOSAL TO FUND A RESILIENT AND SUSTAINABLE RECOVERY FOR THE MEDITERRANEAN AND AFRICA

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During 2020-21, the Covid-19 pandemic has caused widespread concern about debt unsustainability in both developed and emerging economies. Adding to that, there has been the war in Ukraine with its disastrous consequences for the global economy, pushing global debt even higher.

The volume of global indebtedness including governments, businesses and households is dangerously high, reaching 300 trillion in 2021 and it keeps growing1. In the Euro zone, government debt for countries such as Italy and Greece is heading above 150% of GDP.

Low-income countries and households suffer the most from high debt levels and a lower capacity to service the debt.

These increases come on top of debt levels that were already historically high. In 2020, global debt was around 226 trillion – the jump in one year is alarming, with the expectation that there will be a further increase during 2022.

Many advanced economies had the capacity to borrow (low interest rates and risk premia) and a higher capacity to service that debt, particularly the external element of it.

Emerging markets and low-income countries faced much tighter limits on their ability to carry additional debt, whilst they are at risk of a default spiral (the cases of Zambia, Argentina and others more recently, such as Sri Lanka, Lebanon and the list is growing).

Back in 2021, a benign scenario – when interest rates remained low, vaccines eventually worked to bring the pandemic under control and there were still questions about recovery and future growth – back then, we did not know about the speed and scale of recovery.

In 2022, with the war in Ukraine, increasing inflation and risks of stagflation, debt crises are becoming a serious threat to the global economy and financial systems

In June 2022, concerns were raised about the Euro zone – with the jump in risk premiums on government bonds for Greece and Italy – which prompted the ECB to work on an instrument to buy government debt, in order to tackle potential extreme market turmoil.

The low-income countries, with high external debt position are already in debt distress and close to debt distress… Today, there are countries who are already engaging in debt restructuring and messy defaults.

In this policy paper, we review the main achievements by the international organisations in responding to the challenges facing low and middle-income countries, with a focus on the African continent. We propose an innovative financing mechanism to put the continent back on the road to economic recovery and resilience.

[1] https://www.weforum.org/agenda/2022/05/what-is-global-debt-why-high/

PROGRESS AND ACHIEVEMENTS IN DEALING WITH A LOOMING DEBT CRISIS

In April 2020, a Debt Service Suspension Initiative[2] (DSSI) was launched under the World Bank Group (WBG) to address debt vulnerability in the poorest countries, to enable the freeing up of some fiscal space to combat the health crisis and its consequences. The implementation of the DSSI was accompanied by the monitoring of spending, promoting public debt transparency and ensuring prudent borrowing. However, the lack of debt transparency remains a major obstacle to restructuring and relief efforts involving the private sector - despite the ongoing initiatives to enhance debt transparency, such as the OECD debt transparency initiative launched in 2021[3].

Since then, the DSSI has addressed the debt relief problems of many low-income countries, yet the framework expired in December 2021 and the common framework, which does not seem to work, has taken the lead in debt relief discussion and processes. It is worth noting that the DSSI does not include middle-income countries.

In 2021, the IMF called for the urgent need to reform international debt architecture, a call that came on the eve of the IMF-WBG Annual Meetings.

A call that was underpinned by three fundamental reforms:

1- more debt relief
2- strengthening contractual provisions via the extension of collective action clauses to non-bonded debt, enhanced by clauses that lower debt payments or automatically suspend debt service
3- enhancing debt transparency to facilitate restructuring and resolution decisions and actions.

In 2021, the African Development Bank called for a comprehensive plan for debt restructuring in Africa, encompassing a form of a stabilisation mechanism, which would free up the fiscal space Africa needs to deal with its debt. On average, African debt stands at 70% of GDP. The proposed idea is to set up a home-grown Financial Stability Mechanism (FSM) to mutualise the available funds, in order to ensure the limitation of spillover effects from external shocks.

The question is whether this call is realistic, without the prerequisites to engage in such a structure?

In Europe, the ESM was created for the European Commission to provide financial assistance to any EU country experiencing or threatened by severe financial difficulties.

The ESM is built on the following conditions:

[2] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative
[3] https://www.oecd.org/finance/debt-transparency/

- high level of monetary and economic integration within the euro area
- there is a single currency and monetary policy in the Euro zone to make the European Stability Mechanism (ESM), with its currency being the euro, as the main stability mechanism for the euro area.
- there is a justification that having a Member State in financial difficulties could create risks for the financial stability of the euro area as a whole.
- there is the principle of reinforced solidarity between Member States whose currency is the euro, which is needed for the good functioning of a monetary union, with the financial assistance mechanism operated under Union law.

The ESM has worked well and can issue bonds (up to 30BI annually) – and, so far, it has disbursed €295 bn to stabilise distressed economies such as Greece… in addition to ECB operations to buy governments bonds.

The discussion for such a framework in the African context is already a step towards financial stabilisation.

It is worth noting that such an idea is not even being discussed and explored at the Southern Mediterranean level.

For the Mediterranean and Africa, exploring these structures could provide examples of what the conditions are to build fully-fledged, home grown stabilisation mechanisms to tackle financial instabilities and drive the regions into a comprehensive integration process.

The plan to build such frameworks for the Mediterranean and Africa can already start with the support of the EU and leverage its experience of the ESM and other integration mechanisms.

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In line with this thinking and to drive the countries into a credible recovery process that deals with short to medium term financial challenges, we propose a prompt and innovative stabilisation mechanism to deal with the huge piles of unpaid debt.

The proposal (in line with Ayadi (2022 forthcoming[4]) is to extend the timeline of DSSI until a post COVID-19 global recovery is resumed and the Ukraine war has ended with a peace deal with

[4] Forthcoming at G20 insights.org under The G20 presidency in Indonesia.

Russia. It also includes enlarging the eligibility of LMICs, including many countries which are in the Mediterranean and Africa.

The DSSI should systematically engage with the private sector to contribute to the debt relief efforts and to get the engagement of countries benefitting from debt relief that they won't be excluded from capital markets for new issuances.

Whilst the Common Framework could become a permanent instrument to inherit the temporary nature of the DSSI after expiry, it has to improve its clarity, be more transparent and to provide a clear roadmap to the countries that engage in debt relief negotiations. Countries that access the DSSI must credibly commit to register all forms of new debt in the OECD debt transparency repository[5].

In line with the proposal of Altuwaijri, Altuwaijri and Ayadi[6] (2021) and Ayadi[7] (2022), we propose complementing the DSSI with **a public-private SDG-compliant financing fund/plan,** as part of a global economic post COVID-19 recovery plan, to accelerate the transition towards a net zero scenario and to fully comply with the SDGs principles and relevant indicators. This mechanism can be used to restructure existing debt piles and interest, as well as to finance a sustainable recovery and transition towards SDG objectives and a net zero scenario[8].

The mechanism could take the form of a partial guarantee (between 40% and 60%) issued by the Resilience and Sustainability Trust (RST) that, thanks to the Special Drawing Rights (SDR) allocation, has the financial capacity to help the needy countries to issue long-term maturity (up to 50 years) Recovery, Resilience and Sustainable Transition Bonds (RRST Bonds), with lower interest rates (no more than 1% above market interest rate levels on the USD[9]). This would dramatically transform their existing unpaid debt and finance their recovery plans post COVID-19 and sustainable transition to 2050, in line with the SDGs. It is essential that the private sector, represented by the International Institute of Finance (IIF), contributes with a firm written commitment to provide affordable liquidity within a period of time for these countries.

The DSSI and Resilience and Sustainability Trust (RST) (recently set up by the IMF) must work in close coordination with the private sector, represented by the IIF executive board. Coordination must be achieved via a tripartite taskforce with the country in difficulty, to co-design a comprehensive

[5] https://www.oecd.org/finance/debt-transparency/
[6] https://www.g20-insights.org/policy_briefs/debt-relief-for-sustainable-recovery-in-low-and-middle-income-countries-proposal-for-new-funding-mechanisms-to-complement-the-dssi/
[7] Forthcoming at G20 insights.org under Indonesia presidency.
[8] Other proposals have been vocal in adopting a coherent global approach to deal with sovereign debt in emerging and developing countries.
https://eprints.soas.ac.uk/34346/1/DRGR-report.pdf
[9] Undoubtedly, the pressure to increase interest rates to tackle high inflation might hurt a resilient recovery and may lead to higher interest rates on issuance in USD and in other currencies.

financing approach for recovery, resilience and sustainable transition. This will be considered as a collective approach to avoid massive defaults of countries that have succumbed to their structural problems, exacerbated by the COVID-19 pandemic and the war in Ukraine.

The terms and conditions of the prospectus for the RRST bonds must be agreed up front, when the DSSI country has completed the debt relief process and committed to the conditions of the RRST. The main conditions of the RRST are to use a predetermined percentage (up to 20%) of the proceeds of the bond to finance the unpaid debt that subsequently matures, with the remaining 80% being allocated to the recovery and sustainable transition in line with the RST conditions. It would entail the very strict monitoring of the use of proceeds and a firm requirement to publish the debt issued and the breakdown of its use in the debt transparency repository of the OECD.

For this to happen, the EU, together with the key private sector players, should engage in a taskforce to use funding under the Multi-Financial Framework and Team Europe to partially guarantee these new issuances and channel part of the SDRs under the RST for that purpose. At a later stage, a EU-MED- Africa Taskforce should support the countries of the Mediterranean and Africa to engage in a meaningful integration process. At the same time, these countries, who engage in such a mechanism, could start revamping their monetary and fiscal policies and embark on further integration, using examples such as the Euro zone and ESM.

ABOUT EMEA

The Euro-Mediterranean Economists Association (EMEA) is a Barcelona-based regional think-tank established in 2012 that serves as a leading independent and innovative policy research institution; a forum for debate on the political and socio-economic reforms in Mediterranean and Africa; and promoter of actions and initiatives that fulfill objectives of sustainability, inclusiveness, regional integration and prosperity. It strives to contribute to the rethinking of the Euro-Mediterranean and Africa partnerships in view of the new dynamics of an emerging multi-polar world.

EMEA has a large network of economists, high-level experts and institutional partners (research institutes, think tanks and universities) in the Euro-Mediterranean and Africa. EMEA builds on the collaborative research network MEDPRO (funded by the EU's Seventh Framework Programme (2009-13) and provides forward-looking thinking and political and socio-economic integrated analyses on the Euro-Mediterranean region. EMEA is also the promoter and co-funder of the Euro-Mediterranean Network for Economic Studies (EMANES), co-funded by the European Commission (DG NEAR) between 2015 and 2019. EMANES is a regional network composed of 30 institutions and more than 100 experts and researchers in the Mediterranean and Africa region.

From January 2020, EMEA coordinates The Euro-Mediterranean and African Network for Economic Studies (EMANES). EMANES, aims to provide a renewed vision for socio-economic development in the Mediterranean region, mainly focusing on employment creation, social inclusion, sustainable development and regional integration. It performs economic and policy research exploring the pillars of inclusive and sustainable economic models in the Euro-Mediterranean region.

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