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Note by the Independent Expert on debt and human rights, Ms. Yufen Li, on options to consider for a human rights based debt relief during COVID-19 for developing countries

The world is facing multiple crises that cannot be dissociated: a health crisis, an economic crisis, a social crisis and a human rights crisis. One main trigger is the coronavirus disease (COVID-19) pandemic, which has claimed many lives worldwide. To date, almost 20 million people have been infected and more than 728 thousand people have died across the planet.¹ Those figures may be even higher, owing to various underreporting issues. In the absence of a vaccine and an effective cure, many countries have resorted to extensive lockdowns and social distancing measures to contain the spread of the virus and have struggled to maintain the rights to health and life of their people.

As a consequence of effort to try to flatten the curve of the pandemic, many countries around the world are faced with rising expenditures, lower GDP growth and exploding debt. For developing countries which have limited fiscal space and had already confronted with significant debt challenges prior to the Covid-19 pandemic, their difficulties are thus now exacerbated.

Traditionally, through a narrow and sectoral understanding of debt, the issue has been considered a matter pertaining to financial and economic studies, overlooking human rights. Nevertheless, the current crisis has clearly demonstrated how much debt issues are closely linked to the realization of human rights, exposing to the international community and Governments the connection between debt, available resources and the fulfilment of human rights obligations. The problems arising from the pandemic have, once again, clearly underscored the fact that the progressive and full realization of economic, social and cultural rights should not be perceived as a mere ideal.

The purpose of this note is to inform States confronted by significant debt challenges of the potential solutions from a human rights perspective.

Debt relief is crucial to address the current crises

For many developing countries saddled with debt, it is now clear that debt relief, in addition to liquidity injection, is essential to ensure that a maximum of resources could be deployed by

¹ World Health Organization (WHO), WHO Coronavirus Disease (COVID-19) Dashboard. Available at <https://covid19.who.int/> (accessed on 31 July 2020).

States to fight against the pandemic, provide a human rights response to the economic crisis and for the progressive realization of economic, social and cultural rights.

In this connection, on 14 May 2020, I have called on international financial institutions, the G20 and private creditors to extend the announced debt standstill until at least the middle of next year, and to expand country coverage to include debt distressed middle-income countries² as a way to ensure the continued promotion and protection of human rights during this challenging period.

While I welcome the latest development in this regard, and the efforts from the IMF and the G20, which respectively offered debt service suspension in April 2020, this is far from sufficient for countries at the same time hit by COVID-19 and suffering from heavy debt burden. Further questions must also be raised, while despite this opportunity, many debt relief eligible countries have either declined or shown no interest in the initiatives. More specifically, by mid-July 41 out of 73 countries eligible for the G20 Debt Service Suspension Initiative (DSSI) expressed interest and for the IMF debt service suspension, quite a number of the 25 eligible countries had not requested assistance by July. This is not because these countries do not need debt relief. Just the contrary, they need larger debt relief. This also clearly explains why the IMF emergency funding has proved to be the most popular initiative and more than 100 countries have applied to it.

The response to the debt relief initiatives is a reflection rooted in the changed landscape in developing countries' debt, a change that includes not only the composition of debt instruments but also in the composition of borrowers and lenders. For debt instruments, bonded debt has been occupying an increasing share. Some low-income countries and even HIPCs have entered the international capital market becoming new borrowers for bond and this is indeed an important change in the landscape. The different laws governing the bond contracts, predominantly New York law and UK law, as well as the special borrowing terms are straightjackets on countries. From the creditor side, some new creditors have joined and they are outside the Paris and London Clubs. Therefore, debt relief initiatives should take into consideration the needs of developing countries against the changed debt landscape.

Credit rating by private agencies have been playing a key role in States' decision to enter in debt relief discussions and when it comes to looking into the range of options to address related challenges. In fact, a request by a State to participate in the DSSI could be taken as a signal of distress by credit rating agencies, which would thus affect its borrowing capacity in the future. For example, eurobond default clauses indicate that non-payment of external debt, including seeking a moratorium, would be considered as defaulting, which would trigger the acceleration clause. Consequently, there is the fear of reputation loss, of credit rating downgrade and the resultant loss of access to international capital market by developing countries when considering whether to accept debt relief offers. This can also lead to important impacts on the resources available to States for the progressive realization of human rights. In this regard, it is thus of specific concern that, for instance, Moody's, a prominent credit rating agency, has already put countries expressed interest in International Financial Institutions' debt moratorium under rating review and downgraded one country participating in DSSI.

The debt relief initiatives have also run into serious problems when it comes to the private sector participation. While the DSSI invited the private creditors to participate debt relief

² <https://www.ohchr.org/en/NewsEvents/Pages/DisplayNews.aspx?NewsID=25888&LangID=E>

voluntarily, yet, up to now no private creditors have offered to participate even though they must also comply with international human rights standards. In this regard, the Guiding Principles on business and human rights provides that business must respect human rights. This, indeed applies to private creditors, as business entities, wherever they operate. As highlighted by the Guiding principles on foreign debt and human rights “this implies a duty to refrain from formulating, adopting, funding and implementing policies and programmes which directly or indirectly contravene the enjoyment of human rights”³

Looking into debt relief options through a human rights lens

As early as April 2020, the United Nations Secretary-General had warned about the risk of potential default, highlighting that, in many countries, including both low- and middle-income countries, it was becoming clear that, unless sizable debt relief was provided, private and public creditors could face multiple unilateral defaults.⁴ Without sufficient debt relief or injection of liquidity, countries with heavy debt would not be able to fight the pandemic and protect the human rights of their people as they have very limited fiscal space. States, international financial institutions and private creditors must abide by their human rights obligations in deciding their position and actions relating to debt relief. In addition, as highlighted by the Guiding principles on foreign debt and human rights ”any foreign debt strategy must be designed not to hamper the improvement of conditions guaranteeing the enjoyment of human rights and must be directed, inter alia, to ensuring that debtor States achieve an adequate level of growth to meet their social and economic needs and their development requirements, as well as fulfilment of their human rights obligations”⁵

In order to make debt relief effective and allow countries to mount proper pandemic response to protect lives, human rights and livelihood, policy initiatives relating to debt relief should give due attention to this changed landscape of developing country debt.

As the pandemic is still developing and affecting more countries and increasing number of populations, time is of essence. To reform the international financial architecture to enable timely crisis response would take time. On 6 August 2020, I spoke as a panelist at a meeting on the *Follow-up to the High-Level Event on Financing for Development in the Era of COVID-19 and Beyond* and highlighted that for debt relief there is a need to think about different solutions for two different groups of countries, one group that has market access to international capital market for mobilizing financing and rolling over their old debt and the other group which does not have market access at present.

To meet the needs of these two groups, I recommend looking into debt relief from both angles. The first being more market based, should not affect ratings and the second one relying on concerted actions from creditors and would be considered as distress or defaulting. The aim of proposing different policy options is to ensure more tailor-made debt relief for countries so that they could benefit from timely debt relief to reduce their debt servicing burden and allow more effective response to the pandemic thus, protect human rights, save lives and maintain livelihoods.

I. Market based solutions

³ Guiding principles on foreign debt and human rights, para. 9.

⁴ United Nations, “Debt and COVID-19: a global response in solidarity”, policy brief, 17 April 2020.

⁵ Guiding Principles on foreign debt and human rights, para. 8.

For market-based solutions, there could be voluntary debt buybacks and debt swaps , which could be considered first giving their limited impact on future access to credit and their ability to be directed to pre-determined objective such as the progressive realization of economic social and cultural rights.

A. Voluntary debt buybacks. Most bond contracts allow debt buybacks and such an operation should not trigger a credit rating downgrade if handled well. Right now bonds are traded at discounts, lower than their face value. To buy them back at current market prices reduces debt burden and default risk. Aiming to reduce debt burden, debt buybacks have proven to be effective in the 1990s and debt crises of some countries. It should be noted that the design of such programmes could also be tied to human rights objectives and the advancement of the Sustainable Development Goals for example, ensuring that resources that would have previously been devoted to debt payment remains at the disposal of States, thus contributing to the realization of human rights and fighting the pandemic⁶

However, debtor countries may not have the financing to buy the bonds back. Recently some scholars have proposed to set up a multilateral buyback facility to be managed by an international financial institution such as IMF, using its financial resource including SDRs.⁷

B. Debt Swaps is a popular market-based instrument. It is a kind of conditional debt relief for a pre-determined objective. There are different kinds of swaps: debt-for-development swaps, debt-for-nature swaps, debt-for-climate, debt for health etc. It could be rapid. The arrangement could waive all or part of the entire stock of the outstanding debt obligations and interest claims for bonds or loans.

Debt swaps could be a good exit-strategy from the debt crisis and to transform the post-COVID global economy. It would not only address the debt crisis, but also stimulate investment in the areas which would provide States with financial resource while reducing debt burden, thus allowing governments to devote the maximum of available resources to human rights, promote sustainable development and create more jobs during economic downturn.

C. Debt exchange deal is another option but relatively restrictive. It can only be considered as market based if rating agencies are considering it not to be coercive and that it has not led to material loss by investors. For instance, the United Nations Economic Commission for Africa has proposed to set up a special purpose fund allowing countries to exchange debt for new concessional paper. The fund is designed to be guaranteed by some G20 central banks, which is a sweetener and enhances confidence. The proposal contains elements like the Brady bonds. If done speedily, this approach could provide African nations with relief on their private debt obligations and have significantly higher levels of concessional assistance.

However, rating agencies have already warned that any attempt to renegotiate payments on sovereign bonds would be classed as a default. Therefore, this kind of operation is

⁶ Joseph Stiglitz, Hamid Rashid. [How to prevent the looming sovereign debt crisis](https://voxeu.org/article/how-prevent-looming-sovereign-debt-crisis) . 03 August 2020.

<https://voxeu.org/article/how-prevent-looming-sovereign-debt-crisis>

⁷ Ibid.

very delicate. Nevertheless, it could be worth pursuing in view of the lack of options and mounting challenges to protect human rights.

II. Non-market based debt relief options

While leading to loss of market access, they include deeper debt reduction that is debt restructuring and debt re-profiling, which require a critical mass of creditors and IMF agreement and support. A human rights based approach to debt restructuring process should guide discussions surrounding debt relief and inform the decision for all stakeholders involved, including the private sector.

In this regard, the Basic Principles on Sovereign Debt Restructuring Processes along with the Guiding principles on foreign debt and human rights provide essential guidance. States must also bear in mind that debt sustainability, just like debt renegotiation and debt restructuring, goes beyond economic concerns and includes human rights considerations. In addition, it should be stressed that Sustainable Development Goals' target 17.4 call for "Assist(ing) developing countries in attaining long term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate, and address the external debt of highly indebted poor countries to reduce debt distress".

The high relevance of the Guiding Principles on business and human rights must also be highlighted. Private creditors, as businesses entities, must respect human rights and must operate with due diligence and ensure that their operations are doing nor harm, while States have the obligations to protect their population from human rights violations that could be incurred by companies.

A. Debt restructuring and debt re-profiling: A restructuring would normally include the reduction of the face value (i.e. 'haircut'), lengthening of maturities, lower interest rates, and grace periods from interest payments. Debt restructuring could be lengthy and costly. There is no agreed framework or mechanism and is undertaken case by case.

Some countries had been under debt restructuring before COVID-19 and it is expected that at least a dozen more countries will likely join the debt-restructuring list, as some predict that much more than a dozen countries may have to consider defaulting in the coming years.

Debt re-profiling extends the maturities of existing debts. From 2016 onward, the IMF has granted countries access to its financing during debt re-profiling to see whether the sovereigns would have high probability of returning to sustainability after receiving bridging finance.

B. Debt cancellation is naturally, the biggest debt relief. Across-the-board debt cancellation will require great political will, which does not seem to be available at this moment. The current situation is different from the HIPC initiative time. All countries are suffering and there is synchronized global economic recession in both developed and developing countries. The magnitude of the crisis by depth and geographical coverage are unprecedented. However, more and more governments are facing unsustainable debt because of the economic downturn as well as the pandemic and are already at risk of defaulting.

With the current trajectory of the world economy and the huge uncertainties of the pandemic, it is difficult to imagine that debt distressed countries would miraculously grow out of debt overhang, no matter their debt situation has been aggravated by or caused by the COVID-19. Therefore, down the road, the international community will have to weigh how to carry out debt cancellation, on what criteria, from what kind of financial resources, how to ensure the private sector participation and to make sure that international human rights obligations of all stakeholders are met.

Lastly, the Country Coverage of debt relief should be considered. Heavily indebted and COVID hit middle-income countries and other countries which are not IDA or LDC would need also debt relief. In this regard, a special vulnerability index would be needed to decide the eligibility of countries requiring debt relief.

Early warning

The vulture funds are expected to be a problem as investors specialized in distressed debt could come in the way of potential debt relief initiatives, in buying States' debts. It is therefore important to anticipate their potential impacts on State's resources and the realization of human rights. As we speak, some funds have already started to buy African sovereign bonds. Thus this is still a big headache. Bonds now represent over 30 percent of Africa's foreign debt. Options like immunization of assets and special legal reform must be considered to minimize the risks of litigations against debt relief and prevent exacerbating potential debt crisis impacts. In this regard, it is important to highlight that some institutions, especially the African Legal Support Facility hosted by Africa Development Bank, are offering key legal advice to poor debtor countries to overcome potential future challenges. States must react quickly and consider such options in order to secure a maximum of resources, for the wellbeing of their population and to comply with their human rights obligations.

In concluding, greater debt relief and more liquidity provision should be envisaged now than later to ensure the full enjoyment of human rights for all and to leave no one left behind. This is essential to prevent the possible scenario as envisaged by the Secretary General already in April⁸ --having to handle a massive amount of defaults, and a shrinking fiscal space to avoid defaulting with potential consequences on a range of human rights. Therefore, the international community needs to prepare for the eventuality of more defaults as the pandemic drags on and prevent potential harsh economic and human rights impacts. It is high time to seriously consider debt relief and debt restructuring with a human rights approach and remind all parties of their human rights obligations, including when it relates to economic and debt matters.

⁸ UN SG, "Debt and COVID-19: A Global Response in Solidarity", 17 April 2020, available at: https://www.un.org/sites/un2.un.org/files/un_policy_brief_on_debt_relief_and_covid_april_2020.pdf, p. 7 "In many countries, including both low and middle-income countries, it is becoming clear that unless sizable debt relief is provided, private and public creditors may face multiple unilateral defaults. The choice is no longer between default and continued debt-service payments, but between a wave of disorderly defaults, and orderly payments agreed to between debtor countries and their lenders, once the economic situation improves. It is in the interest of all, and especially creditors, to safeguard international capital markets, at risk over a potential wave of defaults."

In this connection, debt challenges must be addressed urgently to ensure a more effective pandemic response and the full realization of human rights, in this regard it is recommended:

1. For debtor countries hoping to maintain access to international capital markets, to consider voluntary debt buybacks, debt swaps and debt exchange to achieve debt relief and mobilize more financial resources. In doing so, special purpose financial facilities from international financial institutions and donor countries would be needed;
2. For debtor countries without market access and not suffering from immediate economic and financial consequences of credit rating downgrades, their options include accepting available debt relief offers, actively try to get more financial support from IFIs and other partners, and requesting for debt re-profiling or debt restructuring if required
3. It would be necessary to ensure technical assistance and mobilize legal support for poor countries which are likely to face vulture fund problems down the road
4. Consider establishing a special vulnerability index, including from a human rights perspective, to decide the eligibility of countries including middle income countries and others, requiring debt relief.
5. Build consensus on the formulation of debt workout mechanism with a human rights approach.