Debt of Emerging Markets & Developing Economies Rose

For Prelims: Sovereign Debt, External commercial borrowings.

For Mains: factors contributing to debt crisis, impact of sovereign debt on countries

Why in News?

The report from Debt Relief for a Green and Inclusive Recovery (DRGR) Project states that **the sovereign debt of emerging markets and developing economies (EDME) increased by 178%** from USD 1.4 trillion to USD 3.9 trillion between 2008-2021, **indicating a looming debt crisis in the** Global South.

- The G20's **"Common Framework"** created to provide debt relief has shortcomings, as it failed to bring all creditors, including private and commercial creditors, on board and link debt relief with development and climate goals.

Note: An emerging market economy is the economy of a developing nation that is becoming more engaged with global markets as it grows. Countries classified as **emerging market economies are those with some, but not all, of the characteristics of a developed market** such as India, Mexico, Russia, Pakistan, Saudi Arabia, China, and Brazil.

What are the Factors and Impacts of the Debt Crisis?

- **EDMEs are Experiencing Weakened Economic Growth due to:**
  - Slow recovery from the **COVID-19 pandemic,**
  - High food and energy prices, and
  - **Russia's war in Ukraine.**
  - Escalating climate impacts
  - Strong US dollar and depreciating currencies for many EMDEs.
- **Impacts on Vulnerable Countries:**
  - Countries vulnerable to climate change tend to face the most significant **debt distress.**
  - **Higher climate vulnerability** is linked to **lower sovereign borrowing** space.
  - **High debt service payments, forcing** countries to **set aside** a significant **portion** of their **foreign reserves to pay off debt.**
  - Providing immediate debt relief to EDMEs could free up their fiscal and borrowing, allowing them to pursue a low-carbon, socially inclusive, and resilient future.

What are the Proposed Solutions?

- The report calls for a reform of the Common Framework and proposes three pillars to address the issue.
  - **The first pillar** involves **public creditors granting significant cuts** in debts to bring a

distressed country back to debt sustainability and also helping it achieve development and climate goals.
    - **The second pillar** involves **private and commercial creditors** granting **debt reductions** comparable to public creditors.
        - For the remaining debt, the government should issue new bonds for private creditors, backed by a guaranteed fund.
    - **The last pillar** is for countries not at risk of debt distress, for which international financial institutions can **provide credit enhancement.**
- **Debt Restructuring:** The report also **calls for the restructuring** of USD **812 billion of debt** owed by 61 countries that are in or at high risk of debt distress.
    - At least **USD30 billion in debt should be suspended** over the next five years for 55 of the most debt-distressed countries, the authors calculated.

What is G20 Common Framework?

- The Common Framework for debt treatment beyond the Debt Service Suspension Initiative (DSSI) is **an initiative endorsed by the G20 in 2020, together with the** Paris Club, to support, in a structural manner, Low Income Countries with unsustainable debt.
- The framework is aimed at providing a coordinated and comprehensive approach to addressing the debt vulnerabilities of low-income countries (LICs) that are facing the most severe debt challenges, exacerbated by the **COVID-19 pandemic.**

Note: DRGR Project is a collaboration between the Boston University Global Development Policy Center, Heinrich-Böll-Stiftung and the Centre for Sustainable Finance at SOAS University of London.

Source: DTE