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How Germany can tackle the looming global sovereign debt crisis

The high indebtedness of many developing countries could trigger a global debt crisis. But the German G7 presidency can point the way forward

Sovereign debt levels of many developing countries are worryingly high. After the spring meeting of the International Monetary Fund (IMF) and the World Bank in April, Germany's Finance Minister Christian Lindner announced that Germany would provide additional funding for further loans. Beyond that, Germany should use its G7 presidency to specifically push for a sustainable mechanism to restructure sovereign debt - as agreed in the coalition agreement.

The high sovereign debt levels of many developing countries, which have risen even further in recent years, poses the threat of a global sovereign debt crisis. It is currently one of the greatest macroeconomic risks for developing countries. The reasons for this are manifold: large loans were taken out towards the end of the 2010s. In combating the consequences of the Covid pandemic, there was a resort to fiscal stabilisation. The G7 countries are currently pursuing a monetary policy that attempts to curb inflation. The Russian war of aggression in Ukraine further exacerbates the situation.

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In the wake of the covid pandemic, many countries' sources of income were massively reduced by disrupted supply chains, restricted tourism, capital flight and low remittances. In 2020, the debt-to-GDP ratio of developing countries rose from an average of 57 per cent to 69 per cent. A first payment default shows the extent: In autumn 2020, Zambia was no longer able to meet its debts.

The Russian war of aggression in Ukraine again highlights the high dependency and vulnerability of developing countries. The increased prices of food, energy and fertilisers, as well as the renewed disruption of

supply chains, are already having a devastating impact. Inflation, the slump in trade growth, rising interest rates and a strong US dollar are exacerbating fiscal pressures. According to World Bank President David Malpass, more than 60 per cent of low-income countries are currently considered to be at acute risk of a debt crisis.

A sustainable solution to existing debt levels in developing countries is economically, geostrategically and morally appropriate and essential.

Revising the existing Framework

From an economic perspective, debt is neither good nor bad per se. It can promote growth and investment and have a counter-cyclical balancing effect. However, excessive debt levels pose risks to growth and stability and restrict fiscal space. So far, there is no fair and effective procedure for restructuring sovereign debt at the international level. The Common Framework of the G20 countries adopted in 2020 is a first - but not sufficient - step.

The Common Framework is intended to give countries the opportunity to negotiate the further handling of outstanding debts in case-by-case procedures. It is essential that each case is dealt with separately. The debt and creditor structures of individual countries are very different and require close examination. While the importance of China and private creditors has increased significantly in the past decade, their relevance depends strongly on the country-specific context. The reluctance of the G7 countries to push for a systematic restructuring mechanism should therefore not be justified by China's role.

Less than two years after its creation, the IMF and the World Bank are already calling for a revision of the Common Framework. This could be a step in the right direction: The goal must also be to include private creditors systematically and legally and to extend the framework to other highly indebted countries, for example among the emerging economies.

That a sustainable mechanism is also geostrategically important was not only made clear by the UN resolution of 2 March condemning Russia's war of aggression, which was not supported by several developing countries, among others. Putin's summit with African heads of state in Sochi in October 2019 painted a clear picture of Russian interests in and with Africa: it focussed on the sale of Russian armaments and nuclear technologies as well as military-technical cooperation. Against this background, it is more important than ever to support democratic partner countries that are faced with destabilising circumstances due to unsustainable debt levels. From the point of view of multilateral

cooperation within the Bretton Woods system, a mechanism for restructuring sovereign debt in which creditor and debtor countries see eye to eye to find a constructive solution is in the interest of Germany.

Last but not least, a sustainable solution that counteracts the risk of sovereign debt crisis in developing countries is simply morally imperative. People in the poorest countries are the hardest hit by the global economic slowdown. Without decisive and coordinated action, the risk of a full-blown debt crisis in developing countries increases. And with that, hunger, poverty, and inequality will only worsen.

Long-term over short-term commitments

The high indebtedness was discussed intensively at the Spring Meeting of the IMF and the World Bank in Washington, DC in mid-April. German Finance Minister Christian Lindner announced that Germany would provide loans of 6.3 bn euros to the IMF's new Resilience and Sustainability Trust and another 100 million euros to the Poverty Reduction and Growth Trust for interest rate relief. Action must be taken now, Lindner stressed, warning of a 'global debt crisis'.

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The new short-term commitments by Germany's Federal Finance Minister are to be welcomed. However, further loans only give short-term respite and do not solve the problem. It would be more important than the additional loans announced by Christian Lindner to give critically indebted countries access to a codified mechanism for restructuring their sovereign debt.

In the coalition agreement, the traffic light coalition agreed to work towards a new consensus with regard to international debt management. An international procedure for sovereign insolvency, which includes all creditors and implements debt relief for particularly vulnerable groups of countries, is also to be supported.

This goal must be realised as soon as possible. It should be equally embedded in the strategy of German development policy, so that restructuring agreements with partner countries are accompanied by capacity-building programmes in finance ministries and central banks as well as by the promotion of good financial governance. German

development cooperation is already well positioned to do so and can, together with the G7 countries, create an attractive offer.

With the G7 presidency, Germany now has a special opportunity to get the ball rolling. Finance Minister Lindner should use the meeting of the G7 finance ministers and central bank governors to push for the further development of the Common Framework and to establish a permanent and comprehensive mechanism for sovereign debt restructuring. As the second largest donor worldwide, Germany should take a clear leadership role.



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