Dear Adnan Khan,

The number of people living in countries where spending on debt interest exceeds that of health or education has reached 3.3 billion. [Guterres A., 2024]. A record 12 countries have a risk of defaulting that exceeds 50% (see Figure 1), with four already in default [Steil B., Harding E., 2024]. This reality threatens debt spirals as credit ratings for these governments crumble, causing the cost of borrowing to skyrocket, worsening finances further. This is salient for the private sector, as public sector borrowing to fund current spending raises market rates, leading to the crowding out of investment. As seen in Europe, public sector parsimony offers little consolation; austerity policies have starved public services and stagnated growth, whilst debt has risen nonetheless [Blyth, M. 2013]. Significant innovation is necessary to restructure sovereign debt and bolster both public and private sector investment. In this letter, I offer two proposals. The first is to encourage the issuance of State Contingent Debt Instruments (SCDIs) by governments globally to restructure debt and prevent it from impeding investment. Secondly, I propose taking measures to improve debt transparency including minimum mandatory disclosure requirements with incentives to discourage opacity.

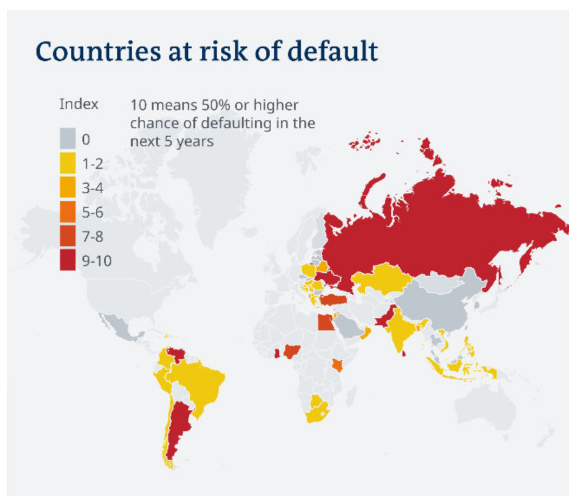

Figure 1 [Synergia Foundation, 2022]

State Contingent Debt Instruments are government debt securities that link the amount owed by the state to its ability to pay. A state's capacity to service debt is quantified by variables such as GDP, commodity prices or natural disasters [IMF, 2017]. As such, SCDIs like GDP indexed bonds present a unique opportunity to dampen the impacts of economic downturns on government finances and facilitate fiscal stimulus during recessions. Therefore, owing a larger proportion of public sector debt in this form would limit the risk of debt spirals. The recovery of Greece from its sovereign debt crisis

in the aftermath of the financial crisis serves as a salient example. During its 2011-12 debt restructuring, Greece issued GDP - linked warrants where the payoff was a function of the difference between real potential growth and actual growth rates [Igan D. et al, 2022]. In spite of persistently high national debt levels (161.9% of GDP in 2022 [CEIC]) the Greek economy has flourished, topping The Economist's annual rankings for two consecutive years, based on five indicators – inflation, inflation breadth, GDP, Employment and stock market performance (2023). Academics at the LSE cite limited debt maturities, extended grace periods and low interest expenditure as one of the 'four pillars for boosting economic growth' - all of which is substantiated by SCDIs. In this instance, the sharing of risk between the public and private sector bolstered government finances, inspiring business confidence and facilitating higher levels of investment. By contrast, in the absence of SCDIs, emerging markets are forced to undergo austerity policies during a recession to maintain credibility and access to financial markets. This prevents the use of the Keynesian stimulus required to recover, hence exacerbating growth slowdowns and worsening finances further [Borenzstein et al., 2004]. GDP – linked warrants naturally carry a higher risk premium, however this is compensated for in the long run by a number of factors. Primarily, the pro-cyclical nature of the discount rate on these debt instruments grants them invaluable status as automatic stabilisers. Standard government bonds carry higher premiums during recession, worsening cyclical instability, whilst SCDIs act to the contrary and limit volatility. By extension, restructuring debt in this way can allow an economy to gain higher credit ratings, which increases access to cheap credit in the long run. Hence, I propose the issuance of SCDIs in nations with particularly high default risk to ameliorate public finances and promote investment.

Information opacity in sovereign debt markets threatens investor confidence and impedes governments' access to capital, increasing risk of default. Zambia is a pertinent case for the dangers of debt opacity. After the pandemic, it was the first nation to default, having withheld payment on a Eurobond, as creditors could no longer guarantee the integrity of investments. Underlying doubt was driven by the refusal of the government to disclose its financial position, specifically concerning significant sums of debt owed to Chinese institutions [Rodhes et al., 2022]. The distrust triggered by information asymmetries rendered successful debt restructuring impossible as sovereign debt markets mirrored Akherlof's 'Market for Lemons' [1970]. As such, I propose introducing minimum mandatory disclosure requirements, where high credit ratings are contingent upon compliance. Requirements would involve disclosing the nature of liabilities held by governments, amount owed, length of term, and the nature of the creditor. Transparency would restore investor confidence and facilitate the efficient operation of financial markets. In the public sector, this would improve credit availability, lower interest rates and reduce risk of default, therefore creating headroom for

investment. In the private sector, investors would hold greater trust in public finances, strengthening animal spirits and encouraging business investment. Moreover, in times of crisis, debt transparency promotes debt validation and reconciliation, creating conditions for debt resolution to be possible where it would not be without full and accurate disclosures. This promotes stronger synergies between the public and private sector, limiting the risk of capital flight caused by uncertainty, thus bolstering investment. The onus lies with all governments globally to promote transparency by using development banks like the IMF and World Bank to enforce disclosure requirements. China holds a particularly significant position as the largest single lender to developing markets. Effective diplomacy is necessary to leverage this by making future access to Chinese credit contingent on adequate disclosure. These measures to ensure debt transparency will restore confidence in debt markets, reducing the impact of the debt burden by improving credit availability and lowering interest rates. This will pave the way for future debt restructuring and growth, therefore allowing debt to fall as a percentage of GDP without austerity measures.

I believe that these policy measures offer effective solutions to the problem of significant debt interest payments that impede development. It is vital that the UK uses its longstanding relationship with institutions like the IMF and World Bank to lobby for these measures to improve transparency. Overall, this will create the foundation for debt to be restructured with innovative solutions like SCDIs.

Yours Sincerely,

Avi Juneja.

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