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Debt and Development for Low- and Middle-Income Countries: Two Faces of the Same Coin

by Marianna Lunardini and Sara Vicinanza

For many low- and middle-income countries (LMICs), the burden of public debt has become unsustainable. In 2023, LMICs' external debt reached an all-time high of 8.8 trillion dollars.[1] The issue lies not only in the sheer volume of debt, but in the soaring cost of servicing it. In 2023, LMICs paid a record 1.4 trillion dollars in total debt service, of which 225 billion in interest payments alone. This financial pressure absorbed 15 per cent of their export revenues and 4 per cent of their gross national income.[2]

To address the situation, the UN Secretary General, Antonio Guterres, appointed the Expert Group on Debt to identify and advance policy solutions. Paolo Gentiloni, co-chair of the Group, summed up the gravity of the moment: "Today, the issue of debt in LMICs has returned to a crisis level not seen since the 1990s".[3]

Indeed, the debt burden becomes acute when measured against economic capacity or export performance. Countries such as Guinea-Bissau and Niger face debt-to-GNI ratios above 60 per cent, while Suriname, Lao PDR, Zambia and Djibouti report debt-to-exports ratios between 200 per cent and 300 per cent.[4] In regional terms, though Africa holds just 7 per cent of LMICs' total external debt, it faces the highest vulnerability, being the only region where debt is growing faster than GDP.[5] The most pervasive form of default is not on creditor obligations

[1] World Bank, *International Debt Report 2024*, December 2024, p. xv, https://hdl.handle.net/10986/42444.

[2] Ibid., p. x.

[3] Giampiero Gramaglia's interview with Paolo Gentiloni [in Italian]: "Spazio Transnazionale", in *Radio Radicale*, 24 May 2025 (audio), https://www.radioradicale.it/scheda/760263.

[4] Ibid.

[5] UN Conference on Trade and Development (UNCTAD), *A World of Debt: A Growing Burden to Global Prosperity*, June 2024, p. 6-7, https://unctad.org/system/files/official-document/osgttinf2024d1_en.pdf.

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but on development itself. Rising debt service obligations are crowding out public spending on essential services: 3.3 billion people now live in countries that allocate more to debt repayments than to health or education.[6] This fiscal strain also hinders climate adaptation and stalls progress on the implementation of Sustainable Development Goals (SDGs). These challenges are particularly aggravated by a gloomy international cooperation environment, where declining official development aid (ODA) levels are also affecting debt-related actions. The existing mechanisms are inadequate, and discussions are underway on how to reform them. This year the Fourth International Conference on Financing for Development in Seville, Spain, the G20 Summit in South Africa and November's UN Climate Change Conference in Brazil are the crucial moments of action.

The evolution of LMICs' debt situation

The growing burden of debt on LMICs' development stems from structural vulnerabilities rooted in a long-standing cycle of dependency on creditor countries and financial institutions, compounded by recent global shocks. Many of these countries began their post-independence trajectories already indebted, as they either inherited obligations from colonial powers or could only fund development by borrowing.

The evolution of LMIC debt accelerated in the 2000s and 2010s. After the Jubilee 2000 campaign led to the cancellation of over 130 billion dollars in debt for 36 low-income countries (LICs), a new borrowing wave began. Between 2007 and 2024, LMICs' sovereign bond issuance increased drastically, driven by easy financial conditions, abundant liquidity and investor demand. However, many of these bonds had short maturities and high costs, with nearly half maturing by 2027, raising refinancing risks under tougher conditions.[7]

The situation worsened after 2020: the Covid-19 pandemic and the war in Ukraine triggered rising inflation and monetary tightening in advanced economies, leading to a spike in interest rates and heightened global risk aversion. One major consequence was the sharp appreciation of the US dollar. As LMICs lack deep local capital markets and around 25 per cent of their debt – 40 per cent in LICs – is denominated in foreign currencies, they are highly exposed to local currency depreciation and exchange rate volatility.[8] This significantly increased the cost of servicing debt and restricted their access to international markets. In fact, between 2022 and 2024, net borrowing from foreign markets turned negative for LMICs.

A key vulnerability is LMICs' growing reliance on private and non-traditional

[6] Edith M. Lederer, "3.3 billion People Live in Countries Spending More on Debt than Education or Health, UN Says", in *AP News*, 12 July 2023, https://apnews.com/article/e5a858308ff5bd1f464f9fcc427e94fa.

[7] Organisation for Economic Co-operation and Development (OECD), *Global Debt Report 2025*, Paris, OECD Publishing, 2025, p. 13, https://doi.org/10.1787/8ee42b13-en.

[8] World Bank, *International Debt Report 2024*, cit., p. 54.

IAI COMMENTARIES 25 | 36 - JULY 2025 ISSN 2532-6570

creditors, especially China. By 2023, 56 per cent of external public debt was owed to private entities[9] whose loans are costlier than concessional financing, shorter in maturity and harder to restructure than official financing. These creditors often pull back during crises and are not bound by debt-relief frameworks like the Paris Club,[10] whose relevance has faded. Adding to this are entrenched asymmetries in the global financial architecture. In fact, borrowing costs for LMICs are much higher than for advanced economies: in 2024, they paid over 7 per cent on dollar-denominated bonds vs 2 per cent for high-income countries.[11] LMICs often face higher interest rates even with similar risk profiles, due to harsher assessments by international credit rating agencies.[12] Moreover, limited access to affordable finance forces them to rely on costly, volatile external sources, while lacking real influence in debt-governing international financial institutions.

As a result, by late 2024, 54 per cent of LMICs were either in or at high risk of debt distress – double the figure in 2015.[13] Since 2020, 15 countries have defaulted or undergone major restructuring.[14] Yet, because today's crisis affects smaller economies and poses no major threat to global financial stability unlike in the 1980s and 1990s, it is less likely to prompt support from advanced countries at the multilateral level.

Efforts at the multilateral level

Several reforms are needed to address the challenges faced by LMICs at the multilateral level and tackle their condition of debt distress. With the debt situation rapidly worsening, the existing multilateral mechanisms have proven to be no longer effective in assessing the needs of LMICs and opportunities to support them.

Several multilateral instruments have been put in place over the years to govern debt. Two of them are particularly relevant. One is the Debt Sustainability Analysis (DSA) which has been used since 2005 to guide lenders and donors and assess a country's capacity to finance its policy goals and service its debt relief. Developed under the Debt Sustainability Framework for LICs by the International Monetary Fund (IMF) and the World Bank, it is designed to evaluate annually the capacity of each country to meet all current and future debt payments. It influences the determination of the blend of grants vs loans a LIC receives from the International Development

[9] Multilateral organisations hold 30 per cent of LMICs' external public debt, while 14 per cent is owed to bilateral creditors. See ibid.

[10] The Paris Club is an informal group of official creditors coordinating debt relief for countries in distress.

[11] OECD, *Global Debt Report 2025*, cit., p. 118.

[12] UNCTAD, *Credit Rating Agencies, Developing Countries and Bias*, January 2025, https://unctad.org/publication/credit-rating-agencies-developing-countries-and-bias.

[13] Phyllis Papadavid and Sherillyn Raga, "Beyond the Battlefield: The Russia–Ukraine War's Economic Toll on Africa, Three Years on", in *ODI Insights*, 21 February 2025, https://odi.org/en/insights/beyond-the-battlefield-the-russiaukraine-wars-economic-toll-on-africa-three-years-on.

[14] Kanan Mammadov, "Emerging Markets Face a Perfect Storm", in *PFM Blog*, 14 April 2025, https://blog-pfm.imf.org/en/pfmblog/2025/04/emerging-markets-face-a-perfect-storm.

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Association (IDA)[15] and is used by the Paris Club as a basis for negotiating debt relief. The other instrument is the G20 Common Framework for Debt Treatment, which aims to tackle insolvency and protracted liquidity problems for 73 LICs and is supported not only by the Paris Club but also by new lenders (China, India and Saudi Arabia, for instance).

The current situation has shed light on the critical elements of these two instruments: an excess of technicalities, lack of transparency, slowness of the process and a shortsightedness on the social and environmental impacts of the decisions made. DSAs are considered overly technical and disconnected from the reality of LMICs: a debt is considered sustainable even if its repayment forces a government to drastically cut spending on social issues. The DSAs' conclusions have shown a certain level of discretion in final ratings and rely on assumptions or long-term projections that are inherently uncertain.[16]

In 2020, when it was created, the G20 Common Framework appeared promising. However, five years later, there is already a need to rethink its structure, the opaqueness and slowness of the process has led only four countries – Chad, Zambia, Ghana and Ethiopia – to apply, with only little progress for help.[17]

Recent developments at the international level seem to offer little promise for improvement as global economic and export growth are expected to slow.[18] This will further complicate the situation for LMICs, with risks of default on development for many countries. Reducing the financial constraints on debt-distressed countries could be achieved by curbing the cost of servicing existing debt and through new development finance as well as by improving debt workout mechanisms. Not only multilateral measures, but also country-level actions are all much needed to tackle the current debt crisis. Political feasibility and rapid response seem the immediate goals at the multilateral level.

What can be done?

The urgent situation faced by many LMICs countries calls for a comprehensive strategy at the global, regional and national levels. Meaningful progress in the debt crisis is needed not only to ensure solvency but also to restore hope in LMICs that they can return to sustainable development. Under the current economic constraints, achieving the SDGs targets by 2030 will be impossible for many LMICs, which are currently

[15] IDA allocates a mix of grants and concessional loans to LICs based on their risk of debt distress as assessed through the DSAs.

[16] Clemens Graf von Luckner, "Lifting the Hood of the LIC-DSF to Revamp Its Accuracy and Transparency", in *FDL Policy Notes*, No. 18 (October 2024), https://findevlab.org/?p=33189.

[17] Yunnan Chen and Tom Hart, "Common Framework, Uncommon Challenges: Lessons from the post-COVID Debt Restructuring Architecture", in *ODI Insights*, February 2025, https://odi.org/en/insights/common-framework-uncommon-challenges-lessons-from-the-post-covid-debt-restructuring-architecture.

[18] World Bank, *Global Economy Set for Weakest Run since 2008 Outside of Recessions*, 10 June 2025, https://www.worldbank.org/en/news/press-release/2025/06/10/global-economic-prospects-june-2025-press-release.

on track to meet less than one-fifth of them. Solutions seem complex but possible.

One is to call on all stakeholders – the IMF, World Bank, and both public and private creditors – to support debt reprofiling: extending maturities to reduce the annual pressure of interest payments and free up fiscal space; expanding the use of debt-for-development swaps, whereby part of the debt is exchanged for targeted investments in climate action, education or vocational training; and converting part of the debt denominated in foreign currencies into local currency, to lower exchange rate risks and support the development of local capital markets.

Furthermore, the G20 Common Framework could be reformed by extending eligibility to middle-income countries, strengthening creditor coordination, addressing the lack of enforceable participation by private creditors and introducing a payment standstill for countries undergoing debt restructuring negotiations. The South African G20 Presidency could provide the necessary momentum to advance this reform.

Additionally, the UN Expert Group on Debt should continue to catalyse action to establish borrower cooperation platforms to foster knowledge sharing, technical capacity and best practices sharing. Developing initiatives going beyond conventional rule-based solutions, which have not paid enough attention to social and environmental impacts, could help address LMICs vulnerabilities.[19]

Lastly, development financing models should make greater use of Special Drawing Rights:[20] SDR-backed bonds could help ease debt burdens by turning unused reserves into long-term, low-cost financing, enabling multilateral development banks to provide more concessional lending to countries under pressure.

2 July 2025

[19] Raka De and Rob Floyd, "Strengthening Coordination among Borrowing Countries", in *Amplifying Africa's Voice Blog*, 5 December 2024, https://findevlab.org/?p=33378.

[20] SDRs are reserve assets created by the IMF, valued against a basket of major currencies, that provide liquidity without increasing debt. See IMF website: *Special Drawing Rights*, https://www.imf.org/en/Topics/special-drawing-right.

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