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Reprieve and Mercy: Debt Relief for the Developing World during Coronavirus

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Economic Affairs & National Development

Working Paper

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Abstract

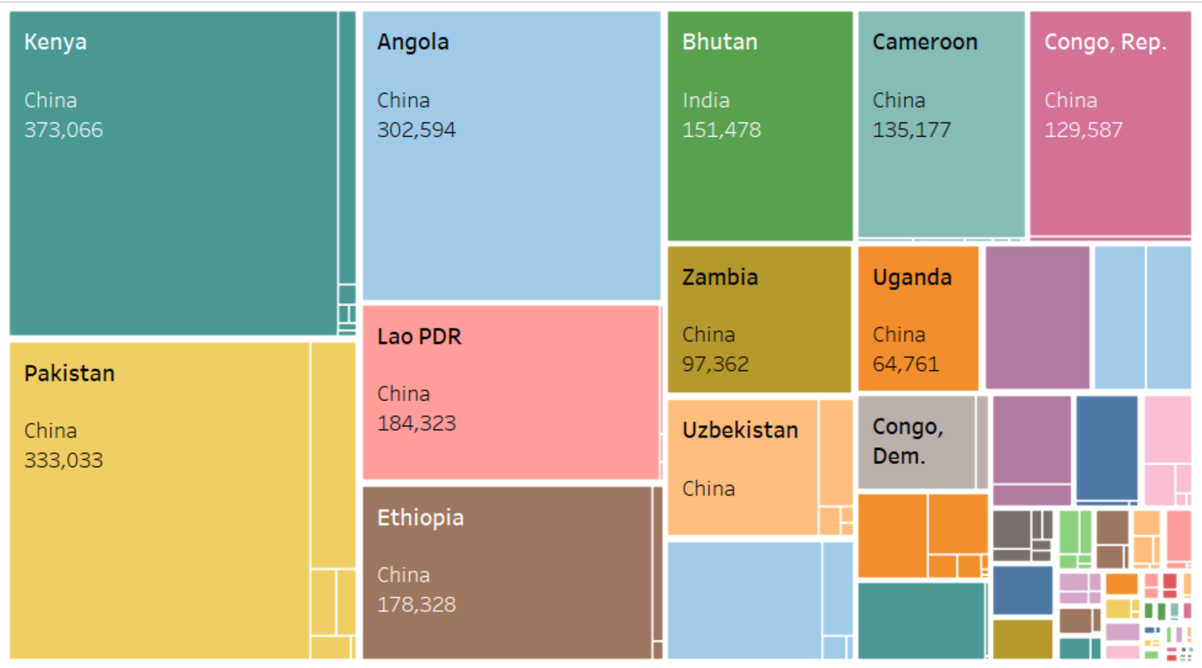
This paper seeks to highlight key issues pertaining to debt relief and moratoria under the Debt Service Suspension Initiative (DSSI), including the importance of debt relief under public resource constraints in the developing world, the difficult trade-offs of capital markets access and accruing interest payments, the need for prolonging moratoria, and the disinterest of private creditors in the rehabilitation of third world economies. The findings suggest that, while international cooperation on debt relief is necessary during the pandemic, the distorted motives of private power make the rescue of the developing world a more difficult proposition.

Keywords: COVID-19, Debt Servicing, International Cooperation, Pakistan.

Introduction

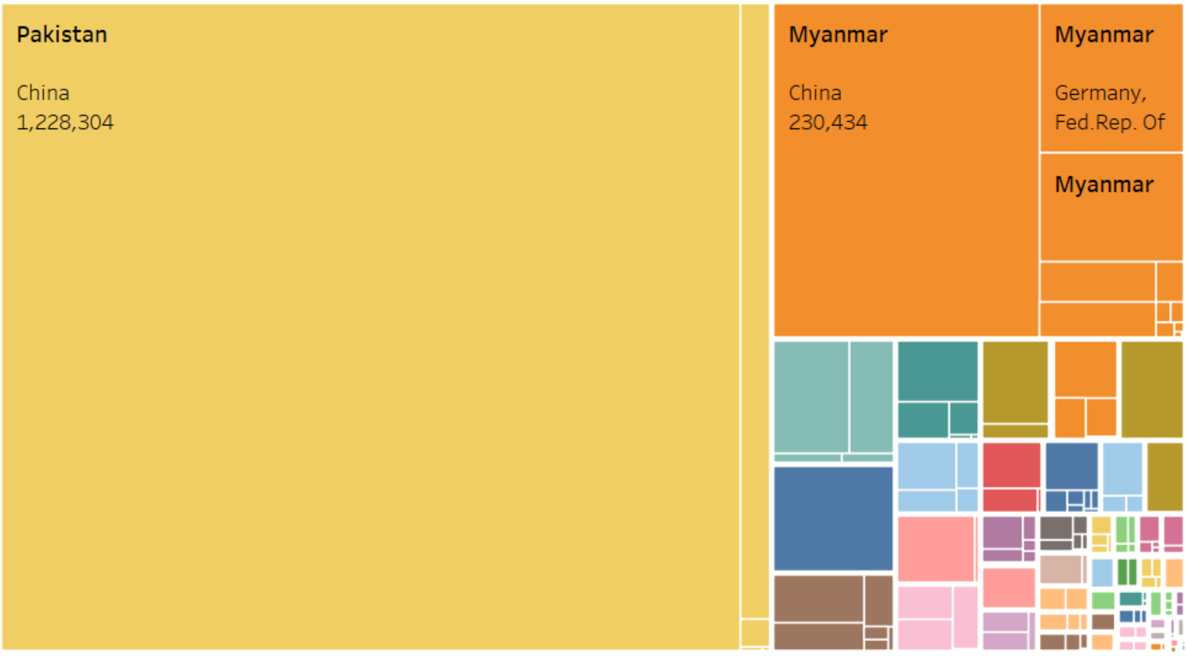
Pakistan is among the largest countries to pay debt servicing during January 2021 among the countries eligible for the Debt Service Suspension Initiative. Along with Angola and Kenya, it owes a significant bilateral debt servicing payment to China. China is, in fact, the largest bilateral creditor to most DSSI countries. It should be noted however, that Figure 1 excludes multilateral debt as well as private creditor debt.

Figure 1: Monthly Total Debt Servicing to Official Bilateral Creditor Countries (USD Thousands) among DSSI Group of Countries (January 2021)



Source: World Bank.

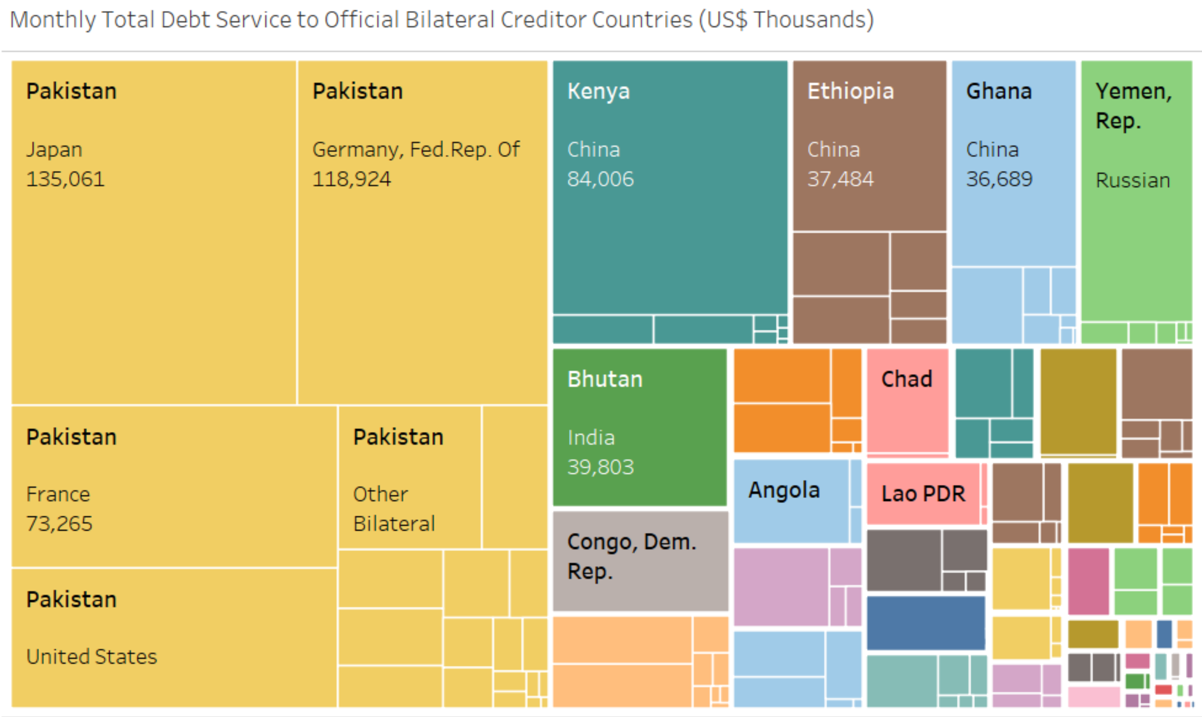
Figure 2: Monthly Total Debt Servicing to Official Bilateral Creditor Countries (USD Thousands) (April 2021)



Source: World Bank.

Pakistan will be the largest country to pay bilateral debt servicing by far during the month of April 2021 among the countries eligible for the Debt Service Suspension Initiative (Figure 2). The vast majority of this is owed to China. China is, in fact, the largest bilateral creditor to most DSSI countries. It should be noted, however, that this figure excludes multilateral debt as well as private creditor debt.

Figure 3: Monthly Total Debt Servicing to Official Bilateral Creditor Countries (USD Thousands) (November 2021)



Source: World Bank Estimates.

Pakistan will be the largest country to pay bilateral debt servicing by far during the month of November 2021 among the countries eligible for the Debt Service Suspension Initiative (Figure 3). The creditor countries during this month include Japan, Germany, France, and the United States, among others. For most other DSSI countries during November 2021, China remains the largest bilateral creditor. It should be noted, however, that the figure excludes multilateral debt as well as private creditor debt.

ANALYSIS

Debt relief is a theme in the developing economics literature that has always garnered considerable interest, both from proponent and opponent camps (Bird and Milne 2003; Boote and Thugge 1997; Chauvin and Kraay 2005). Boote and Thugge discussed how the Heavily-Indebted Poorer Countries (HIPC) began to receive debt relief after problems emerged with national balance sheets in the 1980s, but find the record at best mixed. Chauvin and Kraay examined 62 countries between 1989 and 2003 and found "little evidence that debt relief has affected the level and composition of public spending in recipient countries," and that there was insufficient evidence that "debt relief has raised growth, investment rates or the quality of policies and institutions among recipient countries," (2005). Bird and Milne attributed this to several factors including the lack of completion of programs, through which it was difficult to really assess how effective and efficient debt relief really was (2003). Yet in those conditions of comparative normalcy, things appeared different – much more so than in the global pandemic that engulfed the world in 2020. These new and severely distressing conditions in fact precipitated a debate around renewed debt relief efforts, that came to be known as the Debt Service Suspension Initiative (DSSI). The aim of this paper is to analyze the degree to which such an initiative is both necessary and yet incomplete, since it leaves out private power (private creditors).

The violent tremors of the coronavirus pandemic have been felt across the developing world since early 2020 (Chohan 2020b-e, 2021a-c), and despite the comparative success of some developing countries in managing the immunological fallout of Covid-19 (see Pakistan case in Chohan 2021 a-c), the economic burden placed by the pandemic remains dire (Ahmad 2020). What is of particular concern is the constrained public finance resources of developing countries, which fall on the horns of a dilemma between paying off international debts and diverting financial resources towards public health spending, given that developing countries have long struggled with public health expenditures (Bossert 1998; Alexandre 2003).

It was for this reason that the multilateral Debt Servicing Suspension Initiative (DSSI) which was led by the Group of 20 (G20) advanced economies was so critical in the first half of 2020 (Malpass 2020). It is estimated that, even before the pandemic's eruption, the countries that have been eligible for DSSI were vulnerable to increasing debt burdens. According to a recent World Bank study, the countries eligible for DSSI had seen their external debt loads swell by 9.5% to USD 744bn in 2019 (World Bank 2020). Going forward, the IMF has cautioned that African states alone face a revenue financing shortfall of USD 345bn through to 2023 due to the pandemic and its economic fallout (IMF 2020).

Pakistan shares this concern with other developing countries, and this is why the country's advocacy for debt relief in early 2020 on behalf of the third world helped culminate in the DSSI (Gul 2020; Raza 2021). In fact, Pakistan is one of the largest economies to face this debt financing distress in the near future. According to the Economist magazine, Pakistan faces more than USD 4.5 billion dollars in debt service payments due in the period January-June 2021, out of which USD 2.1 billion is to bilateral lenders and the remainder is to other lenders including multilateral institutions and bondholders (2020). This is twice the size of debt servicing payments due for Angola and four times the size of that due for Ethiopia.

Prime Minister Imran Khan is absolutely correct that debt relief is one of the fastest ways of creating fiscal space for developing countries, hence the need for an extended reprieve (see also work by Weeks and McKinley 2009). Recently, the DSSI has been extended from the end of 2020 to mid-2021. According to the European Network on Debt and Development (Eurodad 2020), extending the DSSI moratorium by six months might provide an additional USD 6.4 billion of relief to deserving countries, which would rise to USD 11.4 billion if the DSSI would be further extended to 2021. This would amount to at least one-fourth of the combined debt payments for those countries included within DSSI. For countries such as Angola, it could amount to nearly 5% of GDP, according to the Fitch ratings agency (Fitch 2020).

But getting government creditors on board through DSSI is only part of the picture. There are very large private creditors, such as international hedge funds and global non-bank financial institutions, who have looked at reprieve and mercy for the third world in a contemptuous manner. This speaks to a longstanding observation about private bondholders and sovereign crises (Mola 2012; Eichengreen 2006), with vultures swooping in to take the pickings of the carcasses of sovereign nations (Gallagher 2011; Fisch and Gentile 2004). These “vultures” have failed to show compassion and are driven by the profit motive to make their collections come hell or high water. Many DSSI countries have urged these vultures for compassion, but have refrained from requesting a formal waiver from them, fearing that such a move would trigger a re-rating of their creditworthiness and lock them out of international debt markets, and that too at a time when many major central banks are pushing their rates down to near-zero rates.

It has long been noted that many low-income and middle-income countries spent more on debt servicing than on their public health systems (Gupta et al., 2002; Ooms et al., 2008) , which have come under immense strain during this pandemic (Chohan 2020b-e). At the same time, many frontier markets have struggled to get this far in gaining international market access for raising capital over the past decade, and would lose all that effort if the ratings agencies re-rate them into defaults and restructurings. According to Moody’s, the DSSI developing countries face a USD 40 billion funding gap as it is (Moody’s 2020; Hodgson 2020), and State Bank Governor Reza Baqir has made recent comments regarding the importance of maintaining access to international markets as well.

As such, there are profound distortions in the dynamics of international debt. Poor countries seek the compassion of richer governments given the challenges of managing a pandemic under resource constraints. Richer countries, in addition to any sense of solidarity, also see a self-preserving logic in this, because of their fear of waves of desperate immigrants at their shores if the hardships become too great. At the same time, neither the richer nor poorer countries are compelling the private sector vultures from extracting the few drops of blood remaining in the developing world's open veins. At a time when growing masses, 150 million people according to the World Bank, stare into an economic abyss, there is a pressing need for international solidarity, not just between governments but between all creditors and lenders. Whatever interest payments those vultures expect to extract, it is a minor portion of their balance sheets, but it means the choice of life and death in the developing world. This is where the harder questions of reprieve and mercy truly lie.

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