

Suspend emerging and developing economies' debt payments

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As the COVID-19 virus spreads globally, economic paralysis and unemployment follow in its wake. But the economic fallout of the pandemic in most emerging and developing economies is likely to be far worse than anything we have seen in China, Europe or the United States. This is no time to expect them to meet their debt payments, either to private or official creditors.

With inadequate health care systems, limited capacity to deliver fiscal or monetary stimulus, and underdeveloped (or nonexistent) social safety nets, the emerging and developing world is on the cusp not only of a humanitarian crisis, but also of the most serious financial crisis since at least the 1930s. Capital has been stampeding out of most of these economies over the past few weeks, and a wave of new sovereign defaults appears inevitable.

We have been consistently arguing the urgent need for a temporary moratorium on all debt repayment by any but the most creditworthy developing or emerging sovereign debtors. The case for a moratorium for distressed sovereign borrowers has many similarities to that for households, small businesses and municipalities.

Underscoring the urgency is the reality that the quarantine experience is starkly different in the developing world. In the vast slums of Sao Paulo, Mumbai or Manila, quarantining can mean living in one small room with 10 people, with little food or water and scant or no compensation for lost wages. If history is any guide, the supply disruptions that accompany the pandemic may soon be followed by food shortages.

More than 90 countries have already sought emergency funding from the International Monetary Fund's Rapid Financing Instrument (RFI) and World Bank resources. And in much of the developing world, the worst of the pandemic is not expected until later this year. When that happens, the direct humanitarian and economic impact will come on top of the pandemic's effects on global trade and commodity prices, which are already battering many emerging economies. The World Trade Organization expects global trade to decline by 13-32 percent in 2020. Oil-producing countries (and many more primary commodity producers) have been suffering the consequences of the price war between Saudi Arabia and Russia, sparking downgrades in sovereign credit ratings.

Leaders of the world's largest economies must recognize that a return to "normal" in our globalized world is not possible so long as the pandemic continues its grim march. It is myopic for creditors, official and private, to expect debt repayments from countries where those resources would have to be diverted from the fight against COVID-19.

Deepening and prolonging the global depression is a very risky proposition. At a low point in the mid-1980s, emerging and developing economies accounted for about 18 percent of global GDP (in U.S. dollars); in 2020, that share is 41 percent (and 60 percent if adjusted for purchasing power).

We recommend an immediate temporary moratorium on external debt repayments for all but "AAA"-rated sovereigns. By "external," we mean debts issued under the jurisdiction of foreign courts, typically in New York or London. Debts issued under domestic law would be dealt with by countries themselves. For this kind of debt relief to be effective, it must be encompassing, including debts owed to the multilateral lenders, such as the International Monetary Fund and the World Bank, sovereign creditors (Paris Club members and China), and private investors.

Ultimately, the debt of many countries will need to be restructured; there will be no alternative to a negotiated partial default. But courts and multilateral lenders are no better able to handle debt default en masse than hospitals can handle operating at 10 times capacity. A temporary moratorium may provide the necessary bridge. In the best-case scenario, it might even prevent some defaults. The World Bank and the IMF have vast experience with countries in debt distress, and in recent years have increasingly recognized that partial default is often the only realistic option, a point we stressed in much of our earlier work on external debt. It is a great tragedy that, following the 2008 global financial crisis, the eurozone failed to find a way to restructure Southern Europe's debts beyond the Greek case – a course of action we strongly advocated at the time. Trying to enforce regular debt payments in highly irregular times can only lead to deeper and more protracted recessions than need to happen.

Of course, a debt moratorium will require the U.S., which wields effective veto power at the IMF, to get on board. But so, too, must China.

In the past two decades, more and more developing countries turned to China for loans (which are typically collateralized and carry market interest rates). Although China is now a major creditor in about 40 countries and an important one in scores more, it has so far refused to join the Paris Club (which coordinates rescheduling of sovereign debts) and insists on pursuing its own bilateral closed-door approach.

What can be done? The IMF and the World Bank have the capacity and expertise to coordinate a debt moratorium if the U.S. and other major players conclude that such a move is in their national interest. Private creditors will have relatively little choice but to

cooperate in the short run. Many emerging and developing economies will soon stop paying their debts, anyway. The world needs to get in front of the problem.

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