Debt and pandemic in middle-income countries
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This briefing has been produced with the financial assistance of FORGE, Response and Vision Fund, and Bread for the World. The contents of this publication are the sole responsibility of Latindadd and the authors of this report and can in no way be taken to reflect the views of the funders.

Publication Date – October 2021
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Introduction

The world is experiencing a multidimensional crisis which erupted with the COVID-19 pandemic. This crisis exacerbated the preexisting and unresolved structural economic problems worldwide. Poverty levels and inequality have deepened, especially and disproportionately in low- and middle-income countries. As with the crisis, recovery has also shown evident differences between regions. Heterogeneous response capacities and resilience have also been revealed. While developing economies announced countercyclical plans lower than 10 per cent GDP, developed economies undertake plans around 20 per cent GDP (ESCAP, 2020).

The contraction of macroeconomic aggregates indicated the depth of the pandemic, but households felt the crisis on a daily basis. Women, low-skilled workers, children, and other vulnerable groups saw their basic rights at stake. Data shows that 15.3 per cent of people living in developing countries saw one or more adults in their home going without eating for a full day due to a lack of resources (Dávalos et al., 2021); meanwhile the 75 per cent of COVID-19 vaccines doses have taken place in the 10 of the richest countries in the world (Green, 2021).

The current international financial architecture, its institutions and initiatives, have not been able to ease the disproportionate crisis effects, the huge resilience gaps nor the unfair vaccine distribution in middle-income countries. 23 countries with highly vulnerable debt levels, holding about 65 per cent of the total debt service at risk in the 2021-2025 period, are not eligible for the Debt Service Suspension Initiative (DSSI) nor the Common Framework (Jensen, 2021).

Our document looks at the effects of the crisis, vulnerabilities, and the limitations of the G20 initiatives, and at strategic debt solutions and improvements to the initiatives needed to give middle-income countries a way out of the pandemic. We focus our work on the experience of Latin America, Africa, and Asia during the pandemic, as well as the civil society demands regarding the international financial architecture.
1. Overview of the impacts of the multidimensional COVID-19 crisis

The multidimensional crisis which erupted with the COVID-19 pandemic exacerbated preexisting and unresolved structural economic problems worldwide. Its initial effect was to paralyse production. At the same time, containment policies to fight the virus directly affected demand. As a result, the world economy contracted by 3.3 per cent in 2020 (IMF, 2021d). In some regions, the fall in production was even faster and more sudden: in Latin America -7.0 per cent, Europe -6.6 per cent, South Asia -6.0 per cent, Southeast Asia -4.0 per cent and -5.8 per cent in the Pacific (IMF, 2021d; Asian Development Bank, 2021). United Nations estimates, however, suggest that output in Latin America would decrease by -7.1 per cent (UNCTAD, 2021b).

Along with the global contraction, poverty levels and inequality have deepened, especially and disproportionately in low- and middle-income countries. Estimates suggest that the pandemic pushed around 120 million people into extreme poverty in 2020, of which 82 per cent are in middle-income countries (Atanda & Cojocaru, 2021), that is, where the economic contraction due to COVID-19 was most severe (Figure 1.).

Figure 1. The impact of the pandemic

Since the outbreak of the crisis, the effects have been transmitted to the developing world through various channels, one of them being the balance of payments. The economic recession in advanced economies drastically contracted remittances to low- and middle-income countries. Border closures reduced tourism to zero; these containment measures
affected high-income and G20 countries such as Italy, Spain, and Mexico, where tourism represented at least 14 per cent of their GDP (MacDonald et al., 2020). Meanwhile, in Latin America and the Caribbean, both in Mexico and in the Dominican Republic, where foreign tourist spending in relation to the export of services exceeded 80 per cent, it was estimated that three months of mobility restrictions implied a fall of 2.5 per cent and 0.5 per cent of their GDP, respectively (Mencías & Oglietti, 2020).

For Small Island Developing States (SIDS), whose services exports contribute on average 25 per cent to their GDP and almost half of their exports consist of travel services, there is an estimated fall in GDP of 9 per cent in 2020 compared with a 3.3 per cent decline in other developing countries based on International Monetary Fund (IMF) projections (UNCTAD, 2021a). Likewise, SIDS could have a larger fiscal deficit due to the collapse of tourism, from 1.4 per cent in 2019 to 8.5 per cent in 2020 (ESCAP, 2020).

In other parts of the world, countries highly dependent on remittances from Europe and the US, such as those located in sub-Saharan Africa, were also heavily affected by the pandemic. In these, 60 per cent of total remittances came from France, Italy, the United Kingdom, and the United States (Allen, 2021), that is four of the developed economies most affected by the pandemic. In sub-Saharan Africa, remittances represent an important share of their income, reaching US$ 47 billion in 2019. For Asian countries, with an increase in cumulative remittances of 20 per cent during four years until 2019, estimates showed the sharpest decrease ever of 7.4 per cent in 2020 due to the crisis (OECD/ADBI/ILO, 2021).

The contraction of macroeconomic aggregates clearly indicates the depth of the pandemic, which has been felt most intensely within households, due to the decline in the ability to guarantee the rights of their members. Women, low-skilled workers and young people have been the most affected in terms of employment in developing countries. Around 36 per cent of adults stopped working in the period immediately after the onset of the pandemic, 64 per cent of households reported a drop in their income, and relative to men, women had an 11 per cent greater probability of losing their jobs (Dávalos et al., 2021). In the case of children, 1.6 billion saw their studies interrupted during the pandemic, and over 30 per cent did not have the conditions in which to continue with their learning during the closure of schools (Dávalos et al., 2021).

The economic crisis, malnutrition and hunger have come hand in hand. Estimates from the IMF (2021d) indicate that GDP growth is the most important driver in fluctuations in malnutrition. A negative 1 per cent variation in GDP would increase malnutrition by 0.95 per cent, implying that middle-income countries would be the most affected given the contraction in their aggregate production levels. Additionally, the results of Dávalos et al. (2021) show that, on average, 15.3 per cent of people in developing countries saw one or more adults in their home go without food for a full day due to a lack of resources.
As with the negative effects, recovery from the crisis has differed markedly between regions due to their heterogeneous response capacities. In the Asia-Pacific region, for example, developing countries announced plans worth 7 per cent of their GDP, while developed economies planned a fiscal response of 20 per cent (ESCAP, 2020). Some countries managed the pandemic better with fewer resources, but at the expense of high costs and higher indebtedness. A reference case of containing the pandemic but with high economic costs was that of Mongolia. In this country there have been only four deaths from COVID and only 3,300 people infected. However, its economy was stagnant as it is highly export-driven, which is why the government has been forced to increase debt to face the pandemic (Green, 2021).

**Figure 2. Vaccine Administration by Income Group**

After more than a year of crisis, a way out is envisaged through global immunisation efforts. However, there have also been wide inequalities along the way. Excluding China, 46.4 per cent of positive cases were in middle-income countries as of 11 February 2021, while only 17.4 per cent of vaccines have been administered in these countries (Figure 2). In fact, 75 per cent of the doses administered have taken place in 10 of the richest countries in the world, which combined represent 60 per cent of global GDP (Green, 2021). Clearly, the economic recovery of the regions will depend above all on the capacity to vaccinate the population. Therefore, middle-income countries in Latin America, Asia and Africa face a limited capacity to recover at the same rate as advanced economies unless access to vaccines is increased. Not only have the effects been uneven and differentiated, but so will the recovery be.
2. Middle-income country challenges

2.1 The G20 Debt Initiatives

The Group of 20 agreed in April 2020 on a temporary suspension (the “Debt Service Suspension Initiative” or DSSI) of bilateral debt payments for up to 73 primarily low-income countries, and called on private creditors to join in comparable terms, and on multilateral development banks to join to the extent it would not compromise their credit ratings and low-cost lending capacities. The DSSI equates to approximately US$ 10.3 billion of support from DSSI up to the first half of 2021 (IMF, 2021b), while UNCTAD (2020) estimated that developing countries require US$ 1 trillion of debt relief in the face of COVID-19.

The IMF took quick action in April 2020 to enable its Catastrophe Containment and Relief Fund (CCRT) to cancel debt payments due to the institution by 29 low-income countries in the following six months. The G20 has subsequently extended the DSSI twice, with the second extension running until December 2021 and being announced as the last one. The IMF also extended the relief through the CCRT twice, with the second extension running until October 2021 and with an open door to extend it to April 2022 if resources are made available by donor countries.
So far, 46 countries (23 low-income countries, 15 lower-middle income and eight upper-middle income) benefitted from an estimated US$ 5.7 billion of debt service deferral under the DSSI in 2020 plus an estimated US$ 4.6 billion in the first half of 2021 (IMF, 2021b). This was all from public creditors as no private creditor granted a debt payment suspension. Multilateral development banks, in turn, contended that participating in debt suspension efforts – and by extension relief – without compensation for the foregone amounts, would harm their credit ratings and their ability to serve client countries by lending at cheap interest rates. Instead, they have committed to a “positive net flow” approach - ramping up financing so that each client country would receive more than they would pay to the institutions over the suspension period. As recent IMF and World Bank data shows, the DSSI hasn’t delivered sufficient savings to even compensate for COVID-19 related spending (IMF, 2021b).

In November, the G20 launched a “Common Framework for Debt Treatment beyond the DSSI”, which the Paris Club also endorsed. The mechanism aims to facilitate timely and orderly debt treatment with broad creditors’ participation including the private sector (G20, 2020). The mechanism is open to the same 73 countries eligible for the DSSI, excluding most middle-income countries. The framework provides that upon an eligible debtor’s request, the IMF and World Bank perform a debt sustainability assessment to establish the need and amount of debt relief required (ibid). It aims to ensure fair burden sharing among all official bilateral creditors, and debt treatment by private creditors at least as favorable as that provided by official bilateral creditors (ibid). However, after nearly a year since its establishment, with delays and uncertainty, the Common Framework is yet to produce concrete results (see point 3 below).

### 2.2 Debt sustainability: the debt problem of middle-income countries

Middle-income countries are in urgent need of additional fiscal space to respond to the COVID-19 crisis and provide stimulus measures. While advanced economies increased their fiscal expenses by more than 12 per cent of their GDP, middle-income and low-income economies mobilised less than 4 per cent and less than 2 per cent of their GDPs, respectively (UN, 2021).

A recent study, carried out by Jensen (2021), identifies 72 countries with a high degree of debt vulnerabilities, of which 23, holding about 65 per cent of the total debt service at risk in the 2021-2025 period, are not eligible for the DSSI or Common Framework. Another relevant fact is that, of the seven countries that defaulted on their debt last year, not even one was a low-income country.

The fall in GDP of countries worldwide, together with reduced fiscal spaces, and the high need for investment in health services and infrastructure to contain the pandemic, increased the financing needs of middle-income countries. The richest countries had more than 10 per cent of additional spending in response to COVID-19, while for the
majority of the rest of the countries the figure is below 5 per cent – clearly lower which explains the unequal recovery (Figure 3).

**Figure 3. Additional Spending and Foregone Revenue in response to the COVID-19**

External debt stock levels increased in most regions worldwide, except for Europe, Central Asia and Latin America and the Caribbean; countries in these regions typically increased borrowing in domestic markets to meet pandemic-related expenditures. Regarding bond issuances, the private sector entities increased 23 per cent to US$ 159 billion while government saw a 7 per cent contraction, falling to US$ 229 billion from US$ 247 billion in 2019 (World Bank, 2021a).

Globally, the debt stock of 120 low- and middle-income countries, including external public and private debt, increased to US$ 8.4 trillion at the end of 2020 and their combined debt obligations increased by US$ 220 billion. The same year was characterised by the resurgence of private sector bond issuances and a contraction in government bond issuances (World Bank, 2021a).

In terms of debt service, the middle-income countries’ ratio of total debt service to exports increased from 14.7 per cent in 2019 to 17.5 per cent in 2020, a level much higher than in low-income countries and in the least developed countries. The higher burden of debt payment is also on the share of government revenues spent on servicing public and publicly-guaranteed debt, rising from 8.4 per cent in 2019 to 9.0 per cent in 2020 (UN General Assembly, 2021).
The empirical evidence suggests that countries entering a crisis with ample fiscal space take more aggressive fiscal actions to contain crises and that countries that responded faster to the pandemic with containment measures faced less costly packages relative to the size of their economies (Hosny, 2021). In Latin America and the Caribbean, the information for 16 countries shows that 8.7 years were lost in the second quarter of 2020 in terms of production (Ugarteche, 2021).

The G7 countries that recovered losses in their production levels more quickly, did so mainly due to their wider pre-existing fiscal spaces and the aggressive expansionary monetary policy that exceeded the fiscal policy - except for the United States. Of 12 Latin American countries that had an average fiscal stimulus of 7 per cent, the biggest impulse was that of Chile with 22 per cent of its GDP, followed by Brazil and Peru that barely exceeded 15 per cent (Ugarteche, 2021). On the contrary, countries like Ecuador and Costa Rica, which had agreements with the IMF, presented the lowest fiscal impulses, of between 1 per cent and 2 per cent (ibid). This region also struggled with a more than proportional fall in tax revenue of 9.3 per cent in 2020 (Díaz de Sarralde et al., 2021), while the economy contracted by 7 per cent in the same period (IMF, 2021d). In addition, the global deficit in 2019 was 3.2 per cent and increased to 6.9 per cent in 2020 due to the high deficits in Brazil, Panama, El Salvador, Peru and Costa of 13.8 per cent, 9.2 per cent, 9.2 per cent and 8.4 per cent, respectively (ECLAC, 2021).

South Africa was particularly affected by the sell-off of rand-denominated bonds by non-residents, causing a 15 per cent contraction in the stock of external debt at the end of September 2020 compared to the end of 2019. Another key issue in the African continent was the estimated
11 per cent increase in the external debt of Egypt, the region's largest borrower, but external debt also increased by about 13 per cent in both Jordan and Morocco. Most of the financing to the three countries came from the issuance of bonds in the international capital markets and from the International Monetary Fund.

In sub-Saharan Africa, the external debt stock increased by only 2.8 per cent in 2020 compared to the 9.7 per cent increase in the previous year. The sharp contraction in the level of South Africa’s external debt, due to non-residents withdrawing from rand-denominated bonds, accounts for most of the slowdown. For other sub-Saharan African countries, the external debt stock is estimated to have increased by an average of 11 per cent in 2020, slightly faster than the 10 per cent increase in 2019. For some countries in the region, however, the increase was much higher based on third quarter data reported to World Bank’s QEDS or information published in national debt bulletins. For instance, Burkina Faso, Nigeria, Rwanda and Uganda saw a rise in creditor inflows and debt stock increases of 16 per cent, 20 per cent, 19 per cent and 14 per cent, respectively (World Bank, 2021a).

South Asian countries’ debt stocks declined marginally compared to the 7.6 per cent increase seen in 2019. But India, having a 70 per cent share of the external debt balance of the region, largely explains this finding. In other countries, the external debt stock increased, such as Bangladesh and Nepal, 10 per cent, and Pakistan, 3 per cent (World Bank, 2021a).

On the contrary, the stock of external debt in the Europe and Central Asia region contracted by 1.3 per cent and by 2.6 per cent in Latin America and the Caribbean, “reflecting a fall in short-term debt parallel to the reduction in trade flows and the massive sale of bonds issued in the region held by non-residents. Countries in these regions generally increased indebtedness in domestic markets to cover COVID-related expenses” (World Bank, 2021a).
2.3 Vulnerability dimensions of middle-income countries

2.3.1 Latin America

Most Latin American countries are middle-income countries. In addition to not being able to access debt relief mechanisms or concessional financing, they are also highly vulnerable to the dimensions on which the COVID-19 crisis has had its strongest effects. The effects on the tourism sector were particularly severe for Central America and the Caribbean countries. That is the case for Dominican Republic, Panama, El Salvador and Costa Rica, where the relationship of the tourism sector revenues with respect to exports in 2019 is 36.4 per cent, 24.9 per cent, 20.8 per cent, and 19.5 per cent, respectively (Latindadd & Jubilee USA, 2021).

In addition, this same region is highly dependent on the remittances sent by its migrants in Mexico or the United States. In 2019, Honduras and El Salvador received 21.5 per cent and 20.9 per cent of their respective GDP in remittances, while Guatemala and Nicaragua received around 13.9 per cent and 13.5 per cent, respectively (ibid).

It should be remembered that, during the year 2020, hurricanes Eta and Iota destroyed a large part of the crops in agricultural areas in Central America, in addition to leaving many victims and people affected. These events exacerbated levels of food insecurity. The spread of the virus was even more difficult to control in the makeshift shelters and high levels of overcrowding. The lack of infrastructure necessary to face these natural disasters is clear evidence of the region’s low levels of resilience to climatic phenomena.

But food insecurity is not only a major problem for Central American countries, as its advancement and incidence are also of great concern for the rest of the region. In Central American countries such as El Salvador, Guatemala, Honduras, the levels of food insecurity affect more than 40 per cent of the population, and in countries such as Argentina, Brazil, Chile, Costa Rica, Ecuador and Peru it has been gradually increasing (Latindadd & Jubilee USA, 2021). Failure to meet basic food needs in a structural way makes it impossible for households to cope on their own with unforeseen external shocks in the form of natural disasters or an unprecedented pandemic such as COVID-19.

Strong expansive policies, social protection and guaranteeing human rights must be key elements of the agenda to fight COVID-19. Latin America continues to be the most unequal region in the world, so part of the structural combat should be aimed at advancing towards higher levels of equality, so that those who have more resources contribute substantially more than those who are in situations of high vulnerability and poverty. In countries like Argentina, Bolivia, Colombia, Ecuador and Honduras, indicators of extreme poverty are at two-digit levels (Latindadd & Jubilee USA, 2021).
2.3.2 Africa

The African debt crisis has been accelerated by the onset of the global health pandemic. And while many developing countries were already facing crises before the pandemic, the nature of developing country debt is far more complex than in the past, with a new landscape that poses greater risks. An increasing share of public debt is now composed of commercial bonds traded on international capital markets. In recent years, the official creditor landscape has changed considerably.

As in past crises, advanced countries had availability to inject trillions of dollars of liquidity in more attractive terms. Many African governments began to issue sovereign bonds to raise money in the international capital market, even countries that a decade ago were HIPC countries (Heavily Indebted Poor Countries). Between 2013 and 2020, African governments – many of them rated below investment grades – issued over US$ 90 billion in sovereign bonds (Stiglitz & Rashid, 2020).

While African governments initiated national plans to prevent the spread of the virus and try to protect incomes, businesses, and livelihoods, the global initiatives to combat the negative effects of COVID-19, such as the G20 Common Framework and the Debt Service Suspension Initiative (DSSI) amongst others, do not involve all African countries, excluding many middle-income countries. At least 17 African MICs are categorised as debt vulnerable and would need debt relief and cancellation, and were not qualifying for debt relief (Jensen, 2021). Thus, there is a need to pay attention to the state of affairs obtaining in these countries and debt relief and aid have to be expanded to accommodate them as the COVID-19 pandemic has triggered a wave of the new poor in MICs (Bretton Woods Project, 2021). Participating countries are expected to resume debt payments when the moratorium lapses by the end of 2021. Furthermore, the situation with private-sector creditors is daunting and complicated by a collective action problem.

Financing Africa's structural transformation requires a menu of financial options that are predominantly designed and mobilised domestically on
the continent. The return on investment from Africa’s resources, including financial instruments such as debt, are not yielding the tax revenue mobilisation to spur sustained development as well as economic and social transformation. At the global level, Africa’s Domestic Resources Mobilisation (DRM) efforts are hindered by an economic and financial architecture that promotes profit shifting, aggressive corporate behavior, and illicit financial flows.

Africa’s interaction and participation in the global economy is affected by the rise in the use of concessional, non-concessional, and private sector instruments more commonly known as “privatisation or financialisation” to finance investments in social sectors, for example, health, education, water and sanitation. These come with user fees and unequal access leading to increasing inequality (AFRODAD, 2021). The ecosystem is supposed to complement the finance menu for Africa’s structural transformation agenda, however, the political interests driving the continent’s interaction in this ecosystem is resulting in a major source of indebtedness. It has become part of a new wave of extractive development finance in the African context.

Therefore, without comprehensive cancellation involving all creditors, countries will still be diverting freed-up resources to external debt payments. Addressing developing country debt vulnerabilities is therefore a very critical component in the global response to the COVID-19 health and economic crises. The debt architecture needs an overhaul with a greater role for the United Nations where global south voices can be heard on an equal footing.
2.3.3 Asia

Like many other regions of the global south, Asia is caught in multiple crises that arose from the pandemic, which acutely worsened pre-existing socioeconomic problems and further heightened the risks to climate change. Most of the public health systems were in conditions of neglect following years of privatised delivery. Countries had accumulated high levels of domestic and external debt, with several on the brink of sovereign defaults.

Reports that Asia is well-positioned for an economic rebound mask persistent risks as well as sharply uneven conditions especially among subregions and countries. Overall, the region shrank by 0.2 per cent in 2020; by region, South Asia showed the largest contraction, pulled by a decline of 8 per cent in India’s GDP, followed by Southeast Asia with the Philippines shrinking 9.6 per cent and Thailand by 6.1 per cent (Asian Development Bank, 2021).

An additional 89 million people are estimated to have been pulled into absolute poverty, setting back what limited gains had been made previously in poverty reduction. Moreover, working hour losses amounted to the equivalent of 140 million full-time jobs in 2020 (ILO, 2021). Reliance on remittances by high labour-sending countries added to the acute impacts of the pandemic when return migrants increased and new migrant flows decreased. Just as in any other crisis, the harshest impacts both in the short and long-term, are falling on large numbers of impoverished and low-income groups, including those facing discrimination, such as women and girls, the elderly, the urban and rural poor and indigenous communities.

Data from 42 Asian economies, accounting for almost 100 per cent of total GDP in the developing subregions of Asia, show significant budget deficits as a share of total GDP, which widened from 5 per cent in 2019 to 9.8 per cent in 2020. The average ratio of government debt to GDP was also reported to swell by nine percentage points in 2020 to 64.7 per cent (Asian Development Bank, 2021). Other observations point to the effect on public debt-to-GDP ratios that large fiscal deficits and economic recession will bring, which could push ratios higher among Asia-Pacific developing economies from around 51 per cent in 2019 to 63 per cent in 2021 (ibid).
On public and publicly-guaranteed debt, South Asia spent US$ 33 billion on debt service payments in 2019 while East Asia and the Pacific (excluding high-income countries) paid US$ 65 billion during the same year (World Bank, 2021b). Arguably, the debt levels are not as deep as other regions but the swift rise in debt ratios in a context of uncertainty, starting with access to COVID-19 vaccines and therapeutics, spells huge adverse implications for fiscal sustainability and justice.

3. Strategic solutions - critical evaluation of the DSA and access to debt treatment initiatives

Almost a year after its adoption, the Common Framework has not delivered on the timely and orderly debt restructuring it aimed to achieve. Only three countries have applied so far and the first applicant, Chad, has yet to see any debt relief out of the initiative. In the meantime, the three countries that applied for the Common Framework saw their ratings downgraded by credit rating agencies precisely for daring to ask for debt restructuring. There is no evidence so far that the Common Framework tools for ensuring private creditor participation in debt relief work.

The lack of an adequate debt resolution mechanism is particularly worrisome as a number of DSSI beneficiaries will see debt pressures go up when they resume debt payments at the end of the year, and particularly in 2023 when the one-year grace period within the DSSI will be over. The normalisation of interest rates in advanced economies also puts debt sustainability at risk for several other countries with high debt burdens.

An important dimension to highlight is that the G20 debt policy responses so far exclude most middle-income countries – except for those that happen to be IDA-eligible. In Spring 2020, the Development Committee asked the World Bank Group and the IMF to “review the debt challenges of middle-income countries, and to explore expeditiously a range of solutions to fiscal and debt stress in those countries on a case-by-case basis.” (Development Committee, 2020). The same body, in its most recent communiqué, noted the “serious impact of the pandemic in many small states and middle-income countries, where new risks and vulnerabilities are arising.” (Development Committee, 2021).

But the G20 seems unwilling to find out to what extent middle-income countries need support. In the lead up to their October 2020 meeting when G20 finance ministers would agree on the Common Framework, they requested a report from the IMF and World Bank Group on the liquidity needs of – only - [DSSI] eligible countries. Since the start of the
crisis, a request for a similar report surveying debt difficulties of middle-income countries has been conspicuous by its absence.

In case the Common Framework approach extends its reach to middle-income countries, the use of the IMF-conducted debt sustainability assessment raises several concerns. The IMF instrument to assess debt sustainability in the case of most middle-income countries is its Debt Sustainability Framework for Market Access Countries (DSF MAC). To determine whether countries will face difficulties in servicing debt, staff use the framework to classify countries based on their assessed debt-carrying capacity, estimate threshold levels for selected debt burden indicators and evaluate baseline projections and stress test scenarios relative to these thresholds.

However, the DSF MAC suffers from important weaknesses that may lead to an underestimation of the debt restructuring needs.

Baseline debt sustainability projections tend to err on the side of overoptimism, according to both IMF-produced and independent analyses. In spite of reforms in 2013 intended to address this issue, earlier this year the most recent review of the DSF MAC reports this as an ongoing concern: on average, projections errors for some debt drivers (primary balance and real growth rate), were smaller than for others (exchange rate and interest rate) but “forecasts for the change in debt/GDP remain more optimistic than outturns, and medium-term debt stabilization is predicted more frequently than it occurs.” (IMF, 2021c).

The framework does not adequately account for vulnerability to external shocks (Rustomjee, 2017). For instance, despite their strong impacts on debt dynamics in some countries, the severe exposure to commodity price fluctuations and weather-related natural disasters are left to alternative and stress test scenarios.

A more profound limitation critics pointed out is the definition of debt sustainability at the core of the exercise. The framework considers debt is sustainable when “the primary balance needed to at least stabilize debt under both the baseline and realistic shock scenarios is economically and politically feasible, such that the level of debt is consistent with an acceptably low rollover risk and with preserving potential growth at a satisfactory level.” (IMF, 2021c).

Civil society organisations have long called for debt to only be considered sustainable when debt payments do not compromise the debtor’s ability to satisfy priority human development spending or an acceptable level of human rights obligations. Consistent with this approach, the UN Basic Principles on Sovereign Debt Restructuring state that “Sustainability implies that sovereign debt restructuring workouts are completed in a timely and efficient manner and lead to a stable debt situation in the debtor State, preserving at the outset creditors’ rights while promoting sustained and inclusive economic growth and sustainable development, minimizing economic and social costs, warranting the stability of the international financial system and respecting human rights.” (UN General Assembly, 2015).
4. CSO proposals: urgent need to support middle-income countries, ensuring their access to fair and timely debt treatment.

Expansion of Common Framework to middle-income countries - Need and vulnerability to the health, social and economic impacts of the pandemic, rather than income level, should be the criteria to determine access to debt relief and, particularly, to the Common Framework. Timely and orderly restructuring of debts is not only in the interest of the concerned debtor countries, it will contribute to global pandemic recovery efforts and, beyond the pandemic, to a more stable global economy.

A debt service standstill - A standstill on debt payments should be granted to all countries in debt distress. Such standstill should be enforceable as soon as the debtor applies to the Common Framework. This will make the framework and any debt restructuring more effective in its aims of broad-based creditor participation and comparability of treatment.

Private creditor engagement - Measures to compel private creditors to participate in debt restructurings should be essential to any debt resolution framework, particularly to the Common Framework. The proportion of debt owed to private creditors has grown so significantly in the last decades that sustainable resolutions to debt crises, especially in middle-income countries, will rarely be feasible without effective ways to ensure that fair burden-sharing includes the private sector. Possible avenues to compel private creditor participation include reforms of domestic legislation in key jurisdictions governing adjudication of sovereign bonds and use of the UN Security Council powers (Chapter VII of UN Charter) to shield assets of countries in need from private creditor action.

Review Debt Sustainability Assessment (DSA) – As a tool for debt treatments and new financing decisions, DSAs should allow the creditor country to fulfill its obligations regarding human rights, particularly economic, social and cultural rights, and the provision of public services, as well as international commitments such as the Agenda 2030, the Paris Agreement or the Beijing Action Plan on gender equality. Any debt treatment should be deep enough to prevent a return to restructuring soon. This may require relying on assessments that go beyond the IMF Debt Sustainability Assessments considering the overall debt landscape and integrating the financing needed to achieve Sustainable Development Goals and to tackle the climate emergency.

In parallel, the international community should take steps towards more structural reforms to the global debt architecture:

Multilateral debt resolution framework: Create a multilateral and
comprehensive framework on sovereign debt workout mechanisms within the aegis of the United Nations to ensure fair, timely and orderly resolution of debt crises and fair burden-sharing, in a process convening all creditors. Negotiations on such a framework should start in the United Nations.

Responsible lending and borrowing: Adopt binding rules on responsible sovereign lending and borrowing in order to support improved debt crisis prevention.

Debt transparency: Increase debt transparency and disclosure from both lenders and borrowers, including the creation of a publicly accessible registry of loan and debt data.

Protection from external shocks: Mainstream state-contingent debt instruments for new lending, so debt payments standstill or cancellation is automatically granted in the case of a climate extreme event, a health emergency or other external shocks.

Multidimensional vulnerability assessment: Rely on an appropriate multidimensional vulnerability assessment to determine concessional finance and debt relief access. The pandemic exposed characteristics that made developing countries, including middle-income countries, more vulnerable (Latinadd & Jubilee USA, 2021).

Concessional lending: Increase availability of concessional and below-market rate lending, particularly to middle-income countries, preserving debt sustainability assessment with a human development approach.
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Endnotes

1. According to the World Bank (WB) Middle Income Countries (MICs) are those defined as lower middle-income economies - with a GNI per capita between US$ 1,036 and US$ 4,045; and upper middle-income economies - those with a GNI per capita between US$ 4,046 and US$ 12,535 (Link).

2. 33 countries in or at high risk of debt distress at the start of 2020 (Link).

3. The DSSI is not a debt cancellation initiative. It is worth noting it has been extended through to end December 2021 (Link).

4. It is reckoned that countries participating in the initiative would experience a bigger debt repayment obligation post-DSSI. It is critical to note that deferred official debt payments under the G20 suspension will need to be repaid in full when low- and middle-income countries already have huge repayment obligations falling due – estimated at US$ 4,482 billion between 2022-2024 - and we can reasonably expect that already very tightened financing conditions will remain. This will significantly increase debt burdens due to economic slowdown induced by the coronavirus and the spendthrift utilisation of meagre resources being earned.

5. Based on the poverty threshold of US$ 1.90 per day.
in middle-income countries

Debt and pandemic