Sovereign Debt and the COVID-19 Pandemic

By:

Tafadzwa H C Kwaramba

May 23, 2020

"We are asked to reimburse our Debt. But if we do not pay, the capital lenders will not die; if we pay, we will die. We cannot pay; and we don't want to pay." – Thomas Sankara

The COVID-19 virus has, once again, uncovered the global economic power distribution that has had the global south exposed to cyclical debt crises over the last 50 years. The economic crises precipitated by the COVID-19 virus creates a high probability of another debt crisis as countries accumulate more debt to manage the effects of the crisis. The virus, which originated in China, is highly contagious and this forced Chinese authorities to enact a lockdown in various parts of China, which suspended all economic activity in many parts of China. As the virus spread throughout the global north, restrictions on movement and economic activity were imposed in some parts of the USA, Singapore, Germany and the UK amongst others. This is important as USA and China, combined, make up more than 34% of global GDP. When combined with Germany and the UK, this figure rises to about 40% of global GDP. These numbers are important as they demonstrate the extent of the global economic slowdown due to the lockdowns.

On the other hand, according to a 2019 UNCTAD report, over 89% of sub-Saharan Africa countries, two-thirds of North-African and Middle-East countries, half of East Asian and Pacific countries, and half of Latin American and Caribbean countries are commodity dependent, where commodity dependent is defined as a scenario where over 60% of a country's merchandise exports consist of commodities. For many of these commodity dependent countries, China is a major destination of exports and the partial lockdown of China, which restricted Chinese citizens to their homes and thus reduced economic activity, and the inevitable low growth figures to be expected of China have started to impact the balance of payments positions of these countries. Global travel restrictions have added another layer of complexity as tourism has been wiped out of the economies of some low-income countries. Tourism, according to the African Travel & Tourism Association, accounts for about 8.5% of the GDP of Africa. The fall in the price of oil to levels less than US$20/barrel, amplified by the global economic slowdown has put more pressure on the fiscal space and balance of payments positions of countries that are oil dependent. These series of crises have come at a time when Africa needs to increase her expenditure on healthcare to fight the COVID-19 virus. Sub-Saharan Africa spends roughly 5%-6% of GDP on healthcare against a global average of over 9% of GDP. All these headwinds have come against a background where close to 40% of low-income countries were in debt distress in 2019, according to the World Bank. With contracting fiscal legroom, deteriorating current account positions, intense debt distress and a strengthening $US due to a global $US shortage, a lot of Sub-Saharan Africa countries need creative and potentially revolutionary solutions if they are to remain technically solvent and not default on their loans.

The IMF recently provided debt service relief to 25 low income countries for 6 months to enable them to channel more of their resources towards healthcare, furthermore, the G-20 offered a debt standstill to 76 low income countries which would had to pay more than, a combined, $US20 billion in debt repayments. In addition, creditors, including the International Monetary Fund and the World Bank, have mobilized up to US$57 billion for Africa in to assist in the fight against COVID-19. While these developments are welcome, the question of what happens after the COVID-19 pandemic is crucial as the debts will need to be repaid albeit in the context of a depressed global economy. With more money being channelled towards healthcare amidst a general slowdown of most low-income economies, the prospects of having countries rebounding without external stimuli and fiscal support would be very slim. If more debt is to be channelled towards low-income countries to provide fiscal support during and after the COVID-19 crisis, repayment of this debt must be partitioned to take into account the different sectoral recoveries that are required to enable low income countries to repay these debts.

A portion of the debt repayments must be linked to economic growth figures of these countries such that debt repayment is sustainable without compromising social expenditure and creating sources of more debt distress for low income countries in the future. Some low-income countries have been forced to enforce lockdowns, however, given the high level of informal and/or precarious employment in these countries, some countries such as South Africa and Zimbabwe, amongst others, have created social safety nets such as increases in the scope of welfare grants to include previously excluded groups and nominal increases in the value of welfare grants in cases where grants already existed. These nets might have to be expanded to more households for a longer period of time given that sectors such as tourism are unlikely to recover even if the global south manages to successfully fight COVID-19 as the recovery of the tourism industry is contingent on how the countries from which tourists originate manage to contain COVID-19.

Another portion of the debt repayments must be linked to recovery of commodity price indices and, more specifically, on the specific commodity each of the exposed countries depends upon. The value of a commodity dependent country's currency and the value of its major export commodity have a direct relationship and tend to move together in the same direction thus low commodity prices lead to a weaker exchange rate. The current oil price crash has exposed the difficulty that oil-dependent, and commodity dependent countries in general, face ahead on the road to recovery as the low commodity prices are leading to weaker currencies for commodity dependent low income countries and this will reduce the ability of these countries to pay off $US denominated debt without creating too much pressure on their fiscus'. The global geo-politics and discohesion influencing oil price dynamics are independent of the COVID-19 crisis, though they exacerbate the economic impact of the crisis and thus it is imperative that this be considered when designing debt repayment matrices.

To ensure prudent fiscal management and prevent slipping into deeper debt positions, the governments of the day must be obliged to have a fiscal deficit of not more than a certain percentage of GDP, where the percentage is different based on the objective financial circumstances each country finds itself. This enables governments not to borrow too much money to manage debt repayment and avoid defaulting. Cash budgeting also helps to keep governments out of local debt markets and thus the private sector is not crowded out of debt markets and this would help facilitate the recovery of small businesses as interest rates would not have been nudged upwards by governments. Furthermore, checks and balances must be put in place to ensure that the portion of expenditure which is over and above revenues is capital expenditure as such expenditure will accelerate growth in the future. Creating legal mechanisms that require governments to have low fiscal deficits protects the local economies as governments will not be able monetise local deficits they accrue and pay them off with the aid of inflation due to an increase in money supply to pay off domestic debt. Zimbabwe is an extreme example of this phenomenon, where the government has inflated away a huge domestic debt over the last three years.

Monetary policy is primarily used to promote economic growth through facilitating macro-economic and price stability. This is done using a combination of three methods, (i) buying and selling government bonds in the open market, (ii) adjusting the rate at which commercial banks can borrow from the Central Bank also known as adjusting the repo rate and (iii) by adjusting the statutory reserve ratio. The low sophistication of financial and securities markets and very low or absent bond ratings in Africa and some developing country economies makes monetary policy a weak instrument to fight COVID-19 as the bond market is illiquid and Central Bank participation in the market does not effectively influence the money supply. Therefore, for a large portion of low-income countries, the only monetary policy instrument that is available is adjusting the repo rate which can influence the inflation rate, growth and, only marginally, the exchange rate to the extent that capital inflow legislation is liberal and the bond ratings and bond markets are vibrant. The effectiveness of this policy position also hinges on the willingness of commercial banks to lend to the private sector.

Over 1/3 of sub-Saharan African countries are in different variants of monetary unions. Eight countries are members of the West Africa Economic and Monetary Union (WAEMU), the Central African Economic and Monetary Community (CEMAC) has seven members and the Common Monetary Area (CMA), which uses the Rand as its de facto currency, has three members. This level of economic integration amongst economically unequal countries makes the use of monetary policy instruments quite sensitive. A consensus, between members of each monetary union, should be reached that interest rates must be lowered to make borrowing for investment and consumption cheaper and thus boost growth. However, in the presence of monetary unions, the extent of lowering the interest rates is a question that should be robustly and expeditiously debated and anchored on the objective circumstances of each monetary union.

In conclusion, the COVID-19 crisis is likely to make countries in the global south accumulate more debt in a global economic environment where repayment of current debt will be difficult. The speech by Thomas Sankara on the morality of debt repayment asks us very difficult questions which humanity must collectively confront if debt crises are to become relics of past economics. The collective inability by the global south to assert itself on negotiating tables and to recreate itself in the aftermath of various global crises has been a sad misuse of crises. Famous leftist economist and mathematics professor, former Greece finance minister, Yanis Varoufakis stated “Regular crises perpetuate the past by reinvigorating cycles which started long ago. In contrast, (capital-C) Crises are the past's death knell. They function like laboratories in which the future is incubated. They have given us agriculture and the industrial revolution, technology and the labour contract, killer germs and antibiotics. Once they strike, the past ceases to be a reliable predictor of the future and a brave new world is born.”. The COVID-19 crisis may be the capital-C crisis that creates a platform for us to rethink the repayment structures of debt in the global south. The methods of debt repayment outlined in this essay such as commodity index related debt repayment terms and economic growth related repayment terms would help to avoid a potential debt crisis due to COVID-19 induced borrowing and if the methods are utilised beyond the loans accumulated due to the crisis to include already existing loans, these methods may help create a sustainable debt trajectory for the global south in the long term.