Deutsches Institut für Entwicklungspolitik
German Development Institute

COVID-19: How can the EU support its partner countries to avoid and resolve debt crises?

DG INTPA InfoPoint, March 19th, 2021

Dr. Kathrin Berensmann, German Development Institute (DIE),
kathrin.berensmann@die-gdi.de

Overview

1. **Current debt situation in low-income countries**
2. **Short-term measures: Provision of liquidity**
3. **Conclusion**

1. Current debt situation in low-income countries

Before the COVID-19 crisis

=> About half of LICs were already highly indebted (IMF/ WB)

Main reason:

- Change in the composition of debt from concessional to market-based loans from private and public creditors
- Increased government debt

1. Current debt situation in low-income countries

COVID-19 pandemic further deteriorates the debt situation in LICs

- ***Public debt** increased in LICs*

  public debt in % of a country's GDP rose:
  2011: 29.6 % => 2019: 43.3% => 2021: 49.7%(IMF)

- ***Government revenues** declined*

  Government revenues in % of a country's GDP declined:
  2011: 17.8 % => 2019: 14.7% => 2020: 13.0 %(IMF)

  Reasons: decreases of growth and export earnings

- ***External official debt** in % of a country's GDP increased*:

  Example SSA: 2011: 14.0 % => 2019: 23.4% => 2020: 28.1%(IMF)

⇒ Heavily indebted countries are obliged to use scarce financial resources to service their debts

but: resources needed for sustainable development

2. Short-term measures: Provision of liquidity

LICs will not be able to cope with the COVID-19 crisis alone.

=> International community = key role in providing financial assistance:

⇒ Foremost economically stronger countries such as those of the EU and international financial institutions (e.g. World Bank and IMF)

Immediate support by IFIs

- WB: US$ 160 billion to developing countries
- IMF: US$ 50 billion to developing countries

But:

- ➢ Countries still lack liquidity
- ➢ Loans provided further increase debt

World Bank President: Without immediate financial support the progress that these countries have made in their development over the past decade will be lost.

2. Short-term measures: Provision of liquidity

Debt Moratorium:
Participation in Debt
Services Suspension Initiative

Contribution to IMF's
Debt service relief trust

EU Countries:
Short-/medium term
liquidity support

Debt restructuring / debt relief:
Participation in Common Framework

2. Short-term measures: Provision of liquidity

a) Debt moratorium: “Debt Service Suspension Initiative (DSSI)”

Paris Club / G20
= suspension of debt service payments for LICs from May 2020 to June 2021

main aim: improve the debtor’s liquidity position
<u>=> EU has also committed to participate in the DSSI</u>

Problems:

- DSSI too short
- DSSI only suspension, often debt service relief is needed in the course of COVID-19 crisis

Policy recommendation: EU should

- promote further extension of debt moratorium by at least one year
- discuss debt relief on debt service

2. Short-term measures: Provision of liquidity

b) Debt relief on debt service

Catastrophe Containment and Relief Trust (CCRT) IMF

IMF’s debt service waiver

EU contribution to the IMF’s CCRT: €183 million

But: CCRT is not enough for highly indebted LICs

=> Grants for debt service under the DSSI

2. Short-term measures: Provision of liquidity

c) **Debt restructuring including debt relief**

Paris Club / G20 established in November 2020

“Common Framework for Debt Treatments beyond the DSSI”

- Debt restructuring for LICs with unsustainable debt + could in some cases include debt relief
- Case-by-case approach
- Based on IMF/WB Debt Sustainability Analysis
- Broad participation of bilateral official creditors including the call for private creditors participation

<u>=> EU has recognised that LICs with unsustainable debt levels need debt treatments beyond the DSSI and has welcomed the G20 and Paris Club agreement on the “Common Framework”</u>

2. Short-term measures: Provision of liquidity

Challenges of the Common Framework

- ➢ Equal treatment of all creditors: all public and private creditors should participate equally in debt restructuring / debt relief
- ➢ Transparency on debt contracts: Ensure that all public creditors and public debtors should disclose their loan agreements as well as private creditors
- ➢ Debt restructuring and relief should be tied to economic reforms and earmarking

⇒ Use financial resources for sustainable development including social and health sectors and sustainable infrastructure

3. Conclusion

The international community and in particular those countries with strong economies, such as the EU member states, have a shared responsibility for attaining debt sustainability in the poorest countries of the world.

Thank you!

Dr. Kathrin Berensmann
kathrin.berensmann@die-gdi.de

German Development Institute
Tulpenfeld 6
D-53113 Bonn
Tel.: +49 (0)228-949 27-0
DIE@die-gdi.de
www.die-gdi.de
twitter.com/DIE_GDI
www.facebook.com/DIE.Bonn
www.youtube.com/DIEnewsflash

