

# ECA Research Notes

OFFICE OF THE CHIEF ECONOMIST

EUROPE AND CENTRAL ASIA

Debt Sustainability

June 2020



Hi Everyone,

This month we are taking a look at the implications of the COVID-19 crisis and debt sustainability. The emergence of COVID-19 and the near-global lockdowns that came with it have created the most precarious environment for emerging economies since the great depression.

Just like advanced economies that have put in place unprecedented fiscal and monetary stimulus programs, developing countries need to support their health care systems, their vulnerable citizens and firms as they fight the pandemic. But given the huge global contraction, reduced demand for their exports, lower tax revenues, commodity prices, and plunging portfolio and other flows, they are also under much greater fiscal pressures, renewing debt sustainability concerns. We had a discussion on some of these issues on June 1. You can find a link to the video and also selected research and reading on debt issues below.

We have also just launched the **2020 ECA Academy** and we are seeking the best new research for the region. The deadline for submissions is August 31, and there is more information in the link below.

Happy reading!

Asli

## FEATURE STORY



Clockwise from upper left corner: Asli Demirgüç-Kunt, Charles Calomiris, Doerte Doemeland, and Carmen Reinhart.

### Debt and COVID-19

Vulnerability to debt problems had been building in many emerging and developing countries prior to the COVID-19 (coronavirus) pandemic. The issues with debt varied significantly across countries but spanned the “classic” cases of deteriorating fiscal finances, growth in private debt, and “hidden debts” to China. In the recent ECA Talks, new World Bank Group Chief Economist Carmen Reinhart presents an assessment of some of the current and future risks, and discusses some policies that could tackle pre-existing or new debt problems.

[Video and Event information](#)

[Presentation by Carmen Reinhart](#)

[Presentation by Charles Calomiris](#)

## RELATED RESEARCH

### [China's Overseas Lending](#)

*Sebastian Horn, Carmen M. Reinhart, Christoph Trebesch, NBER Working Paper 26050 - July 2019 (revised in May 2020)*

Building a new database of 5000 loans and grants to 152 countries, 1949-2017, the authors study the size, characteristics, and determinants of China's capital exports. The analysis shows that 50 percent of China's lending to developing countries is not reported to the IMF or World Bank, and these "hidden debts" distort policy surveillance, risk pricing, and debt sustainability analyses.

### [Can This Time Be Different? Policy Options in Times of Rising Debt](#)

*M. Ayhan Kose, Peter S. O. Nagle, Franziska L. Ohnsorge, Naotaka Sugawara, Policy Research Working Paper 9178 - March 2020*

What are the factors that are likely to determine the outcome of the most recent debt wave? This study reports that the rapid increase in debt has made emerging and developing economies more vulnerable to shifts in market sentiment. But there are policy options available to lower the likelihood of financial crises and to help manage the adverse impacts.

### [Global Corporate Debt during Crises: Implications of Switching Borrowing across Markets](#)

*Juan J. Cortina, Tatiana Didier, Sergio L. Schmukler, Policy Research Working Paper 9142 – February 2020*

Using data on worldwide debt issuance from advanced and emerging economies, the authors look at how crises prompted firms to shift their issuances between domestic and international syndicated loans and corporate bonds. The analysis generates patterns consistent with credit supply shocks that are different from those obtained when studying the dynamics of individual markets.

### [Debt and Financial Crises](#)

*Wee Chian Koh, M. Ayhan Kose, Peter S. Nagle, Franziska L. Ohnsorge, Naotaka Sugawara, Policy Research Working Paper 9116 – January 2020*

This paper examines the consequences of debt accumulation using a combination of an event study, a set of case studies, and a series of econometric models. The analysis shows that a rapid buildup of debt increased the likelihood of a financial crisis, and countries that experienced financial crises frequently employed combinations of unsustainable fiscal, monetary and financial sector policies, and often suffered from structural and institutional weaknesses.

### [Inflation and Public Debt Reversals in Advanced Economies](#)

*Ichiro Fukunaga, Takuji Komatsuzaki, Hideaki Matsuoka, Policy Research Working Paper 9129 – January 2020*

This study quantitatively assesses the effects of inflation shocks on the public debt-to-GDP ratio in 19 advanced economies using simulation and estimation approaches. The results suggest that modestly higher inflation, even if accompanied by some financial repression, could reduce the public debt burden only marginally in many advanced economies.

### [Is Short-Term Debt a Substitute or a Complement to Good Governance?](#)

*Deniz Anginer, Asli Demirguc-Kunt, Mete Tepe, Serif Aziz Simsir, Policy Research Working Paper 9022 – September 2019*

Can internal monitoring through independent boards and stronger shareholder protections substitute for external monitoring through the use of short-term debt? The analysis suggests that the relationship between debt maturity and governance depends on shareholder rights in a given country.

### [Eurobonds: A Quantitative Analysis of Joint-Liability Debt](#)

*Vasileios Tsiropoulos, Policy Research Working Paper 9017 – September 2019*

This paper assesses the consequences of implementing a joint liability debt system in a two-country small open economy model. The results show that the welfare consequences of this policy proposal hinge critically on the timing of its introduction.

### [A Framework to Assess Debt Sustainability and Fiscal Risks under the Belt and Road Initiative](#)

*Luca Bandiera, Vasileios Tsiropoulos, Policy Research Working Paper 8891 – June 2019*

The authors present a framework to assess the impact of infrastructure investment expected under the Belt and Road Initiative (BRI) on the debt vulnerabilities of countries that are located on BRI transport and connectivity corridors. In the medium term, around one-third of assessed BRI-recipient countries are estimated to face elevated debt vulnerabilities.

## BLOGS

### **E** Why the recent debt buildup is a concern, in four key charts

Peter Nagle, January 28, 2020

Emerging market and developing economies (EMDEs) face weak growth prospects, mounting vulnerabilities, elevated global risks, and record highs debt growth since 2010. A menu of policy options is available to reduce the likelihood of the current debt wave ending in crises and, if crises were to take place, to alleviate their impact.

[Read the blog »](#)

### **E** A recipe for sound debt management

Diego Rivetti, December 16, 2019

Should debt be in local or foreign currency? Short-term or long-term? Fixed or variable interest rate? These choices have a critical impact on both the cost/risk profile of the debt portfolio and the country's future budget balances. Both game theory and country experience show that a strategic approach delivers better outcomes in the long run.

[Read the blog »](#)

### **E** Sovereign debt standstills: and update

Patrick Bolton, Lee Buchheit, Pierre-Olivier Gourinchas, Mitu Gulati, Chang-Tai Hsieh, Ugo Panizza, & Beatrice Weder di Mauro, May 28, 2020

The official sector has moved swiftly to assist the poorer countries most affected by the Covid-19 pandemic, under the banner of the Debt Service Suspension Initiative. Will private sector creditors follow suit? This column discusses the challenges in attempting to coordinate wholly voluntary private sector debt relief for sovereigns afflicted by the pandemic.

[Read the blog »](#)

### **E** Necessity is the mother of invention: How to implement a comprehensive debt standstill for COVID-19 in low- and middle-income countries

Patrick Bolton, Lee Buchheit, Pierre-Olivier Gourinchas, Mitu Gulati, Chang-Tai Hsieh, Ugo Panizza, & Beatrice Weder di Mauro, April 21, 2020

Many low- and middle-income countries may face problems servicing their external debts while addressing the COVID-19 emergency. Urgent action is needed to prevent disorderly defaults and litigations. This column presents a mechanism to implement a debt standstill which would free significant resources to cover some of the most immediate costs of the COVID-19 crisis.

[Read the blog »](#)

## CALENDAR OF EVENTS

- **2020 ECA Academy - Submit your paper by August 31, 2020:**

The Office of the ECA Chief Economist invites you to submit papers to the 2020 ECA Academy on any topic of policy relevance for the region. The feature topics for the upcoming ECA Economic Updates are Human Capital (Fall 2020), Governance (Spring 2021) and Competition (Fall 2021). Analytical work on these topics, including the impact and implications of COVID-19, are of particular interest. **Find more details about 2019 ECA Academy and winning research [here](#).**

Check [ECA Lectures](#) and [ECA Talks](#) to learn more about our events.

The ECA Research Notes newsletter is produced by the Europe and Central Asia (ECA) Chief Economist's Office. Please send comments, suggestions, and feedback to [ECACEoffice@worldbank.org](mailto:ECACEoffice@worldbank.org).

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