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Press Release

Developing countries are benefiting from debt suspension

A new study by Valentin Lang (University of Mannheim), David Mihalyi (Kiel University) and Andrea Presbitero (International Monetary Fund) shows that creditors can help heavily indebted countries manage crises by allowing them to defer debt repayments. The findings are also relevant for political decision-making.

A new debt crisis is about to hit the Global South. The pandemic and rising prices for raw materials and food are a heavy burden for many developing countries. Can creditors help these countries by providing debt relief? A new study shows that the debt suspension, granted to many developing countries at the beginning of the pandemic, have, in fact, helped them. Countries that were allowed to repay their debt at a later point in time benefited from a higher credit rating and thus from lower interest rates at the international capital market.

In their study, Professor Dr. Lang and his colleagues analyze the effects of the Debt Service Suspension Initiative (DSSI), a debt moratorium for developing countries, set up by the G20 at the beginning of the pandemic. Due to the initiative, the 77 poorest countries in the world were allowed to defer the repayment of their debts from mid-2020 until the end of 2021. They were then able to use the freed-up funds to support their health system and economy during the pandemic.

As it was the case with debt suspension in the past, there were great concerns that the initiative would be more damaging than helping these countries. Critics feared that, by participating in the initiative, the countries would signal that they were having financial difficulties. This would put off investors and increase the borrowing costs. In fact, many of the countries refused to apply for debt suspension at first.

An analysis of the data, however, shows that the opposite is true: A few weeks after the initiative has started, the situation in the countries eligible for participation improved. Instead of an increase in borrowing costs, the borrowing costs for these countries declined. For their analysis, the researchers used daily bond market data. They created a statistical doppelgänger for each country eligible for participation to analyze the development of the interest rates for government bonds without debt suspension. In all cases, debt suspension improved the situation and improved even more in countries which received a larger relief.

In light of the critical debt burden of many poor countries, these results are also relevant for political decision-making. According to the International Monetary Fund, more than half of all low-income countries are in a debt crisis or are about to hit a debt crisis. More and more voices are demanding debt relief for these countries. Since creditors are often unwilling to waive the repayment of debt in full or in part, debt relief is difficult to implement on the political level. If repayment is simply suspended, however, the amount of debt owed is not reduced. If creditors are not willing to waive the repayment of debt, suspending repayment can be an effective first step that may also help in the debt crises these countries are about to experience.

Original publication:
The study has recently been published in the *American Economic Journal: Economic Policy* and is available here.
On the *Vox EU* platform, you can find a summary of the study.

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