DEBT
FROM THE PANDEMIC

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As the novel coronavirus swiftly spreads, governments started to initiate policies to combat it. One way of doing it was to impose strict lockdowns. One by one, countries closed their economies, shuttering activity, and in many ways halting projects and progress. Governments and companies alike were forced to look for credit facilities to stay afloat; debts upon debts were acquired, so much so that lending and credit dispensation levels are unprecedented. Before the vaccine is rolled out widely, it is expected that the economic situation may only get worse before it can start stabilizing. The question with this dire situation is what will be the cost of these unprecedented borrowing levels in the near, mid, and long term?

For developing countries especially those in Africa, the pandemic and the resultant loans could not have come at a worse time. Debt levels relative to the GDP have been increasing at a worrying speed, threatening a return to that in the 1980s when debt reached over 270 billion dollars, about 107 percent of the GNP. By 2018, 40 percent of African countries were already at high risk of debt distress. Yet as the pandemic struck, many of these countries rushed to rack up even more debt. Uganda for example secured loans totaling 888 million US dollars to fight the coronavirus as well as to fill spending gaps. This included among others 300 million from the World Bank and 491.5 million from the IMF. Kenya, Uganda's neighbor to the East received over 788 million dollars in loans from the IMF and World Bank. It is now projected that Kenya's public debt will reach 69.8 percent of GDP by 2023[1]. For such countries, high levels of debt mean that a significant portion of national revenues goes towards debt servicing, curtailing human and economic development as key sectors become underfunded. This in turn will halt progress at sustainable development and poverty eradication. Failure to pay sufficient attention to sectors such as education, health, and infrastructures could eventually have long-term consequences.

The rich countries may not be spared too. The pandemic has already forced wealthy countries to rack up so much debt that paying it back could have significant long-lasting effects on the global economy. For instance, the United States' public debt was estimated at 23.08 trillion dollars in November last year. This year alone it has grown by over 4.4 trillion dollars to about 27.45 trillion U.S dollars.[2] According to the IMF estimates, advanced economies alone will run an average deficit of 11 percent of GDP this year and their public debt could run to 66 trillion US dollars which might be 122 percent of GDP by year's end even if there were no more lockdowns imposed.[3] The IMF is currently availing a quarter of its lending capacity of 1 trillion dollars to member countries. So far 63.809.66 million dollars have been approved during the pandemic, although the largest portion of which is expected to go to developing countries.

There are about three defined paths from which governments may choose to ameliorate the debt burden. They can pay the debt using taxation. But this could face considerable political repercussions. It would for instance involve raising taxes and cutting spending, both of which could upset at least some people. Austerity measures such as those enacted after the financial crisis of 2007-2009 and those in countries like Italy and Greece faced a lot of resistance from the public and resulting in political instabilities as evidenced by numerous short-term government changes. When the post-pandemic time comes, the public may favor increased rather than reduced expenditures on sectors such as health.

The second way governments may ameliorate the burden would be to opt not to pay back the debts, by seeking cancellation or restructuring. However this path may limit the countries' access to future financing facilities in the global financial markets, a cost so high that even countries such as Kenya have opted not to participate in initiatives such as the G20 Debt Service Suspension Initiative (DSSI) over concerns that it would impact its access to international financial markets.

But the alternative is to pay the sometimes-high interest rates, further limiting the country's resource envelope. Countries could also opt to wait, or roll over the debts in the hope that they will shrink as the economy grows over time. This may be done in the hope that the real economy and inflation will be able to grow above the interest rates. Inflation in this sense helps to wash away some debt. But inflation would lead to disruptions in the economy to the disadvantage of the poor. Instead of the required inflation, deflation may be experienced due to debt overhang- as the debts sap the economy out of demand.[4]

Corporate companies too are racking up credit as cheap loans are extended to help them keep afloat. Government stimulus packages and financial institutions have extended trillions in credit to corporations and SME's. For now, it seems the largest corporations are swimming in liquidity. According to the Economist, cash held by the world's 3000 most valuable companies has exploded to 7.6 trillion dollars from 5.7 trillion dollars last year.[5] The debt level of the non-financial business sector in the U.S alone increased by about 20 percent relative to GDP and it now stands at a record high of 130 percent of the GDP (Board of Governors of the Federal Reserve System 2020). The pandemic has pushed business debt ratios higher yet earnings are falling thus risks debt overhang. According to the recently published paper by the federal reserve bank of San Francisco, the economic costs of corporate debt booms rise with inefficient debt restructuring and liquidation, likely resulting in corporate zombies.[6]

In a nutshell, the impacts of the pandemic may linger even after it ends. But that too now looks like a distant dream. Despite several vaccines being authorized in the developed world, there are fears that it could take up to 2024 to have inoculations wide enough to cover significant portions of the world's population. Already, rich countries have hoarded more than half of possible vaccines, leaving the developing world with limited hopes of ending the pandemic in their own countries. The only alternative may be to keep strict lockdown measures for considerable periods of time to curtail the spread of the virus, a decision which would require even more debt to sustain livelihoods and finance budgetary shortfalls; otherwise not doing so may result in further loss of lives, and a future irredeemably bleak at least in the short to medium term.

Endnotes

1 Ssuuna Robert, Kenya, Covid-19 and Debt, European Network on Debt and Development, published 05 November 2020. Eurodad.org

2 Statista, Public debt of the United States of America from November 2019 to November 2020, by month(in billion U.S. dollars) https://www.statista.com/statistics/273294/public-debt-of-the-united-states-by-month/#:~:text=In%20November%202020%2C%20the%20public,around%2023.08%20trillion%20U.S.%20dollars

3 The Economist, What would Keynes do? The pandemic will leave the rich world deep in debt, and force some hard choices Who takes the pain, and can there be gain Briefing Apr 23rd 2020 edition https://www.economist.com/briefing/2020/04/23/the-pandemic-will-leave-the-rich-world-deep-in-debt-and-force-some-hard-choices

4 ibid

5 The Economist, A year of raising furiously: Companies have raised more capital in 2020 than ever before What now? Dec 9th 2020 edition https://www.economist.com/business/2020/12/09/companies-have-raised-more-capital-in-2020-than-ever-before?utm_campaign=the-economist-this-week&utm_medium=newsletter&utm_source=salesforce-marketing-cloud&utm_term=2020-12-10&utm_content=ed-picks-article-link-2&etear=nl_weekly_2

6 Federal Reserve Bank of San Francisco Working Paper Series, Zombies at large? Corporate debt overhang and the macroeconomy, 2020