

Protecting and Transforming Social Spending for Inclusive Recoveries

# COVID-19 and the Looming Debt Crisis

April 2021



## UNICEF OFFICE OF RESEARCH – INNOCENTI

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# **COVID-19 and the Looming Debt Crisis**

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## Key messages

- The COVID-19 pandemic has exacerbated the risk of a debt crisis for low- and middle-income countries (LMICs) that has been rising since the 2008 global financial crash. According to the IMF, a quarter of LMICs, home to 200 million children, are currently already in, or at high risk of, debt distress.
- In many countries, debt payments outweigh government budgets for social expenditure. Even before the current crisis, one fifth of LMICs spent more on debt service than on education, health and social protection combined. As the global economy contracts and revenues fall, the growing burden of debt interest threatens to crowd out social spending still further.
- In response to the COVID-19 pandemic, the G20 nations have agreed on a Debt Service Suspension Initiative (DSSI) covering the period April 2020– June 2021. This appears to have had some effect in maintaining social spending on health and social protection in the 46 countries participating, although spending on education has contracted. Despite this, only one third of eligible countries have signed up to the DSSI and further investigation into obstacles to participation is required.
- Overall, the current international response to the debt crisis is insignificant in comparison to the overall fiscal response to COVID-19, as well as previous debt relief packages such as the Heavily Indebted Poor Countries Initiative (HIPC). The majority of LMICs are not included under DSSI. In addition, the debt standstill does not currently cover debt to commercial creditors, leaving middle-income countries increasingly exposed.
- Initial reports from UNICEF country offices suggest that COVID-19 has negatively affected social spending in indebted countries, in sectors including education, child protection, nutrition, and water, sanitation and hygiene (WASH). This brief identifies priority countries with high levels of child poverty, where budget expenditure on key social sectors may be threatened if debt levels continue to rise.
- It concludes that designing a new international debt restructuring architecture, which encompasses the heterogenous needs of LMICs, will be crucial to protecting children's rights in the wake of COVID-19. This should include greater concessional support for heavily indebted poor countries. Greater transparency on debt as part of national budget processes, as well as coordinated action on the part of creditors is needed to convert debt into investments for children.

## Overview

The COVID-19 pandemic has triggered an emerging global economic crisis with severe, long lasting impacts. The IMF predicts a -4.4 per cent global contraction for 2020. Global GDP in 2021 is expected to be only 0.6 per cent above 2019 levels, reflecting the extent to which economies will have been scarred by the recession. A reversal of the progress that has been made since the 1990s in poverty reduction and global inequalities is also predicted (IMF 2020).<sup>1</sup> According to the OECD's Global Outlook on Financing for Sustainable Development 2021, the estimated annual Sustainable Development Goal (SDG) financing gap of US\$2.5 trillion is expected to increase in 2020 by about US\$1.7 trillion or +70 per cent under the dual pressure of increasing need and declining resources (OECD 2020).<sup>2</sup> A UNICEF review of the evidence suggests that these crises are often followed by budget cuts, with negative effects on services for children (UNICEF – Innocenti 2020).

Governments' capacity to respond has also been affected by their ability to access finance to meet the additional cost of COVID-19 and to finance future fiscal stimulus. While overall, economic stimulus packages – amounting to an estimated \$11 trillion by May 2020 (IMF 2020b) – could be more than twice as large as those of the Great Recession of 2008–2009 (Almenifi, M. et al. 2020), the disparities between low- and high-income countries are likely to be higher. A recent study of 41 countries found that fiscal spending in response to COVID-19 ranged from 0.35 to 42.3 per cent of GDP (Almenifi, M. et al. 2020). Many governments have limited options from their own resources and so will have to turn to increased domestic borrowing or to the international community for concessional finance or debt relief. Again, there is wide disparity between income groups in this regard, with the level of domestic finance ranging from almost zero in low-income countries to 37 per cent in lower middle-income countries, and to 47 per cent in upper middle-income countries (ibid). Already, more than 100 countries have approached the IMF for emergency funding from its Rapid Financing Instrument (Spiegel, S. et al. 2020). In addition, many developing countries have recently taken on increasing levels of debt from private lenders and non-Paris Club members (World Bank 2020). Despite historically low global interest rates, these loans have come with high borrowing costs for developing countries (ibid). A significant projected increase in public debt service will need to come from a smaller tax base than previously envisaged, compounding difficulties for many developing nations (IMF 2020).

1 This has since been updated to -3.5% for 2021. International Monetary Fund (2021). *World Economic Outlook Update, January 2021*, IMF, Washington DC.

2 Unless otherwise stated, all amounts shown are in US dollars.



Consequently, the UN is amongst others raising the alarm about the COVID-19 pandemic turning into a protracted debt crisis for developing countries (Spiegel, S. et al. 2020). Debt risk has been rising for a decade, and public debt in emerging markets has surged to levels not seen in 50 years (World Bank 2020). With the onset of COVID-19, UNCTAD estimates that in 2020 and 2021, developing countries' repayments on their public external debt alone will rise to between \$2.6 trillion and \$3.4 trillion (UNCTAD 2020). In GDP terms, average debt ratios for 2021 are projected to rise by 10 per cent of GDP in emerging market economies, and about 7 per cent of GDP in low-income countries (Craviotto, N. 2020).

The international community has acted to alleviate some of the effects of the debt crisis in the short term. The IMF has announced \$100 billion in lending through the Rapid Financing Instrument and the Rapid Credit Facility and pledged to increase the capacity of the Poverty Reduction and Growth Trust (OECD 2020b). The IMF has also allocated almost \$500m in debt service relief grants to eligible countries through the Catastrophe Containment and Relief Trust (CCRT) covering the period April 2020–April 2022. In reaction to COVID-19, the World Bank aims to increase its operations to \$160 billion, and has committed \$14.8 billion in financing for countries participating in DSSI, of which \$5.4 billion was in the form of grants, between April and September 2020 (World Bank 2021). However, the scale of the response remains small in comparison to the overall contribution of creditors to the HIPC and the Multilateral Debt Relief Initiative. By 2019, creditors had cancelled more than US100 billion in debt under the two initiatives (IMF 2019).

In response to a joint call from IMF and the World Bank, the G20 nations established the DSSI, with the aim of allowing the poorest countries to free up resources for social or economic spending in response to the crisis. The DSSI allows qualifying countries to suspend repayment of official bilateral credit between April 2020 and June 2021. As of January 2021, 46 countries have requested to benefit from the DSSI, amounting to an estimated \$5.7 billion of 2020 debt service deferral (World Bank 2021). China is estimated to be the single biggest lender affected by the debt standstill, with official bilateral lenders from non-Paris Club nations also bearing a significant proportion of the cost (OECD 2021). Although the Institute of International Finance is encouraging private lenders to join the DSSI, to date there has been no agreement on this.

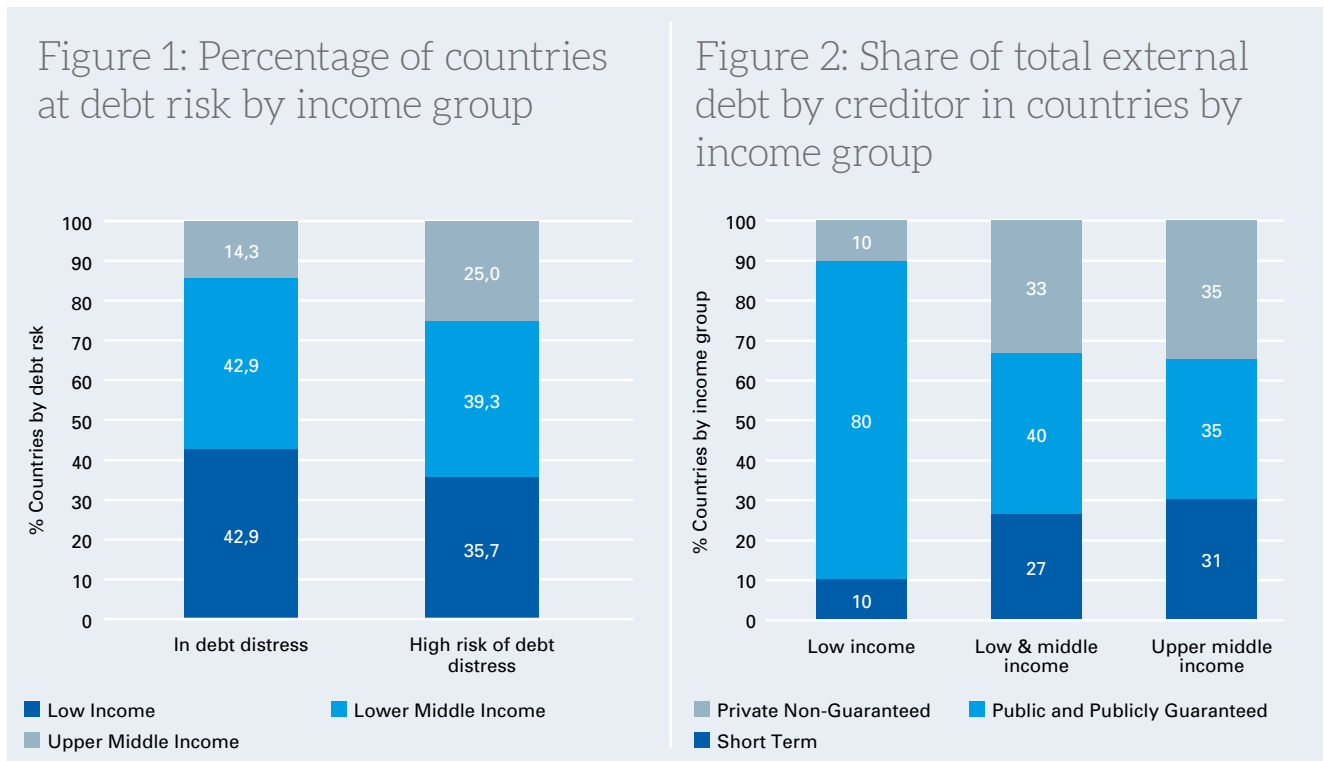
These policies are in part an acknowledgement of concerns amongst the international community about the potential for a debt crisis to impact negatively on public spending during COVID-19. Historically, the impact of rising debt on social spending has not been well defined, although high levels of external debt have been linked to significant cuts in public spending in many low- and lower middle-income countries over the past 20 years (Jubilee Debt Campaign 2020; Watkins, K. 2020).

This policy brief looks at the extent to which these initiatives are helping to maintain social spending during COVID-19 in countries with historically high levels of multidimensional poverty (countries in which a high proportion of children live in households without sufficient material resources to realize rights like health, education or nutrition), and in the face of the disruption the pandemic has already caused to the delivery of basic social services.

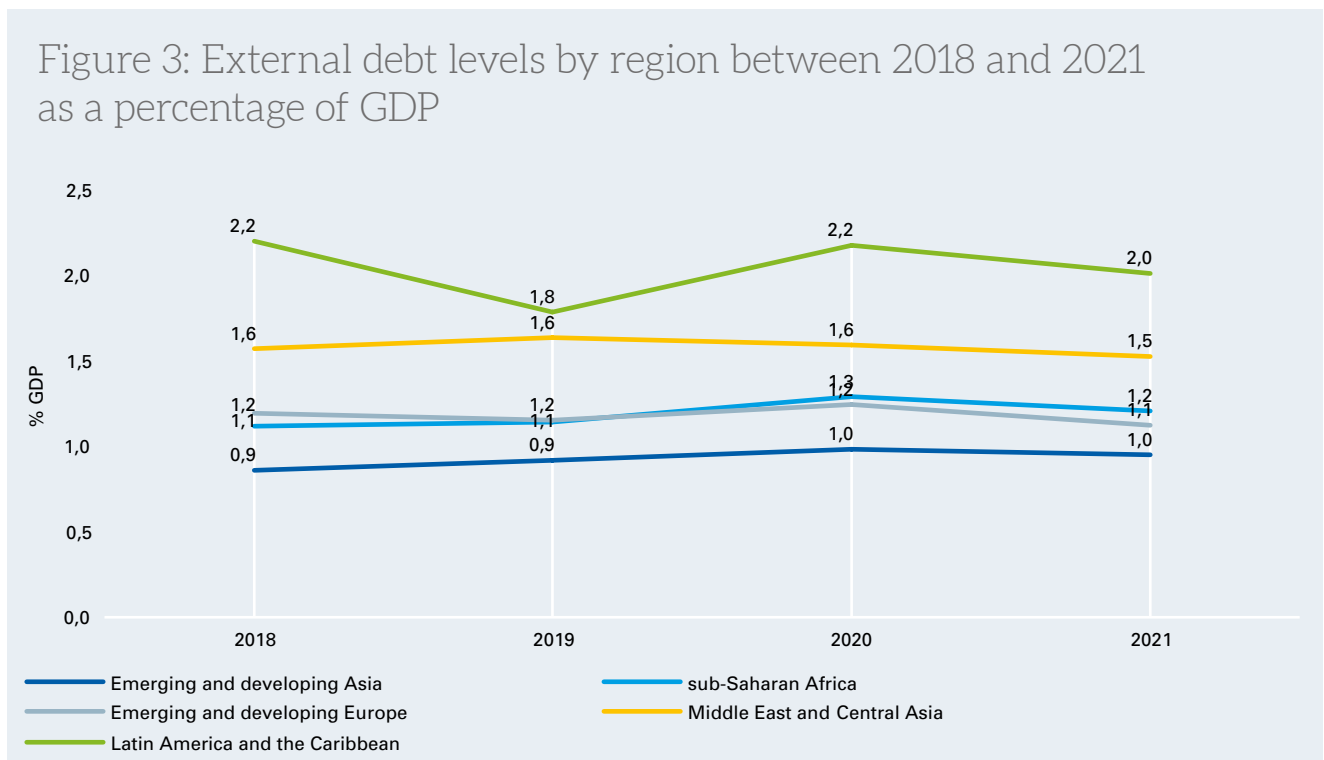
## Countries facing debt distress during COVID-19

The IMF categorizes a country as being in debt distress if it is experiencing difficulties servicing its debts or is already in arrears, or where there are indications that these conditions will occur in the near future. As of 31 December 2020, the IMF identifies seven countries as being in debt distress: Grenada, Mozambique, Republic of Congo, São Tomé and Príncipe, Somalia, Sudan and Zimbabwe. All these countries were assessed as being at the same level of risk pre-COVID-19. According to the IMF, a further 28 countries are at high risk and 23 countries are at moderate risk of debt distress (IMF 2020). These countries are spread across income groups (*see Figure 1*). Altogether, there are 13 low-income countries, 13 lower-middle income countries and 8 upper-middle income countries in or at high risk of debt distress, making up a quarter of all LMICs. Not all of these countries are eligible for, or have chosen to apply for, the debt standstill. As Figures 4 and 5 indicate, this means there are wide disparities in the financial assistance countries at risk are currently receiving from the international community.

While official debt owed to bilateral and multilateral creditors comprises the most significant portion of external debt for most LMICs, an increasingly significant component comes in the form of private credit from non-traditional sources, such as commercial banks and international bond markets. In 2019, debt to private creditors in low-income countries made up 10 per cent of overall debt. This proportion was three times higher in lower middle-income and upper middle-income countries at 30 per cent and 35 per cent of total debt respectively (*see Figure 2*) (World Bank Debt Data). The largest proportion of this is in bonds (Spiegel, S. et al. 2020). This is significant as government debt to private creditors is not covered under the G20 debt standstill. While debt of low-income countries will be largely covered by the debt standstill, middle-income countries will be continuing to service at least a third of their total external debt over the course of the pandemic. This type of borrowing often comes at high cost. Reflecting this trend, debt service as a proportion of GDP is highest amongst countries in Latin America and the Caribbean, followed by countries in the Middle East and Central Asia. On average, countries in Latin America and the Caribbean pay over 1.5 times as much debt service as a proportion of GDP than those in sub-Saharan Africa (*see Figure 3*).



Source Figures 1 and 2: <https://datatopics.worldbank.org/debt/>



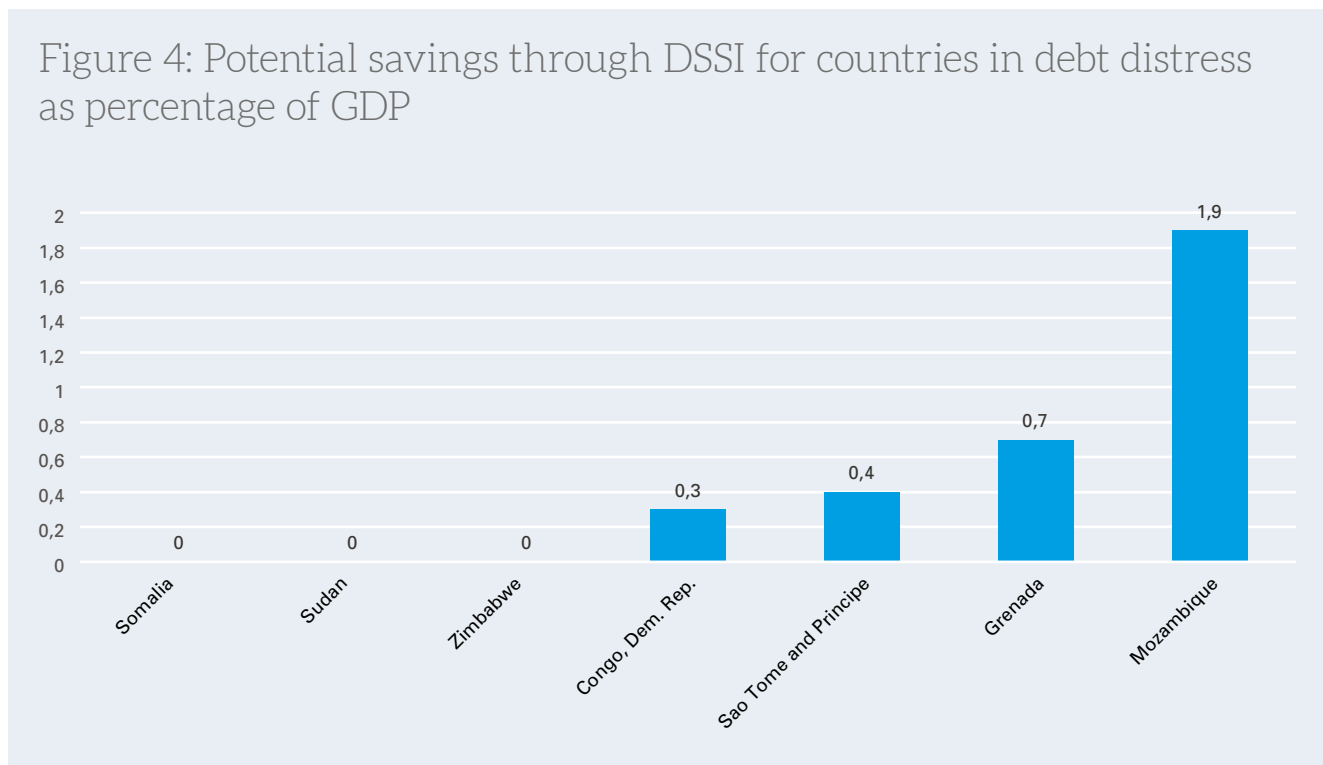
Source: IMF World Economic Outlook database October 2020

## In the wake of the COVID-19 pandemic, the international community has moved to provide debt relief to the poorest countries

With the onset of COVID-19, the G20 nations agreed on the DSSI covering the period April 2020–June 2021. In all, 73 countries are eligible for a temporary suspension of debt-service payments owed to their official bilateral creditors. These include all International Development Association (IDA) countries and all least-developed countries (as defined by the United Nations) that are up to date with debt service payments (IMF 2020c). As of 12 January 2021, 46 countries have requested to participate and an estimated \$5.7 billion of debt service deferral has been approved (*see Table 3*). Eight countries at high risk of or already in debt distress are currently retaining over 1 per cent of their GDP through the debt standstill. However, not all countries in debt distress or at high risk of debt distress are either eligible, or have chosen, to participate. Three of the seven countries in debt distress are in Africa: Somalia, Sudan and Zimbabwe. They are receiving no assistance through the scheme (*see Figure 4*). Sudan and Zimbabwe are ineligible for the DSSI due to their arrears status. Somalia was cleared for debt relief by the IMF and the World Bank in March 2020 and has still to apply. An additional four countries at high risk of debt distress – Kiribati, Marshall Islands, Micronesia and Tuvalu – are also receiving no debt relief through the scheme (*see Figure 5*). It is notable that the latter four are all Small Island Developing States (SIDS). These countries are IDA-eligible for DSSI due to their SIDS status; however, to date they have chosen not to participate in the debt standstill.

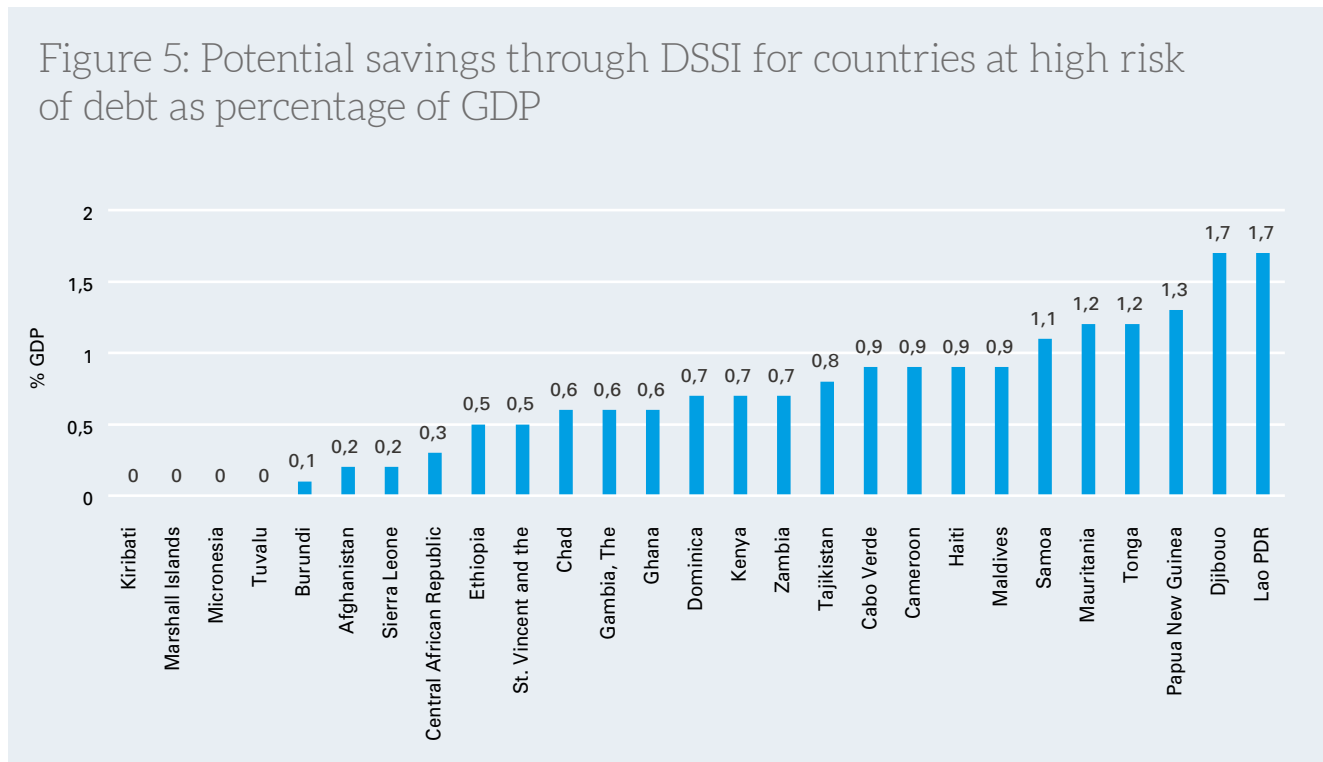
The IMF has also disbursed funds through the CCRT, which provides grants for debt service relief to low-income countries during times of natural disasters or public health crises. Although on a much smaller scale than DSSI, as of November 2020, the CCRT has allocated grants worth \$488.7 million, with Guinea, Yemen and Sierra Leone amongst the top recipients (IMF 2020d). In addition, the World Bank has also increased financial flows and technical support to low and lower-middle income countries as part of its COVID-19 response. Between April and September 2020, the World Bank committed \$43 billion, or 41 per cent of the \$104 billion of its lending capacity indicated for the 15 months from April 2020 to June 2021 (World Bank 2020b). During the same period, the IMF has also committed \$81 billion in other lending, of which \$46 billion are credit lines to middle- and upper middle-income countries (*ibid*). Despite the above measures, the World Bank estimates that increased grants have only partly offset the decline in domestic revenue in recipient countries, which has, on average, decreased by 3.7 per cent.

Figure 4: Potential savings through DSSI for countries in debt distress as percentage of GDP



Source: World Bank (2021)

Figure 5: Potential savings through DSSI for countries at high risk of debt as percentage of GDP



Source: World Bank (2021)

## Health and social spending has held up since April 2020 in the countries hardest hit, although there are signs that education spending is contracting slightly

The IMF asks for a commitment from DSSI borrowers that they will use freed-up resources to increase social or economic spending in response to the crisis (World Bank 2021). Initial signs from IMF monitoring of this commitment are that, in the process of tackling the pandemic, recipient countries are managing to maintain social spending, particularly on health and social protection. As Table 1 below indicates, since April 2020, there has been no substantial diversion of spending away from social sectors in DSSI-recipient countries. On average, there has been a 0.6 per cent of GDP increase in health spending and a 0.4 per cent of GDP increase in spending on social protection, whereas education spending has been cut by 0.1 per cent of GDP on average (IMF/World Bank (2020)).

Table 1: Fiscal policy responses to COVID-19 in DSSI countries as percentage of GDP

Budget adjustments in response to COVID-19 (% GDP)		
	Average	Median
<b>Overall revenue</b>	<b>-3.7</b>	<b>-1.8</b>
■ Domestic revenue	-3.9	-2.3
■ Grants	0.2	0.3
<b>Overall spending</b>	<b>-1.5</b>	<b>0.6</b>
■ Recurrent spending	0.2	0.7
■ Development spending	-1.6	-0.9
<b>Priority/social sector spending<sup>2</sup></b>	<b>0.9</b>	<b>0.6</b>
<i>of which,</i>		
■ Health	0.6	0.3
■ Education	-0.1	0.0
■ Social protection	0.4	0.1
<b>COVID-19 related spending</b>	<b>2.1</b>	<b>1.9</b>
<i>of which,</i>		
■ Prevention, containment and management	0.6	0.6
■ Households	0.7	0.5
■ Businesses, state-owned enterprises and government entities	0.8	0.6

Source: World Bank/IMF (2020). Based on 2019 GDP.

Similarly, IMF reports that, on average, CCRT countries have boosted projected 2020 priority spending relative to pre-COVID-19 projections by some 1.2 percentage points of GDP. Health and social protection each increased, on average, by about 0.5 percentage points of GDP. Average spending on education remained at 2019 levels (see Table 2).

Table 2: COVID-19 related fiscal measure by CCRT countries (% GDP)

	2019 (average)	2020 (average)	
	Actual	Pre-COVID-19	Post-COVID-19
<b>Priority and social spending</b>	<b>5.4</b>	<b>5.6</b>	<b>6.7</b>
<i>of which</i>			
■ Health	1.5	1.8	2.3
■ Education	3.0	2.8	3.0
■ Social protection	1.0	1.0	1.5
■ Percent change in nom. GDP		9.7	-3.3

Source: IMF (2020d)

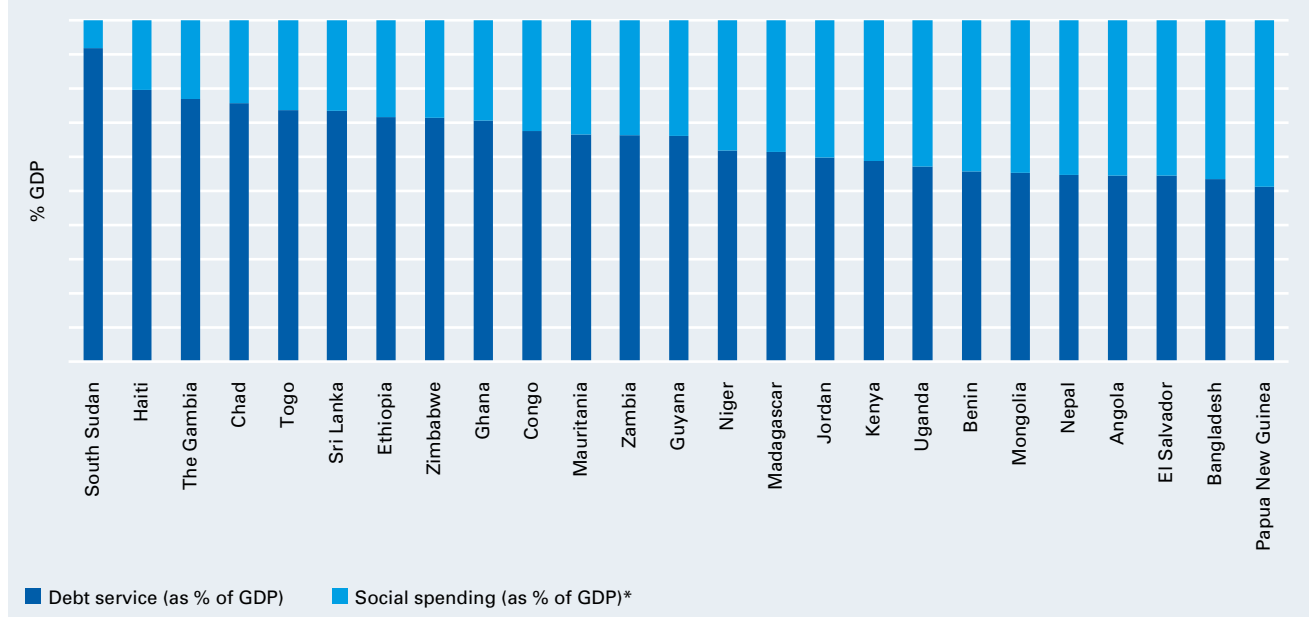
This is supported by recent analysis from Save the Children that finds that despite reduced government revenue, on average, low income and lower middle-income countries appear to be maintaining overall spending levels. On a country level, available budget data from nine countries – Bangladesh, Kenya, Nigeria, Peru, Rwanda, Senegal, South Africa, Uganda and Zambia – indicates that all had maintained or expanded spending on education, health and social protection since the onset of the crisis (Save the Children 2020). Taken together, initial evidence therefore suggests that the timely access to debt relief for IDA countries, complemented by the monitoring requirements stipulated by the IMF, may be having a positive effect in maintaining social spending in the countries affected. Nonetheless, it is important to remember that the small increases in spending reported are averages, and in some countries social spending has decreased. In addition, this data only applies to countries that are participating in the G20 debt standstill. Countries that are either ineligible for DSSI or have chosen not to participate are not included in the IMF analysis.



## Debt and social spending during the COVID-19 Pandemic

Overall, evidence suggests that rising debt levels remain a threat to social expenditure, especially in countries that are not currently accessing debt relief through the IMF. In 2019, 25 countries spent more on debt service than on social spending on education, health and social protection combined (see Figure 6, Table 3).<sup>3</sup> For example, South Sudan spent over 11 times more on debt service than on these social services; Haiti, The Gambia and Chad spent over three times more. According to UNICEF, seven of these 25 countries are amongst those with the highest rates of multidimensional child poverty, with over 60 per cent of children severely deprived of at least one essential social service (namely, education, health, housing, nutrition, water or sanitation) (UNICEF-DAPM 2020).<sup>4</sup>

Figure 6: Proportion of debt service to social spending as percentage of GDP



Source: Government Spending Watch (2020). Data from 2019. Author's analysis.


























Children in these countries may also be more likely to live in households experiencing monetary poverty post-COVID-19. Six of the fifteen countries spending over 1.5 times more on debt service than on education, health and social spending combined are also those

<sup>3</sup> Note: based on data from 80 countries where comparable data are available.

<sup>4</sup> Note: data is not available for South Sudan and Sri Lanka.

with the highest rates of children living in monetary poor households in the world post-COVID-19 (see Table 3). Over 60 per cent of children in these countries are estimated to be living in poor households in 2020 (UNICEF-DAPM & Save the Children 2020; UNICEF-DAPM 2020). These countries need to be prioritized in order to maintain social services during the COVID-19 pandemic, with a particular focus on those that are not benefitting from the debt standstill.

Table 3: Countries with high debt service to social spending ratios and high levels of monetary and multidimensional poverty

	Country	Total social spending (as % of GDP)*	Debt service (as % of GDP)	Debt service as proportion of social spending
Countries highlighted in red: 60% of children living in multidimensional poverty				
Countries highlighted in orange: 60% of children living in monetary poor households post-COVID-19				
Countries highlighted in yellow: reports of declining public expenditure in response to COVID-19				
1	 South Sudan	1.21	13.54	11.19
2	 Haiti	5.46	21.25	3.89
3	 The Gambia	7.19	23.95	3.33
4	 Chad	3.44	10.71	3.11
5	 Togo	6.59	18.45	2.80
6	 Sri Lanka	5.26	14.65	2.79
7	 Ethiopia	5.14	13.01	2.53
8	 Zimbabwe	1.83	4.58	2.50
9	 Ghana	6.47	15.49	2.39
10	 Congo	6.46	13.42	2.08
11	 Mauritania	3.68	7.32	1.99
12	 Zambia	7.55	14.86	1.97
13	 Guyana	8.17	16	1.96
14	 Niger	5.49	8.9	1.62
15	 Madagascar	4.12	6.58	1.60
16	 Jordan	12.78	18.96	1.48
17	 Kenya	6.95	9.93	1.43
18	 Uganda	3.89	5.17	1.33
19	 Benin	4.73	5.96	1.26
20	 Mongolia	7.33	9.09	1.24
21	 Nepal	5.76	6.98	1.21
22	 Angola	5.94	7.11	1.20
23	 El Salvador	6.87	8.21	1.20
24	 Bangladesh	4.71	5.41	1.15
25	 Papua New Guinea	5.58	5.87	1.05

\*Combined spending on education, health and social protection.

Sources: For debt and spending, Government Spending Watch (2020), 2019 data (countries with no data for 2019 using 2017/2018 data or omitted); for poverty, UNICEF-DAPM 2020; UNICEF-DAPM and Save the Children, (2020). Children in monetary poor households post-COVID-19 based on national poverty lines; Multidimensional poverty most recent available data based on at least one deprivation using severe thresholds). Author's analysis.

## Initial reports from UNICEF country offices of COVID-19-related cuts to social expenditure budgets

In addition, there are initial reports from UNICEF country offices of COVID-19-related adjustments to budget expenditure across the social sectors, including in DSSI-recipient countries (UNICEF 2020).<sup>5</sup> Figure 7 is derived from the UNICEF COVID-19 Socio-economic Impact Survey, 2020, which provides quarterly updates based on administrative or survey data and/or reliable localized reports (ibid). This data indicates that, while 96 out of 148 countries have reported increases in expenditure on health, and 78 countries have reported increases in social protection spending, 19 out of 148 countries are currently reporting a decrease in budget expenditure in one or more social sectors in response to COVID-19.<sup>6</sup> Over 93.3 million children under 18 are estimated to live in the countries affected (United Nations 2020).<sup>7</sup> Of these, just under a third are DSSI-recipient countries.

As Figure 7 illustrates, education appears to be the most affected by spending cuts, with 16 countries (10.8 per cent) reporting a decrease in education expenditure. Other programme budgets may also have been affected as school closures impact service delivery. Students have missed an average of 68 days of school in lower middle-income countries compared to 40 in upper middle-income and 27 in high-income countries (UNICEF 2020b). Consequently, spending on programmes such as school feeding and nutrition programmes in schools has decreased in several countries, such as the Maldives. Child protection budgets are also affected, with 10 countries recording a decrease in budget expenditure, again potentially related to a decline in service delivery (see Figure 7). Lao PDR, Maldives and Madagascar, for example, have seen a drop in home visits by social service/justice workers.

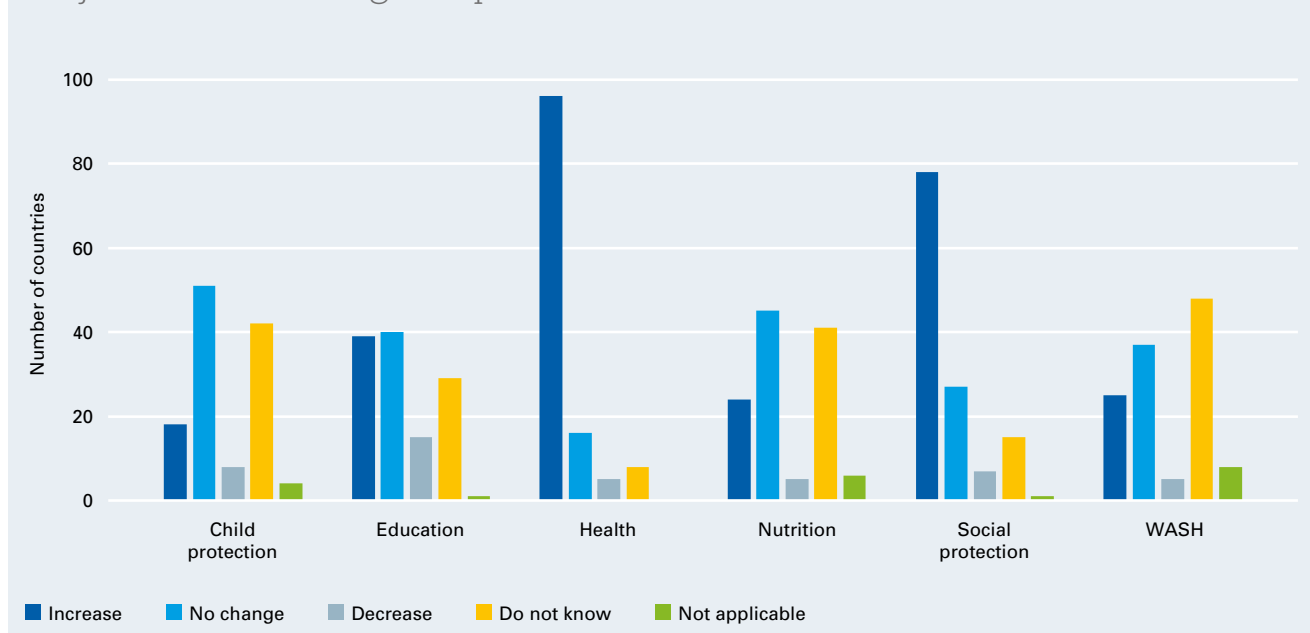
Nine countries are also reporting cuts to social protection expenditure (see Figure 12). Five per cent of countries are reporting decreases in WASH and nutrition spending respectively, and 4 per cent note a decrease in health spending. Lao PDR, Maldives, Madagascar and Burkina Faso have seen a drop in newborn care services, routine vaccinations, and treatment and/or screening of child wasting among other services. While these are initial reports in an evolving pandemic, they do indicate that COVID-19 is already affecting planned expenditure on social sectors impacting on children worldwide.

5 While DSSI countries have, on average, slightly increased social expenditure, this masks differences between countries. Source: UNICEF COVID-19 Socio-economic Impact survey, August 2020 (consultant's analysis).

6 The UNICEF socio-economic survey is based on self-reported data from country offices. Note: this is based on data from August 2020 when data from mid-year budget adjustments may not have been available. These estimates may not accurately represent the full national response to the COVID-19 pandemic.

7 Data downloaded from <https://population.un.org/wpp/Download/Standard/Population/>. Author's calculations.

Figure 7: Number of UNICEF country offices reporting COVID-19 related adjustments to budget expenditures worldwide



Source: UNICEF 2020 (author's analysis)

Table 4 flags the countries where debt service may put social spending for children at risk under COVID-19, using the following measures:<sup>8</sup>

1. Debt service as proportion of social spending (> 1)
2. High monetary poverty post-COVID-19 (>60 per cent)
3. High multidimensional poverty (>60 per cent)
4. Initial reports of cuts to social expenditure post-COVID-19
5. Low assistance available through DSSI (< 0.5 per cent of GDP)

Thirteen countries have been identified as having one or more of the above risk factors. As such, these are countries where debt may be putting social expenditure on children most at risk. South Sudan and Zimbabwe are receiving no assistance through either DSSI or CCRT and have over 60 per cent of children living in monetary poverty.<sup>9</sup> Mongolia is also receiving no assistance through either DSSI or CCRT and UNICEF reports suggest that social spending cuts in response to COVID-19

<sup>8</sup> Note on limitations. This is a comparison of countries for which data on all five measures was available. Some countries may have been excluded due to missing data. This methodology highlights countries with the highest levels of child poverty. This is not to discount the serious debt crisis in middle-income countries, such as Ecuador, Lebanon and Sri Lanka, where the burden of debt repayments may also be putting social spending at risk.

<sup>9</sup> Benin, Haiti and Mongolia are eligible for DSSI but have not yet applied/been approved.

are already being implemented. Benin and Haiti are currently receiving no assistance through the debt standstill and have high levels of child poverty; Madagascar and Togo are receiving less than 0.5 per cent of GDP through DSSI (although they are receiving some assistance through CCRT), and have high levels of both monetary and multidimensional poverty. All of these countries are spending more on debt service than on social spending. Some may already be cutting social spending in response to the COVID-19 pandemic. Of top priority are the countries highlighted in yellow – South Sudan, Zimbabwe, Mongolia, Benin, Haiti, Madagascar and Togo – which are currently spending on average 2.5 times more on debt service than on social spending for education, health and social protection combined; have little or no access to the debt standstill; and have high levels of child poverty.

Table 4: Countries with low levels of debt relief where debt may be putting social spending at risk (top priority countries highlighted in yellow)

Countries where debt may be putting social spending at risk	Debt relief through CCRT (US\$ million) Tranche 1 + 2	Potential savings through DSSI (% GDP)	Current savings through DSSI (% GDP)
South Sudan	0	(No data available)	0
Zimbabwe	0	(Not eligible)	0
Mongolia	0	0.5	0
Benin	19.15	0.1	0
Haiti	11.22	0.9	0
Madagascar	8.5	0.3	0.3
Togo	8.38	0.4	0.4
Ethiopia	18.33	0.5	0.5
The Gambia	5.83	0.6	0.6
Chad	2.82	0.6	0.6
Mauritania	0	1.2	1.2
Niger	15.67	1.2	1.2
Angola	0	2.0	2.0

Sources: IMF (2020d); World Bank (2021)

## Conclusion and recommendations

The COVID-19 pandemic has exacerbated the risk of a debt crisis for developing countries that has been rising since the 2008 global financial crisis. Over a quarter of LMICs are currently in, or at high risk of, debt distress according to the IMF. Middle-income countries make up over two thirds of the countries affected. Many more may be at risk if debt held privately by businesses and households is considered. These include countries such as Ecuador, Lebanon and Sri Lanka, which all currently face levels of debt repayments that threaten social spending responses to COVID-19.

In reaction to the current crisis, the international community has disbursed over \$2 billion since April 2020 to IDA-eligible countries under the G20 debt standstill and other debt relief responses from the IMF. Initial signs are that these initiatives are helping alleviate the impact of the pandemic on social spending in recipient countries. On average, countries in receipt of the DSSI and CCRT have maintained or increased spending on health and social protection since April 2020. They are, however, seeing slight declines in education spending.

Nonetheless, as of January 2021, only 46 countries are participating in the G20 debt standstill. Over a third of those eligible have chosen not to apply. Seven countries currently in, or at high risk of, debt distress are not currently benefitting from the scheme. In 2019, almost a fifth of LMICs spent more on debt service than on education, health and social protection combined. With most LMICs not benefitting from the debt standstill, this imbalance is likely to deteriorate further in 2021.

Two obstacles to participation in the existing debt standstill will need to be overcome to address this. Firstly, eligibility should be extended to all countries who request it. Current criteria for participation exclude many middle-income countries, home to 62 per cent of the world's poorest children (United Nations 2020b). Secondly, the reluctance of eligible countries to sign up to DSSI needs to be investigated and addressed. This includes the four SIDS nations at high risk of debt distress as well as countries such as Lao PDR, which, despite facing a mounting debt crisis, have not yet signed up to DSSI. Initial reports suggest that there are concerns amongst middle-income countries in particular about participation affecting their credit ratings and future ability to access global financial markets, as well as a potential reluctance on the part of national governments to sign up to the IMF monitoring requirements (Ruikang 2020, Michaelson 2020).

However welcome, the current international response to the debt crisis is insignificant in comparison to the overall fiscal response to COVID-19, which reached \$11 trillion in the initial stage of the pandemic. It is also dwarfed by previous debt relief packages such as the HIPC initiative. The scale of the challenge is daunting with the SDG financing gap estimated at over \$3.7 trillion last year. The UN is calling for more comprehensive action, including debt relief, to assist the most vulnerable countries in the medium to long term. Debt relief is not a stand-alone strategy, and a more holistic approach is needed to provide affordable finance to countries to enable the delivery of basic services to children.

The COVID-19 pandemic offers lessons on the importance of enhancing the equity and efficiency of social sector spending worldwide. We are already seeing cuts to the services most affecting children: from school feeding and nutrition programmes to newborn care services, routine vaccinations and screening of child wasting. Child protection services are particularly badly hit, with an almost complete cessation of home visits by social services in several countries. While the crucial importance of health and social protection infrastructure has been laid bare by the pandemic, it is equally important not to forget the obligation to protect and enhance education services to protect child rights as we build back better.

This brief has identified a list of priority countries where social expenditure may be most at risk of being crowded out by increasing debt service payments. These countries already have high levels of child poverty and are less likely to be receiving debt relief. Debt relief urgently needs to be scaled up for these countries. In addition, the analysis has also highlighted the looming debt crisis facing middle-income countries. In the wake of COVID-19, supporting the extension of the current debt standstill to all LMICs who need it could be one short-term measure to support social spending for children. In the medium term, designing a new international debt restructuring architecture that encompasses the heterogeneous needs of LMICs will be crucial to protecting the social rights of the generation of children impacted by the pandemic. This needs to be supported by external financing to help protect and continue to increase social spending. Budget transparency, along with strong medium-term fiscal frameworks and medium-term revenue strategies, will be essential to help raise the necessary financing. Debt transparency on the part of all multilateral, bilateral and private sector creditors is also crucial to ensuring that all liabilities can be monitored. Only coordinated action on the part of creditors and national governments will pave the way to establish modalities for converting debt into investments for children.

## Zambia defaults on debt with debt payments threatening to crowd out social spending

Zambia has become the first African country to default on its debt since the start of the pandemic, raising concerns that it may be subjected to higher sovereign borrowing costs in its future transactions. The default presents challenges to the implementation of the 2021 budget, of which over 40 per cent was due to come from domestic and external financing (Business Day 2020).

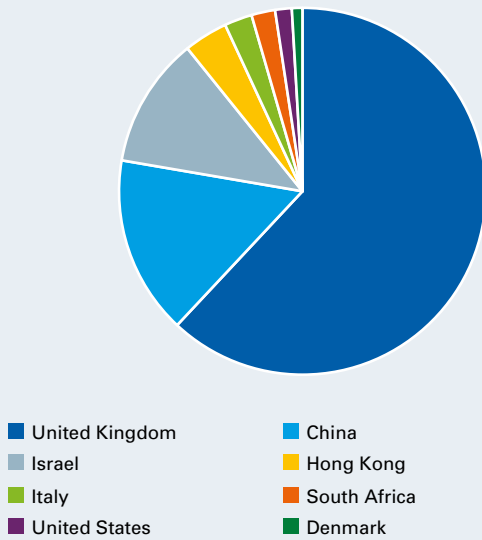
Even before the pandemic hit, Zambia's debt payments were threatening to crowd out social spending. Education spending as a share of the total government budget has fallen from 20.2 per cent in 2015 to a budgeted 11.5 per cent in 2021 (UNICEF Zambia 2019; author's analysis of 2021 National Budget Statement). Health spending was also projected to decrease from 9.6 per cent of total government spending in 2015 to a budgeted 8.1 per cent in 2021. The social protection budget, however, has risen during this period: from 2.7 per cent of total spending in 2015 to 4.0 per cent of total spending in 2021 (UNICEF Zambia 2019; author's analysis of 2021 National Budget Statement). During this time, total external debt doubled as a proportion of GNI, rising from 56.5 per cent of GNI in 2015 to 120.1 per cent of GNI in 2019 (World Bank Debt Data). By 2020, Zambia was due to pay debt service amounting to an estimated \$2.65 billion (World Bank Debt Data). In 2021, debt financing was projected to reach 43 per cent of total government revenue (KPMG 2020).

Zambia has signed up to the DSSI, although official debt eligible for the debt service standstill currently makes up just over a quarter of the country's debt service obligations. Almost half is due to non-official bilateral lenders, of which UK-based creditors make up 62 per cent (see Figure 8) (World Bank Debt Data). In November 2020, holders of Zambia's \$3 billion of Eurobonds rejected a request to suspend interest payments for six months, and the grace period for an overdue \$42.5 million coupon lapsed, triggering a default (Business Day 2020). Debt service to bondholders currently makes up 18 per cent of total payments, with \$474.9 million due in 2020 (see Figure 9) (World Bank Debt Data).

Bondholders had expressed concerns that any relief they granted would be used to service debt to Chinese lenders. China is the country's main official bilateral creditor and Zambia was due to pay \$537.75 million in official debt service to China in 2020 (see Figure 10). Chinese non-official bilateral lending, not covered under the DSSI agreement, currently comprises less than a fifth (18 per cent) of Zambia's outstanding debt service in 2020. Although China has now signed up to the debt standstill, discussions amongst the G20 nations on Zambia's default have failed to come to fruition. The Jubilee Debt Campaign estimates that some financial institutions will make a 250 per cent profit on their Zambian bonds (Jubilee Debt Campaign 2020).

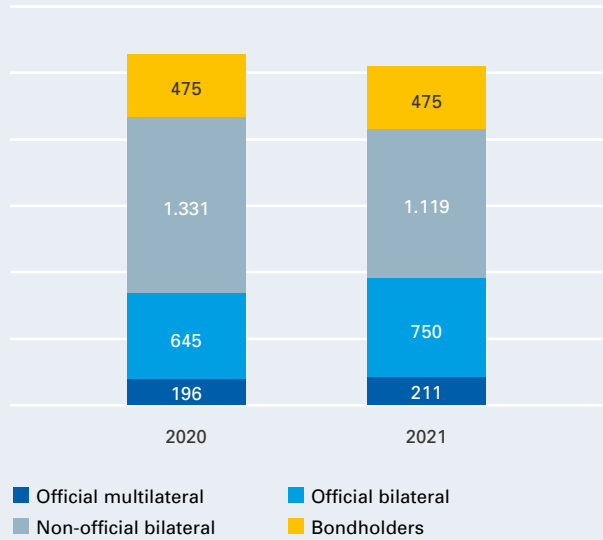


Figure 8. Zambia: Proportion of debt service to nonofficial bilateral lenders due in 2020



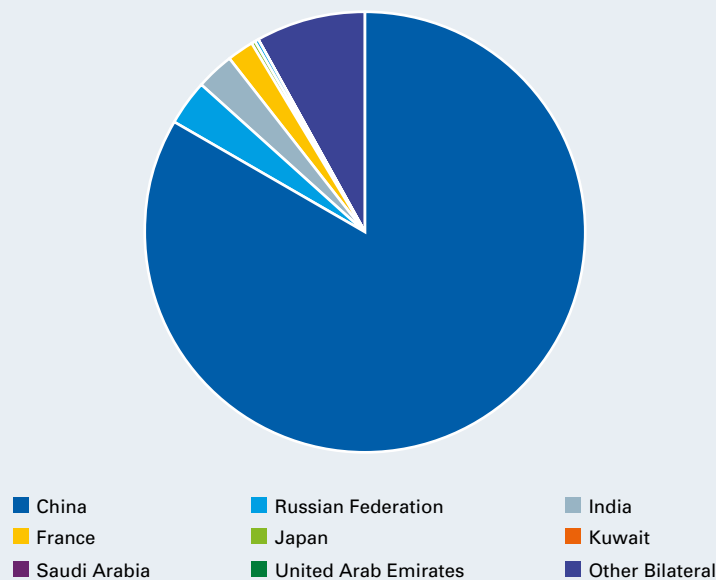
Source: World Bank Debtor Reporting System, author's calculations.

Figure 9: Zambia debt service by creditor in 2020 and 2021 (US\$ 000s)



Source: World Bank Debtor Reporting System, author's calculations.

Figure 10. Zambia: Proportion of debt service to nonofficial bilateral creditors in 2020



Source: World Bank Debtor Reporting System, author's calculations.

## Lao PDR still to join Debt Service Standstill Initiative despite facing default

The World Bank is warning that limited fiscal space and the mounting pressure of debt servicing will limit the ability of the government of Lao PDR to address the COVID-19 downturn (World Bank Group 2020). Debt levels in Lao are predicted to reach up to 68 per cent of GDP in 2020, with the ratings agency Moody's warning of a possible default this year (Zhai, K. and Johnson, K. 2020).

Recent reports have suggested that the country is set to cede majority control of its electric grid to a Chinese company as it struggles to avert a potential debt default. Heavy recent expenditure on projects such as hydroelectric schemes and a new Chinese high-speed railway are at the centre of a debt crunch (ibid). The country is due to pay over \$2 billion in debt service in 2020, of which 42 per cent (\$846.1 million) is owed to China (World Bank Debt Data).

Despite this context, Lao PDR is not currently participating in the debt service relief initiative (DSSI). Lao PDR is one of five of the 22 Fitch-rated DSSI-eligible sovereigns that would see their external financing requirement for 2020 reduced by 1 per cent of GDP or more through participation (Fitch Ratings 2020). Over half the country's debt obligation is official bilateral debt, and \$1.1 billion of official bilateral debt would be eligible for the debt standstill this year (see Figures 11–13).

This decision may adversely impact children. Government spending has already contracted over the past several years (Fitch Ratings 2020b). Initial reports suggest that the COVID-19 outbreak has affected essential service delivery, with UNICEF country offices reporting cuts in budget expenditure for nutrition, health and education services for children (UNICEF 2020). Antenatal care visits, skilled birth attendance, and immunization rates may have also declined. Strengthening social protection and ensuring access to essential health services for children from the most vulnerable groups need to be prioritized to mitigate the impact of COVID-19 (World Bank Group 2020).

Figure 11. Lao PDR debt service to multilateral banks in 2020 (US\$)

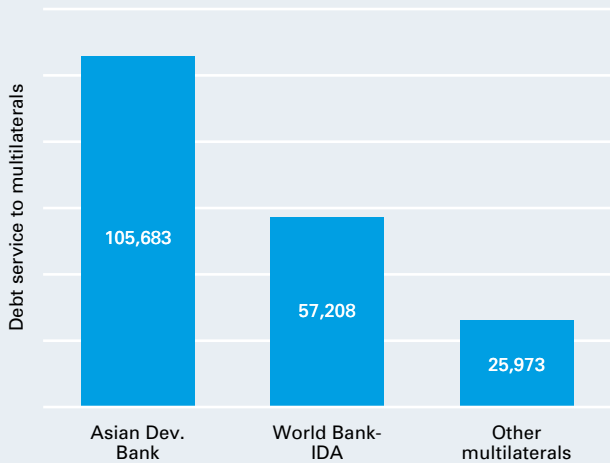


Figure 12. Lao PDR debt service to official bilateral lenders in 2020 (US\$)

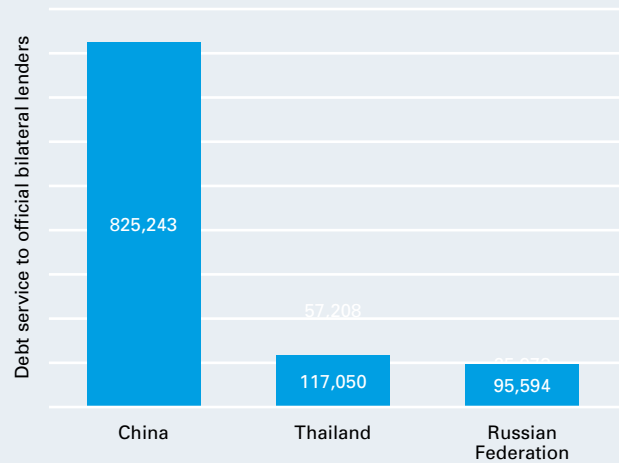
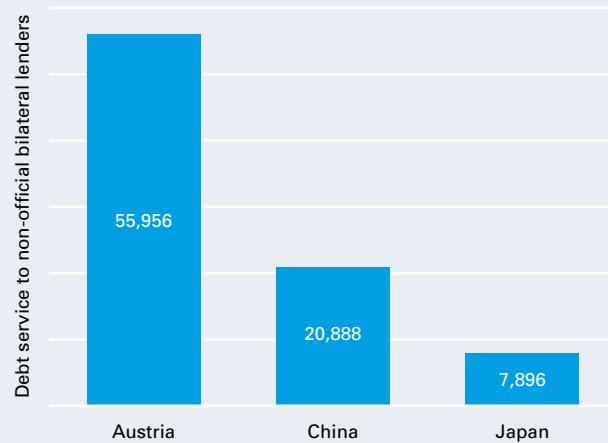


Figure 13. Lao PDR debt service to non-official bilateral lenders in 2020 (US\$)



Source: World Bank Debtor Reporting System, author's calculations  
 Note: Lao PDR Charts indicate debt service to top three lenders (not total debt service).

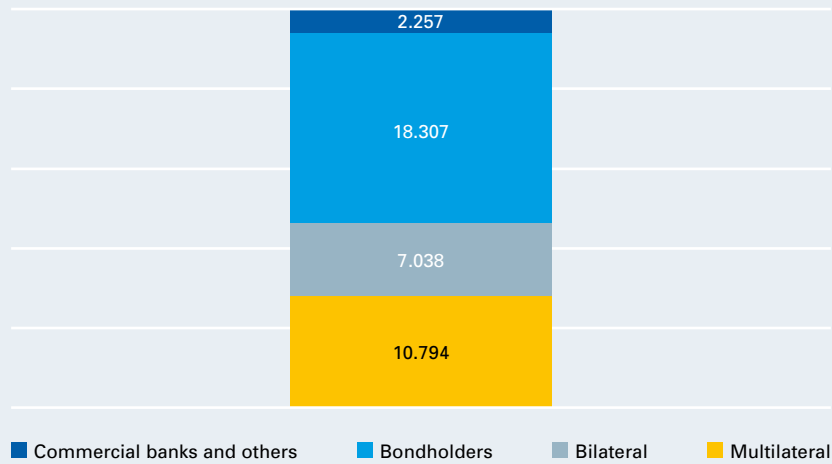
## Ecuador: Default averted with country facing new austerity measures

Ecuador's economy was hard hit by the collapse of oil prices and sharp drop in global demand triggered by the COVID-19 pandemic. GDP for the first half of 2020 fell by as much as 14 per cent year-on-year (Fitch Ratings 2020d). External debt has risen four-fold as a proportion of GDP in the last 10 years, and is projected to reach 68.9 per cent of GDP in 2020, with debt to bondholders making up approximately half of Ecuador's public debt (see Figure 14) (World Bank Debt Data). Although Ecuador is not amongst the most highly indebted countries in Latin America, it is assessed to have low debt tolerance due to its dependence on oil exports and the dollar (Fitch Ratings 2020d).

In March 2020, Ecuador's lawmakers called on the government to suspend debt payments to increase liquidity to deal with the COVID-19 pandemic, prompting concern about a possible default (Bloomberg 2020). In consequence, the government requested a four-month deferral in April on approximately \$800 million in upcoming interest payments due to bondholders, in order to pursue comprehensive debt restructuring. The 'distressed debt exchange' reduced near-term debt service and paved the way for a new 27-month \$6.5 billion Extended Fund Facility with the IMF (Fitch Ratings 2020c).

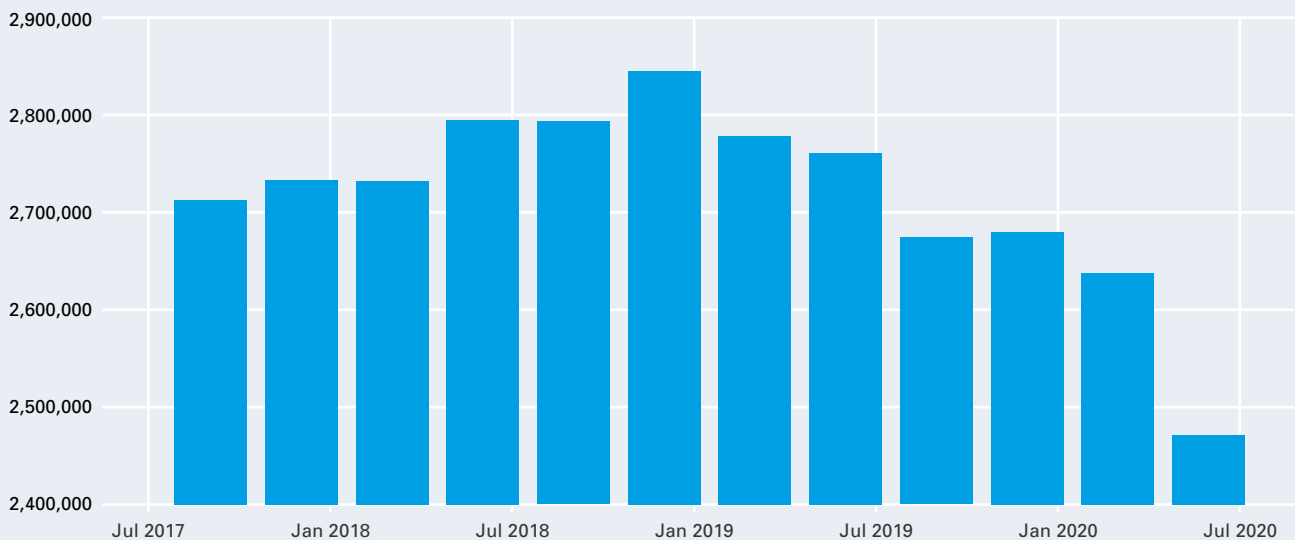
The agreement, however, included explicit goals to consolidate the public sector wage bill. In May 2020, the government announced spending cuts of \$4 billion and reduced the workday by two hours, cutting state workers' wages (see Figure 15). This has led Amnesty International to warn that any future commitment regarding Ecuador's debt must not jeopardize human rights (Amnesty International 2020). Emerging reports from UNICEF country offices suggest that Ecuador has seen cuts to budget expenditure for children's services during COVID-19 in all sectors: nutrition, social protection, child protection, WASH, health and education (UNICEF 2020).

Figure 14. Ecuador public and publicly guaranteed debt by creditor (2019, US\$ 000s)



Source: World Bank Debt Data (author's calculations)

Figure 15. Ecuador government spending between 2017 and 2020 (US\$ 000s)



Source: <https://tradingeconomics.com/ecuador/governmentspending>

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