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Evaluation of debt moratorium, a financial solution during the COVID-19 pandemic: The pros and cons

Background and objective

According to TransUnion's research, almost eight in ten South Africans say their household income has been cut by the Covid-19 pandemic, while one in ten had already lost their jobs (West, 2020). The corona virus came at a time when the budgets of several countries already suffering from the severe impact of common security challenges and climate change (Wadagni, 2020). A loss of income results in an inability to service debt. A strategy had to be devised. This paper seeks to evaluate debt moratorium, one of the financial solutions to this crisis.

What is a debt moratorium?

A moratorium is a temporary period during a loan term when the borrower is not obliged to make a payment (Bankrate ®, 2020). Over the last thirty years as wages have stagnated across South Africa, average household debt has more than doubled (Strike Debt, 2014). Increasingly, people are forced to take on debt to meet their needs; from housing to education and medical care (Strike Debt, 2014). High debt and low income disenable many households, producers and sectors of the government from meeting their short and long-term obligations. The core question is whether or not a debt moratorium is an effective solution to the current global crisis.

Does a repayment break result in increased disposable income?

The head of Budget Analysis of Alternative Citizen Space, Qutes Hassane Boukar, supports the idea of a debt moratorium. He says that a debt moratorium enables states to mobilize the resources they could have committed to repay the public debt to fighting COVID-19?? (Garcia, 2020). Munevar (2020) concurs. This view assumes that the amount that would have been set aside to repay debt is sufficient to tackle socio-economic issues heralded by COVID-19 in the affected nations.

Any additional assistance in conjunction with the debt moratorium?

The World Bank will help countries devise customised fiscally sustainable policy mitigate the impact of COVID-19 in the short term and economic recovery in the medium term

(The World Bank, 2020). This might mean that experts in economics and finance join forces to maintain current cashflow and future financial plans.

Will interest also pause a debt moratorium?

A debt moratorium provides a reprieve to the borrower in the payment of the principal debt, but does not absolve them from paying the interest accrued on the loan (Bankrate ®, 2020). Given that a debt moratorium means that there is a time during which the borrower is not servicing their debt, it means that to cover for this period the debtor has to service their debt over a longer repayment period or that they should pay their debt within the originally agreed upon repayment period but at higher capital repayment portions when the debt moratorium is over. The question remains, however, about how possible it is that one who fails to service their debt now could be able to do so in the future.

Are there any reputational implications?

Analysts say that debt moratorium solutions are likely to tarnish the reputation of governments, and jeopardize their access to future financing and capital markets as this solution demonstrates creditor leniency (Wadagni, 2020). If we recall that following the Heavily Indebted Poor Countries (HIPC) initiative, debt write-offs in the past decade left deep wounds both for private creditors and public bilateral lenders; many of whom never returned to finance the countries which had applied for debt moratoriums, except through grants (Wadagni, 2020).

Conclusion

A debt moratorium for distressed sovereign borrowers has many similarities to that for households, small businesses and municipalities (Reinhart & Rogoff, 2020). As such, all arguments in favour of or against debt moratorium are applicable to all beneficiaries of a debt moratorium. The consequences of debt moratoriums are the same across households, firms and governments. The golden rule is that debt moratoriums should be considered in circumstances in which there is a real need for additional resources and that these resources cannot be mobilised without resorting to and applying for a debt payment reprieve.

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(The views and opinions expressed in this blog are those of the authors and do not necessarily reflect the organization, FES South Africa.)