



Developing Countries on the Brink of a Debt Crisis

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The end of expansionary monetary policies in developed countries, the decline in financing from China, and the economic turbulence resulting from the COVID-19 pandemic and Russia's aggression against Ukraine increase the risk of a major international debt crisis for developing countries. Such crises tend to spill over and the number of defaulting countries increases. While the threat of the destabilisation of the economies of developed countries remains low, the states may be affected by the consequences of the crisis, such as increased migration pressures.

Risk Factors. Since the 2008 financial crisis, developing countries' external debt has almost tripled (according to UNCTAD data) from around \$2.5 trillion to around \$7 trillion. Developed countries had until recently pursued expansionary monetary policies, consisting primarily of keeping interest rates low and central bank investments in financial markets to increase liquidity. The resulting excess cash was invested in, among other things, loans to developing countries, which led to an increase in availability of funds and over-indebtedness of borrowers. The flow of money to developing countries is now decreasing and costs of debt servicing have risen with interest rates hikes in developed countries aimed at countering inflation. [Moreover, the domestic debt repayment guarantees and debt moratoria introduced as a result of the COVID-19 pandemic have ended.](#) The expiry of these instruments increases the risk for financial institutions and, as a result, reduces their willingness to finance developing countries.

The consequences of the COVID-19 pandemic also influence the likelihood of an international debt crisis involving developing countries. The pandemic caused a global economic crisis and was costly due to the need for social programmes, and, at the same time, it discouraged investors from financing higher-risk countries. These problems have been exacerbated in the wake of Russia's aggression against Ukraine. [Energy commodity prices and the dollar exchange rate rose rapidly in 2022, and food prices remain historically high.](#) This is causing a deterioration in developing countries' trade terms, which leads to greater borrowing needs and

higher debt servicing costs. [These crises are also causing an economic slowdown \(resulting in reduced budget revenues\)](#) and a decline in export earnings in developing countries due to falling demand in developed countries.

Developing countries' debt was also growing because of loans from China, now their largest bilateral creditor (the World Bank estimates that low- and middle-income countries' debt to China was 30% of their total bilateral debt in 2021). Many of the investments financed by loans from China were not economically sound and did not deliver the expected benefits—such as the Bar-Boljare highway in Montenegro, which Western financial institutions refused to finance. Montenegro, faced with the risk of default, had to seek bailout financing to repay loans for this investment. [In Sri Lanka, China took over some infrastructure but that still did not stop the suspension of debt service in May 2022.](#) [China's current economic problems](#) are forcing it to be more cautious in its lending, which will be another factor reducing the availability of financing for developing countries.

Probability of a Crisis. The World Bank estimates that 60% of low-income countries are in debt distress, or at high risk of debt distress. According to the credit ratings agency Fitch, Lebanon, Ghana, Sri Lanka, Zambia, and Belarus (where the reasons are not purely economic, but also due to sanctions) are currently in default. Mozambique has not paid its obligations in 2023. It is impossible to indicate which countries in distress will be forced to stop repayments and which will obtain further financing and avoid defaults. However, given the number of countries at risk, further

PISM BULLETIN

repayment difficulties are almost certain—Egypt, Malawi, Pakistan, and Tunisia are particularly vulnerable, and foreign debt has remained a serious problem in Argentina for years. A foreign debt crisis in a country leads to instability in its financial markets and, as a result, problems in the real economy (i.e., the actual production of goods and services rather than the financial servicing of these processes) due to reduced financing for consumers and businesses. These phenomena influence international trade, causing spillover of the crisis abroad. In addition, developing countries have limited capacity to stem the impact of economic crises that lead to a decline in the living standards of the population, which in extreme cases can take the form of humanitarian and political crises. Debt problems in one country can also lead to an overly sharp reaction by lenders, balancing risks by withdrawing funds from similar economies and ultimately creating an international crisis.

Currently, we might be on the threshold of a major international debt crisis for developing countries. Its occurrence is almost inevitable; what remains unknown is its scale and effects.

Possible Consequences of the Crisis. Individual defaults by developing countries will not have a profound impact on the global economy. However, a possible regional or supra-regional crisis could slow global GDP growth. Still weakened by the COVID-19 pandemic and the aftermath of the Russian aggression against Ukraine, the economies of developed countries are vulnerable to shocks, and there are limited options to counter them due to the need for anti-inflationary measures. [While the potential crisis will not be of a magnitude comparable to the pandemic or energy crisis in Europe](#), it will delay the return of developed countries to a path of stable growth.

The foreign debt crisis and the subsequent financial, economic, and humanitarian crisis even in individual developing countries will impact regional security. Political destabilisation in African and Middle Eastern countries will

encourage increased migration flows toward the EU. It will also increase opportunities for terrorist groups activities.

The risk of more countries defaulting will prompt China to enter the competition with the West in the area of bailout financing. Until now, this type of lending has been the domain of the International Monetary Fund. However, in recent years, bailout loans from China have been granted to Egypt, Belarus, Ecuador, Pakistan, and others. Their provisions allow a greater degree of influence over borrower policy than development loans. On the one hand, this results in greater availability of financing for developing countries while, on the other hand, it may raise the risk of China using this instrument to obtain political concessions.

Conclusions. The available data do not indicate that a possible crisis could destabilise even the most exposed financial markets of developed countries (especially the U.S. and the UK). However, due to the peculiarities of the sovereign debt market, especially the difficulty of identifying bondholders, we cannot estimate the risk in detail, so it is potentially possible. Poland may suffer from the crisis indirectly through problems in financial institutions in Western Europe and the U.S. Given Poland's lack of capacity to take direct action, it is therefore advisable to take this risk into account in economic policymaking as part of the broader turbulence of recent years.

Although Poland lies outside the main migration routes from the south of the EU, a possible migration crisis triggered by economic difficulties in developing countries may affect the political situation in the EU. Poland can prepare a position for the next migration crisis in advance and seek possible allies among other Member States. It is necessary to take into account possible attempts by Russia and Belarus to exploit migration flows, including the creation of artificial migration routes targeting Central European countries. This potential provides an opportunity to strengthen cooperation in the context of protecting the EU's external borders with the Baltic States, among others.