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Calamities, Debt, and Growth in Developing Countries

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Abstract

Public debt in developing economies rose at a fast clip during 2020–2021, at least partly due to the onset of the global COVID-19 pandemic. Nobel laureate Paul Krugman opined in early 2021 that "fighting covid is like fighting a war." This paper empirically examines trends in debt and economic growth around the onset of three types of calamities, namely natural disasters, armed conflicts, and external debt distress in developing countries. The estimations provide quantitative estimates of differences in GDP growth and debt trends in economies suffering episodes of calamities relative to the trends observed in economies not experiencing calamities. The paper finds that debt and growth evolve quite differently depending on the type of calamity. With the empirical evidence in hand, the authors argue that debt-financed reconstruction efforts after natural disasters, and thus plausibly in the aftermath of the pandemic, can help accelerate growth after such disasters with lower debt burden than in the aftermath of episodes of armed conflict without necessarily incurring the economic costs associated with episodes of debt restructuring. However, the implied upward trajectory of the debt to GDP ratio in developing economies is not trivial, even after post-disaster growth upticks, which raises concerns about long-term debt sustainability after episodes of reconstruction after natural disasters. If so, the time for orderly preemptive debt restructuring might be approaching quickly since recoveries after debt defaults tend to be more costly.

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