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TARIFFS, A TRADE WAR, AND TUMULT IN THE GLOBAL TRADING SYSTEM: YET ANOTHER POTENTIAL ECONOMIC SHOCK TO EMERGING ECONOMIES

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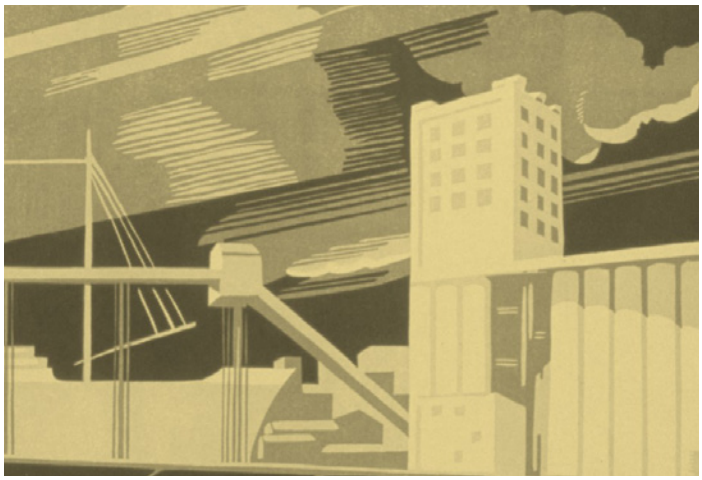
The Trump administration's recent imposition of high tariffs on goods from countries large and small has upended decades-long expectations about how the post-World War II 'rules-based' global trading system, largely designed by the US, was supposed to operate. Unless these new tariffs announced by the Trump Administration are significantly reversed on a permanent basis, it is widely believed that they could potentially have a major disruptive impact on global trade and the global economy.

As of the beginning of May 2025, it appears that an incipient full-blown trade war between the US and China, as well as serious trade tensions between the US and its other large trading partners Canada, Mexico, and the European Union (EU), might ultimately have significant spillover effects for economies across the globe, including emerging economies and developing countries.

Introduction

Upheaval in the global trading system does not bode well for the growth prospects for the global economy. In fact, the International Monetary Fund (IMF) has recently downgraded its earlier forecasts for the level of global economic growth for 2025 and 2026 based on its assessment of the likely effects of tariffs and trade frictions. In its new "World Economic Outlook" released on April 22, 2025, the IMF is now projecting in its base case global economic growth of 2.8% in 2025 and 3% in 2026, down from 3.3% growth in 2024. Just a few months ago, in January 2025, the IMF had projected global economic growth of 3.3% for both 2025 and 2026 (i.e., the April 2025 projections when compared to the January 2025 projections represent a 0.5% reduction for 2025 and a 0.3% reduction for 2026). [*Update*: In June, both the World Bank and OECD also revised downward their earlier forecasts for global economic growth in 2025 and 2026 in



view of the anticipated impact of the new US tariffs and the related policy uncertainty.][1]

Since the US and China are the two largest economies in the world, it is perhaps not surprising that considerable attention has been focused on how the US and Chinese economies will be affected by the tit-for-tat escalation of tariffs that is now unfolding between the two countries. Yet, apart from the US and China, the economies of a broad array of emerging markets and developing countries globally could also potentially be affected in an environment of higher tariffs and global trade frictions (including any marked disruptions of global supply chains that are such a vital part of the global trading system).[2]

Indeed, just as the growth prospects of the global economy as a whole have been downgraded in the IMF's report released on April 22, the IMF has also downgraded its growth forecasts for emerging economies and developing countries. The IMF is now projecting in its base case economic growth for these countries of 3.7% in 2025 and 3.9% in 2026 compared with its earlier forecasts in January 2025 of 4.2% growth in 2025 and 4.3% growth in 2026 (i.e., a 0.5% reduction for 2025 and a 0.4% reduction

[1] See World Bank, Global Economic Prospects, June 2025, Chapter 1, p. 4; and OECD, OECD Economic Outlook, Vol. 2025 Issue 1, June 2025 (https://www.oecd.org/en/publications/oecd-economic-outlook-volume-2025-issue-1_83363382-en.html). For example, in its Global Economic Outlook released in June, the World Bank projected global economic growth of 2.3% in 2025 and 2.4% in 2026, representing a reduction in projected growth of 0.4% in 2025 and 0.3% in 2026 from the forecasts it made earlier in the year in January 2025. World Bank, Global Economic Prospects, supra.

[2] Reuters, "Emerging Economies Brace for Trump Tariff 'Turning Point,'" April 4, 2025 ("[e]merging economies worldwide are bracing for sliding currencies and a possible deterioration of their sovereign credit after U.S. President Donald Trump's tariffs brought levies on U.S. imports to their highest levels in 100 years").

for 2026, when comparing the April 2025 projections against the January 2025 projections). To put this in context, in 2024, these countries as a group achieved a growth rate of 4.3%, according to an IMF estimate. (The April 2025 IMF base case takes into account the high 'reciprocal' tariffs announced by the Trump administration on April 2, 2025.) [Update: In their latest projections released in June, the World Bank and OECD have also lowered their projections for economic growth in emerging markets and developing countries.[3] Separately, on July 29, 2025, the IMF released new projections for growth in emerging markets and developing economies, and these latest projections represent a not insignificant upward revision from the IMF's April projections, jumping from 3.7% to 4.1%.]

If the economies of emerging markets and developing countries are in fact ultimately dealt a serious blow by the fallout from the new US tariffs and escalating global trade tensions, this could place a new strain on the balance sheets of the affected sovereigns. The impact of any new trade-related shock to their economic systems might well be exacerbated by the fact that a number of these countries are already currently facing high sovereign debt burdens, limited fiscal space (and thus a constrained ability to respond to new financial and economic pressures),[4] possibly weakened currencies vis-à-vis the US dollar and/ or in some cases wide current account and fiscal deficits.

Sovereign debt levels and the related debt servicing costs for many emerging economies and developing countries are significantly higher than they were in the pre-COVID-19 period. Many of these countries increased their sovereign debt levels during the pandemic and in the wake of the start of the Ukraine war in order to address the economic and social fallout from these developments.[5]

As a result, the debt-to-GDP ratio (a key metric of sovereign debt sustainability) for emerging economies

[3] See World Bank, Global Economic Prospects, June 2025, Chapter 1, p. 4; and OECD, OECD Economic Outlook, Vol. 2025 Issue 1, June 2025. The World Bank, for instance, is now projecting economic growth for emerging markets and developing countries of 3.8% in both 2025 and 2026 (compared with its earlier forecasts in January 2025 of 4.1% growth in 2025 and 4.0% growth in 2026). World Bank, Global Economic Prospects, supra.

[4] International Monetary Fund (IMF), World Economic Outlook, Chapter 1 (Global Prospects and Policies) (April 2025), p. 7 ("Crucially, much of the available policy space has already been exhausted in many countries… limiting how much support policymakers can give economies in case of new negative shocks or a pronounced downturn. Many countries passed large fiscal support packages, first during the pandemic and then as energy and food prices spiked at the onset of Russia's invasion of Ukraine.").

[5] World Bank, World Development Report 2022, Chapter 5 ("Managing Sovereign Debt") ("The COVID-19 crisis forced emerging and developing economies to exceed their already record-high sovereign debt levels to mitigate the economic impacts of the crisis on families and their domestic economies").

and developing countries as a whole has increased markedly from prior to the pandemic. As the IMF has recently indicated, the debt-to-GDP ratios for these countries rose from 54.5% in 2019 to 69.5% in 2024 and are projected to reach levels of 73.6% in 2025 and 76.7% in 2026.[6] In other words, these countries have gone from what is generally considered a relatively safe debt-to-GDP ratio in the pre-pandemic period to what is generally considered a risky ratio in the post-pandemic period and into the coming years.

Furthermore, sovereign debt distress – i.e., a state where a sovereign's ability to service its outstanding sovereign debt is seriously impaired – is currently an ever-present reality for myriad emerging economies and developing countries. As the IMF noted in its April 2025 "Fiscal Monitor" report, "53% of low-income developing countries and 23% of emerging markets were at high risk of debt distress or in debt distress."[7]

As of the date that this article is being submitted for publication in early May 2025, the overall tariff and trade conflict situation is very much in a state of flux. It may therefore be premature to make any definitive predictions as to whether the new global economic and trade landscape will lead to widespread sovereign debt defaults, sovereign debt restructurings, and/or new or revised arrangements between the IMF and affected sovereigns. Nonetheless, it is not too early to flag the very real possibility that a range of emerging market and developing country sovereigns across Asia, Latin America, Africa and elsewhere might at some point in the coming period begin to experience new or heightened sovereign debt distress as a result of the fallout from the tariffs and trade tensions.

Yet Another Unwelcome External Economic Shock to Emerging Economies

In the last five years, the economies of emerging markets and developing countries have already suffered two external shocks that arose from events that had not occurred in a century or the better part of a century: namely, the COVID-19 pandemic (2020 and beyond), and a major land war in Europe (i.e., the ongoing war in Ukraine that started in 2022). Prior to the COVID-19 pandemic, the last major pandemic had occurred in the late 1910s, and prior to the Ukraine war, there had not been a major land war in Europe since the end of World War II in 1945.

To be sure, the Ukraine war led to ill effects such as higher inflation and shortages of basic commodities (e.g., grains, oil, etc.) among a number of emerging economies and developing countries, such as Egypt and a number of countries in Sub-Sahara Africa. However, the deleterious economic impact of the COVID-19 pandemic was far more profound and pervasive as the COVID-19 pandemic led to the widespread shutdown of economies around the globe.

Now, with higher tariffs, escalating trade tensions, a developing trade war between the US and China, and the resulting possibility of major disruptions of the global trading system, emerging economies and developing countries are now potentially at risk of being hit by a third major external shock in just the five-year period that began with the onset of the COVID-19 pandemic in 2020. In the same way that the COVID-19 pandemic and the Ukraine war were once in a century (or once in three-quarters of) a century events, the tariffs recently imposed by the Trump administration stand at levels that have not been seen in almost a century.

Specifically, compared to an 'average effective tariff rate'[8] of 2.3% in 2024,[9] the so-called 'average effective tariff rate' for the US has increased to an estimated 22% or higher based on the 'reciprocal' tariffs announced on April 2, 2025, with estimates varying depending on who is making the estimate.[10] This is apparently the highest average effective tariff rate for the US since the early twentieth century when, for example, in 1909 the average effective tariff rate was estimated to be approximately 21.1%, according to Fitch Ratings.[11]

Indeed, the current average effective tariff rate in the US is estimated to be higher than it was at the time of the (in)famous and widely derided Smoot-Hawley tariffs of 1930 for which the average effective tariff rate was estimated to be approximately 19%-20%.[12] Of course, the Smoot-Hawley tariffs, which took effect in 1930 in the early days of the Great Depression, have widely been seen by economic historians and other commentators as having contributed to the depth and duration of the Great Depression and as having led to the last great global trade war in the 1930s.

[*Update*: The Yale Budget Lab now estimates that, taking into account tariff developments as of July 27, 2025, the

[6] Id. at p. 3 (Table 1.2, "General Government Debt, 2019–30).
[7] IMF, Fiscal Monitor, April 2025, Chapter 1 ("Fiscal Policy Under Uncertainty"), p. 2.
[8] The concept of 'average effective tariff rate' reflects "the average tariff paid across all imports." Federal Reserve Bank of Richmond, "Tariffs Update: Potential Effects of the April 2 Announcements," Economic Brief (No. 25-13), April 2025 (https://www. richmondfed.org/publications/research/ economic brief/2025/eb_25-13).
[9] Id.
[10] Id. (indicating an 'average effective tariff rate' of 20.2% after giving effect to the April 2, 2025, tariffs). See also Fitch Ratings, "'Liberation Day' Takes US Tariff Rate Back to Level Last Seen in 1909," April 23, 2025 (https://www.fitchratings.com/ research/sovereigns/liberation-day-takes- us-tariff-rate-back-to-level-last-seen-in-1909-03-04-2025) (indicating an 'average effective tariff rate' of 25%).
[11] Id.
[12] Kate Nalepinski, "How the Smoot-Hawley Tariff Act Compares to Trump's Reciprocal Tariffs," Newsweek, April 4, 2025.

'average effective tariff rate' for the US has increased to a level of 18.2%,[13] which it indicates is the highest average effective tariff rate since 1934.[14]]

So far, while the current round of tariffs has led to an incipient trade war between the US and China as well as to fairly pronounced trade tensions between the US and Canada, Mexico, and the European Union (EU), the recently imposed tariffs have not yet led to the outbreak of a full- scale global trade war.

As of early May 2025, there are many unknowns and substantial uncertainty about where the current escalation of tariffs and the trade tensions between the US and China will end up. In the first place, the proposed level of country-level tariffs put forward by the Trump Administration has been an almost constantly moving target, to put it mildly. First there were country-specific tariffs (the so-called 'reciprocal' tariffs) announced on April 2, 2025 (what the Trump administration billed as 'Liberation Day'). These 'reciprocal' tariffs targeted approximately 60 countries with tariffs reaching as high as nearly 50% in some cases effective April 9 (while all countries would be subject to a baseline 10% tariff effective April 5). Such high tariffs were imposed even on some smaller developing countries that do not carry on much trade at all with the US and which therefore do not contribute meaningfully to the US trade deficit.[15]

Then on April 9, after a near-immediate and resoundingly negative reaction in the financial markets –including in the US stock market, the government bond market for US Treasuries, and the foreign exchange market for the US dollar – to the Trump administration's 'reciprocal' tariffs announced on April 2, a 90-day 'pause' was announced with respect to the 'reciprocal' tariffs. Yet, the 10% baseline tariff remained in effect for the countries on which the 'reciprocal' tariffs had originally been imposed. (China has been treated differently throughout the process, with the Trump administration continuing to raise the tariffs on China until a tariff of 145% on goods imported from China came into effect on April 9, 2025.)

Second, it is also unknown whether the Trump administration, during the 90-day 'pause' on 'reciprocal tariffs,' will be able to finalize any trade deals with those specific countries that were initially subject to those 'reciprocal' tariffs; if not, the Trump administration has said the original 'reciprocal' tariffs will snap back into effect. [*Update*: During the 90-day pause, the

[13] Yale Budget Lab, "State of US Tariffs: July 28, 2025," July 28, 2025 (https://budgetlab.yale.edu/research/state-us-tariffs-july-28-2025).
[14] Id. The Yale Budget Lab stated that "[a]fter consumption shifts, the average tariff rate will be 17.3%, the highest since 1935."

[15] For example, the tariffs for Cambodia, Laos, and Vietnam were set at rates of 49%, 48%, and 46%, respectively. The tariffs for the tiny African republic of Lesotho, which is surrounded on all sides by South Africa, were set at 50%, even though Lesotho's total exports to the US are miniscule.

Trump administration has announced only a handful of trade deals with countries such as the UK, Vietnam, Indonesia, the Philippines, and Japan (although at least a few of these deals appear to be more in the nature of agreements-in-principle as opposed to detailed final trade agreements). Further, the 90-day pause that was supposed to expire on July 9, 2025, has now been extended by the Trump administration until early August 2025, but it remains to be seen whether that timeline will be extended as well.]

Third, the targeting of specific industries for special industry-wide tariffs (e.g., tariffs for industries such as steel, aluminum, automobiles, and auto parts) and the exempting of certain products from the tariffs imposed on goods imported from China (e.g., smartphones, computers, electronics, etc.) has also been subject to change on seemingly a moment's notice.

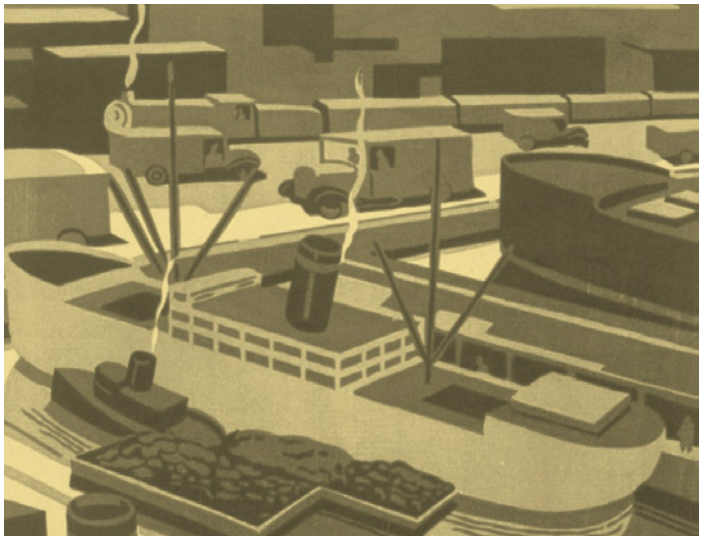
Finally, it is unclear how the unfolding US-China trade war will develop in the coming period. Tariffs imposed by the two countries on goods from the other country are now at fairly stratospheric levels: as noted above, the US has imposed tariffs of 145% on Chinese goods, and China has imposed tariffs of 125% on US goods.

The question is: Will the tariffs on the US and Chinese sides continue to escalate to even higher levels in a continuous cycle of tit-for-tat retaliation, or in the end will the US and China be able to reach some type of trade deal? As of early May 2025, it is not clear whether the US and China are even having discussions to discuss such a deal.[16] [*Update*: As a result of high-level meetings between representatives of the US and Chinese governments held in Geneva on May 10-11, 2025, the bilateral tariffs imposed by the US and China have been rolled back to lower levels—specifically US tariffs of 30% on Chinese goods and Chinese tariffs of 10% on US goods[17]—for ninety days until an August 12, 2025 expiration date (which now looks likely to be extended).[18]]

Pathways from Tariffs and Trade Conflicts to Potential Sovereign Debt Distress

There are multiple potential pathways by which high tariffs and escalating trade tensions (including the possibility of an expanding trade war) might ultimately cause adverse economic and financial developments which might then lead to potential sovereign debt distress for the affected countries. Some countries might feel the

[16] Joe Leahy, Wenjie Ding, and Demetri Sevastopulo, Financial Times, "China Tells US to 'Cancel All Unilateral Tariffs' If It Wants Talks," April 24, 2025 ("Beijing also said there were 'no economic and trade negotiations between China and the United States', despite repeated comments from President Donald Trump that the two sides were talking."). But see also Reuters, "China 'Evaluating' US Offer to Negotiate Tariffs; Beijing's Door Is Open," May 2, 2025.
[17] Financial Times, "China and US Agree to Slash Tariffs," May 12, 2025.
[18] Reuters, "US, China to Discuss Tariff Deadline Extension as Trump Reaches Philippines Deal," July 22, 2025. The temporary ninety-day truce between the US and China expiring on August 12 now looks likely to be extended by the US and China when the two governments plan to meet for discussions in Stockholm during the week of July 28, 2025.



effects of one or more of these pathways at the same time, such as where a country is both a direct exporter to the US as well as an indirect exporter to the US by virtue of its participation in global supply chains.

Further, financial channels – such as flows of capital out of a country, a depreciation or a devaluation of the local currency, increased borrowing costs, and/or investor sentiment – could amplify the effects of tariffs and trade frictions, and possibly vice versa. Moreover, the impact of tariffs and trade tensions is not necessarily a simple cause-and-effect dynamic but can involve ripple effects and feedback loops within and across economies.

Direct Impact of Reduced Exports to the US

The most direct pathway would be high US tariffs causing harm to economies which have significant exports directly to the US. If the tariffs for a particular country are high enough and the exports to the US of the country in question represent a meaningful enough share of the country's GDP, its overall exports, and/or its foreign exchange earnings, then the country could experience serious detrimental effects from the tariffs. There are a number of emerging and developing economies that rely heavily on exports to the US as a percentage of their total overall exports, including, among others, Mexico, various countries in Central America, Vietnam, Bangladesh, the, Thailand, Malaysia, the Philippines, and Colombia.

However, as discussed in further detail below, the mere fact that these specific economies are heavily dependent on US exports does not mean that such economies will necessarily experience sovereign debt distress as a result of the fallout from the tariffs and trade tensions. If the US tariffs become prohibitive enough that there is a reduction in such exports from these countries, the country in question (unless it can find alternative export markets for its goods) may face a major economic slowdown with contracting GDP, higher unemployment, and/or lower tax revenues. If the country attempts to cushion the blow by pumping money into its economy or otherwise providing a safety net for its citizens, it could put undue pressure on its fiscal balance.

Moreover, if the country raises debt in order to be able to undertake such measures, it could be adding debt to what may already be a very high existing debt burden or perhaps even an unsustainable debt burden. Further, where such a country loses access to the US market and is unable to reroute its exports to other countries, it may lose an important source of foreign exchange. If a country's outstanding sovereign debt is denominated in a hard currency such as the US dollar, this loss of export- generated foreign exchange could make it more difficult for the country to repay its outstanding dollar-denominated sovereign debt. This problem would be compounded if the value of the local currency depreciates vis-à-vis the US dollar.

Thus, where a country's exports to the US market are cut off or reduced significantly, the affected country, depending on its pre-tariff position and subject to its economy's ability to withstand economic shocks, may start to experience some degree of sovereign debt distress or any existing sovereign debt distress may be exacerbated. As noted above, this may be due to factors such as growing fiscal imbalances, a higher debt burden and therefore potentially higher debt servicing costs, and/or lower foreign exchange earnings.

However, the situation can get even worse if, as a result of these developments, foreign investors begin to lose confidence in the affected country and start to pull back their investments in the country, resulting in capital outflows. This, in turn, could lead to a weakening of the local currency, inflationary pressures, higher interest rates, and higher borrowing costs for the country in question, and possibly sovereign rating downgrades. To be sure, though, there can be multiple chains of causation for these various adverse economic effects.

In other words, these subsequent developments could exacerbate the more immediate and direct adverse effects resulting from a cutoff or reduction in exports and a slowing of the country's economy. And this downward spiral can feed on itself and lead to further negative effects for the economy in question.

Disruption of Global Supply Chains

The economies of many emerging markets and developing countries are connected to and/or highly dependent on global supply chains, and these supply chains represent a critical feature of the global trading system. Overall, while estimates vary, some estimates indicate that over half

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of total global trade involves 'global value chains' (a close cousin of global supply chains).[19]

Global supply chains remain important notwithstanding the efforts of various large economies in recent years to bring supply chains closer to their home economies (such as through 'nearshoring' or even 'onshoring' of important imports), which was a business and policy response to the significant supply chain disruptions that occurred during the COVID-19 pandemic.

A number of emerging economies and developing countries may not export directly to the US market, but rather they may contribute inputs that are then ultimately incorporated into the final product which is then exported to the US or elsewhere. Moreover, these global supply chains can be very long with many countries contributing inputs into the final product.

In a global supply chain for any particular product (whether it is, for example, a smartphone, computer, automobile, or countless other items), raw materials such as various types of minerals may be sourced in one set of countries and components for the product may be manufactured in another set of countries. The final assembly of the product may take place in a third set of countries, and sales and distribution of the final product may be handled from yet a fourth set of countries.

Even though a particular country may not export directly to the US, the intermediate products that are produced in that country may be in less demand overall if, due to US tariffs, the US market is effectively shut off to the country from where the final product is being exported. Thus, in such a scenario, countries up and down the supply chain might see diminished demand for their output of intermediate products.

This could result in a wide range of adverse effects for the countries that are part of a particular supply chain. These effects might include reduced GDP, lower foreign exchange earnings, higher levels of unemployment, and further strain on its fiscal accounts to the extent the governments try to cushion the impact of the dislocation caused by a slowdown in their economies.

As discussed above with respect to direct exports to the US and the follow-on effects, there could be further negative effects for countries plugged into global supply chains if and when investors start to lose confidence in a particular country. For instance, borrowing costs for the countries in question could rise if and when there

[19] See, e.g., OECD, "Global Value and Supply Chains" ("[a]bout 70% of international trade involves global value chains (GVCs), as services, raw materials, parts, and components cross borders – often numerous times") (https://www.oecd.org/ en/topics/global-value-and-supply-chains. html). 'Global supply chains' are defined as "a network of suppliers, manufacturers, distributors and retailers who are involved in sourcing raw materials, creating a product and selling it to the consumer," whereas 'global value chains' are defined as "a series of activities by a business to offer valuable products or services to its customers." GEP, "Supply Chain versus Value Chain: Why the Difference Matters" (https://www.gep.com/blog/technology/supply-chain-vs-value-chain).

are credit downgrades by ratings agencies (in response to capital outflows and other negative economic developments for the countries), and that could set off its own negative feedback loop.

It should be noted that the effect of tariff-induced disruptions to global supply chains might be magnified if there are other causes for supply chain disruption, such as port closures, natural disasters, pandemics, extreme weather events, and so forth.

Countries Affected by Global Economic Slowdown

Even countries that are not heavily dependent on global trade via exports to the US or integration into global supply chains could find themselves facing financial and economic challenges from an overall slowdown of the global economy that may result from the new tariffs and trade tensions. For example, commodity-exporting economies may be hurt by a slowdown in the global economy if such a slowdown leads to a lower level of demand for the particular commodities the country exports, and this in turn could lead to a drop in the price of these commodities. With falling commodity prices, these economies may generate lower export revenues and thus lower foreign exchange earnings. To the extent that these economies are heavily dependent on commodity exports, this loss of export revenues and foreign exchange earnings could create unwelcome financial and economic pressures on these commodity-exporting countries.

A number of emerging economies and developing countries depend on commodity exports to help sustain their economies, whether the commodities in question are agricultural products (e.g., soybeans, grains, coffee, cocoa, tea, rice, palm oil, etc.), minerals or natural resources (e.g., oil, copper, coal, cobalt, lithium, etc.), or otherwise. But if, as many observers expect, the tariffs and trade tensions lead to a global slowdown and thus lower demand for key commodities that in normal times keep economies humming, the prices of such commodities might drop sharply.

This is certainly the expectation of international institutions such as the World Bank which has stated that "[c]ommodity prices are set to fall sharply [in 2025], by about 12% overall, as weakening global economic growth weighs on demand. [In 2026], commodity prices are projected to decline by another 5%, reaching a six-year low."[20]

For instance, among other commodities, a global slowdown could lead to a significant drop in the price of oil. Thus, whereas baseline projections for the 2025 price of oil might have been roughly in the range of the mid-$70s per barrel[21] absent the recent tariff/trade disruptions, projections taking into the effect of those disruptions would lower the price per barrel to the lower to mid-$60s range per barrel.[22] Obviously, if such a steep price drop were to occur, that could potentially translate into a large loss of export revenues and foreign exchange earnings for an oil-exporting country, with the associated deleterious consequences for the economy in question. (Of course, on the other hand, oil-importing countries might benefit from such a drop in the price of oil, although such countries might suffer from other ill effects of tariffs and trade tensions such as where the prices of commodities exported by these countries also decline.)

Oil-producing countries have a benchmark oil price that will enable their governments to achieve budget balance which is known as the 'fiscal breakeven oil price.' However, if the current global trade and economic conditions lead to a sharp drop in the price of oil, some of these countries may find that the market price of oil is less – even possibly considerably less – than the fiscal breakeven oil price. If that were to occur, that could mean that their fiscal balance might be thrown out of whack.

Potential Impact on Sovereign Debt Distress in Individual Countries

As a result of the tariffs and trade tensions, countries around the world may suffer a wide range of adverse financial and economic effects as discussed above. But whether those adverse effects will translate into sovereign debt distress for the country in question will depend on various factors. For instance, what will be the final rate of US tariffs for a particular country, and specifically will the 'reciprocal' tariff rates come down significantly from the levels announced on April 2, 2025 as a result of any trade deal that is ultimately reached between the US and the country in question? Nonetheless, wherever the tariff rates end up, the issue is how serious will the adverse effects from the tariffs and the trade tensions be for the country's economy.

Fundamentally, whether a country experiences sovereign debt distress as a result of the tariffs and trade war may depend on the extent of the country's fiscal and other buffers that would help cushion any impact that any adverse effects from the tariffs and trade war might have on the country's economy and overall fiscal and financial situation. There are many forms those buffers could take,

[20] World Bank, Commodities Market Outlook, Executive Summary, p. 1, April 2025.

[21] EIA Short-Term Energy Outlook (April 10, 2025) (www.eia.gov/outlooks/steo/) and World Bank Commodity Markets Outlook (April 2025), Table I (World Bank Commodity Price Forecasts), p. 11. Prior to the latest tariff announcements, the Energy Information Administration of the US Department of Energy (EIA) in its March 2025 Short-Term Energy Outlook projected Brent crude oil prices to average $74.22 per barrel in 2025, and the World Bank forecast a price of $73 per barrel. EIA Short-Term Energy Outlook (April 10, 2025) (www.eia.gov/outlooks/steo/)..

[22] Id. After the announcement of tariffs, the EIA forecast a 2025 price of $67.87 per barrel, and the World Bank forecast a 2025 price of $64.

including the country having adequate 'fiscal space' and a degree of fiscal balance, sufficient foreign exchange reserves, manageable public debt levels, and so forth.

If a country is lacking those types of buffers, it could be leaving itself more exposed to the possibility that, as a result of the fallout from the tariffs and trade tensions, it will experience sovereign debt distress or at least will be at the risk of such distress (assuming that its financial and economic situation will suffer serious harm from the fallout of the tariffs and trade war). Thus, for each individual country, one needs to consider whether the country enters this new period of tariffs and trade tensions with adequate buffers or, rather, whether it has a number of fiscal and financial/economic vulnerabilities that make it more likely to experience sovereign debt distress.

For example, is the country's debt-to-GDP ratio and/or its debt servicing costs-to-government revenues ratio too high? Does it have foreign exchange reserves that will cover more than merely a couple of months of imports? Is an inordinately high percentage of its government debt in the form of external, foreign-currency denominated debt, or does it have mostly domestic debt denominated in the local currency?

Finally, it should be noted that not all countries that experience adverse effects from the tariffs and trade tensions will automatically experience sovereign debt distress. Some of the countries may have sound underlying economic and financial fundamentals and will thus be able to withstand the adverse impact on their economies from the tariffs and trade tensions. Thus, as noted above, one cannot simply assume that since a country is heavily dependent on exports to the US and those exports are subject to high tariffs that the country will necessarily end up in a situation where it has difficulty servicing its sovereign debt.

In short, whether or not a particular country will experience sovereign debt distress will require an individualized assessment of the particular characteristics of the country's fiscal and economic/ financial profile. Again, the issue is whether the country's fiscal, economic, and financial fundamentals are basically sound. In other words, does the country have adequate buffers to cushion the impact of the adverse effects that might flow from the tariffs and trade tensions?

Wild Cards

Uncertainties regarding both the recovery of the Chinese economy and the future US relationship with the IMF and World Bank could be wild cards. The extent to which the economies of emerging markets and developing countries may be adversely affected by high tariffs and intensified trade conflicts (as well as the extent to which these

economies begin to experience or otherwise address existing sovereign debt distress that is made worse by such conditions) may be influenced by two important factors. First, will the Chinese economy continue to stagnate as it seems to be doing at the present or will it stage a recovery anytime soon? Second, will the US government continue to provide its usual level of support to the IMF and the World Bank, or will it drastically reduce the US financial support for and/or involvement with these institutions as a result of the Trump administration's policies?

Short-term Recovery of the Chinese Economy?

In the past few years, the Chinese economy has been beset by serious deep-seated problems. Its property market essentially collapsed a few years ago, and property prices remain relatively subdued or depressed even today.[23] The Chinese government has also been grappling with a massive overhang of trillions of dollars of debt incurred by its so-called local government financing vehicles (LGFVs), as was discussed in my article in last year's edition of International Insolvency & Restructuring Report.[24]

So far at least, however, the Chinese government seems to have made fairly limited headway in addressing or resolving this issue. Growth in the Chinese economy has been sluggish, and China has struggled to meet annual growth targets of 5% GDP growth. The IMF recently reported that China had achieved 5% growth in 2024, although there has been some skepticism as to whether China actually achieved 5% growth that was reported by the Chinese government.[25] Yet, in any event, the IMF is now projecting lower growth of 4% for China in both 2025 and 2026.[26] [*Update*: China recently reported growth of 5.2% growth in the second quarter of 2025 and 5.3% for the entire first half of 2025,[27] but many analysts believe that it will be difficult for China to sustain that level of growth for full-year 2025.[28]]

Many analysts have expressed the view that the Chinese economy is experiencing a period of stagnation. Further, unlike much of the rest of the world where inflation has been a major concern, China has been facing just the opposite problem: what many consider to be a deflationary environment with a broad-based decline in prices across the Chinese economy.[29]

Some observers have even wondered whether China is falling or may fall into a deflationary trap such as Japan experienced in the 1990s (Japan's 'lost decade') and even beyond.[30] Others, however, have pointed out that the Chinese government, with its state-directed economy and its control of state-owned enterprises and state-owned banks, has many more policy levers at its disposal to reverse deflationary pressures in the Chinese economy than were available to the Japanese government at the time that it was experiencing its long-running bout of deflation.

The Chinese government has sought to provide important stimulus to the Chinese economy by, for example, providing significant additional resources to its large state-owned banks with the expectation that the banks will then in turn sharply increase their overall lending to companies in China. Nonetheless, it is unclear when China will truly turn the corner in overcoming deflationary pressures in its economy and also when China will resume having the type of relatively healthy economic growth that it had experienced in the pre-COVID period.

To be sure, though, the Chinese government continues to make huge and important investments in advanced science and technology in cutting-edge areas (e.g., AI, electric vehicles (EVs), biotechnology, semiconductors). These investments may yield substantial and possibly

[23] Reuters, "China's Home Prices to Drop Further, Recovery Not Expected Until 2026: Reuters Poll," February 25, 2025 ("Home prices were expected to drop at a faster pace this year than previously estimated, with growth resuming in 2026….").
[24] Steven T. Kargman, "A Tale of Two Debt Burdens: A Day of Reckoning for China's Debt-Fueled Infrastructure Development at Home and Abroad," International Insolvency & Restructuring Report 2024/25, May 2024, pp. 11-24.
[25] Gerard DiPippo, "Focus on the New Economy, Not the Old: Why China's Economic Slowdown Understates Gains," Rand Corporation, February 18, 2025 ("In 2024, China achieved its politically mandated real (inflation- adjusted) GDP growth target of 5% with implausible precision. More plausibly, China reported nominal (not adjusted for inflation) growth of 4.2%.").
[26] IMF, World Economic Outlook (April 2025), Projections Table ("World Economic Outlook Growth Projections") (https://www.imf.org/en/Publications/WEO/Issues/2025/04/22/world-economic-outlook- april-2025).
[27] Wall Street Journal, "China's Solid Economic First Half Will Be a Tough Act to Follow," July 17, 2025.
[28] Reuters, "China's Economy Slows as Consumers Tighten Belts, US Tariff Risks Mount," July 15, 2023. Many analysts believe that, among other reasons, China's stronger-than-expected first half results are due to the fact that China seems to have been 'front-loading' exports to the US during the first half of 2025 while the US-China tariff truce announced in mid-May 2025 remained in effect.
[29] Alexandra Stevenson, "Can China Fight Deflation and Trump's Tariffs at the Same Time?," New York Times, April 17, 2025 ("The Chinese government has for several years been dealing with deflation, the pernicious side effect of a property crisis crawling through the economy and putting a freeze on much economic activity.").
[30] See, e.g., Reuters, "China's Deflationary Pressures Persist as Trade Gloom Worsens," April, 9, 2025 ("China's consumer prices fell for the second straight month in March while factory-gate deflation worsened"); Patrick Bolton and Haizhou Huang, "Is China Facing a Deflationary Trap?," Project Syndicate, October 18, 2024 ("Now, China is teetering on the edge of a deflationary trap: the consumer price index has been hovering near zero for 16 months, and the producer price index has been in negative territory for 24 months.")

transformative benefits for the Chinese economy over the longer term.[31]

In past periods of global economic slowdown such as at the time of the 'global financial crisis' of 2008-2009, China 'primed the pump' with a massive fiscal stimulus plan of nearly US$600bn and the Chinese economy grew at a very healthy rate during this period, with growth reported to be over 9% in both 2008 and 2009.[32] This growth in China occurred notwithstanding the gloomy global economic environment and the global economic slowdown that was then affecting many other countries around the world. Indeed, growth of the Chinese economy in the period of the global financial crisis helped fuel overall growth in the global economy (or at least provided a ballast for the global economy so that it did not contract further) as evidenced by the fact that growth in the Chinese economy constituted approximately a quarter of total global growth during this period.[33]

However, if the Chinese economy remains in the doldrums relatively speaking, then a crucial engine for economic growth in the global economy might be missing from the global economic equation. Thus, to the extent that emerging economies and developing countries experience major economic slowdowns as a result of the new tariffs and trade conflict, the Chinese economy may not necessarily be in a position to pull these economies out of their economic troughs. This, in turn, will make it even more difficult for these economies to address any sovereign debt challenges, including any sovereign debt distress that they may then be experiencing.

Separately, if Chinese companies remain locked out of the US market for an extended period of time or even if they are exporting at a much lower level than they have in the past, such Chinese companies may end up looking for new export markets for their products that would otherwise have gone to the US market. The Chinese government may be supportive of the Chinese companies undertaking such a strategy since presumably it will not want to see Chinese factories operating at significantly reduced capacities with the result that such Chinese companies might potentially have to lay off large numbers of their employees. The Chinese government has long wanted to avoid widespread Chinese unemployment which it views as a potential threat to one of its overriding policy objectives, namely maintaining social stability in China.

Yet, some observers have speculated that if Chinese companies shift products from the US market to other markets, this may result in Chinese companies effectively 'dumping' their products in these other markets at artificially low prices, i.e., flooding these markets with relatively inexpensive products. That could potentially hurt the economies of these alternative markets, especially if they produce the same goods that the Chinese companies are shipping into these other markets.

It remains to be seen, though, whether Chinese companies, with (or without) the possible support or encouragement of the Chinese government, will in fact pursue such an export diversification/'dumping' strategy as a way of addressing the loss of exports to the US market due to high US tariffs on Chinese goods. But if the Chinese companies do send such excess goods to economies that may already be suffering in one way or another generally from the new tariffs and trade conflicts, this may simply be adding insult to injury. Moreover, if those alternative markets involve vulnerable emerging economies or developing countries, that could put additional stress on their economies and potentially on their sovereign balance sheets.

Finally, it has to be remembered that China has its own agency in the trade war with the US. It can decide if and when it wants to enter into trade negotiations with the US and what terms it is willing to accept in a trade deal, if any, that might ultimately be negotiated by the US and China.

Continued US Support for the IMF and World Bank?

Countries look to the IMF as a crucial source of financial support when they are facing balance-of-payments crises or financial/economic crises generally. When countries cannot access financing from other sources (such as when they are cut off from the international capital markets), they will often turn to the IMF to provide the necessary financing. In that sense, the IMF has played the role of a 'lender of last resort.'

To be sure, IMF loans come with strings attached, namely a series of conditions, such as macroeconomic targets and 'structural' reform benchmarks, which borrower countries must satisfy in order to receive disbursements under the relevant IMF loans and the associated IMF programs. These conditions can be controversial, especially if they lead to severe austerity measures and if any such austerity measures have a contractionary effect on the economy.

Further, complementing the role played by the IMF, the World Bank also often provides important financial support to countries undergoing financial or economic crises (in addition to its broader, more customary role

[31] Gerard DiPippo, "Focus on the New Economy, Not the Old: Why China's Economic Slowdown Understates Gains," Rand Corporation, February 18, 2025.
[32] World Bank DataBank (indicating that the Chinese economy grew 9.7% in 2008 and 9.4 percent in 2009, albeit at a reduced level from 2007 when it grew 14.2%) (https:// data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN).
[33] See, e.g., IMF, World Economic Outlook April 2010, Chapter 1 ("[i]n 2009, China and India together accounted for almost half of global GDP growth, with China alone contributing more than 27%"). See also World Bank, Global Economic Prospects 2010 ("[w]ithout the contribution of China and a few other large developing countries, global output would have fallen more sharply in 2009").

of providing loans and grants in order to promote development in developing countries).

Nonetheless, in early February 2025, the Trump administration announced pursuant to an executive order that it would undertake a 180-day review of the US roles in international institutions.[34] It should be noted that the highly controversial Project 2025 report, which was designed to serve as a blueprint for policy in a second Trump Administration, called for the US to withdraw from both the IMF and the World Bank and to cut off financial contributions to both institutions.[35]

Yet, on April 23, 2025, in connection with the spring 2025 annual meetings of the IMF and the World Bank, US Treasury Secretary Scott Bessent delivered an address in which he indicated that the US was not planning to withdraw from either the IMF or the World Bank but instead wanted to see major changes in the direction of these institutions, such as de-emphasizing areas such as climate change in the work of these institutions.[36] Of course, until President Trump himself weighs in on this matter, it is very difficult to predict where the Trump administration will end up on this issue. Thus, a more drastic change in the nature of the US relationship with the IMF and World Bank cannot be completely ruled out.

Even then, though, the Trump administration's position could be subject to further change in response to market reaction (as reflected for example in stock market movements, the price of US Treasuries, or the value of the dollar) or otherwise as has become evident recently with the topsy-turvy way in which the Administration has handled its announcement of tariffs in early April. [Update: Since Treasury Secretary Scott Bessent's statements on this issue in late April, there have not been any major pronouncements from the Trump administration regarding this issue. Thus, it still remains to be seen what actions the Trump administration will ultimately end up taking vis-à-vis the IMF and the World Bank and, in particular, whether it will limit itself to what Treasury Secretary Bessent stated in late April or whether it will take more sweeping actions. (It should be noted, though, that in early May as part of its fiscal year 2026 budget, the Trump administration asked Congress to provide $3.2 billion of funding for the International Development Association, the arm of the World Bank that provides concessional lending to the world's poorest countries.[37])]

If, however, the Trump administration was ultimately to decide to cut off all US financial support for these institutions or even to significantly reduce such support, that could potentially seriously affect ability of these institutions to carry out their missions. For example, since the US provides a large part of the IMF's overall funding, any diminution of US support and funding for the US could make it potentially more difficult for the IMF to provide rescue packages for countries in need of emergency financing.[38]

(Separately, if the US were to withdraw from the IMF and the World Bank or substantially reduce its contributions to these institutions, various observers believe that the US would be giving up its enormous influence at these institutions, possibly to the benefit of China[39] and certain other countries. Some observers have even suggested that such moves might even undermine the role of the US dollar as the world's reserve currency.[40] The US is the largest shareholder of these institutions, and, for example, with approximately 16.5% of the total voting power of the IMF, the US government has an effective veto power over certain specified major decisions by the IMF Board which require a supermajority vote of 85%. Thus, with this de facto veto power and the significant influence that comes with being the IMF's largest shareholder, the US is seen as having an important voice in influencing the policy direction of the IMF.)

With diminished support from the US (if that comes to pass), the IMF might not be in a position to step in and provide financing packages to countries experiencing financial distress of the same size and scope as it has in

[34] DW, "Trump Probe Raises Doubts Over US role in IMF, World Bank," April 23, 2025 (https://www.dw.com/en/trump- probe-raises-doubts-over-us-role-in-imf- world-bank/a-72271143); Fitch Ratings, "US Review of Participation in International Organizations Highlights Risk to MDBs," February 11, 2025.
[35] Heritage Foundation, Project 2025, Chapter 22 ("Department of the Treasury"), pp. 701-702.
[36] Claire Jones and James Politi, Financial Times, "Scott Bessent Accuses IMF and World Bank of 'Mission Creep,'" April 23, 2025.
[37] Reuters, "Trump's Budget Includes $3.2 Billion for World Bank's Fund for Poorest Countries," May 2, 2025. This funding request came as a welcome surprise to development experts in light of prior statements from the Trump administration that have been generally critical of international institutions.
[38] DW, "Trump Probe Raises Doubts Over US role in IMF, World Bank," April 23, 2025 (https://www.dw.com/en/ trump-probe-raises-doubts-over-us-role- in-imf-world-bank/a-72271143) ("[a]ny US withdrawal may create an immediate liquidity crisis for the IMF and World Bank, whose combined $1.5 trillion in resources depend heavily on US contributions").
[39] Alan Rappeport, "Global Economic Leaders Gathering in the US Confront Trump's New World Order," New York Times, April 22, 2025 (withdrawal of the US from the IMF and World Bank would "most likely cede more global influence to China by giving it more sway in how the institutions are operated").
[40] Edwin Truman, "Imagine What Would Happen If America Left the IMF," Financial Times, April 20, 2025 (arguing that a US withdrawal from the IMF could undermine the role of the US dollar as the world's reserve currency).

past sovereign debt episodes (unless, for instance, other IMF members step up and fill the financial gap created by any potential US reduction of financial support). As discussed above, emerging economies and developing countries may face increased incidence of sovereign debt distress as a result of the new tariffs and increased trade tensions so a lack of adequate resources for the IMF could hinder the IMF's ability to respond to sovereign debt crises.

Similarly, assuming that the Trump administration also reduces financial support for the World Bank, it too may also be constrained in its ability to provide assistance to countries undergoing financial and economic difficulties.[41] However, unlike the IMF, the World Bank can and does access the capital markets to support its operations, but query whether a US withdrawal from the World Bank would harm the Bank's triple-A credit rating and thereby raise borrowing costs for the Bank.

[41] Alan Rappeport, "Global Economic Leaders Gathering in the US Confront Trump's New World Order," New York Times, April 22, 2025 ("The United States is the Bank's largest shareholder. If America tried to withdraw, it would substantially reduce the bank's lending power and influence.")

Consequently, if the IMF in particular (but the World Bank as well) were to have reduced financial resources and thus less overall firepower available to address financial and/or economic challenges facing distressed sovereigns, such countries may have greater difficulty in addressing and resolving their financial and/or economic travails. In short, a crucial part of the existing overall sovereign debt restructuring/resolution machinery would no longer be available to help sovereigns address their financial and/or economic travails and any related sovereign debt distress.

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