FORUM: Economic & Social Council 2

ISSUE: Measures to Alleviate National Debt to Encourage Sustainable Economic Development

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Introduction

When the UN met at the Sustainable Development Summit in September of 2015, a total of 17 goals were established to summarize the main areas countries should focus on to ensure sustainable development. These goals established how economic growth must be considered side-by-side with social equality and environmental protection to ensure that the world is more sustainable by the year 2030. Among the 193 countries that have agreed to follow these policies, many of them have found national debt to be a crippling issue, especially for LEDCs.

While most development financing increased from 2015 to 2019, the amount of unsustainable debt among both MEDCs and LEDCs had risen significantly. Even if we were to completely disregard the devastating blows that the COVID-19 pandemic had on the global debt, the amount of fiscal space that had been left dwindled since 2019, and it doesn’t seem to be reversing with current policies. Given the gradual increase of countries moving towards debt distress, the feasibility of reaching sustainable

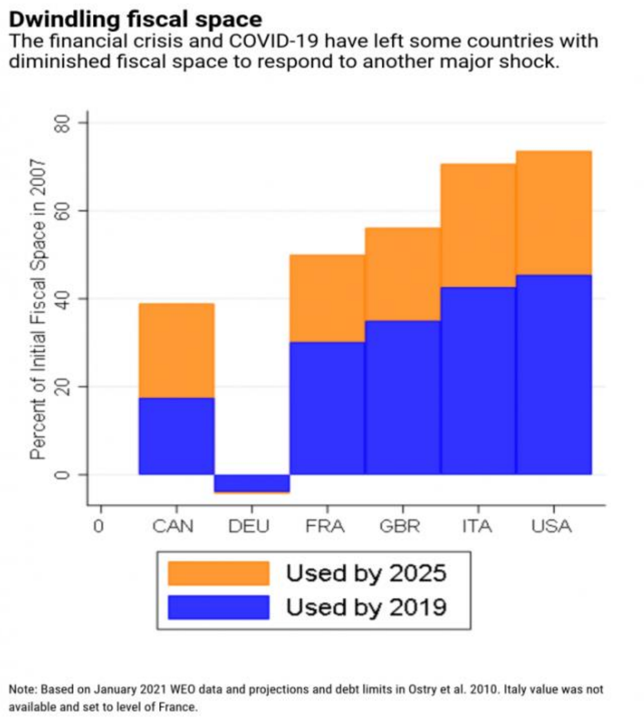
le development has been somewhat halted across the world. This isn’t to say that no improvements have been made; countries following the Sustainable Development Goals (SDGs) have progressed under great economic prosperity throughout the 2010s. However, gradual increases in national debt and global crises, such as the COVID-19 pandemic, decreased the leeway for becoming more sustainable, becoming a vast roadblock within the foreseeable future if policies aren’t appropriately amended.

Background

The Financial Situation of Global Debt

Even though the world experienced a net increase in GDP of 12.7% (from $75 trillion in 2015 to $84.5 trillion in 2020) and the net debt of LEDCs fell 28% to $529 Billion, data reports have shown that the amount of unserviceable debt within developing countries is rising. In fact, as noted in 2018 by IMF

Deputy Managing Director Tao Zhang, 40 percent of LEDCs have risked debt distress or were unable to service their debt; this increased from 21 percent in 2013. This increased the debt among LEDCs from $529 Billion to $744 billion until 2019, which the COVID-19 global pandemic would further exacerbate. An increase in debt isn't limited to only LEDCs, though; In fact, many of the G7 nations have been cutting down the amount of fiscal space within their debt spending, which was originally preconceived from the 2007 financial crisis, and expressed uncertainty of their economic ability to manage future crises like the COVID-19 pandemic. As depicted in the graph above, except Germany, the G7 countries have cut significant portions of the fiscal space made available to them from the 2007 recession (highlighted in blue), which have led to higher predicted fiscal deficits in their debt (highlighted in orange). Once countries utilize all their financial resources and remaining fiscal space, they risk defaulting on their loans. This was especially evident in Greece, 2015 when it became the first developed nation to default; They missed a required debt payment of €1.6 billion to the International Monetary Fund (IMF), which was originally loaned to bail out both a liquidity crisis and account deficit which had been slowly building up over the course of the 21st century.



Bar graph of estimated remaining fiscal space among the G7

The issue of properly balancing the fiscal space of each country's governmental debt was escalated to a higher level in 2020 than ever before due to the COVID-19. It's estimated that MEDCs spent approximately $12 trillion, 31% of their combined GDP, to dampen the economic effects of the pandemic (this fiscal statistic doesn't account for monetary stimulus through lowering interest rates and purchasing financial assets through the central bank). Similarly, to this fuller extent, the economic effects of COVID-19 on LEDCs were devastating. World Bank president David Malpass described it as "worse than the financial crisis of 2008 and for Latin America worse than the debt crisis of the 1980s". Furthermore, Ken Ofori-Atta, Ghana's finance minister, stated that "The ability of central banks in the West to respond [to the pandemic] to an unimaginable extent, and the limits of our ability to respond, are quite jarring… You really feel like shouting, 'I can't breathe."

David Malpass commenting on behalf of the World Bank, about the DSSI in response to COVID-19

The temporary solution that MEDCs placed in response to the pandemic's economic implications was the Debt Service Suspension Initiative (DSSI); this was an offer given to the 77 least developed countries to suspend their interest payments to official creditors (like MEDCs, the IMF, and the World Bank) until June 2021. The suspended payments would be added to their existing debt and need to be paid back within 5 years. However, the true value of these programs was questioned. While this does temporarily release some of the economic strain on poorer countries in the short term, this would prove to be ultimately detrimental to the economies in the future 5 years as they pay off their debt. Because this program only suspends interest payments from governments, (not private lenders), and doesn't consolidate any of the existing debt that the country already owes, it places a huge economic burden that these LEDCs can't already handle but places a time limit of 5 years to pay it all off. If the LEDCs felt like they couldn't breathe before, this would be the equivalent of allowing them to shortly catch their breath before suffocating them with the burden of additional debt in, very shortly after. In addition to distributing the strain across only 5 years, the simple fact that DSSI countries request suspensions in interest payments has been proven to have significant, if not permanent, effects on the countries involved. Countries, such as Ethiopia, Pakistan, and Cameroon, have already faced some of the consequential effects on their economic debt: Their suspension of interest brings down their economic creditworthiness, which makes countries vulnerable to credit rating agencies downgrading their debt. This downgrade in debt increases the borrowing costs to those countries, thus increasing the debt burden that nation carries, whether eventually consolidated or defaulted.

Problems Raised

Fiscal Management

With the boundaries between the amount of fiscal space remaining for the G7 and G20 slowly tightening, proper fiscal management is a priority for managing governmental debt. Not being able to properly manage debt can lead to devastating results and have serious implications for not only the country that defaults but also for countries that hold debt from the defaulting countries. This was slightly illustrated with the situation of Greece's financial crisis during the 2000s; The lack of revenue due to systemic tax evasion combined with the 2007 global financial crisis rendered Greek bonds useless. They were marked by U.S. financial rating agencies as a "junk" grade in 2010, which lowered the value of these bonds. As a result, much of their capital dried up until Greece faced a liquidity crisis, which ended up forcing the government to seek bailout relief. These bailouts were granted by the IMF and other European countries under the contingency that Greece would stabilize their fiscal policy through budget reforms by cutting spending and increasing tax revenues. This, however, inadvertently created a cycle of recession that brought the unemployment rate down to 25.4% in August 2012; further weakening tax revenues and trade relationships with the European Union. This would culminate in the country defaulting in 2015. Because these problems occurred due to a pre-existing weak economy —through widespread corrupt tax evasion and lower productivity rates— it's important that countries have a proper economic foundation to ensure their fiscal policies won't be undermined by their citizens.

Low Tax Revenue/International Support

The primary problem for LEDCs regarding national debt is being insufficient in raising public revenue. This lack of tax revenue can be traced back to tax evasion and weak administration, especially given that the median tax revenue of these LEDCs is just 13.3 percent of GDP. For example, Tanzania and Mozambique are losing tax revenue to international companies who are extracting gas, coal, and other materials. These companies evade taxes by transferring their funds to subsidiaries they have in tax haven countries, which has cost African LEDCs a total of $50 billion in taxes annually. This, combined with the lack of international participation and collaboration on tax in a world where the business has become a global effort and not a domestic one, has left the developing countries with more fragile economic systems, which are unable to maintain sustainable development without international support or internal revenue. This holds true for African LEDCs who've suffered losses in tax revenue, because of the lack of international cooperation to crack down on tax evasion. Another example that covers a different aspect of this problem is Venezuela —a once wealthy country impoverished by hyperinflation and government spending. Because most Venezuela's exports are oil from its borders, when the price of oil dropped in 2015, so did their economy. Since then, they've experienced hyperinflation of 13,116,674%, and have been unable to diversify their economy; Especially without the aid and guidance of foreign nations, they've been unable to make any progress into sustainable development.

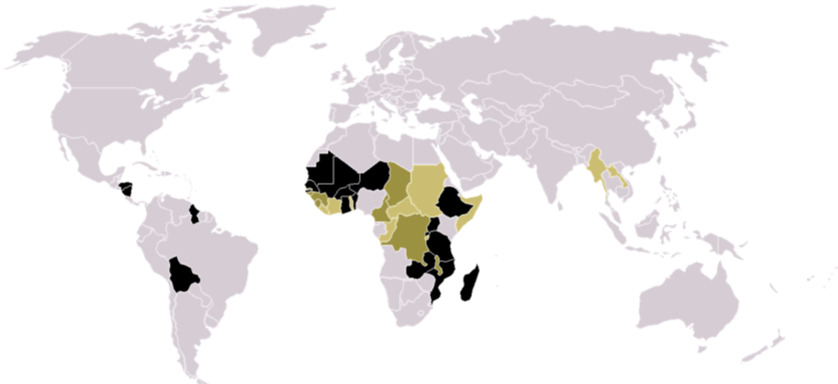
International Actions

Sovereign Debt restructuring

In 2015, the UN General Assembly adopted a resolution stating that sovereign debt restructuring processes should be guided by basic international principles of law such as sovereignty, good faith, transparency, legitimacy, equitable treatment, and sustainability. It also guarantees the sovereign state's right to exercise macroeconomic policy, including the restriction of its sovereign debt. The United Nations Department of Economic and Social Affairs(UNDESA) launched a range of multi-stakeholder consultations on Sovereign Debt restructuring to solicit views of distinguished experts from different sector representatives.

Heavily indebted poor countries initiative

The heavily indebted poor countries (HIPC) initiative was launched in 1996 to remove the debt overhang from highly indebted poor countries. The initiative was modified in 1999 to deliver faster and broader debt relief which incorporated poverty reduction strategies to pursue the Millennium Development Goals. In June 2012, 33 countries had reached the completion point, and 3 countries (Chad, Comoros, and Guinea) had reached the decision point under the initiative. During the period from 2001 to 2010, the 36 decision point countries have undergone reductions in average debt service to GDP ratios and an increase in poverty reducing expenditure to GDP ratios. However, HIPC's have made uneven progress towards achieving the debt sustainability targets as some countries have already achieved the completion point while others are far from achieving it soon. This situation calls for deeper solutions to be found at the international level to remedy future sustainability.



The Heavily Indebted Poor Countries(HIPCs)

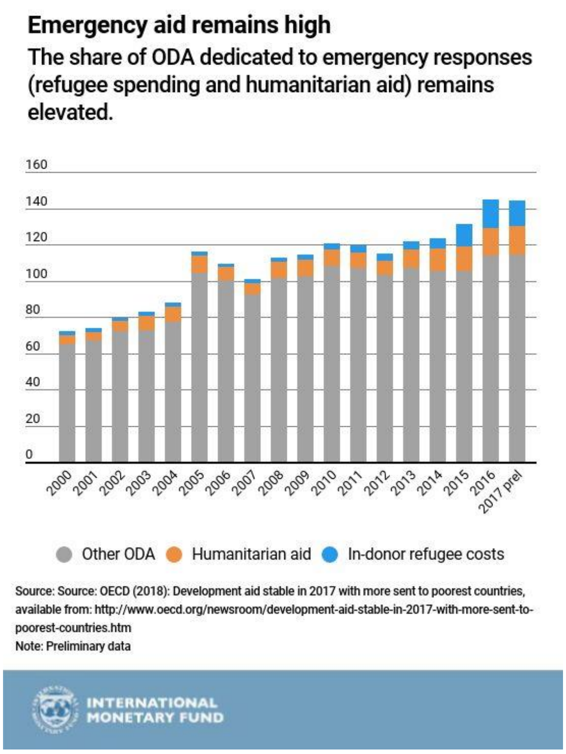
Key Players

International Monetary Fund

The International Monetary Fund (IMF) advises low-income countries on balancing borrowing to finance development spending and managing debt-related risks and strengthening technical assistance in critical areas such as public debt reporting and management. In addition, it focuses on helping low-income countries to pursue borrowing strategies that promote development while safeguarding debt sustainability which lets the governments meet all its current and future payments without exceptional financial assistance or going into default as well. The IMF currently provides stand-by arrangement(SBA), which is the financing of countries in an economic crisis to overcome their balance of payments problems, to Armenia, Honduras, Senegal, and Ukraine. Moreover, the IMF also plays a major role in Sovereign debt restructuring. Ir judges about the scale of the financing it is willing to provide in the absence of a debt restructuring and the design of an economic program as well.

Official Development Assistance

The Official Development Assistance (ODA) flows constitute an essential source of financing for developing countries to pursue the objectives outlined under the internationally agreed development goals such as eradicating poverty and hunger and achieving primary education which further connects to the SDGs. ODA aid amounted to $146.6 billion in 2017. Although the amount of the aid might seem enough, it is less than half the internationally agreed target which works toward 0.7 percent of the gross national income in each country. The share of the ODA is growing, as shown in the graph. However, these funds are only placed for the emergency needs such as refugee costs and humanitarian aid, benefitting only a few of the most vulnerable countries.



Emergency aid provided by the ODA

Possible Solutions

Infrastructure development by private investment

Even though the funding by the ODA is crucial, it lacks sustainable investment and leaves less room for long-term public investments as well. As the ODA cannot fulfill the need of the countries in debt and solve their problem sustainably, more private investment will be critical. The private sectors as individuals and corporations should not only donate money to the international community but also focus more on developing the infrastructure and setting environments for competitive business for the long term.

International collaboration on tax

One reason for the accumulation of national debt is the lack of tax collection, which can easily occur in the less economically developed countries as the nations have less GDP per capita. However, this is not the only reason for the low tax revenue in LEDCs. The low level of international collaboration on tax lets countries lower tax revenue. To manage the national debt, it is vital to support the promotion of LEDCs' capacities to identify and combat fraud, tax evasion, and avoidance by international collaboration, especially the systematic support from the MEDCs to the LEDCs to efficiently manage and collect taxes without much burden to the public. Each nation should increase financial transparency, reduce competition over tax incentives and 'tax spillovers,' which is an effect when one country's tax rules and practices impact another's tax rules and practices. The lack of tax collection in the LEDCs could be handled adeptly with the international collaboration on tax.

Glossary

National debt

The national debt is the public and intergovernmental debt owed by the federal government. It can also be called sovereign debt, country debt, or government debt. The public debt is what governments owe buyers of their bonds, either the country's citizens, international investors, or foreign governments. The intragovernmental debt is what the federal government owes to other governmental departments.

LEDCs & MEDCs

LEDCs (Less Economically Developed Countries) are a sector that includes countries with a lower GDP and a lower standard of living than MEDCs (More Economically Developed Countries) countries. Some indicators that are used to classify countries as LEDCs or MEDCs may include industrial development and education.

Fiscal Space

The comfortable room within governmental budgets allows it to provide resources without risking the sustainability of financial resources, or the economy's stability. Generally, countries with more fiscal space are less likely to face unsustainable debt, and countries with less fiscal space have more budget room to account for government overspending in budget and emergencies like the COVID-19 Pandemic.

Debt Distress

When countries are unable to fulfill their financial obligations, debt needs to be restructured. These typically lead to higher borrowing rates, limited access to the market, harming economic growth, and high risk within investments.

G7 & G20

G7 and G20, or Group of Seven and Group of Twenty, are intergovernmental political forums between differing MEDCs.

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