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Opening Speech

by

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The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.

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Opening Statement by Ms Isabelle Durant, Deputy Secretary-General of UNCTAD

11th UNCTAD Debt Management Conference

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Excellences,

Distinguished delegates,

Ladies and gentlemen,

It is a great pleasure and honor for me to join you today to open the 11th UNCTAD Debt Management Conference. As you know, this conference is a unique forum and opportunity for countries to convene and discuss the greatest challenges posed to policy makers and debt managers from around the world.

One of the core concerns, of this Conference, over the past decade, has been to assess how best developing countries can leverage and manage sovereign debt financing for sustainable development, in an increasingly volatile and fragmented global economic environment, following the Global Financial Crisis of 2007/08.

In principle, public sector debt is a powerful and long recognized financing instrument of development as well as an important policy tool to smooth out short-run macroeconomic fluctuations. The past decade, however, has seen not only a steady increase in the debt burden accumulated in many developing countries, but also profound changes in the composition and risk exposure of this debt. This has given rise to renewed worries about pending debt and financial crises in the developing world.

At the same time, the United Nations adopted the most ambitious development agenda in history, its Agenda 2030, only a couple of years ago. This entails enormous financing requirements, ranging in the trillions of USD per year. The Addis Ababa Action Agenda, adopted in July 2015, sets out means of implementation to address the current financing gap for Agenda 2030, and a framework for generating transformational investment in sustainable development, more broadly.

On this occasion of the 11th Debt Management Conference, we will turn our attention to a discussion of the mechanisms and policies, suggested by the AAAA framework, to finance development, and the question of what is, more specifically, required to allow developing countries to leverage debt financing under current global economic conditions. We will have a closer look at the Financing for Development agenda – its pros and cons – and at specific policies under this Agenda, such as financial inclusion and responsible financing, as well as take forward debates on what determines debt sustainability under current global economic conditions.

The global economic environment remains difficult for developing countries: Rising debt vulnerabilities

The global financial crisis was a debt crisis. Economic growth in the lead centers of the world economy had been driven by fast growing stocks of debt, amounting to USD 142 trillions by the time the crisis struck. This mountain of debt ultimately proved unsustainable as the main driver of global growth, since this relied on fickle investor sentiments in the financial assets they were trading in. Once this confidence took a hit, so did the world economy.

Since then, global debt stocks have risen again, and way above the record levels registered at the onset of the global financial crisis, surpassing these by 75 USD trillion at the end of 2016. While

developing countries led global growth between 2011 and 2014, contributing around 60 per cent of overall GDP growth in the wake of a weak recovery in advanced economies, they have eventually been caught up in the unfolding global ‘debt saga’.

Developing countries debt-to-GDP ratios are still relatively low, by historical standards, ranging around 30- 40 per cent of GDP on average. But not only does this average keep rising relatively fast. It also is a very crude and insufficient measure of actual sovereign debt vulnerabilities in the majority of developing countries.

These vulnerabilities are now showing, very clearly:

In an initially benign economic environment, characterized by high net capital inflows and high commodity prices, new debt obligations were built up in largely un-coordinated ways, creating a mix of public and private, direct and contingent liabilities, in both foreign and local currency denominations, and with both resident and non-resident ownership claims attached to them.

This highly favourable global environment has shifted since, witnessing the reversal of capital flows to developing economies since mid-2014, a precipitous drop in commodity prices, and unfavourable movements in exchange rates.

This mix could prove treacherous, should these claims have to be unraveled without any overarching legal frameworks in place to address these systematically.

- **Developing countries have led global growth since 2011, contributing around 60% of overall GDP growth, while advanced economies have seen only very slow recoveries** - they are expected to have grown at around 2% in 2015 signaling a moderate acceleration, compared to 2014 (1.6%), but still remaining very low. **But the 'debt saga' is now reaching emerging markets and undermining their roles as global driver economies.**
- Developing country debt/GDP ratios have generally been modest over the past decade. They are now again reaching higher levels, in particular in countries that have recently benefited from debt relief, such as Mozambique, Ghana and Kenya**. But debt/GDP ratios alone are an insufficient indicator of sovereign debt sustainability:** Even where debt/GDP ratios have remained relatively modest, concerns about sovereign debt sustainability are now growing.
- A case in point **are Sub-Saharan African economies**, more generally: Following a boom period of high commodity prices and growth rates combined with substantial debt relief, the outlook now is less optimistic: Stagnating and falling commodity prices together with aggressive sovereign bond issuance in international markets mean that external sovereign debt sustainability is in question, whether or not debt/GDP ratios have reached critical levels: **Government borrowing - which accounts for the bulk of foreign debt in African economies - doubled from US$ bn in 2009 to US$11 bn in 2014** - initially at relatively low rates of interest in international markets, especially compared to domestic market rates, but yields on sovereign bonds in Africa are now rising in many cases, driving up the cost of government borrowing
- A core issue is the **fast growth of corporate (private) external debt** in many emerging markets. Overall corporate external debt in these markets rose from US$4tn in 2004 to US$18 tn ten years later (including bank loans as well as bonds). Differently from (most) government debt, much of corporate external bond debt is in foreign denominated currency. **In Peru alone, for example, corporate foreign denominated bond debt rose from US$ 200 million in 2010 to no less than US$30 billion at present (Nov 2015)!** Clearly such private sector exposure to high market risks also threatens public sector debt sustainability, since unsustainable private debt either has to be

carried by public authorities eventually, and at the very least imposes high costs of private bankruptcies on the economy's productivity, growth rates and on its labour force.

- **Risk of renewed sovereign debt crises** in developing economies, with very high social and economic costs. Estimates vary but a recent IMF paper finds that such financial and debt crises lower current growth figures by around 5 to 10 percentage points and that after 8 years output is still lower (than country trend) by some 10 per cent.

To a great extent the context of our discussions will be framed by the developments and condition of the global economy, which have left countries vulnerable to external shocks and lingering uncertainties. The faint signs of economic recovery in developed countries have thus far proven to be uneven and timid. The economic growth forecast for developed countries has been downgraded for 2013 to 1.2 per cent, indicating that little has improved from last year's weak economic performance. Economic recovery is expected to remain modest in developed countries and is expected to remain so for some time to come. Developing countries continue to make the largest contribution towards global growth, with growth rates estimated at 4.5 per cent followed by transition economies at 2.5 per cent for 2013.

Prior to the crisis, buoyant consumer demand in some developed countries enabled the rapid growth of manufactured exports from industrializing developing and transition economies. This provided opportunities for primary commodity exports from other countries, fueling a virtuous expansionary cycle that was boosted by global growth. However, the global crisis resulted in a sharp contraction of export growth of developing countries as the growth of international trade slowed dramatically.

Another challenge facing countries are high unemployment levels. Developed countries are dealing with a jobs deficit that has been larger and longer lasting than any previous crisis affecting these countries in the past three decades. In developing countries, unemployment levels

have fared better, however the quality of employment has not improved with underemployment and informal sector jobs persistent structural challenges.

Emerging market countries have also had to contend with volatile capital flows. Short-term capital inflows, attracted by higher interest rates than in the major developed countries, have been exerting appreciation pressure on the currencies of several emerging market economies, thus weakening their export sectors. The recent sharp capital outflows have led to depreciation and financial instability.

The lagging global economic recovery has left countries vulnerable to unexpected shocks and changes in investor sentiment, which carries important implications for managing sustainable levels of debt in the years ahead. These evolving complexities of the global economy have increased the demands placed upon debt managers to respond quickly to unexpected shocks and to actively manage risks.

Prior to the global crisis, developing countries had managed to sharply reduce their average debt ratios and also made progress towards altering the composition of their public debt by borrowing more domestically and less abroad. The crisis stopped this trend but did not completely reverse it. This reduction of debt ratios was not due to a reduction in the stock of external public debt but to rapid GDP growth. Over the same period of time, developing countries started accumulating large external reserves, leading to a dramatic drop of their the net external public debt-to-GDP ratio and of currency mismatches in their aggregate balance sheets. These policy buffers enabled many developing countries to respond to the global recession with countercyclical policies of some sort.

Since the outbreak of the global crisis, the growth of total external debt stock of developing countries has grown at a faster pace. Along with rising debt stocks, developing countries have also experienced a slowing of output and export growth, which has contributed to a worsening of key debt ratios over the past year. While the external debt situation of developing countries as a group remains manageable, it is important to remember that aggregate statistics mask important differences between countries.

As the discussion of tapering and exit from the unconventional expansionary monetary policy in developed countries is picking up, rates on long-term bonds have begun to rise after years of historically low global interest rates. This is particularly true for developing countries that have expended a significant degree of their fiscal buffers in recent years to mitigate the negative shocks stemming from the global financial and economic crisis, which came on the back of the food and fuel crises in 2007-2008. At the outset of the crisis, many developing countries had a strong or balanced fiscal position, which now has greatly diminished for many. Consequently developing countries will likely find themselves in a situation of costlier financing and in an environment of sluggish global economic growth, which will pose hurdles to maintaining sustainable debt.

Debt crisis prevention:

Debt sustainability depends on a multitude of factors that include not only future growth, but also borrowing conditions, terms of trade, foreign exchange risk, interest rate risk, among other considerations. As such, debt sustainability is part of a much wider policy discussion. As part of its core activities UNCTAD has engaged in consensus building, research and analysis and

technical assistance on a wide range of debt issues, including debt crisis prevention, design of a debt workout mechanism and strengthening debt management.

In an increasingly integrated world the importance and need of adeptly addressing emerging challenges in a timely manner is crucial. The prevention and resolution of debt problems is at the foundation of all development efforts. Unsustainable sovereign debt can quickly undermine a country's ability to function. Inability to prevent and promptly resolve debt problems as they arise contributes to development losses in areas where gains have been made —whether it be in poverty reduction, education, health, capital formation, market functioning, etc.— and ultimately impair the ability of countries to maintain a sustainable development path.

As the frequency and severity of debt crises have increased, it has brought to light the need for timely, impartial and transparent resolutions of debt problems so as to minimize welfare losses and spillover effects to other countries. The global economic and financial crisis highlighted that debt problems are not isolated to developing countries and that mechanisms are needed to address debt difficulties for all countries. Reform of the international financial architecture must place greater emphasis on crisis prevention and timely resolution of debt crises to minimize potential negative contagion effects.

Crisis prevention hinges on steady progress in key reform areas. Setting norms and standards is one area where international cooperation can have a significant impact on debt sustainability. For example, the establishment of international norms and principles for responsible sovereign lending and borrowing is a first step towards preventing crises generated by irresponsible, imprudent or opportunistic behavior on the part of creditors and sovereign debtors. To this end, UNCTAD has formulated a set of principles that emphasizes the need for creditors and debtors to

share responsibility for preventing unsustainable debt situations. The purpose of the Principles is to fill in a crucial gap in international sovereign financing, namely the non-existence of a set of globally agreed essential principles that cover all types of sovereign debt contracting. The Principles are conceptualized in a holistic way and are thus meant to delineate mutual responsibilities of lenders and sovereign borrowers, for developed or developing countries alike. The Principles create neither new rights nor new obligations in international law, but identify and systematize the basic general principles and best practices applied to sovereign lending and borrowing and elaborate the implications of these standards.

As it is not realistic to assume that additional challenges will not arise in the future, the international community should make its best effort to learn from this experience to better prepare for debt crisis response in the future. We are at a crossroads when new proposals and ideas are being advanced to reshape and bring order to the international financial system, which presents us with a moment of great opportunity The international community should more actively explore a rules-based approach to sovereign debt workouts to increase the predictability and timely restructuring of debt when required, with fair burden sharing. In this context UNCTAD has set up a working group to develop a debt workout mechanism that involves the participation of all stakeholders.

In addition to this work at the international level, as you are well aware, UNCTAD has been active in capacity building activities in debt management. Effective management of a country's public debt requires building and retaining strong national capacity. Capacity building in debt management is therefore a pre-requisite for developing countries to reach and maintain debt sustainability. UNCTAD's Debt Management and Financial Analysis System (DMFAS) Programme is a leading provider of technical cooperation and advisory services in the area of

debt management. The Programme has been successfully helping governments improve their capacity to manage debt, working directly at the country level with over 100 institutions in almost 70 countries to deliver practical assistance in this critical area. DMFAS is therefore an excellent example of how UNCTAD's technical cooperation can assist countries to build sustainable national capacities.

The availability of comprehensive, reliable and timely debt data is essential for the strategic decision-making and policy implementation needed for maintaining sustainable debt levels. Maximizing synergies with UNCTAD's research and analytical work on debt management, the DMFAS Programme offers countries a set of concrete and proven solutions for improving their capacity to handle the day-to-day management of public liabilities and produce reliable debt data for policy-making purposes. It focuses on providing solutions to the problems faced by debt management offices in the areas of operational, statistical and analytical debt management, which can be considered as the foundations for effective debt management. This includes its state-of-the-art specialized debt management software, as well as advisory services and training activities, which have systematically evolved in accordance with new developments such as the increasing importance of managing domestic and private debt.

The DMFAS Programme and the projects on Responsible Sovereign Lending and Borrowing would not have been able to support so many countries without the support of the donor community. I take this opportunity to thank donors for their generosity and urge them and other potential donors to continue supporting UNCTAD as part of our joint effort to assist developing countries to improve their debt sustainability and debt management capacity. I would also like to extend our appreciation to the DMFAS beneficiaries for their steadily increasing cost-sharing

contributions, which demonstrate the importance they place in the assistance that UNCTAD provides to them.

I would like to end my opening statement by wishing you all very fruitful deliberations on this occasion that brings together more than 100 countries. Thank you