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Rising Debt of the Developed World and Implications for Developing Countries

by

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Discussion Outline

- Introduction
- European Debt Crisis
- Implications for Developing Countries-MEFMI Region
- Some mitigations strategies
- Conclusion

Key Messages

- The European debt crisis should be a concern globally;
  - Uncertainty in the global financial market.
  - Developing countries not immune in the medium to long term.
  - High risk on economic growth and achievement of MDGs.
- The crisis has adverse implications to developing countries.

- Developing countries need to develop domestic debt markets, improve domestic revenue mobilisation, and diversify the trading partners beyond the EU.

The Debt Crisis in Developed Countries

- Developing countries are concerned about potential adverse impact of the debt crisis in some EU countries.
- **Why?**
  - o The global financial crisis negatively affected Developing Countries through slow down in trade, reduced capital flows, low remittances, declining tourism receipts among others, resulting in significant slow down in some economies.
  - o GDP growth declined in Sub-Saharan Africa from about 5.6 percent average 2001-2008, to around 2.5 per cent in 2009, Leading to increased poverty and unemployment and failure to be on target on the MDGs
- It is with this hindsight that Developing Countries are very concerned about the current euro zone sovereign debt crisis.

- Eurozone is facing serious public debt challenge with Greece at the centre.
- It is hoped that this will not be the case with other developed countries.
- Emerging markets seem to be the hope of the future.

The Level of Debt in Developed, Emerging & Developing Countries (% of GDP)

Developed Countries	2009	2010	2011
Portugal	83	93	105
Greece	85.8	104.4	125
Japan	216.3	220.4	233.6
United States of America	53.5	62.1	70.2
All Developed	**90.6**	**95.8**	**100.4**
Emerging Countries	**2009**	**2010**	**2011**
Brazil	12.2	12.3	11.9
Russia	11	11.7	11.6
India	74.7	76.7	74
China	8.6	9.3	10.1
All Emerging Countries	**36.2**	**35.3**	**34.6**
Developing Countries	**2009**	**2010**	**2011**
Kenya	44.8	46.9	46.8
Malawi	19	21.8	23.3
Tanzania	34.5	37.6	41.1
Zambia	20.7	20.9	21.1
Sub-Saharan Africa	**24.4**	**20.7**	**19.9**
World	**65.4**	**67.1**	**68.6**

Origins of the European Debt Crisis

- The Global Financial Crisis and Revelations of misreported data largely triggered the Greek debt crisis.

- The persistent Budget and Current Account Deficits in the last decade (15.4% Revised Budget Deficit for 2009), high debt to GDP ratio, coupled with investors jittery to hold Greek Government debt led to higher interest rates driving up borrowing costs, and exacerbating debt levels- leading to logical expectation of a Greek default.

Has the response been adequate?

- EU countries have pledged to resolve the fiscal deficits and decrease their debt levels over time through stringent programmes of budget cuts, among other measures such as:
  - Establishment of the EU/IMF stabilisations funds.

However

- In Greece, there has been a knee jerk reaction from society to the austerity measures.

Therefore

- It is not certain if the "right" measures will be sustained or if the measures taken will reduce budget deficits & lower public debt to appropriate levels.

Is the Problem Localised in Europe?

- MEFMI Region, and Africa in general, has so far been immune to the turmoil in Europe:
  - IMF reports that effects have been primarily financial in nature and contained within Europe.
  - But the negative impact, in the medium to long term, will not be localized given the economic and financial inter-linkages and interdependencies with EU economies.
- The risks to global economy and Africa's economic growth have increased.
  - There is need to examine the possible threats and potential effect arising from the Euro-zone debt crisis.
  - The impact would manifest through several channels including trade, ODA and remittances.

Implications for Developing Countries

- **Trade:** Many countries especially from Africa are major trading partners of the EU. Hence, there will be Reduced Forex Inflows due to reduced exports to Europe.
- **Reduced ODA flows:** Several countries budgets are hugely reliant on ODA inflows and a decline would severely affect the fiscal management.
- **Increased Borrowing Costs:** As concessional financing dwindles, countries wishing to go to the international market by issuing sovereign bond will face relatively higher costs as investors price in higher risk. This does not augur well for debt sustainability in developing countries.
- **Financial Contagion:** The impact of financial contagion depends on the level of financial integration of the domestic financial sector to the eurozone banking sector. There is dominance of foreign banks, in the MEFMI member countries

Impact on Trade

- Given the low responsiveness to the rescue packages thus far, it is apparent that Europe's economic growth would be sluggish.
  - Thus developing countries with strong trade links to EU (with above 20 per cent export to GDP) are vulnerable

Exposure to Eurozone	
Country	**Exports to EU (As % of GDP, 2009-ADB)**
Angola	58.35
Botswana	34.54
Kenya	25.58
Lesotho	54.31
Malawi	25.24
Mozambique	25.03
Swaziland	57.22
Tanzania	23.48
Zambia	34.97
Zimbabwe	50.92

Impact on ODA Flows to Developing Countries

- In the event of prolonged low growth in Europe as a result of the crisis, expenditure would be tightened and ODA flows to LDCs may decline substantially.
- Several countries budgets are hugely reliant on ODA inflows and a decline would debilitate the fiscal management

ODA inflows to Some MEFMI Countries	
Country	**ODA (As % of Total Revenues, 2008)** **(Source ADB)**
Botswana	14.40
Kenya	18.26
Lesotho	12.71
Malawi	**71.04**
Mozambique	**78.52**
Rwanda	**77.01**
Tanzania	**49.32**
Uganda	**64.82**
Zambia	33.10
Zimbabwe	**420.37**

Impact on Borrowing Costs

- As official sources of concessional funding dwindle, Countries would have to borrow from commercial sources.
- Countries like Zambia, Tanzania, Kenya have been postponing issuance of sovereign bonds amid Global Financial Crisis. As the plans remain alive, Countries will face relatively higher costs as investors price in higher risk.
- There are however counter arguments that this offers opportunities for Developing Countries to develop their financial markets by attracting investors away from the Eurozone.

Potential Financial Contagion

- Banking sectors in MEFMI countries are dominated by foreign Banks which transact with Banks in Euro zone that are holding some of the bonds that may default leading to huge losses. This may reduce dominant foreign banks access to credit lines etc as inter bank lending declines due to tightening of credit markets.
- This will potentially result in severe liquidity conditions in the domestic financial markets in LDCs

No. of Foreign Banks as a % of total 2006	
Country	**For. Banks (As % of Total Banks, 2006) (ADB)**
Malawi	61.00
Mozambique	90.00
Rwanda	78.00
Swaziland	80.00
Tanzania	61.00
Uganda	64.00
Zambia	84.00

Impact on Achievement of MDGs

- The expected reduced inflows of grants and concessional loans will undermine implementation of measures aimed at achieving MDGs by 2015

Other Implications

- **Remittances:** may also reduce as unemployment rises in Europe due to slow growth.

- **Tourism Receipts:** Countries that receive many European tourist would record a slump in this source of earnings, but Asian tourists are increasingly becoming important now (so some offsetting may occur).

- **FDI** – In countries where EU financial institutions participate in financing projects, the reversal would affect project financing.

Some mitigation Strategies

- Fiscal restructuring in developing economies to:
  - Reduce reliance on ODA;
  - Increase domestic Revenue mobilisation efforts; and
  - Remove any wastage that may be in the budgets.
- Development of domestic debt markets to provide alternative sources of financing.
- Well structured Public Private Sector Partnerships (PPPs) to reduce the burden on governments for incurring huge initial costs for infrastructure development.
- Diversification of trade partners with emphasis on South–South trade.
  - Countries should increasingly trade with other regions like Asia and the Middle East: with China, India, Korea, Saudi Arabia

Conclusion

- Developing countries have positive economic growth prospects but the risk of exposure to the eurozone debt crisis needs closer monitoring.
- Global financial inter-linkages bring the threat of adverse effects closer home with the huge presence of foreign banks in the region.
- Developing countries have to start thinking of home grown economic models that look for internal triggers for economic growth.
- The debt crisis also brings lessons on potential problems of taking rising debt levels for granted and having reliable data.

Thank You