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External debt sustainability and development

Report of the Secretary-General

Summary

The present report is submitted pursuant to General Assembly resolution 70/190 and analyses the evolution of external debt sustainability in developing and transition economies since the start of the millennium. It explores structural changes to developing country debt composition and stresses the urgent need to improve the availability and quality of data in specific areas, not least in the context of the ambitious Sustainable Development Goals set by the 2030 Agenda for Sustainable Development. The report further calls attention to growing incidences of microdebt crises, highlights some of the implications of new challenges to developing country external debt sustainability for sovereign debt restructuring and emphasizes the need for continued additional official development assistance in the context of the winding-down of the debt relief initiatives of the 1990s and 2000s.

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I. Overview and trends

A. Evolution of core debt indicators, 2000-2015

1. The total external debt stocks of developing countries and economies in transition reached approximately $6.8 trillion in 2015, compared with $2.1 trillion in 2000, while exports grew from $1.5 trillion in 2000 to $6.9 trillion in 2015. During those fifteen years, the period up until the financial crisis saw average yearly gross domestic product (GDP) growth rates of 6 per cent, which fell to 5 per cent per year, on average, during the post-crisis period from 2009 to 2015. Export growth slowed more markedly post-crisis, from an average growth rate of 16.6 per cent from 2000 to 2008, to 6.5 per cent from 2009 to 2015. As a result of strong overall GDP and export growth during the period from 2000 to 2008, coupled with the results of the debt relief initiatives of the 1990s and early 2000s, debt ratios for developing countries as a whole improved substantially over the period. Total debt stocks to GDP decreased from 36 per cent in 2000 to 22 per cent in 2008, and debt service to exports shrunk from 22 per cent in 2000 to just above 9 per cent in 2008. However, the period 2009 to 2015 is marked by a renewed rise in both ratios, as total debt to GDP crept up to 25.5 per cent by 2015 and debt service to exports increased to 11.5 per cent.

2. International reserves for all developing countries increased to $6.3 trillion in 2015, from $646 billion in 2000. The average growth rate of reserves for the period 2000 to 2008 was 24 per cent annually, while during the period from 2009 to 2015 the rate of growth of reserves slowed significantly to an average of 4.3 per cent annually and registered two consecutive years of decrease, falling by 1 per cent in 2014 and by 8 per cent in 2015. In spite of the recent slowdown, the stock of international reserves as a percentage of short-term debt has substantially improved over the past 15 years, standing at 337 per cent in 2015 compared to 220 per cent in 2000.

3. The overall debt position of Europe and Central Asia is supported by large holdings of international reserves and a healthy reserves to short-term debt ratio. This has steadily increased between 2000 and 2015. From a starting point of 113 per cent in 2000, the ratio peaked at 360 per cent in 2009, but subsequently declined to around 274 per cent in 2015. Total debt stocks increased significantly during the entire period, from $350 billion in 2000 to $1.5 trillion in 2015, but the average GDP growth rate of 6 per cent annually between 2000 and 2008, when most of the new debt was accumulated, has kept the debt to GDP ratio at relatively stable levels over the past 15 years, within the 40 to 50 per cent band. The main issue that continues to plague the region is sluggish export growth since the crisis, caused by tepid growth in the largest European economies. Whereas exports grew by a yearly average of 19.5 per cent over the period from 2000 to 2008, the period 2009 to 2015 registered an average annual growth rate of only 3 per cent.

4. Total debt stocks in sub-Saharan Africa increased from $213 billion in 2000 to $413 billion in 2015. The region's share of the total debt stocks of developing countries decreased from 10 per cent in 2000 to 6 per cent in 2015. Its debt to GDP ratio has improved markedly over the period and in particular during the early 2000s. The improvement was largely driven by debt relief and the commodities price boom. Total debt to GDP stood at 59 per cent in 2000, peaked at 61 per cent in 2002, and followed a downward path until 2011, by which point it had fallen to

21 per cent. Since 2011, there has been a modest but steady increase in the ratio, reaching 27 per cent in 2015. The debt service to exports ratio was never particularly high for the region, peaking at 12 per cent in 2001 and dropping to single digits since 2003. However, since bottoming in 2010 at 3.7 per cent, the debt service to exports ratio has more than doubled and stood at 8.8 per cent in 2015, reflecting a steep slump in the prices of commodities that constitute the main export revenue for the region. The period since 2000 was marked by an important increase in international reserves, from $35 billion in 1990 to a peak of $202 billion in 2013, and a corresponding improvement in the reserves to short-term debt ratio from 110 per cent in 2000 to 368 per cent in 2013. As the commodity boom has reversed in recent years, the amount of international reserves decreased to $170 billion in 2015, and the ratio of reserves to short-term debt worsened, to 291 per cent.

5. As in other regions, in Latin American and the Caribbean, GDP growth has slowed since the global financial crisis, declining from average annual growth rates of 3.5 per cent between 2000 and 2008, to 3 per cent annually over the period from 2009 to 2015. In 2015, the region experienced its worst contraction in recent memory as nominal GDP shrunk by 13 per cent, with a corresponding drop in exports. Total debt stocks reached $1.77 trillion in 2015, up from $760 billion in 2000. The debt service to exports ratio continued its long-term downward trend in the post-crisis period, reaching a low of 16 per cent in 2014, from 39 per cent in 2000. However, the continuing commodity price slump led to an increase of the ratio to 21 per cent in 2015. Total debt to GDP dropped to 21 per cent in 2008 from 36 per cent in 2000, but has been increasing since 2010 to reach 34 per cent in 2015. The region also experienced a sizeable increase in international reserves to $793 billion in 2015, from $157 billion in 2000.

6. The Middle East and North Africa registered the weakest growth of total debt stocks of any of the regions, reaching $195 billion in 2015, up from $144 billion in 2000, owing to a decline in total external debt stocks of 8.8 per cent and 15.3 per cent in 2006 and 2007, respectively. The region holds the smallest share of total external debt of all developing countries, and total debt to GDP ratios decreased substantially during the period. After a high of 38 per cent in 2000, the ratio registered a steady decline to 15 per cent in 2014, with only a slight increase to 16.4 per cent in 2015. The debt service to exports ratio also registered a steady improvement, declining from 15 per cent in 2000 to 7.5 per cent in 2015. International reserves increased almost sixfold during the period, from $60 billion in 2000 to $400 billion in 2013, but have since pulled back somewhat, to $347 billion in 2015. Correspondingly, the ratio of reserves to short-term debt improved dramatically, from 252 per cent in 2000 to 928 per cent in 2015, which represents the highest reserves coverage of short-term debt of any of the regions.

7. In East Asia and the Pacific total debt stocks increased from $497 billion in 2000 to $2.3 trillion in 2015, with average annual growth rates of 7.4 per cent between 2000 and 2008 and an acceleration to an average 13.1 per cent from 2009 to 2015. In spite of the rapid growth of the debt stock, total debt to GDP ratios have declined from 29 per cent in 2000 to 17.3 per cent in 2015 as the region has benefited from robust economic growth. Similarly, the debt service to exports ratio has declined significantly, from 13.6 per cent in 2000 to 4.3 per cent in 2015.

8. The impressive increase in international reserves in East Asia and the Pacific, from $277 billion in 2000 to almost $4 trillion in 2015, has meant that the reserves

to short-term debt ratio remained above 250 per cent during the entire period, peaking at 631 per cent in 2008 and dropping to 330 per cent in 2015. However, there are large differences among countries, as over the past 15 years China's share of total debt stocks of the region increased from 30 per cent in 2000 to 62 per cent in 2015, and its regional share of international reserves increased from 61 per cent in 2000 to 87 per cent in 2015. Excluding China from the regional average, although there is an improvement in all indicators over the 15 year period, debt ratios are higher, with total debt to GDP hovering above 30 per cent over the past 10 years and reaching 40 per cent in 2015, while debt service to exports have oscillated between 6.5 per cent and 10 per cent since 2007. International reserves in the region, excluding China, increased from $108 billion in 2000 to a peak of $542 billion in 2012, while the reserves to short-term debt ratio reached a high of 450 per cent in 2006 just before the onset of the financial crisis, but had halved to 220 per cent by 2015.

9. The total debt stocks in the small island developing States are estimated to have increased five-fold in the past 15 years, reaching $53 billion in 2015, from $10.8 billion in 2000. In terms of debt ratios, this is the only region that does not exhibit an improvement over the period 2000 to 2015 and it continues to have the most worrisome debt ratios of any of the regions. Total debt to GDP increased from 45 per cent in 2000 to 85 per cent in 2015, while debt service to exports worsened from around 13 per cent in 2000 to 20 per cent in 2015. International reserves to short-term debt stood at 290 per cent in 2000 and improved to 405 per cent in 2005, but then began to contract and had dropped to below 156 per cent in 2015.

B. Changes in external debt composition, 2000-2015

10. The external debt sustainability of developing countries is affected not only by the evolution of total debt stocks and debt-servicing burdens relative to their growth and export performances, but also by the composition of their external debt. This has changed considerably over the past 15 years, largely owing to increased access to international financial markets.

11. Thus, the share of external public and publicly guaranteed debt owed to private creditors accounted for 41 per cent of the total in 2000, but had increased to 62 per cent by 2015. The shift towards raising public sector finance in developing countries from the private sector rather than from official bilateral and multilateral creditors has not been equal across the regions.

12. In the Middle East and North Africa, the proportion of public and publicly guaranteed debt owed to private creditors rose from 21 per cent in 2000 to 37 per cent in 2015, effectively returning the region to the state of affairs from the beginning of the 1990s, when 36 per cent of such debt was owed to private creditors. Latin America started the period at an elevated ratio of 65 per cent in 2000 and increased it to 74 per cent in 2015, registering the second largest share of public and publicly guaranteed debt owed to private creditors of any regional group. However, the biggest increases during the 15 year period took place in Europe and Central Asia, where the share of public and publicly guaranteed debt owed to private creditors increased from 42 per cent to 76 per cent. South Asia registered an increase in that ratio from 24 per cent to 39 per cent and sub-Saharan Africa from 16 per cent to 42 per cent over the same period.

13. Furthermore, bond debt now constitutes an important share of public and publicly guaranteed debt in developing countries as a group, having increased from 24 per cent in 2000 to 43 per cent in 2014.[1] In Europe and Central Asia, bond debt as a share of public and publicly guaranteed debt increased from 29 per cent in 2000 to 48 per cent in 2014, and over the same period, from 6 per cent to 28 per cent in sub-Saharan Africa. Latin America and the Caribbean witnessed a further rise from an already high share of 49 per cent to 52 per cent, whereas the Middle East and North Africa saw a steady increase from 7 per cent to 30 per cent. In South Asia the ratio climbed from 8.1 per cent to 23 per cent, and in East Asia and the Pacific from 13 per cent of public and publicly guaranteed debt in 2000 to 47 per cent in 2014.

14. Short-term debt as a share of total external debt in developing countries overall has been increasing progressively, from 14 per cent in 2000 to 31 per cent in 2014, but decreased to 27 per cent in 2015. This trend, most pronounced in East Asia and the Pacific, is worrying, as short-term debt carries higher rollover risk and increases countries' exposure to global interest rate changes.

15. The period since 2000 was also marked by an important increase in private non-guaranteed debt as a share of total long-term external debt stocks. For developing countries overall, the share rose from 28 per cent in 2000 to 49 per cent in 2015. In some regions, the increase has been extremely rapid. For example, in sub-Saharan Africa, private external debt increased sevenfold, from $10 billion in 2000 to approximately $70 billion in 2015. In South Asia, it rose from 12 per cent to 46 per cent, in East Asia and the Pacific from 35 per cent to 54 per cent, and in Europe and Central Asia from 25 per cent to 60 per cent over the same period.

II. Least developed countries

16. The total external debt stock of the group of 48 least developed countries grew by 72 per cent in nominal terms, from $141 billion in 2000 to $242 billion in 2015. However, during that period, the ratios of total external debt stocks to both GDP and to exports fell significantly, from an average of 70.7 per cent and 316.8 per cent, respectively, at the beginning of the period, to 27.3 per cent and 120.2 per cent in 2015. Given that the majority of the sovereign external debt of the least developed countries is on highly concessional terms, their debt-servicing burden has been low compared to the average of all developing economies. The ratios of debt service to GDP and to exports also fell during the period 2000 to 2015, from 2.6 per cent in 2000 to 1.6 per cent in 2015 for debt service to GDP, and from 11.6 per cent to 7.3 per cent for debt service to exports.

17. However, the overall picture tends to hide an incipient reversal of fortunes since the onset of the global financial crisis. Up until 2008, strong GDP growth, averaging 7 per cent per year between 2000 and 2008, as well as high average export growth rates of 18.6 per cent, prevailed on the back of booming commodity prices and the impact of multilateral debt relief initiatives. Following the crisis and the downturn in commodity prices, the GDP and export growth rates of the least developed countries have slowed down markedly, to an average 5 per cent and 4.8 per cent, respectively, in 2015, resulting in increasing trends for both the ratio of total external debt to GDP (from 24 per cent in 2009 to 27.3 per cent in 2015) and of

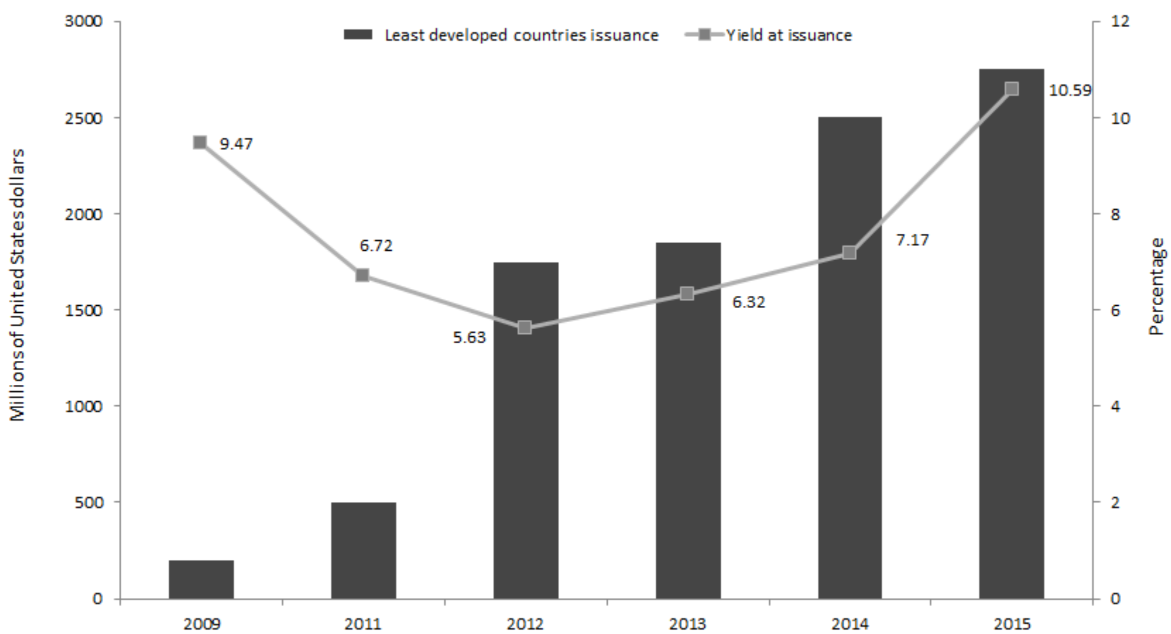
[1] Latest year for which data are available.

total external debt to exports (from 86.9 to 120.2 per cent). Similarly, the ratios of debt service to GDP and to exports rose again, after 2008, from 1.4 per cent to 1.6 per cent and from 5.5 per cent to 7.3 per cent, respectively.

18. Compared to the group of all developing countries (see annex for more information), the share of public and publicly guaranteed debt in total long-term external debt remains high in the least developed countries, but fell from 99.4 per cent in 2000 to 93.3 per cent in 2015. The share of such debt owed to private creditors also rose, from 8.4 per cent in 2000 to 15.8 per cent in 2015. This reflects the shift in the least developed countries towards borrowing via commercial loans and bond issuances in addition to conventional sources of financing, such as bilateral and multilateral loans. The proportion of commercial loans in total long-term debt increased from 4.8 per cent in 2000 to 13.8 per cent in 2015, while bond debt now constitutes 3.4 per cent of total long-term debt, having been non-existent in 2000.

19. In 2015, a number of the least developed countries (such as Angola and Zambia) continued to tap into international capital markets through the issuance of sovereign international bonds. The total issuance of sovereign international bonds in the least developed countries over the period since 2009 amounted to just under $10 billion. As can be seen in figure I, those economies have recently faced considerable increases in the yields on these bonds. Zambia, for example, issued $1.25 billion at 11.4 per cent in 2015 compared to 5.63 per cent for an issuance in 2012. Mozambique paid a yield of 14.4 per cent for its latest international bond issuance in June 2016.

Figure I
Least developed countries international sovereign bond issuance (2009-2015)



Source: United Nations Conference on Trade and Development (UNCTAD) secretariat calculations, based on analysis from Thomson Reuters Eikon.
Note: None of the least developed countries issued sovereign bonds in 2010.

III. Debt relief initiatives

A. Heavily Indebted Poor Countries Initiative and Multilateral Debt Relief Initiative

20. There has been no change in the status of the heavily indebted poor countries eligible for the Heavily Indebted Poor Countries Initiative since June 2015, the end of the previous reporting period. Progress under the Initiative has slowed tremendously, as 36 out of 39 countries have graduated. As of March 2016, the total cost of debt relief to creditors in present value terms, at the end of 2014, is estimated at $74.8 billion for the Heavily Indebted Poor Countries Initiative and $41.6 billion for the Multilateral Debt Relief Initiative.

21. Three eligible heavily indebted poor countries that have yet to reach the decision point (Eritrea, Somalia and the Sudan) have not yet benefited from debt relief. While there have been no new developments in the case of Eritrea, Somalia has made some progress and is preparing its poverty reduction strategy paper, but will need to clear its arrears owed to the International Monetary Fund (IMF) and the World Bank before becoming eligible for financial assistance. The Sudan remains eligible for debt relief but must first normalize relations with external creditors. In addition, Nepal also remains potentially eligible for debt relief, whereas Zimbabwe's eligibility remains unclear as the country's debt to exports ratio at the end of 2013 did not meet the initiative's criteria. Nonetheless, the country presented an arrears clearance strategy to external creditors in October 2015.

22. Many heavily indebted poor countries have experienced an increased risk of debt distress, according to IMF criteria. Among the 36 completion point heavily indebted poor countries, 8 countries were classified as being at high risk of distress in 2016 compared to 7 in 2015, 22 as being at moderate risk of debt distress, up from 18 in 2015,[2] and 5 countries are reported to be at low risk of debt distress, down from 11 in 2015. Debt-servicing burdens are also estimated to have risen in 2015, with the ratio of debt service to exports increasing from 4.7 per cent in 2014 to 5.9 per cent in 2015 and of debt service to GDP from 1.3 per cent to 1.5 per cent. The trend was expected to continue in 2016 As the Heavily Indebted Poor Countries Initiative winds down, questions arise as to how renewed debt problems in many of those countries will be addressed in the future.

B. Paris Club

23. There were only two Paris Club meetings over the past 12 months, reflecting the fact that the Heavily Indebted Poor Countries Initiative is winding down. In November 2015, Paris Club creditors met with the representatives of Grenada to reschedule arrears due as of October 2015 and maturities due between November 2015 and June 2017. Under the terms of the agreement, Grenada will repay the rescheduled amounts over 20 years, including 7 years of grace, for official development assistance (ODA) loans and over 15 years, including 8 years of grace, for non-ODA loans. The agreement includes an innovative clause that envisages calling for an independent assessment of the damage caused to the economy, should

[2] 2016 data for the Plurinational State of Bolivia are not available.

a hurricane strike Grenada. In case a new rescheduling is considered necessary, Paris Club creditors have agreed in principle to organize a new meeting to discuss Grenada's payment capacity.

24. In December 2015, a group of Paris Club creditors met with representatives of the Government of Cuba and reached an agreement on the repayment of arrears due to creditors present at the meeting, over an 18-year period. This is a significant step for Cuba, as it allows the resumption of activities by export credit agencies from the group of creditors that are party to the agreement.

IV. Official development assistance

25. In 2015, total ODA from Development Assistance Committee donors rose to $131.6 billion, representing an increase of 6.9 per cent in real terms from 2014. A significant proportion of the increase is attributed to funds allocated to aid for the 1.5 million refugees who claimed asylum in Organization for Economic Cooperation and Development (OECD) countries in 2015, accounting for 9.1 per cent of ODA in 2015, compared to 4.8 per cent in 2014. When excluding aid to refugees, ODA still increased by 1.7 per cent in real terms from 2014 to 2015.

26. ODA to the poorest countries increased by 4 per cent in real terms in 2015, reversing several years of decline. According to the Development Assistance Committee survey on forward spending plans, a large increase of country programmable aid in 2016, if implemented, will benefit all country groups but primarily the least developed countries and fragile States, whose country programmable aid is set to rise by 6 per cent in real terms. The survey indicates that the upward trend is expected to continue until 2019. Overall ODA, however, is forecast to rise at a slower rate for other developing country groups.

27. In the least developed countries, ODA still accounted for over two thirds of total external finance provided by OECD countries in 2013.[3] Stable and predictable flows of ODA will be crucial for the success of the 2030 Agenda for Sustainable Development. Safeguarding ODA for development and the reduction of poverty must remain a priority, as a larger number of objectives will be competing for limited resources. At present what is known as the principle of ODA additionality is at risk of being undermined. For example, it is currently common practice to merge climate-related finance with ODA budgets in donor economies, owing to perceived overlaps between development assistance and climate finance and a rather broad definition of ODA. While a number of internationally agreed documents state that new and additional climate finance will be needed, it remains unclear how climate finance additionality should be defined and recorded in ODA statistics. The Conference of the Parties to the United Nations Framework Convention on Climate Change has recognized, in a number of its decisions, that further work is necessary to clarify the concept of additionality.[4]

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[3] Organization for Economic Cooperation and Development (OECD) data on taking stock of aid to least developed countries, 2015. Available from www.oecd.org/dac/financing-sustainable-development/Taking_stock_of_aid_to_LDCs_Flyer_2015.pdf .

[4] For more details, see United Nations Conference on Trade and Development (UNCTAD) "'New and additional' climate finance: a continuing lack of clarity", Policy Brief, No. 4 (December 2015). Available from http://unctad.org/en/PublicationsLibrary/presspb2015d15_en.pdf.

V. Challenges to debt sustainability in developing countries

28. Implementing the 2030 Agenda over the next 15 years is estimated to require financing of anywhere between $1.6 trillion and $7 trillion per year. To meet only the first of the Sustainable Development Goals, "End poverty in all its forms everywhere", by 2030, and assuming that savings, foreign direct investment (FDI) and ODA stay at current levels, GDP in Africa, for example, would have to grow at double digit rates of over 15 per cent per year.[5] Maintaining developing country debt sustainability will thus be of vital importance, if the goals are to be met on time.

29. At present, the broader picture for developing countries does not yet provide cause for undue alarm. The recent overall trend for external sovereign debt burdens to increase again is still fairly moderate. In addition to the success of the debt relief initiatives of the 1990s and 2000s, growth-oriented macroeconomic policies and public debt management played an important role in improving developing country public finances and enhancing their external debt sustainability.

30. However, similarly important until recently were highly favourable external factors. Exceptionally low international borrowing costs and booming demand for many export products combined to allow developing economies to lower both fiscal and external deficits for the best part of the past 15 years. The prolonged downswing in the current commodity super cycle and growing concerns over the continued lack of a sustained economic recovery in developed economies have substantially changed this external environment for the worse.

31. In the changing global economic context, new but substantial vulnerabilities to developing country debt sustainability are fast becoming apparent. Those growing risks are closely related to developing countries' rapid integration into international financial and capital markets over the past 15 years, under conditions in which global economic growth has primarily relied on building up public and private debt as a source of demand in the short term, rather than on jobs and income arising from long-term productive investment activity.

32. A core implication for developing country external debt sustainability is that improvements achieved in the more recent past may not last. New debt obligations have been built up under benign external conditions and in largely uncoordinated 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. The mix could prove treacherous, should those claims have to be unraveled without any overarching legal frameworks in place to address them systematically.

33. The new challenges to developing country overall debt sustainability, arising from increasingly closer links between private and public, and between domestic and external components of debt, are explored in greater focus below.

[5] *Economic Development in Africa Report 2016: Debt Dynamics and Development Finance* (United Nations publication, Sales No. E.16.II.D.3).

A. Shifting to domestic public debt: opportunities and risks

34. Recently, many governments in developing countries have shifted from issuing international debt in foreign currency to domestic debt in local currency. While the availability of data for domestic debt in developing economies is notoriously poor,[6] broad trends can be discerned. Thus, data published by the Bank for International Settlements for 65 developing and emerging countries[7] show that the share of domestic debt securities in total debt securities rose from around 56 per cent in 2000 to 87 per cent in 2015. In the same period, international debt security issuance by central governments roughly doubled in those countries, from $345.8 billion to $710 billion. By contrast, for a subset of 21 countries for which such data are available, domestic debt issues by central governments increased more than tenfold, from $518.3 billion in 2000 to $5.3 trillion in 2015 (see table below).

Outstanding total debt issues in developing countries by sector, 1990-2015

(Billions of United States dollars)

	1990	*2000*	*2007*	*2010*	*2015*
Domestic (all issuers)	121.6	704.3	5 617.2	8 756.4	12 388.4
General government	95.7	518.3	3 002.3	4 303.0	5 311.1
Financial corporations	13.3	116.6	1 966.6	3 038.0	3 908.0
Non-financial corporations	12.6	69.4	648.4	1 415.4	3 169.3
International (all issuers)	99.4	539.5	892.4	1 092.7	1 817.6
General government	67.3	345.8	456.4	535.6	709.9
Financial corporations	22.9	84.8	243.6	284.2	581.0
Non-financial corporations	9.2	108.9	192.4	272.9	526.6

Source: International banking and financial statistics database of the Bank for International Settlements.

35. For the group of low-income countries, IMF data for 74 countries show an increase in their domestic debt to GDP ratios from 14.1 per cent in 2007 to 15.1 per cent in 2014 overall, and from 14 per cent to 19 per cent for the so-called frontier low-income countries (i.e., countries with relatively more advanced access to international financial markets).

36. Until recently, greater reliance on domestic public debt and on domestic bond markets in particular, largely reflected a win-win situation primarily driven by large excess liquidity in international financial markets. Even though domestic borrowing is generally more costly than external borrowing in developing economies,

[6] In contrast to comprehensive databases on public external debt, analyses of domestic public debt in developing economies have been plagued by poor availability and quality of data, in part owing to a conventional emphasis on external borrowing as the main means of fiscal deficit financing in poor countries. Data on domestic debt not only remain scattered, but available data are also quite heterogeneous in terms of definition and coverage, such as the criteria to distinguish between domestic and external debt, the definition of the public sector, the type of government liabilities covered and the treatment of specific financial arrangements.

[7] Among the 65 countries are 19 high-income, 22 middle-income, 8 low-income and 2 least developed countries, as well as 14 transition economies, according to UNCTAD classifications available from: http://unctadstat.unctad.org/EN/Classifications.html.

governments can shift the currency risk to international lenders and reduce their vulnerability to exchange rate volatility. At the same time, international lenders in search of higher yields than are on offer in their home countries, in the context of strongly expansionary monetary policies, have been willing to lend under local jurisdictions and assume the currency risk. This also extends to international sovereign bond issuances by developing countries, a growing share of which have been issued in local currency since the late 2000s. As a consequence, the proportion of local-currency sovereign debt held abroad is now higher in many developing economies than it is in the case of reserve-issuers, such as Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America.[8]

37. An important corollary to the role of this global economic dynamic in the expansion of domestic bond markets is the growing presence of foreign investors in those markets. While broadening the investor base, non-resident investor appetite for domestic debt heavily depends on global financial conditions and fickle confidence in host markets. Unsurprisingly, non-resident ownership of local-currency marketable debt is primarily concentrated in high- and middle-income developing economies. Yet, for the very few lower-income economies for which such data are available, IMF reports from 2015 found that in two countries (Ghana and Senegal), foreign holdings amounted to around one third of domestic debt on average since 2009, and in three others (Nigeria, Uganda and Zambia) this rose from a low base to over 10 per cent of total domestic debt in recent years.

38. Developing countries switching from external to domestic public debt could also be trading a currency mismatch for a maturity mismatch. Many developing countries are unable to issue long-term government securities at a sustainable rate of interest, yet need to be in a position to pay off or roll over maturing and short-term obligations. This is in particular the case where domestic commercial banks with usually strong preferences for short-term portfolio allocation remain the dominant investor group in local currency bond markets, such as, for example, in much of sub-Saharan Africa.[9]

39. Moreover, in economies in which a large share of domestic debt is not indexed to inflation, governments may come under pressure to monetize budget deficits, driving up inflation and potentially triggering external debt crises. In addition, any domestic currency depreciations vis-à-vis the United States dollar will increase the value of ex post interest payments in domestic currency, further increasing the relative cost of domestic borrowing.

40. Higher productivity developing economies with already relatively deep domestic financial systems may be able to navigate at least some of those risks. Greater reliance on domestic indebtedness could therefore provide opportunities to proactively leverage cheap capital inflows while those inflows last and to mobilize domestic resources more effectively on their own terms for structural transformation and sustainable development. This is much less likely in poorer developing economies with shallow domestic financial systems, where greater reliance on

[8] Yilmaz Akyüz, "Internationalization of Finance and Changing Vulnerabilities in Emerging and Developing Economies", United Nations Conference on Trade and Development Discussion Paper, No. 217 (Geneva, UNCTAD, November 2014).

[9] Kathrin Berensmann, Florence Dafe and Ulrich Volz, "Developing local currency bond markets for long-term development financing in Sub-Saharan Africa", *Oxford Review of Economic Policy*, Vol. 31, No. 3-4, (2015) pp. 350-378.

domestic debt primarily signals insufficient access to external finance on sustainable terms.

41. Finally, increased reliance on domestic public debt raises complications for sovereign debt restructurings. External and domestic debts are no longer clearly separable, in terms of owners, currency denomination and legal governance frameworks. From an economic point of view, there are widely recognized arguments for treating domestic debt under local jurisdictions separately from external sovereign debt, essentially to avoid a deepening of economic contraction in the wake of the turmoil caused by external debt crises. But with an increasing proportion of locally issued public debt now held by non-residents externally, questions arise, for example, as to whether to differentiate between resident and non-resident holders of local-currency debt. While outright defaults on domestic debt in developing and emerging economies are rare, given the huge social and political costs of such defaults, these are issues that will need to be addressed more systematically in the context of ongoing debates about sovereign debt restructurings.

B. Rapid growth of private debt

42. As reported in section I, private non-guaranteed debt has risen markedly as a share of total long-term external debt stocks across developing economies since 2000. This covers both firm and household debt. While the specific dynamics through which substantial increases in firm and household indebtedness may affect governments' external debt position differ, a marked overall increase in private indebtedness is highly likely to eventually undermine public sector finances, in particular in the absence of national or international legal frameworks to systematically address the contingent liabilities of the public sector.

1. Rising indebtedness of non-financial corporations in emerging market economies

43. Of particular concern at present is the fast growing debt of non-financial corporations in major emerging economies. According to IMF,[10] this rose from $4 trillion in 2004 to well over $18 trillion in 2014 across major emerging market economies. The Bank for International Settlements puts the figure at $25 trillion by the end of 2015, up from $9 trillion at the end of 2008.[11] The increasing reliance of non-financial corporations in developing economies on debt to finance investment is also apparent in the marked rise of their debt-to-equity ratios since 2010, when the ratios had contracted sharply immediately following the global financial crisis.[12]

44. As with the expansion of public domestic debt, the core driver of accelerated corporate indebtedness in developing economies has been excess liquidity in the international financial markets, coupled with the continued deregulation of developing country financial systems.

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[10] International Monetary Fund, *Global Financial Stability Report: Vulnerabilities, Legacies and Policy Challenges: Risks Rotating to Emerging Markets* (Washington, D.C., October 2015).

[11] Bank for International Settlements, statistics on credit to the non-financial sector, updated 6 June 2016.

[12] See also UNCTAD, *Trade and Development Report, 2016*, chapter V (United Nations publication, forthcoming).

45. Specifically, the expansion of corporate external balance sheets and the rise of debt-to-equity ratios seems to have been closely related to the extensive use of quantitative easing programmes in advanced economies since 2008. It is estimated that overseas United States dollar credit provided through bank loans and bonds reached $9 trillion by 2014.[13] Of that total, around $7 trillion are thought to have fuelled the expansion of United States dollar credits in emerging market economies.[14] Original and leveraged quantitative easing cash reached corporate balance sheets in emerging market economies through several channels. By driving down yields on treasury bills and, more generally, safe financial assets, central banks in developed economies sent asset managers and their clients on a search for higher yield and higher risk investments, such as corporate bonds in emerging markets. In addition, central banks also bought treasury bills and asset-backed securities from commercial banks, who went on to lend to financial institutions, such as hedge funds, with high-risk investment strategies aimed at leveraging that cash, for example through the carry trade. Finally, quantitative easing cash also found its way to emerging economies through FDI, in particular in the form of intra-company loans that made up around 40 per cent of FDI in countries such as Brazil and China in 2014.[15]

46. While in most cases corporate debt has primarily been contracted in international financial markets and foreign-denominated currencies, China is the exception. Its corporate debt increased by around 30 percentage points of GDP from 2009, reaching 170 per cent of GDP by 2015. However, the bulk of the debt is held by state-owned enterprises with domestic banks or in domestic-currency bonds.

47. With the end of the United States Federal Bank's major asset purchasing programmes in 2014, many emerging market corporates have found themselves landed with substantial excess capacities and rising debt-servicing costs. With the exception of China, whose external debt burdens remain negligible, the main danger posed to the sustainability of external public debt of affected economies is the growing number of corporate bankruptcies and the transfer of unsustainable corporate debt onto public balance sheets.

48. Figure II charts the debt service ratios of non-financial corporations in large developing economies between the of end 2007 and the end of 2015. Debt service ratios reflect the share of sectoral income used to service debt and are generally considered to be a reliable warning indicator of pending banking crises.

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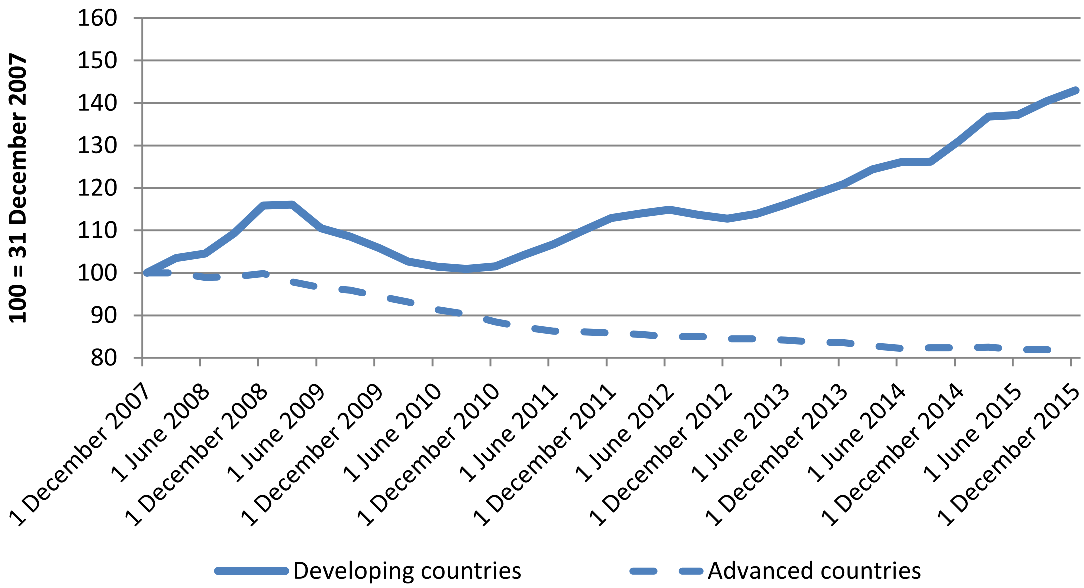
[13] Robert N. McCauley, Patrick McGuire and Vladyslav Sushko, "Global dollar credit: links to US monetary policy and leverage", BIS Working Paper, No. 483 (Basel, Switzerland, Bank for International Settlements, January 2015).

[14] Jonathan Wheatley and James Kynge, "Emerging markets: Deeper into the red", *Financial Times*, 16 November 2015.

[15] Michael Chui, Emese Kuruc and Philip Turner, "A new dimension to currency mismatches in the emerging markets: non-financial companies", BIS Working Paper, No. 550 (Basel, Switzerland, Bank for International Settlements, March 2016).

Figure II
Debt service ratio average for the private non-financial sector since the financial crisis



Source: Statistics on debt service ratios of the Bank for International Settlements and UNCTAD secretariat calculations.

Note: Advanced countries include Germany, Japan, the United Kingdom of Great Britain and Northern Ireland and the United States of America. Developing countries include Brazil, China, India, Indonesia, Malaysia, Mexico, the Russian Federation, South Africa, Thailand and Turkey.

2. Growing occurrence of microdebt crises

49. A further development that so far has garnered only limited attention is the growing incidence of microdebt crises in many developing economies. Microcredit is the provision of a small loan, a microloan, to people living in poverty, in order to enable individuals to establish income-generating projects, thereby escaping poverty.[16] By the mid-2000s, microcredit had come to be regarded as the most important anti-poverty and local economic development intervention in developing economies.

50. More recently, a growing number of microcredit meltdowns in developing countries has undermined confidence in the microcredit model. Microdebt crises manifest themselves through a widespread fall in the amount of repayments on microloans as a percentage of disposable income and a substantial increase in defaults on microloans, as indicative of overindebtedness in the microsector of the economy.

51. Examples of developing and emerging countries that have experienced an acute crisis of overindebtedness in their microsectors include Bangladesh (2008 and 2009), Bolivia (Plurinational State of) (1999), Bosnia and Herzegovina (2008 and

[16] Strictly speaking, the term microcredit has been redefined as just one aspect of a wider set of interventions, including microsavings, microinsurance and microleasing that come under the umbrella term microfinance. However, both terms are often used interchangeably.

2009), India (Andhra Pradesh, 2006), Morocco (2009), Nicaragua (2007), Pakistan (2009) and South Africa (2014). Other developing countries, such as Azerbaijan, Cambodia, Colombia, the Dominican Republic, Ghana, Kyrgyzstan, Mexico, Mongolia, Peru, the Philippines, Senegal and Uganda are experiencing growing difficulties of client overindebtedness and of defaults in their microsectors.

52. The main cause of such microdebt crises is a systematic mismatch between the fast expansion of credit supply to microsectors, not least through supply-driven anti-poverty programmes, and the much more lacklustre growth of effective demand or purchasing power for the outputs of those sectors. The main rationale behind microcredit is the assumption that the demand to absorb the additional supply of products and services generated by microcredit will be automatically forthcoming.

53. That this has not been the case, overall, is largely explained by the fact that microsectors in developing economies have been characterized by hypercompetitiveness between mostly informal enterprises, keeping wages and returns in low productivity microsectors to survival levels for the vast majority and, eventually, prompting rising incidences of defaults. Such hypercompetitiveness between microenterprises has been reinforced by the lack of coordinated efforts to formalize those sectors through explicit governance structures and regulation. As a consequence, microcredit has increasingly underpinned debt-financed basic consumption spending, rather than microlevel productive investment financing. While there is no agreed definition as to what constitutes overindebtedness in those sectors, it is clear that household debt has risen sharply again following the global financial crisis, by around $7.7 trillion, with the bulk of the increase ($6.2 trillion) attributable to developing economies.[17]

54. Furthermore, the occurrence of natural and other disasters has played a non-negligible role in the most serious instances of microsector-led overindebtedness. In the aftermath of earthquakes, tsunamis and conflict, there has often been a widespread deployment of microcredit in order to attempt to rebuild shattered communities and the small-scale business sector. For example, levels of overindebtedness attributable to easy access to microcredit shot up very rapidly in post-tsunami Asia in 2004 and in post-earthquake Haiti in 2010.

55. The financial fragility of the microsectors in developing countries has the potential to affect wider debt sustainability in developing economies for a number of reasons. For the most part, the prevention of microdebt crises places a considerable burden on already stretched fiscal budgets at domestic levels to bail out the core financial players in those microsectors. Moreover, the explosive growth in the global microcredit sector since around 2000 has been greatly underpinned by external borrowing. After initially relying on donor funds and government subsidies, the first commercial microcredit fund made available to investors was launched in 1998 and since then, there has been a rapid expansion in external funding opportunities for microcredit institutions. The external funding is as much subject to global financial instabilities and volatility as any other type of funding.

[17] Institute of International Finance, "Capital Markets Monitor: Key Issues, November/December 2015" (Washington, D.C., Institute of International Finance, 5 November 2015).

VI. Conclusions and policy recommendations

56. As the global economic environment is set to remain unstable, it is becoming more difficult for developing economies to leverage debt financing for sustainable development. At the same time, the international community has adopted the most ambitious development agenda yet, the 2030 Agenda for Sustainable Development. In this context, it is more essential than ever to proactively protect the ability of developing economies to continue to leverage debt financing for sustainable development.

57. Increased access to private capital by developing countries reflects achievements in development over the past quarter of a century, but rapid integration into the global financial system has come at a cost. In addition to heightened exposure to market risks and a high systemic risk of contagion, fast integration into international financial markets has also resulted in structural changes to the composition of developing country debt obligations. Those shifts, towards domestic and local-currency bond financing in public sectors, substantial non-resident participation in local currency bond markets and rapidly rising private firm and household indebtedness, tend to increase rather than mitigate overall risk exposure, with both direct and indirect spillover effects on external sovereign debt sustainability.

58. One aspect of such spillover effects that has thus far been largely neglected concerns developing country microdebt crises. Not least because the recent rise of new digital technologies and payment systems stand ready to effectively swamp the unbanked poor in developing countries with more microcredit than available at present, a reassessment of the role of microcredit as a poverty reduction policy is urgently required.

59. To properly assess both the opportunities and the dangers associated with these new challenges, it will be of utmost importance to improve the availability and quality of data and country coverage in a number of areas, including domestic public debt and both domestic and external private firm and household debt, as well as in terms of legal and regulatory features, such as ownership, currency denomination and jurisdictions. In this context, strengthening in particular so-called "downstream" public debt management capacities in developing economies, including the maintenance of debt databases, debt-data validation, debt operations, internal and external debt reporting, debt statistics and basic debt analysis, will be essential to allow developing economies to engage in appropriate risk management and hedging strategies.[18]

60. Improved availability, quality and transparency of data in this regard should also contribute to facilitating sovereign debt restructuring, where it becomes necessary. As highlighted in the present report, increasingly complex ownership structures of developing country debt mean that there is no longer a clear legal sense in which domestic and external sovereign debt obligations can be treated entirely separately. In addition, growing contingent public liabilities, arising from implicit public guarantees of private debt, including the role of public authorities as lenders of last resort in times of crises, also need to be taken into account more systematically. While recently renewed calls by some international organizations to

[18] For more detail, see A/70/278, section VI on debt management capacities.

retroactively include collective action clauses in all or most existing sovereign debt bonds are welcome, those proposals and others aiming to facilitate and streamline sovereign debt restructuring processes should be reviewed in a systematic and comprehensive manner by the international community. Pursuant to General Assembly resolution 70/190, the international community should therefore promote further opportunities to discuss such issues during the special event of the Second Committee on lessons learned from legislative steps taken by certain countries and other appropriate actions aimed at reducing the vulnerability of sovereigns to holdout creditors.

61. Finally, it should be noted that ODA remains a core source of developmental finance, in particular for the least developed economies. While some donor economies are currently facing exceptional demands on their fiscal resources, in particular in the context of migrant and refugee crises, a clear definition of the additionality of ODA commitments for general developmental purposes vis-à-vis more specific objectives, such as addressing refugee crises and climate change, is required. Here, too, the continuing lack of internationally agreed definitions makes data recording and policy analysis difficult.

Annex

External debt of developing countries

(Billions of United States dollars)

	All developing countries[a] and countries with economies in transition					Sub-Saharan Africa				
	2000-2015	2012	2013	2014	2015[b]	2000-2015	2012	2013	2014	2015[b]
Total debt stocks[c]	4 064.2	5 989.7	6 796.0	7 226.3	6 813.1	277.3	355.7	379.3	407.1	412.8
Long-term debt	2 943.3	4 110.3	4 536.5	4 857.5	4 852.1	220.9	282.4	302.4	325.2	331.1
Public and publicly guaranteed	1 660.5	2 078.8	2 299.0	2 436.0	2 472.4	178.3	201.9	224.4	246.2	261.8
Private non-guaranteed	1 282.8	2 031.5	2 237.5	2 421.5	2 379.7	42.6	80.5	78.0	79.0	69.3
Short-term debt	1 018.4	1 742.9	2 140.5	2 263.9	1 853.6	42.7	51.6	54.9	61.4	58.2
Arrears	81.3	68.7	63.5	67.1	66.2	34.6	28.4	29.9	27.5	28.3
Debt service	515.8	653.6	695.3	801.2	781.9	19.7	24.3	29.3	34.2	31.9
International reserves	3 787.6	6 401.8	6 903.9	6 839.0	6 284.4	122.3	198.9	202.0	187.3	169.5
Debt indicators (percentage)[d]										
Debt service/exports[e]	11.2	8.9	9.2	10.5	11.5	6.3	4.9	5.9	7.5	8.8
Total debt/exports	88.3	81.8	89.8	94.8	100.1	87.6	71.5	75.5	88.4	112.5
Debt service/GDP	3.2	2.6	2.6	2.9	2.9	2.0	1.5	1.8	2.0	2.1
Total debt/GDP	25.5	23.5	25.1	25.9	25.5	28.0	22.6	22.8	23.6	26.7
Reserves/short-term debt	369.1	364.7	320.4	300.2	337.2	286.5	385.4	368.0	305.1	291.1
Reserves/M2[f]	26.7	26.3	25.4	23.5	21.0	35.6	37.9	38.8	34.5	34.6

	Middle East and North Africa					Latin America and the Caribbean				
	2000-2015	2012	2013	2014	2015[e]	2000-2015	2012	2013	2014	2015[e]
Total debt stocks[c]	162.9	172.5	188.9	187.9	194.7	1 073.2	1 455.9	1 609.1	1 761.8	1 766.7
Long-term debt	127.5	130.4	146.5	141.3	147.2	896.1	1 222.2	1 360.5	1 494.5	1 513.2
Public and publicly guaranteed	120.6	121.3	136.6	131.8	140.3	506.9	603.4	664.5	751.3	790.0
Private non-guaranteed	6.9	9.1	9.9	9.5	6.9	389.2	618.8	696.1	743.1	723.2
Short-term debt	30.1	33.5	33.0	36.4	37.4	153.6	208.3	223.4	244.2	231.1
Arrears	4.9	1.4	2.1	2.5	1.5	21.6	21.3	21.7	16.6	17.0
Debt service	19.3	16.3	16.9	18.6	19.2	170.7	211.6	218.1	206.8	225.6
International reserves	262.6	389.5	400.3	389.8	346.9	472.2	803.8	802.6	830.7	793.3
Debt indicators (percentage)[d]										
Debt service/exports[e]	7.5	4.7	5.2	6.5	7.4	20.0	16.5	17.0	16.4	20.6
Total debt/exports	63.1	50.0	57.7	66.0	74.9	125.7	113.4	125.3	139.9	161.5
Debt service/GDP	2.2	1.2	1.3	1.5	1.6	4.4	3.6	3.6	3.4	4.3
Total debt/GDP	18.9	12.7	14.4	15.0	16.4	27.4	24.6	26.6	29.1	33.6
Reserves/short-term debt	871.6	1 163.2	1 212.2	1 072.1	928.2	307.3	385.8	359.1	340.0	343.1
Reserves/M2[f]	45.7	42.9	49.5	44.0	38.9	32.0	33.6	32.5	33.3	36.2

	East Asia and Pacific					*South Asia*				
	2000-2015	*2012*	*2013*	*2014*	*2015*[b]	*2000-2015*	*2012*	*2013*	*2014*	*2015*[b]
Total debt stocks[c]	1 188.3	1 906.0	2 291.2	2 633.7	2 277.7	343.0	527.5	570.0	610.8	641.4
Long-term debt	613.4	833.0	878.7	1 079.3	1 091.5	282.3	403.2	445.3	493.4	509.3
Public and publicly guaranteed	346.1	428.3	442.8	496.9	498.1	173.3	232.4	237.7	272.0	276.2
Private non-guaranteed	267.3	404.7	435.8	582.4	593.4	109.0	170.9	207.6	221.4	233.2
Short-term debt	565.3	1 063.3	1 403.0	1 545.5	1 175.3	50.9	105.9	109.1	103.2	118.2
Arrears	9.7	6.1	5.5	4.7	4.8	0.1	0.1	0.1	0.3	0.3
Debt service	105.7	145.5	117.4	142.0	153.5	39.3	39.4	50.9	103.1	110.5
International reserves	2 191.6	3 875.1	4 355.6	4 363.9	3 890.8	227.7	305.9	313.6	353.3	411.8
Debt indicators (percentage)[d]										
Debt service/exports[e]	5.2	4.4	3.3	3.8	4.3	12.2	7.4	9.1	17.6	21.8
Total debt/exports	58.2	57.1	64.4	70.6	63.6	106.3	99.0	101.3	104.4	126.3
Debt service/GDP	1.7	1.4	1.0	1.1	1.2	2.5	1.7	2.2	4.0	4.1
Total debt/GDP	19.1	18.0	19.6	20.9	17.3	22.1	23.1	24.3	23.8	24.1
Reserves/short-term debt	387.7	364.4	310.4	282.4	331.0	447.8	288.9	287.4	342.5	348.3
Reserves/M2[f]	22.5	22.7	22.0	20.0	16.8	21.2	18.5	18.5	19.1	20.9

	Europe and Central Asia					*Least developed countries*				
	2000-2015	*2012*	*2013*	*2014*	*2015*[b]	*2000-2015*	*2012*	*2013*	*2014*	*2015*[b]
Total debt stocks[c]	1 019.6	1 572.2	1 757.4	1 625.1	1 519.8	169.0	189.4	211.7	224.6	241.8
Long-term debt	803.1	1 239.0	1 403.2	1 323.8	1 259.8	141.3	159.3	178.0	192.2	206.4
Public and publicly guaranteed	335.3	491.4	593.1	537.8	506.0	136.5	151.4	169.7	181.9	192.7
Private non-guaranteed	467.8	747.6	810.1	786.0	753.8	4.7	7.9	8.2	10.3	13.7
Short-term debt	175.8	280.3	317.0	273.3	233.3	18.3	16.5	19.8	19.5	25.3
Arrears	10.3	11.4	4.3	15.5	14.3	33.5	30.0	30.3	28.9	29.9
Debt service	161.1	216.5	262.7	296.4	241.2	8.3	10.9	11.7	14.6	14.5
International reserves	511.1	828.6	829.7	714.1	672.1	63.4	107.9	116.7	115.8	110.7
Debt indicators (percentage)[d]										
Debt service/exports[e]	20.0	16.4	19.8	22.9	24.3	5.7	4.5	4.6	6.2	7.3
Total debt/exports	126.1	119.1	132.2	125.2	153.1	114.2	77.5	82.6	93.5	120.2
Debt service/GDP	6.9	5.7	6.6	8.1	8.4	1.6	1.4	1.4	1.6	1.6
Total debt/GDP	43.4	41.7	44.4	44.2	52.6	33.1	24.4	25.1	24.9	27.3
Reserves/short-term debt	274.3	279.7	247.1	245.9	273.8	345.8	653.9	589.6	593.1	436.8
Reserves/M2[f]	53.7	46.6	43.8	49.9	54.0	40.0	41.1	39.3	34.9	32.8

Source: United Nations Conference on Trade and Development secretariat calculations based on the World Bank International Debt Statistics 2016 (online database).

[a] Developing countries as defined in the International Debt Statistics publication.

[b] 2015 estimates.

[c] Total debt stocks include long-term debt, short-term debt and the use of IMF credit.

[d] Data used for ratio calculation have been adjusted according to country data availability.

[e] Exports comprise exports of goods, services and primary income.

[f] M2, in general terms, refers to money and "near money".