# Application of the UNCTAD Sustainable Development Finance Assessment (SDFA) Framework to Developing Countries

## The Cases of Indonesia & Sri Lanka

Presentation to a meeting on South-South Sharing of Policy Experiences:
Debt Sustainability in Developing Countries
11 May 2022

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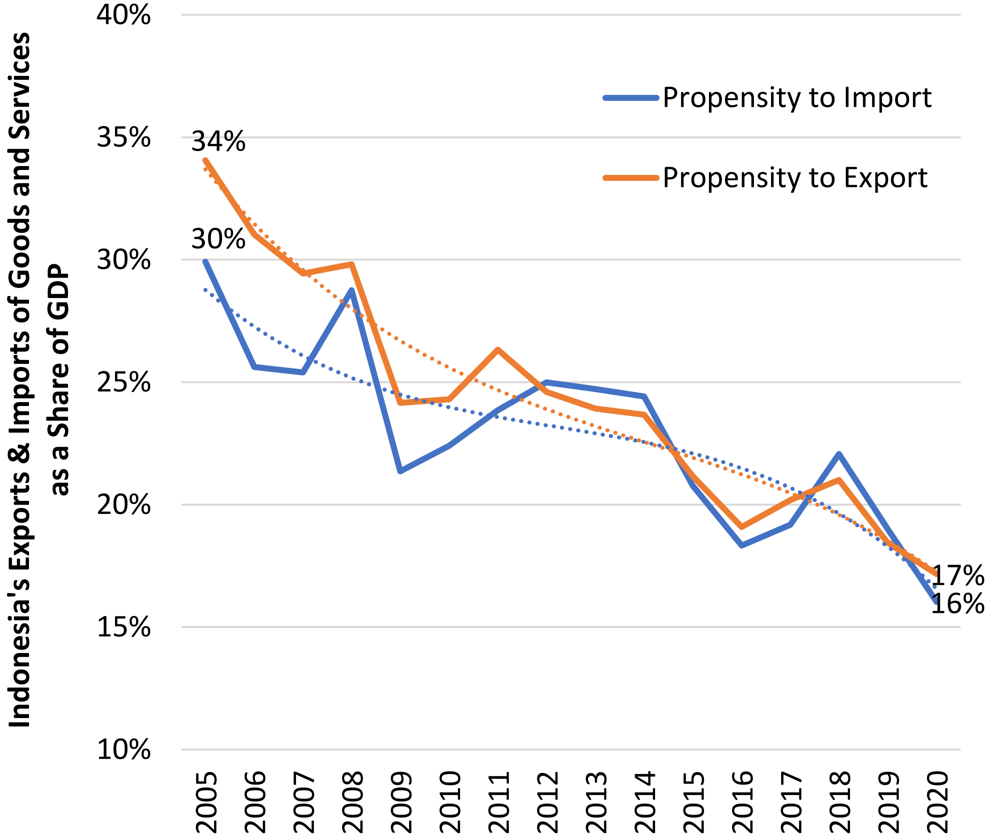
# Application of the SDFA Framework to Indonesia

# Indonesia’s external financial sustainability

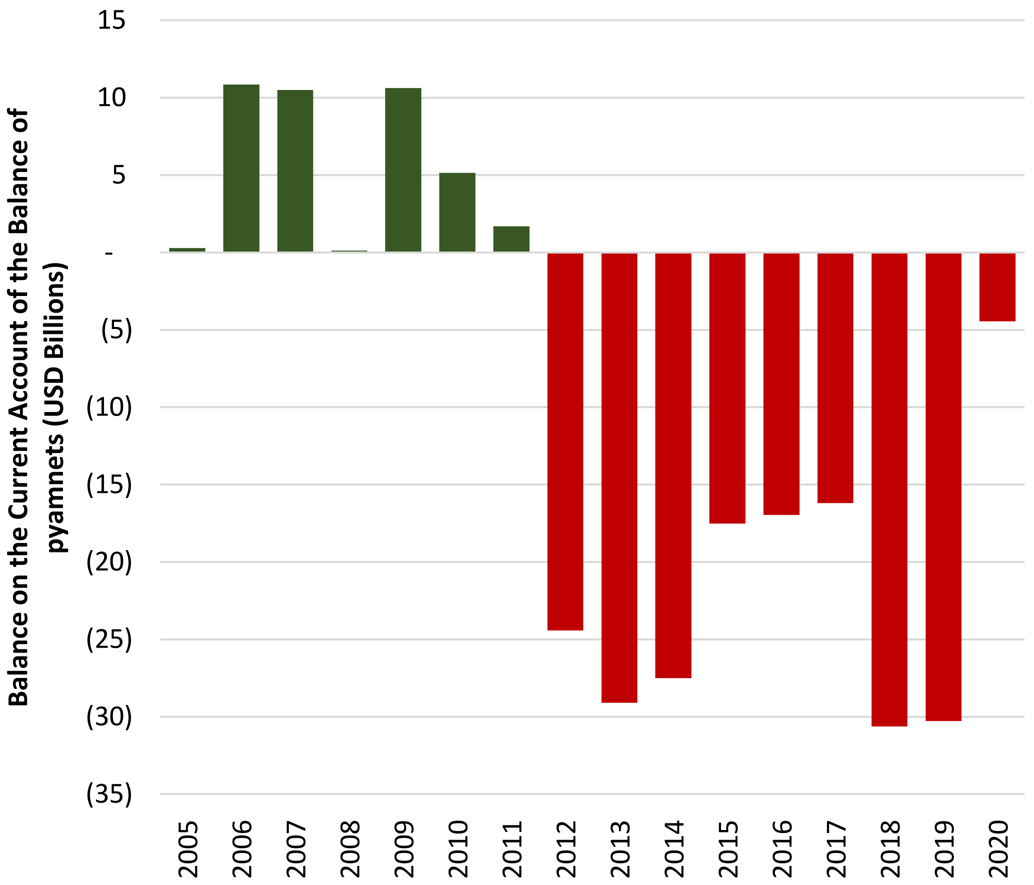
# Indonesia’s propensity to export and import

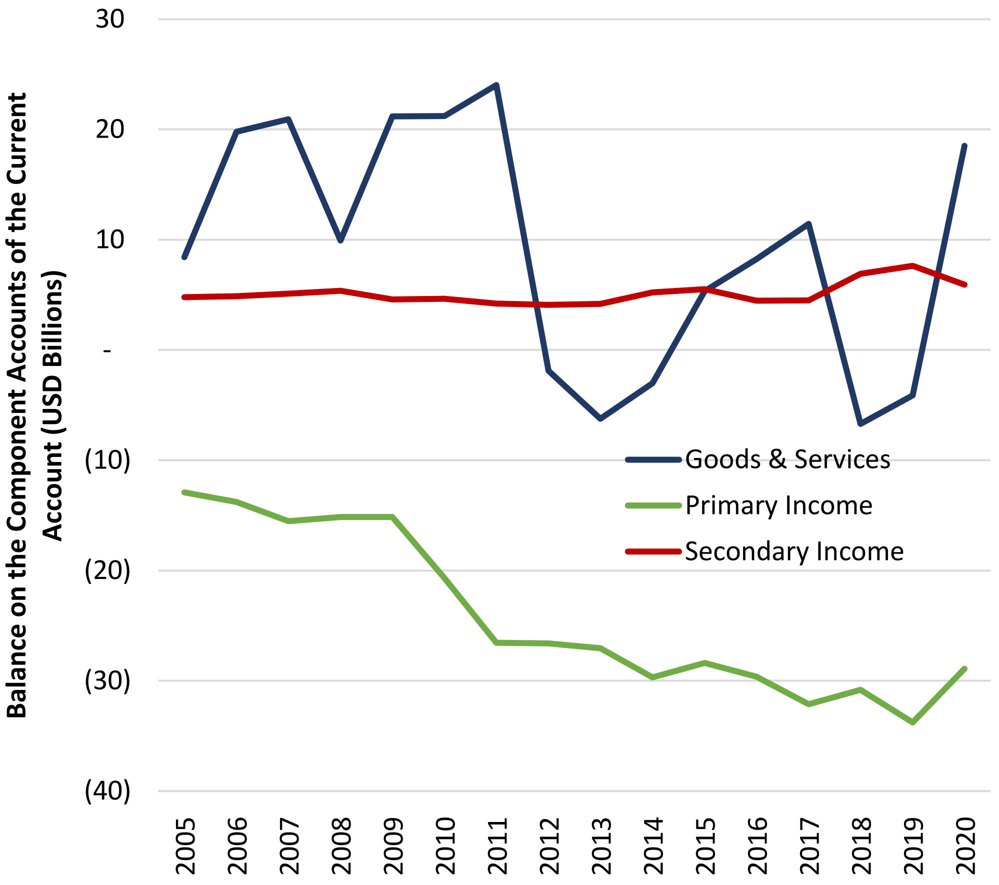



*Source of data: World Bank World Development Indicators, December 2021*

- Propensity to export halved – from 34% in 2005 to 17% in 2020
- Propensity to import declined by 47% over the same period

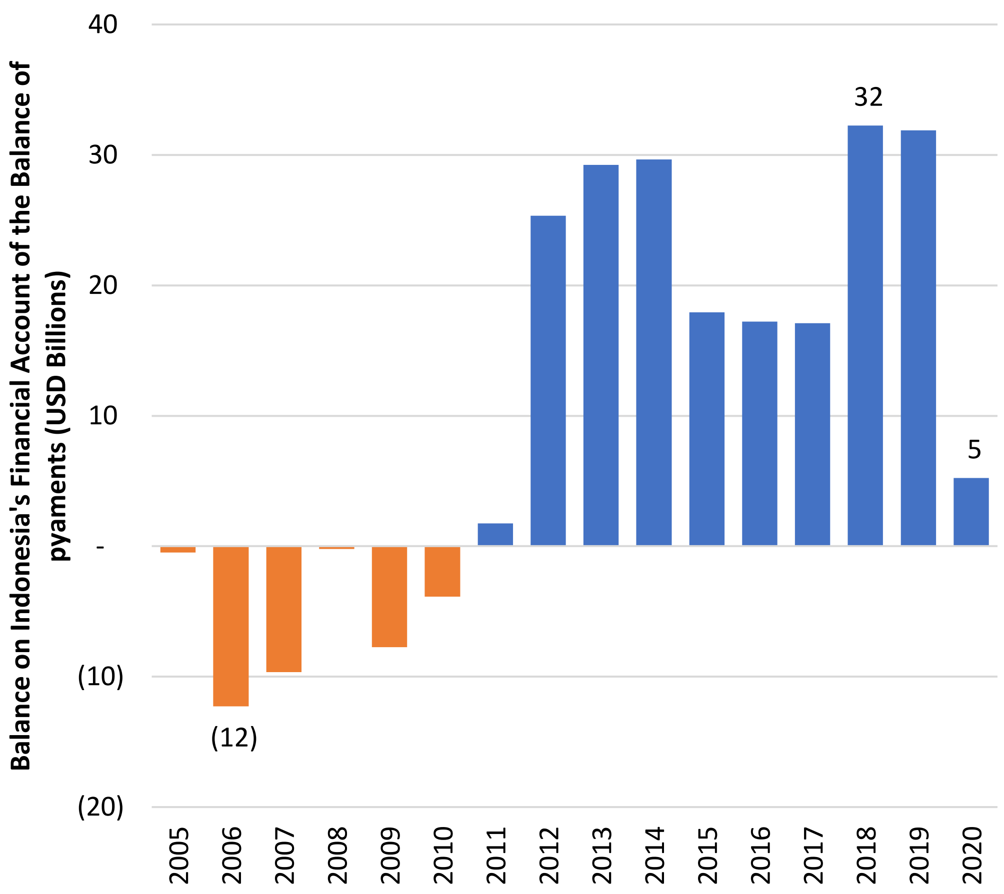
# Performance of Indonesia's Current Account

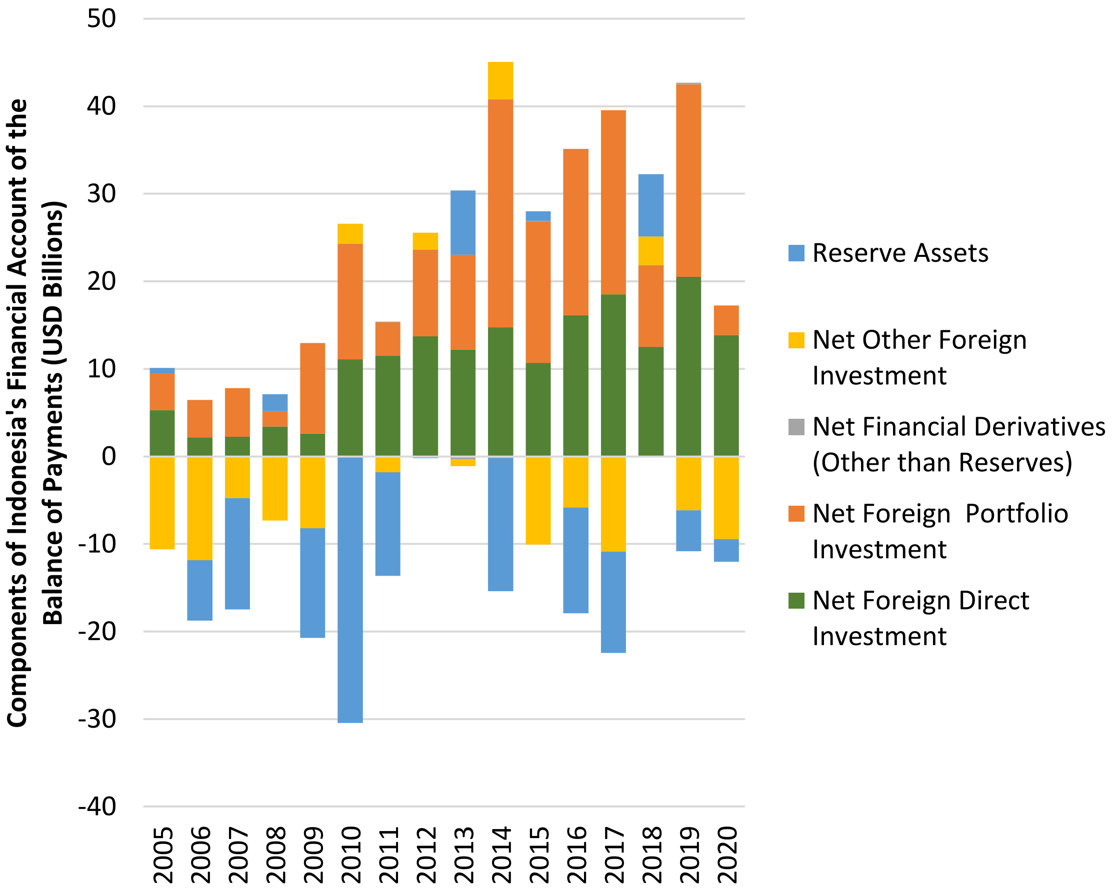



*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*

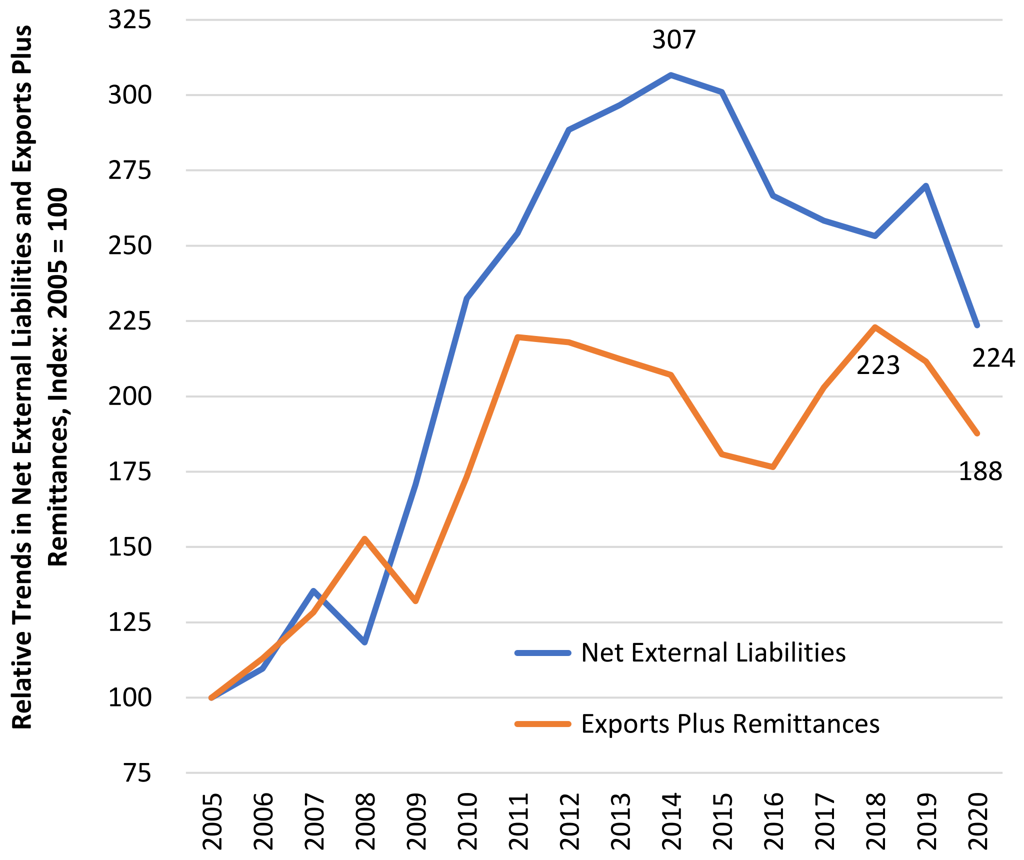
# Performance of Indonesia's Financial Account

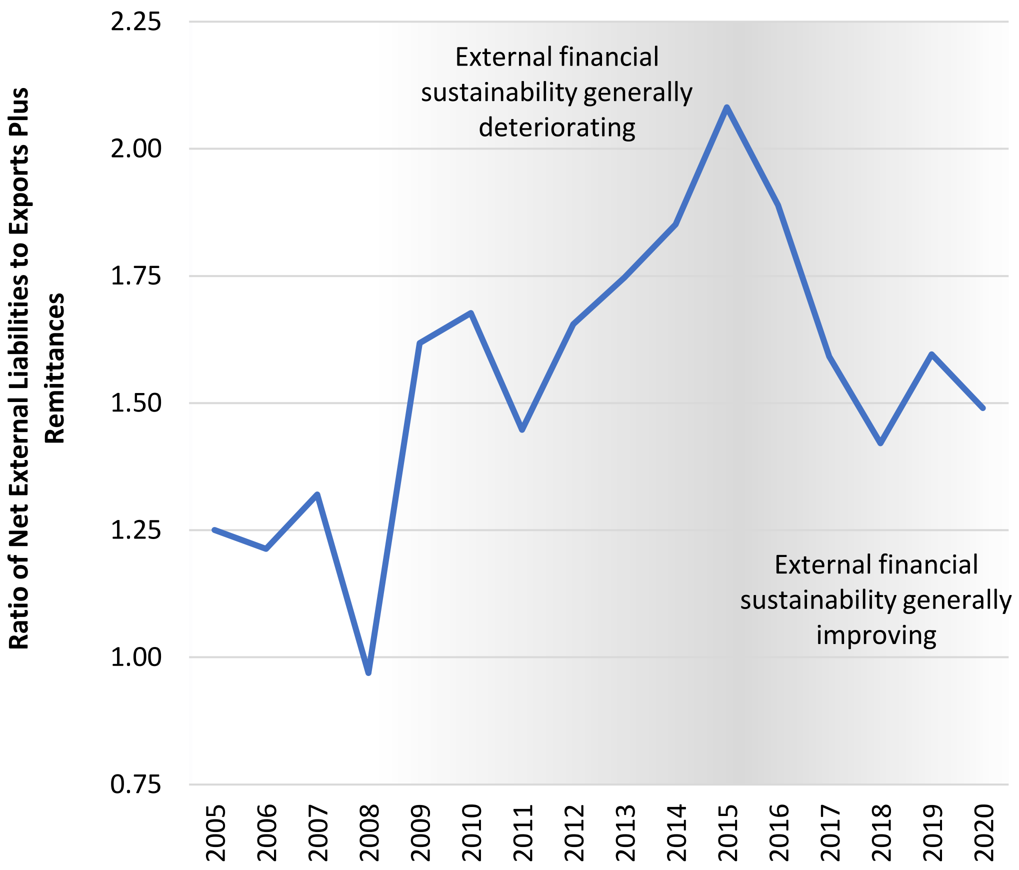



*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*

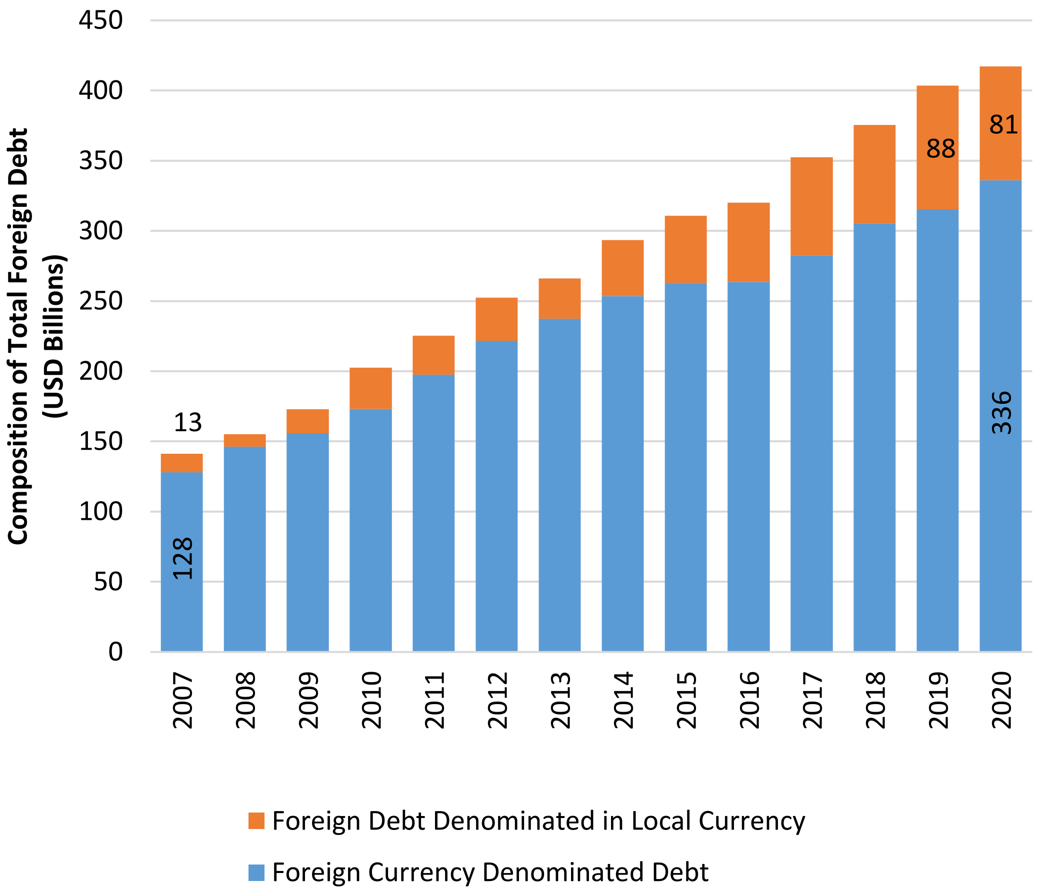
# Trends in Indonesia's net external liabilities and augmented exports

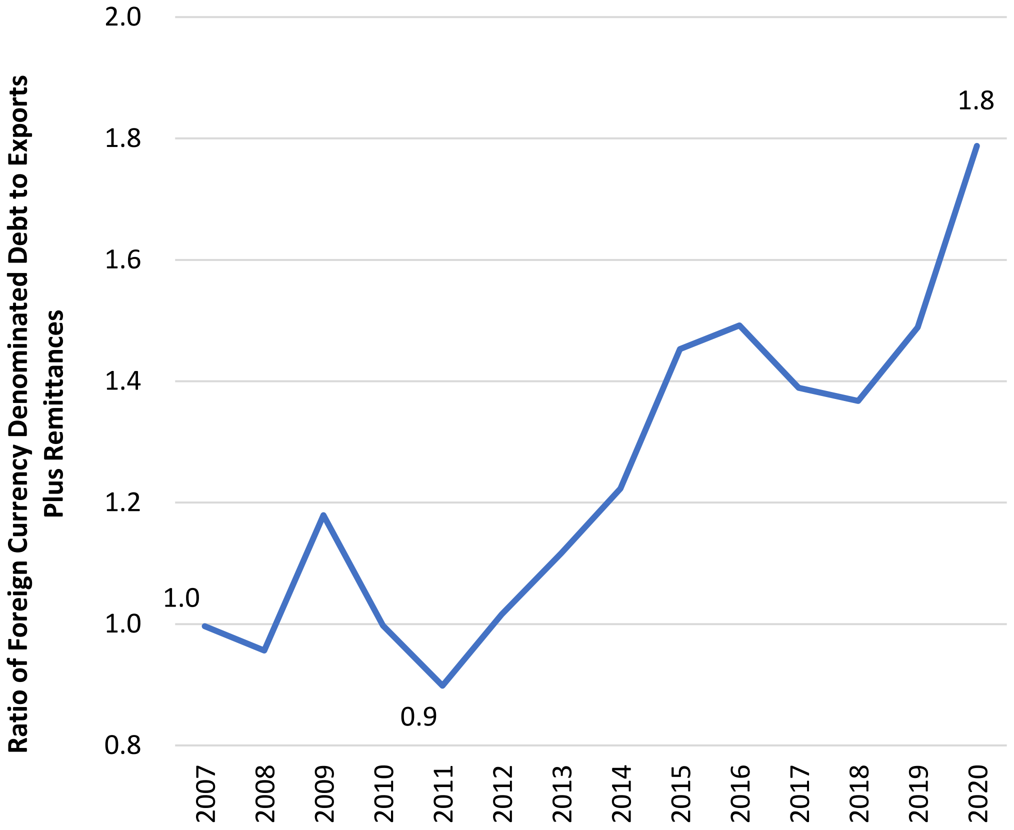


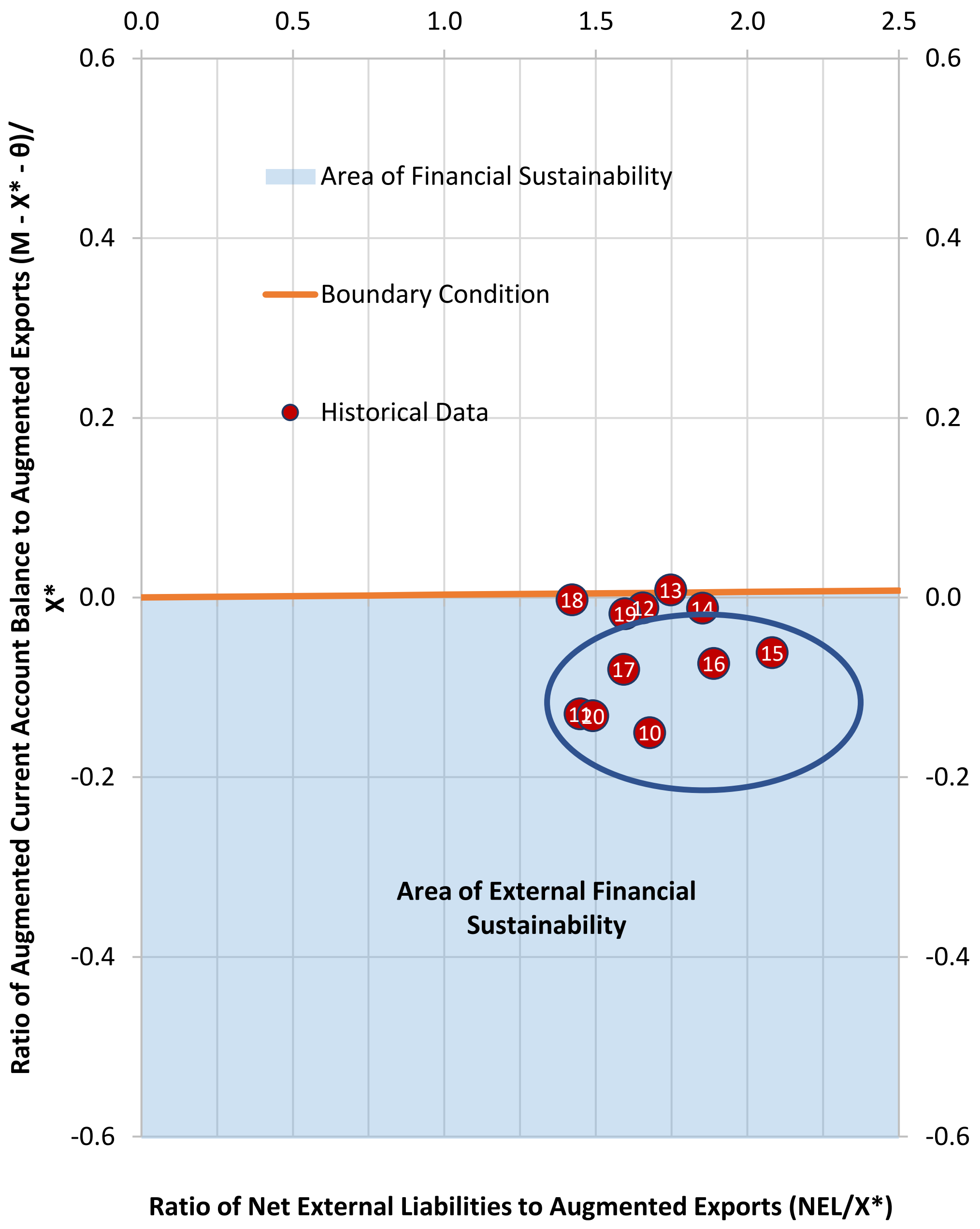

*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*

# Indonesia's foreign currency denominated debt and augmented exports




*Source of data: Bank Indonesia, December 2021, IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*



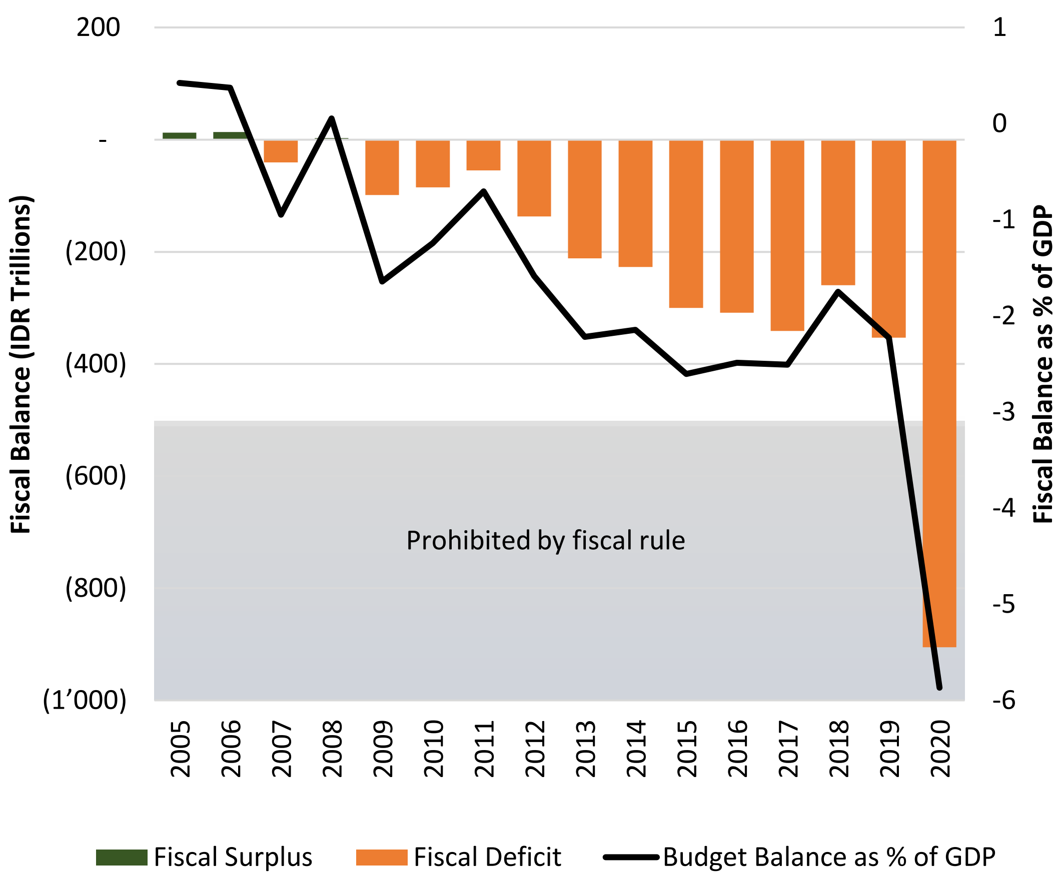

# Indonesia's external financial sustainability between 2010 and 2020

- Indonesia operated within its area of external financial sustainability between 2010 and 2020
- Model indicates that it **could** have grown at faster rates in 2010, 2011, 2015 – 2017 and in 2020 (i.e. imported more) without threatening external solvency
- Slight positive gradient to Boundary Condition indicates that average growth in augmented exports was higher than the average cost of net external liabilities

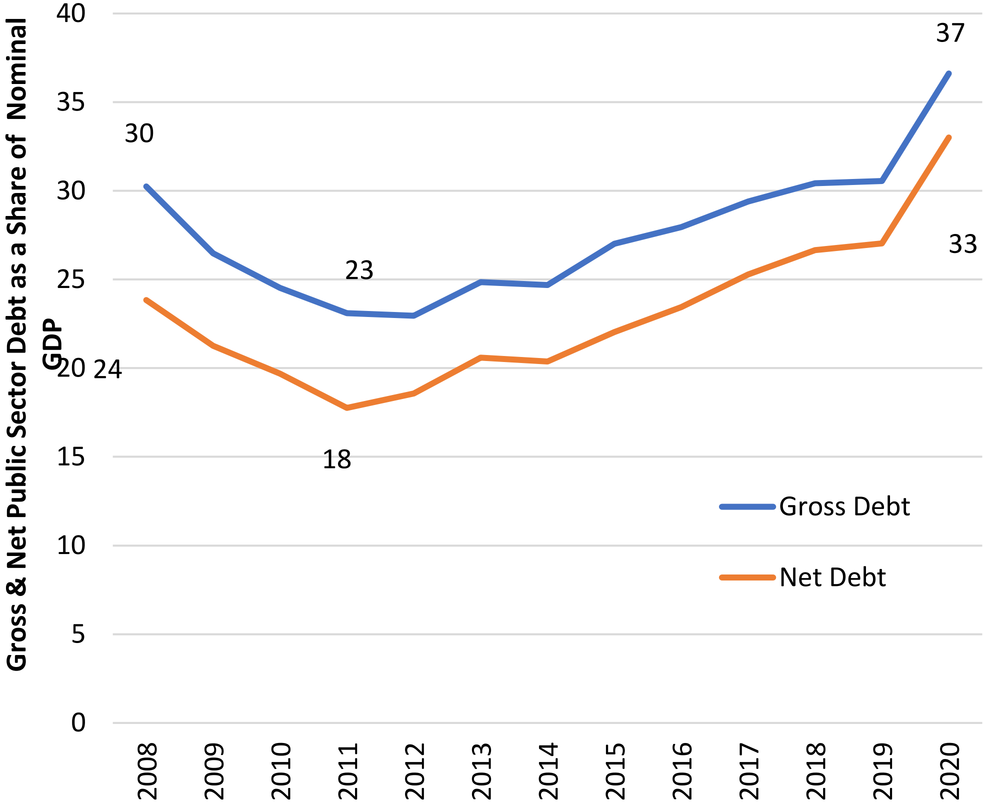
Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021, Bhering (2021)

Indonesia’s public sector
financial sustainability

# Indonesia’s budget balance & gross and net public sector debt



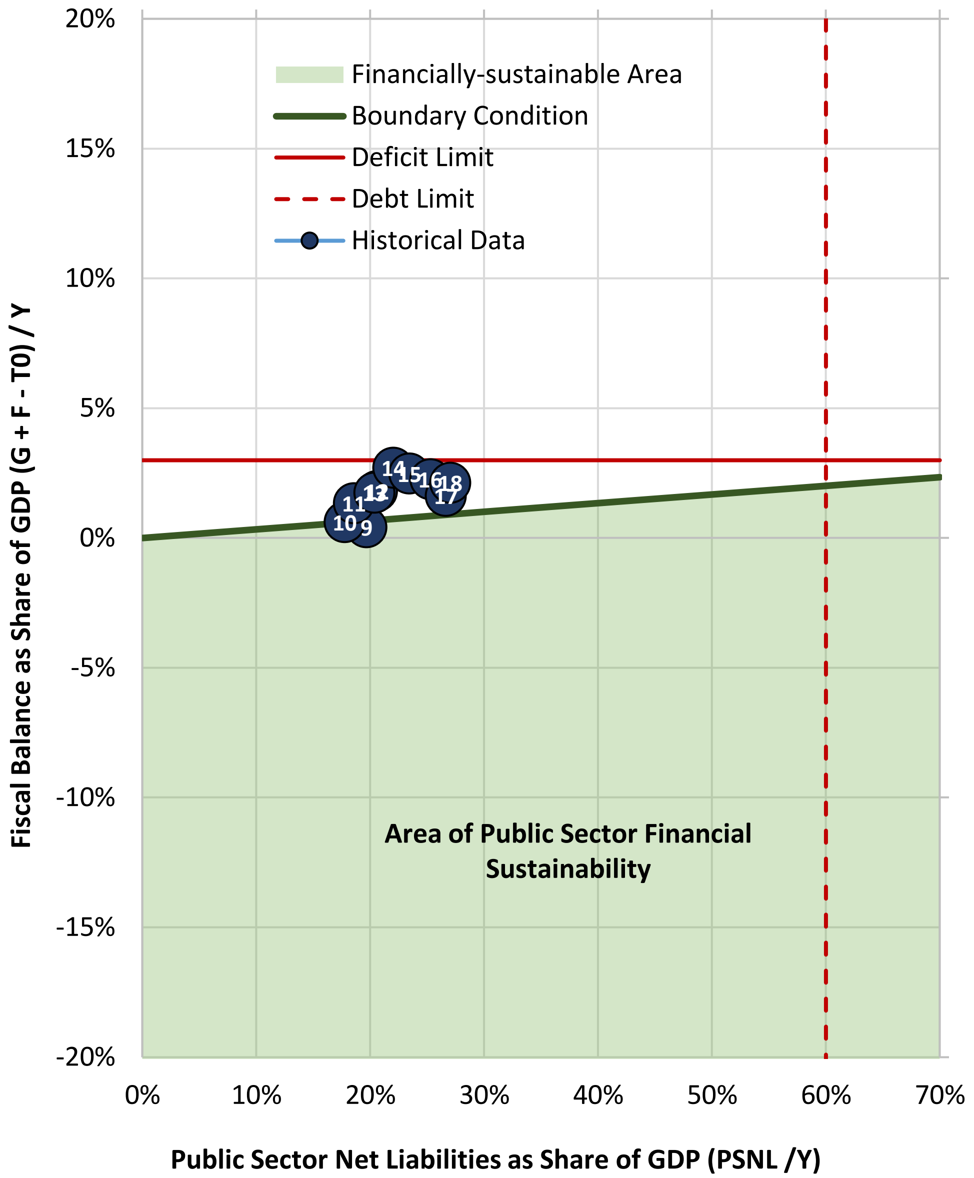

*Source of data: IMF Fiscal Monitor (2021).*
*NOTE: Parliamentary approval was obtained in 2020 for the deficit to exceed the fiscal rule to accommodate the fiscal response to COVID-19*




NOTE: SDFA uses net public sector debt for countries – such as Indonesia - where the data is available

# Indonesia's public sector financial sustainability between 2009 and 2019

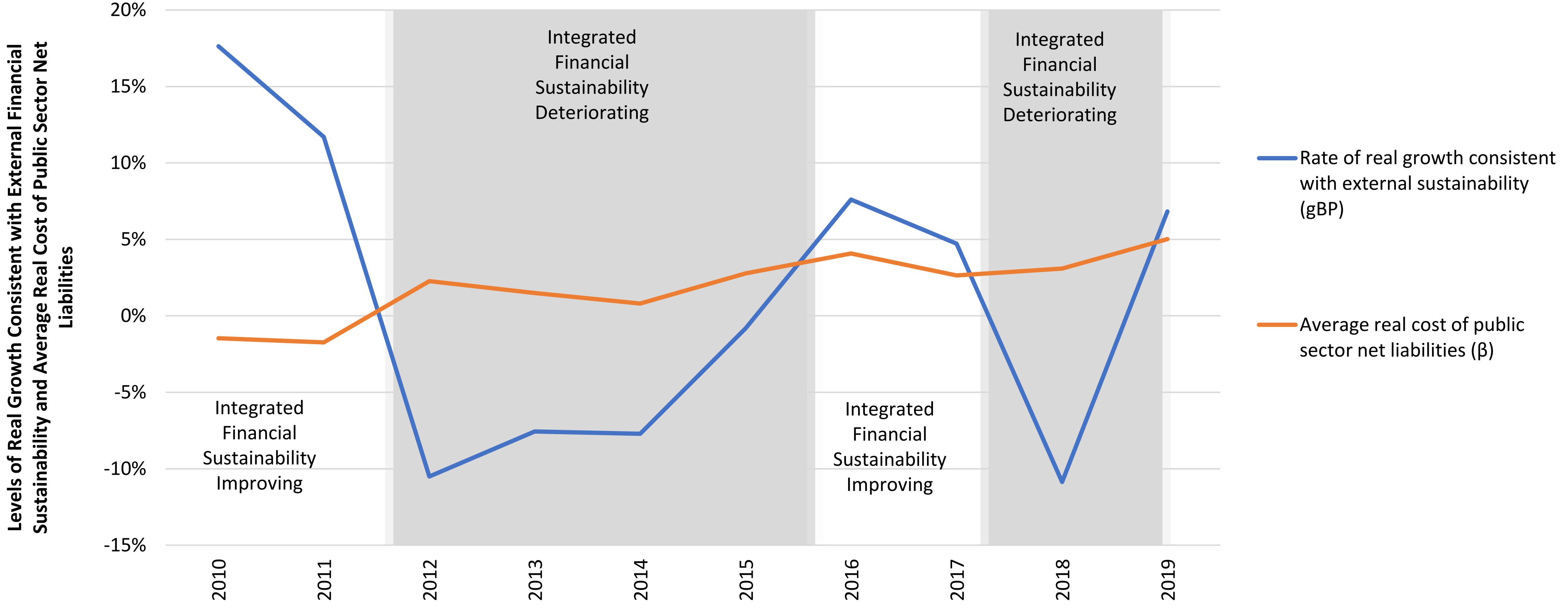
- Indonesia has two fiscal rules: a 3% of GDP deficit limit and a 60% of GDP debt limit
- In 2009 and 2010 it operated within the area of public sector financial sustainability. Between 2011 and 2018 it was slightly outside the area of financial sustainability but was compliant with its fiscal rules.
- The positive gradient of the Boundary Condition indicates that the rate of growth in real GDP was greater than the average real cost of public sector net liabilities



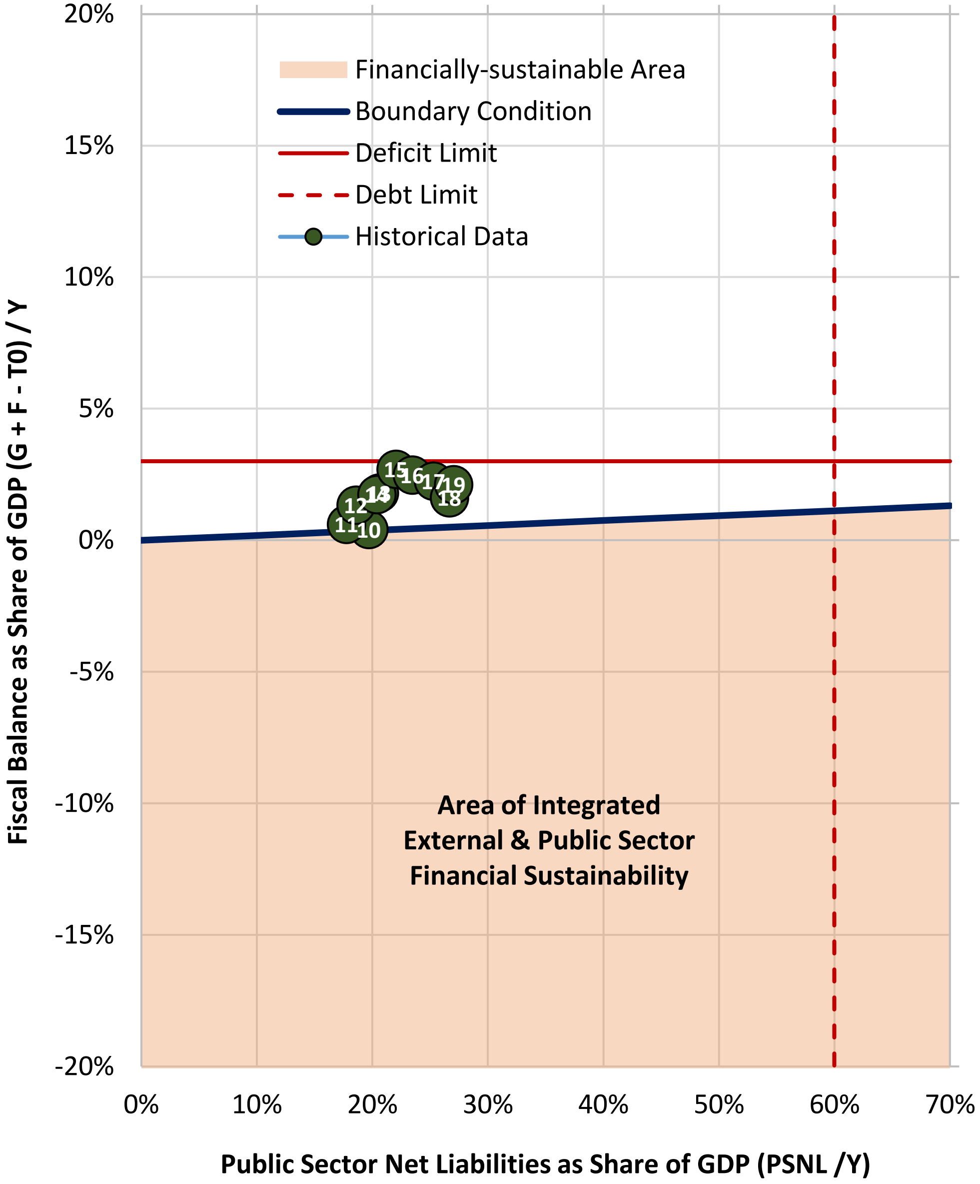

*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021), Bhering (2021).*

Indonesia’s integrated external and public sector financial sustainability

# Relative trends in Indonesia's rate of growth consistent with external sustainability and average real cost of public sector net liabilities




*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021), Bhering (2021).*




# Indonesia’s integrated external and public sector financial sustainability between 2009 and 2019

- The historical performance in relation to public sector finances (the numbered green dots) is the same as for public sector financial sustainability.
- However, because the average growth that is externally sustainable is less than the average actual growth in real GDP, the gradient of the Boundary Condition is slightly less positive . This decreases the area of integrated financial sustainability slightly.

*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021) IMF Balance of Payments and International Investment Position (BoP/IIP) (2021), Bhering (2021)*

# Policy implications

## External Financial Sustainability

- Increase potential external financial sustainability by ensuring that the growth in augmented exports exceeds the average cost of net external liabilities by a widening margin in the years ahead. Policy options :
    - Investments in appropriate infrastructure that facilitate higher export volumes;
    - Assistance to new exporters to access foreign markets;
    - Diversification of exports away from sunset industries towards products encompassing new technologies; and
    - Support for firms and sectors with revealed competitiveness (i.e. growing global market shares) to increase the scale of their operations and export activities.
- Reduction of the average cost of net external liabilities by progressively restructuring external debt to secure more favourable terms.

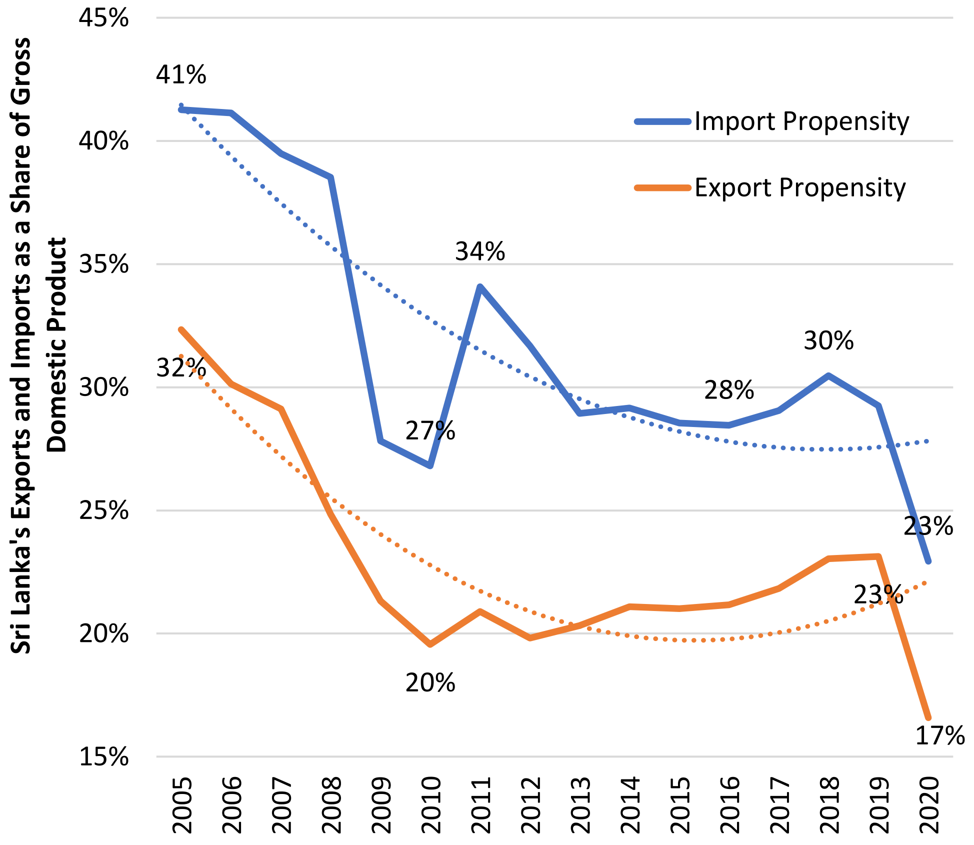
## Public Sector Financial Sustainability

- Policy space could be enhances if capacity to service public sector net liabilities grows and the average cost of servicing public sector net liabilities falls. Policy focus on these two variables could reduce the primacy of Indonesia's existing fiscal rules and – in the process – increase policy flexibility.

# Application of the SDFA Framework to Sri Lanka

# Sri Lanka’s external financial sustainability

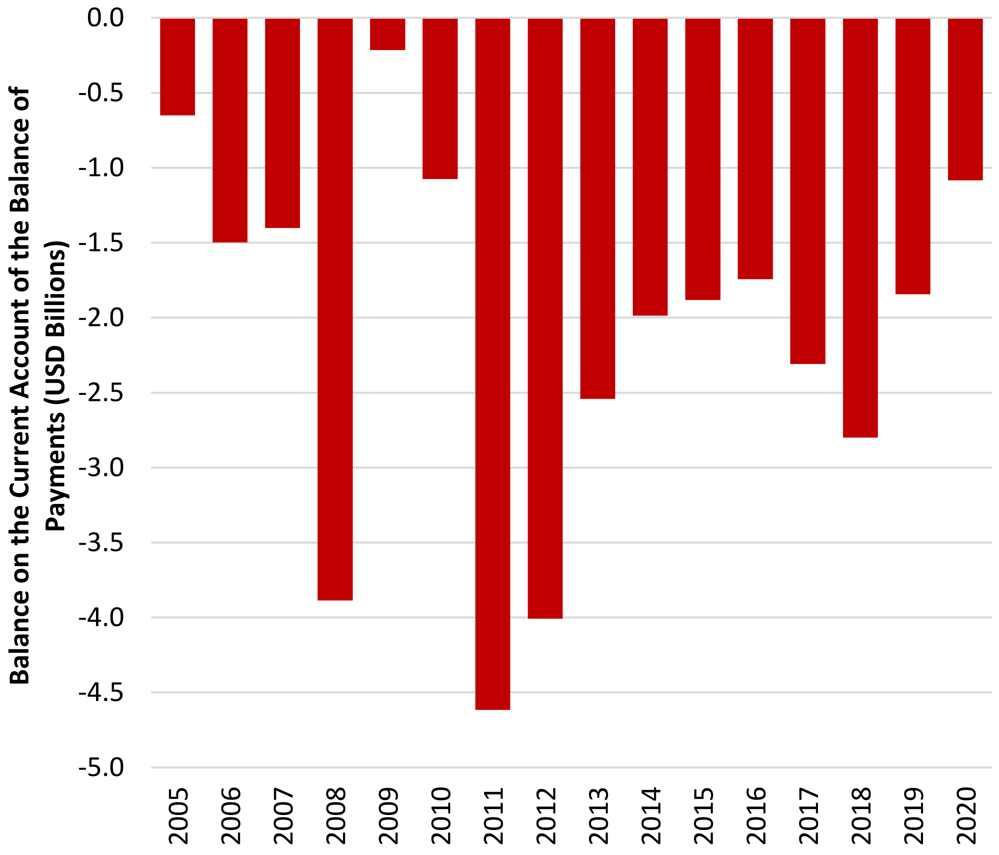
# Sri Lanka’s propensity to export and import

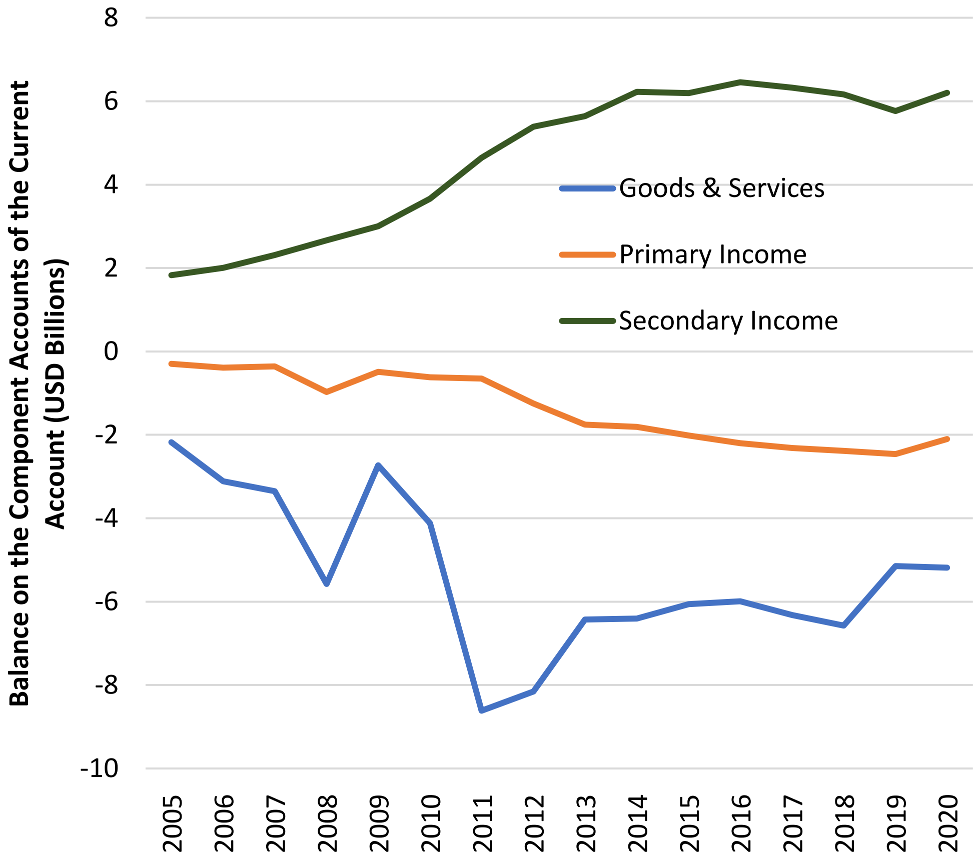



*Source of data: World Bank World Development Indicators, December 2021*

- Both indicators collapsed at the start of the COVID-19 pandemic but trended higher over the previous five years or more of data.
- The propensity to import was consistently higher than the propensity to export – but the gap narrowed from around 13% of GDP in 2011 to 6% of GDP in 2019.

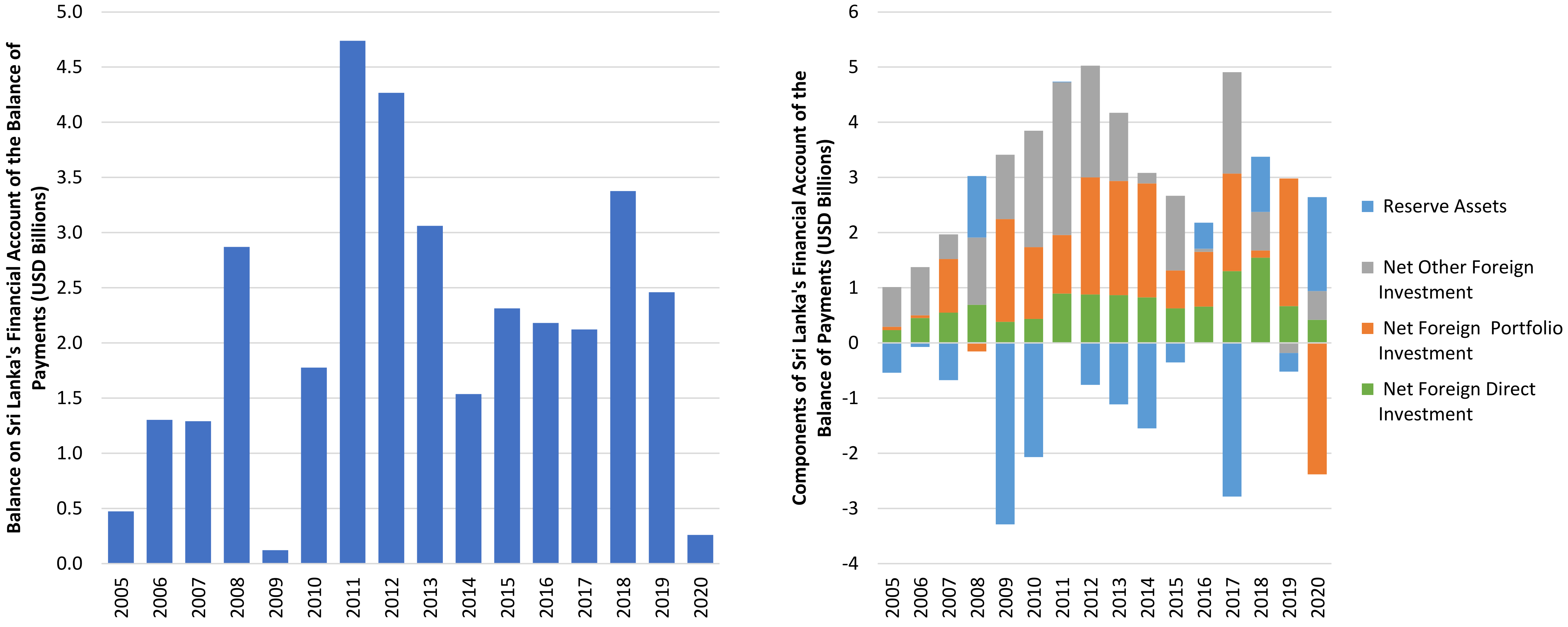
# Performance of Sri Lanka's Current Account



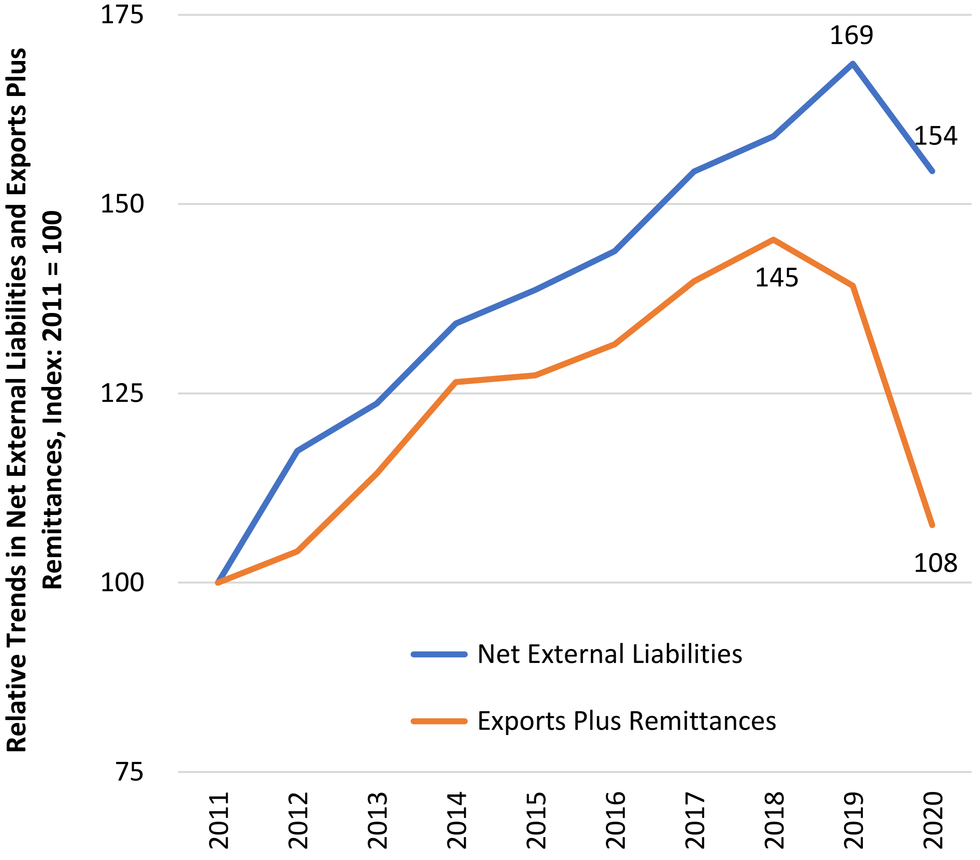

*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*

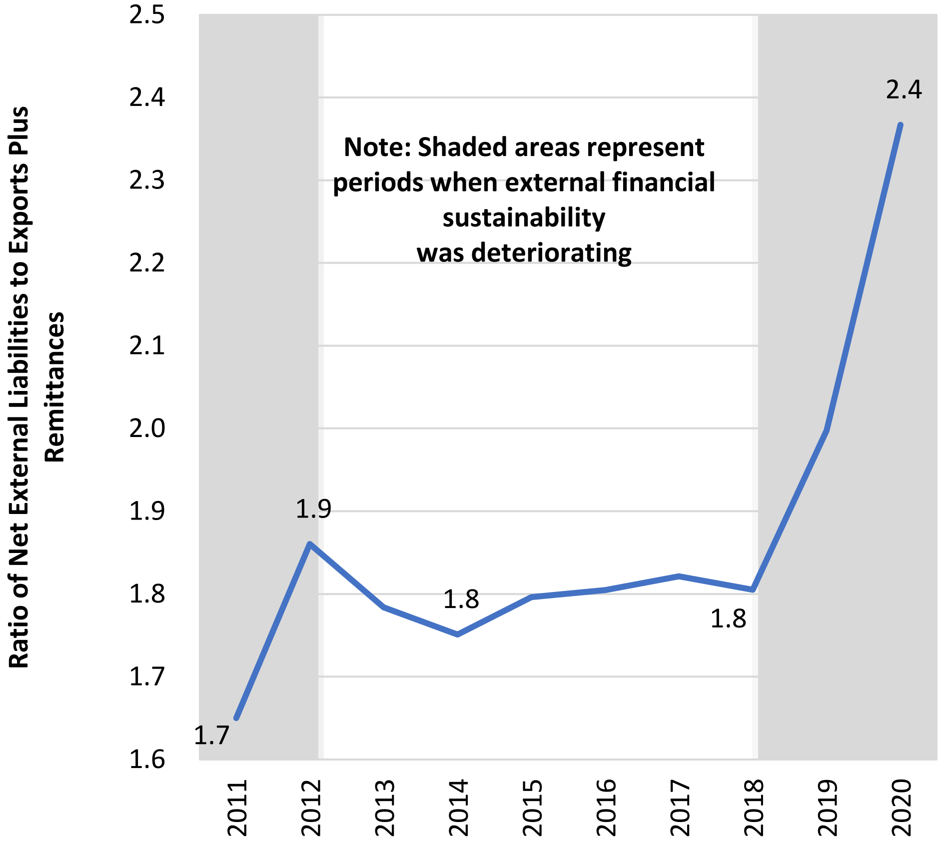
# Performance of Sri Lanka’s Financial Account




*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*

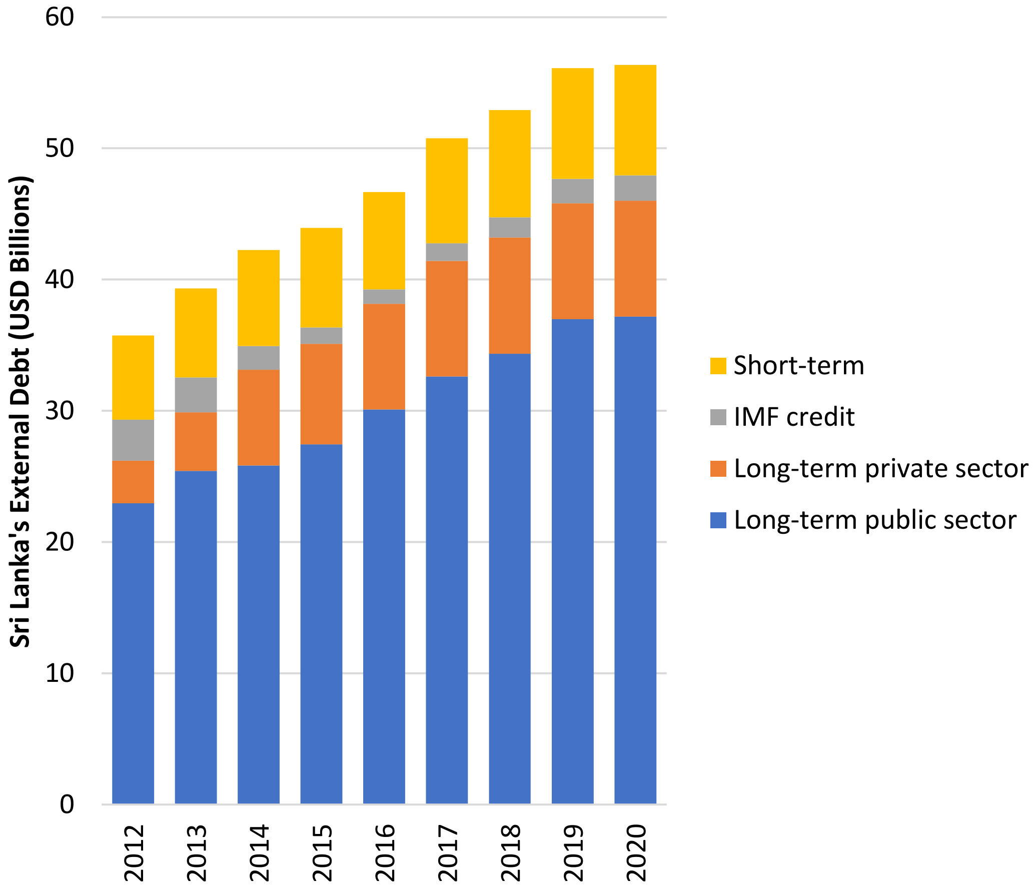
# Trends in Sri Lanka’s net external liabilities and augmented exports

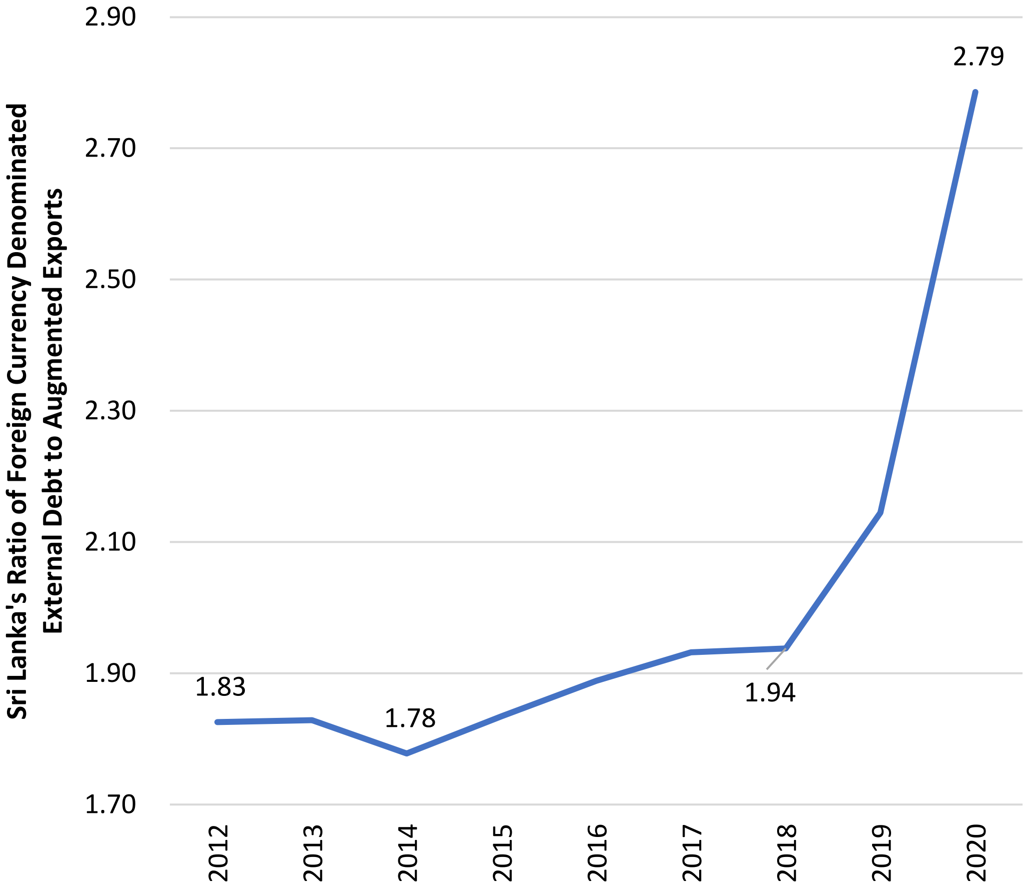


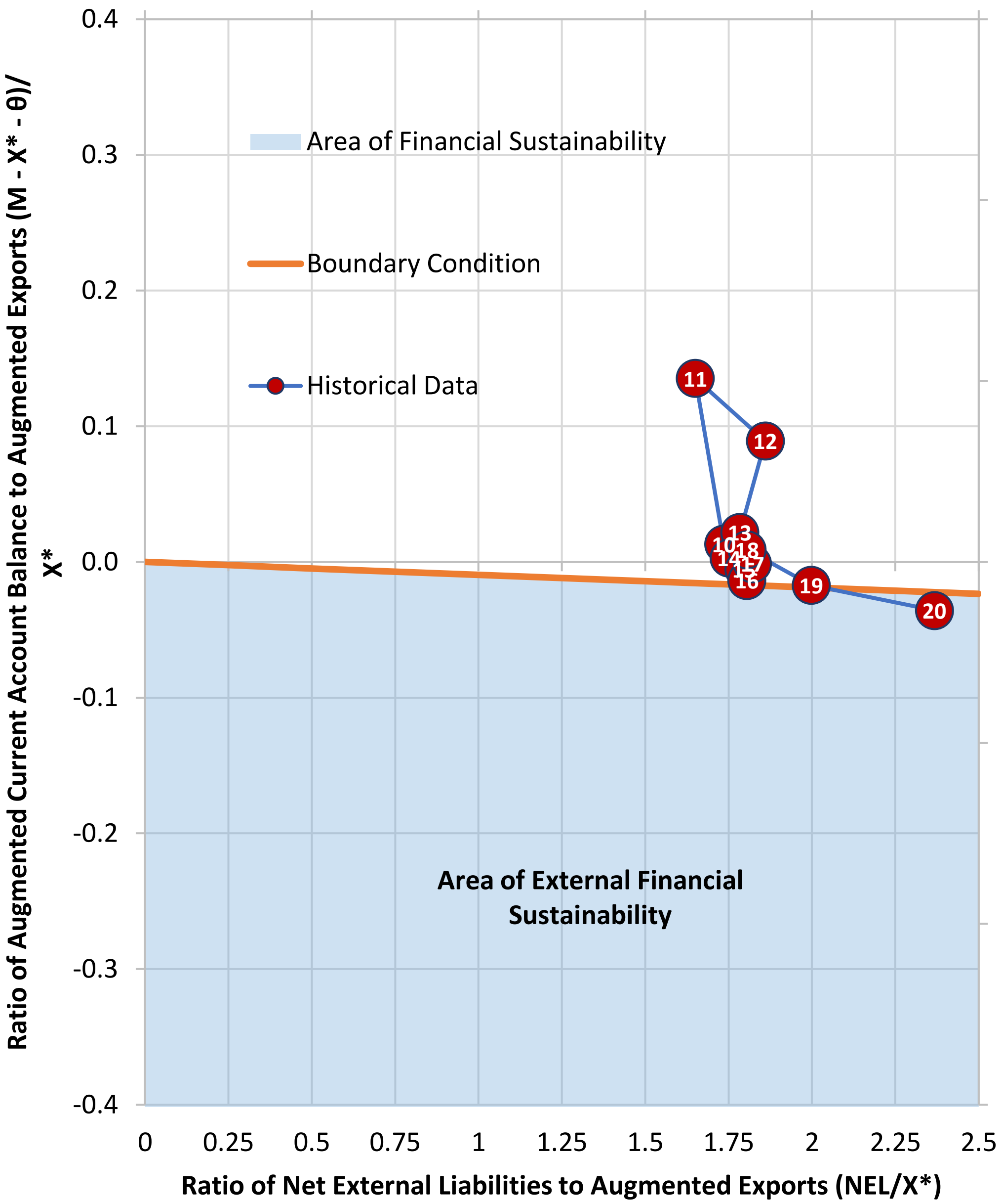

*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021*

# Sri Lanka's foreign currency denominated debt and augmented exports




*Source of data: World Bank International Debt Statistics, 2022; IMF Balance of Payments and International Investment Position (BoP/IIP), 2021.*




*Source of data: IMF Balance of Payments and International Investment Position (BoP/IIP), 2021, Bhering (2021)*

# Sri Lanka's external financial sustainability between 2010 and 2020

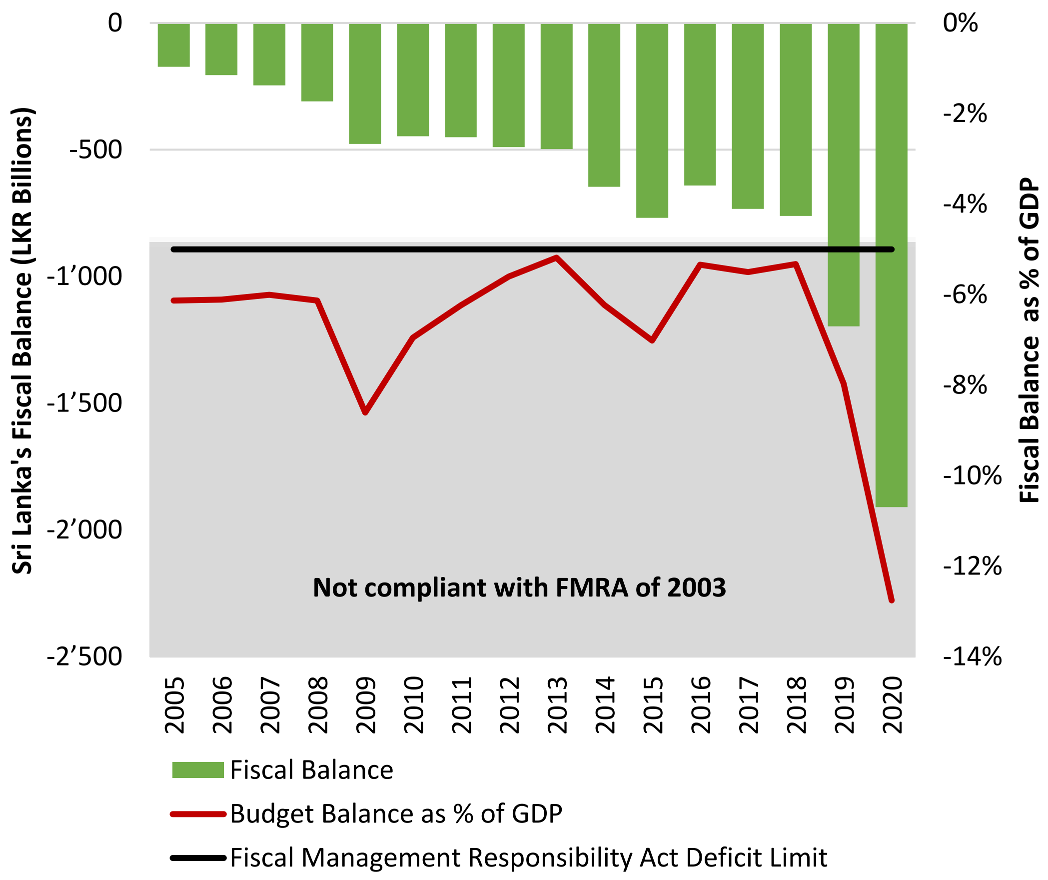
- Sri Lanka operated outside its area of external financial sustainability for most years (excluding 2016, 2019, 2020). It moved significantly away from external financial sustainability in 2011, but then started to return. The relative improvement in 2020 was due more to an "involuntary" decline in imports due to COVID-19 than to an improved export performance.

- Model indicates that Sri Lanka's growth was too high (i.e. it imported too much) for much of this period.

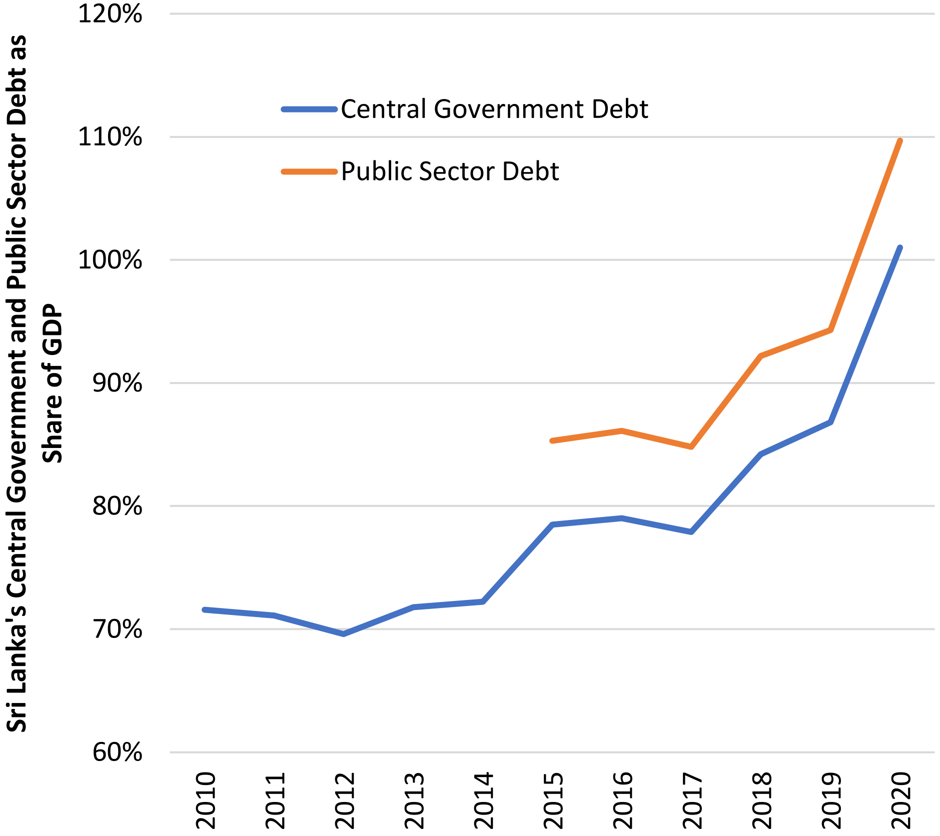
- Negative gradient to Boundary Condition indicates that average growth in augmented exports was lower than the average cost of net external liabilities. This effectively reduced the area of external financial sustainability

# Sri Lanka’s public sector financial sustainability

# Sri Lanka's budget balance & public sector debt

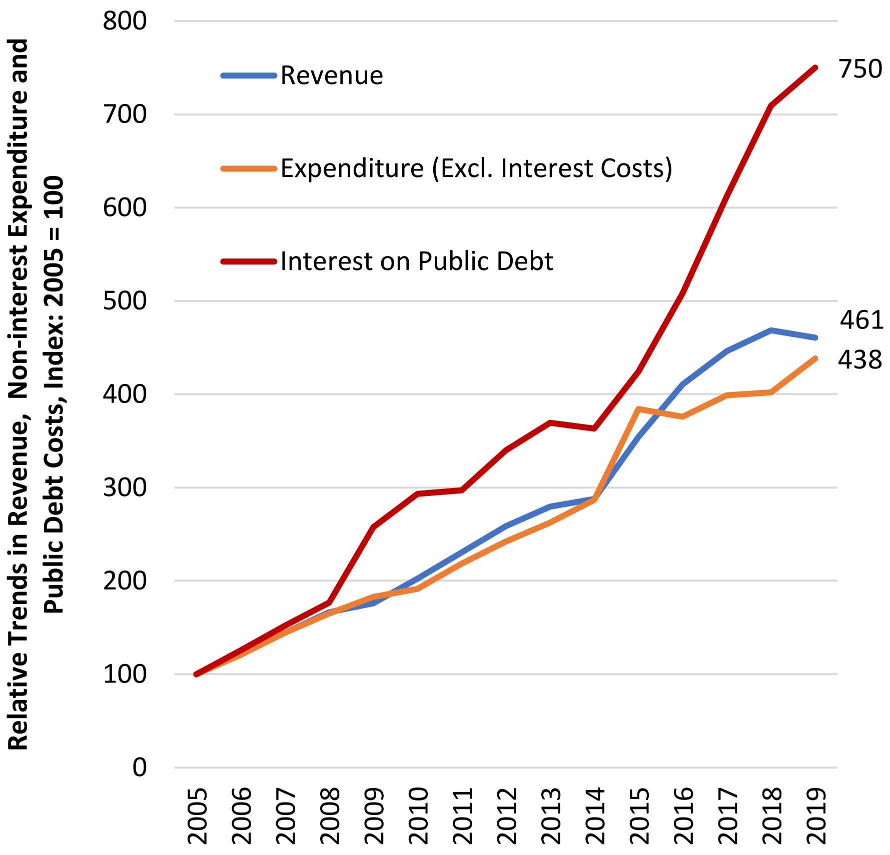


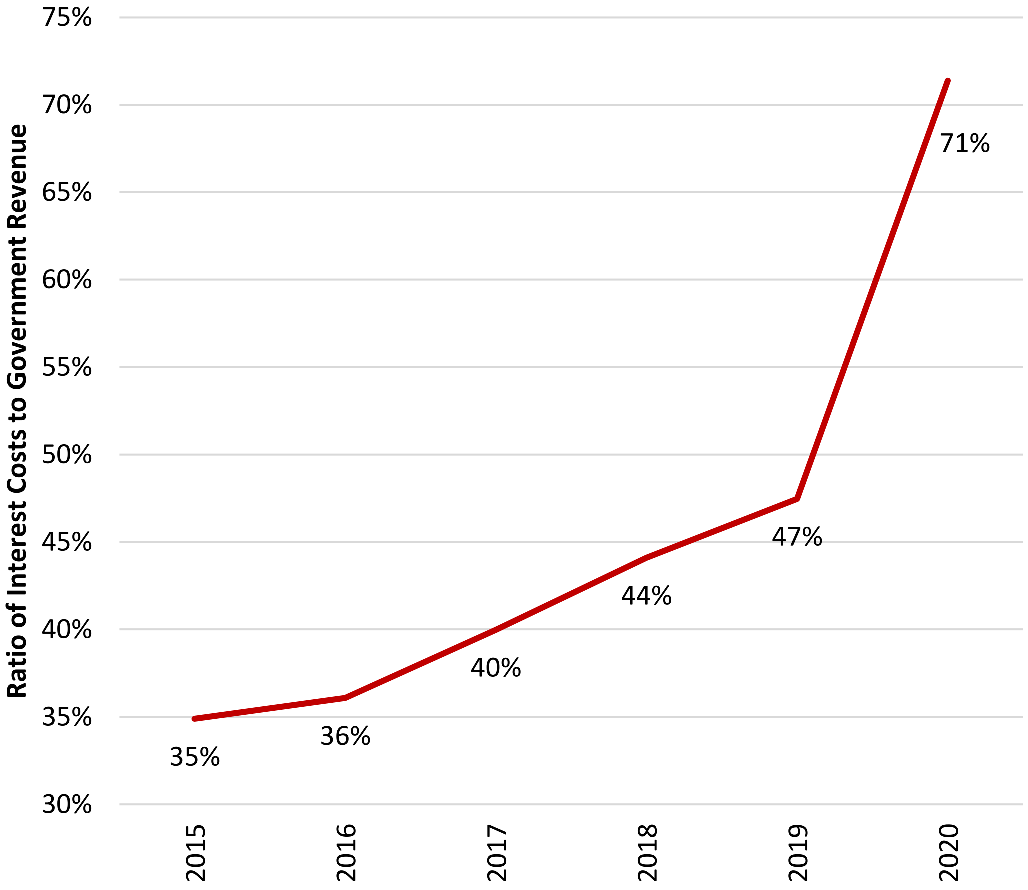

*Source of data: IMF Fiscal Monitor (2021), IMF World Economic Outlook (2021)*




*Source of data: Central Bank of Sri Lanka, Economic and Social Statistics. (2021)*
*NOTE: Model used central government gross debt for the consistency of the time series*

# Sri Lanka's trends in government revenue, expenditure and interest costs

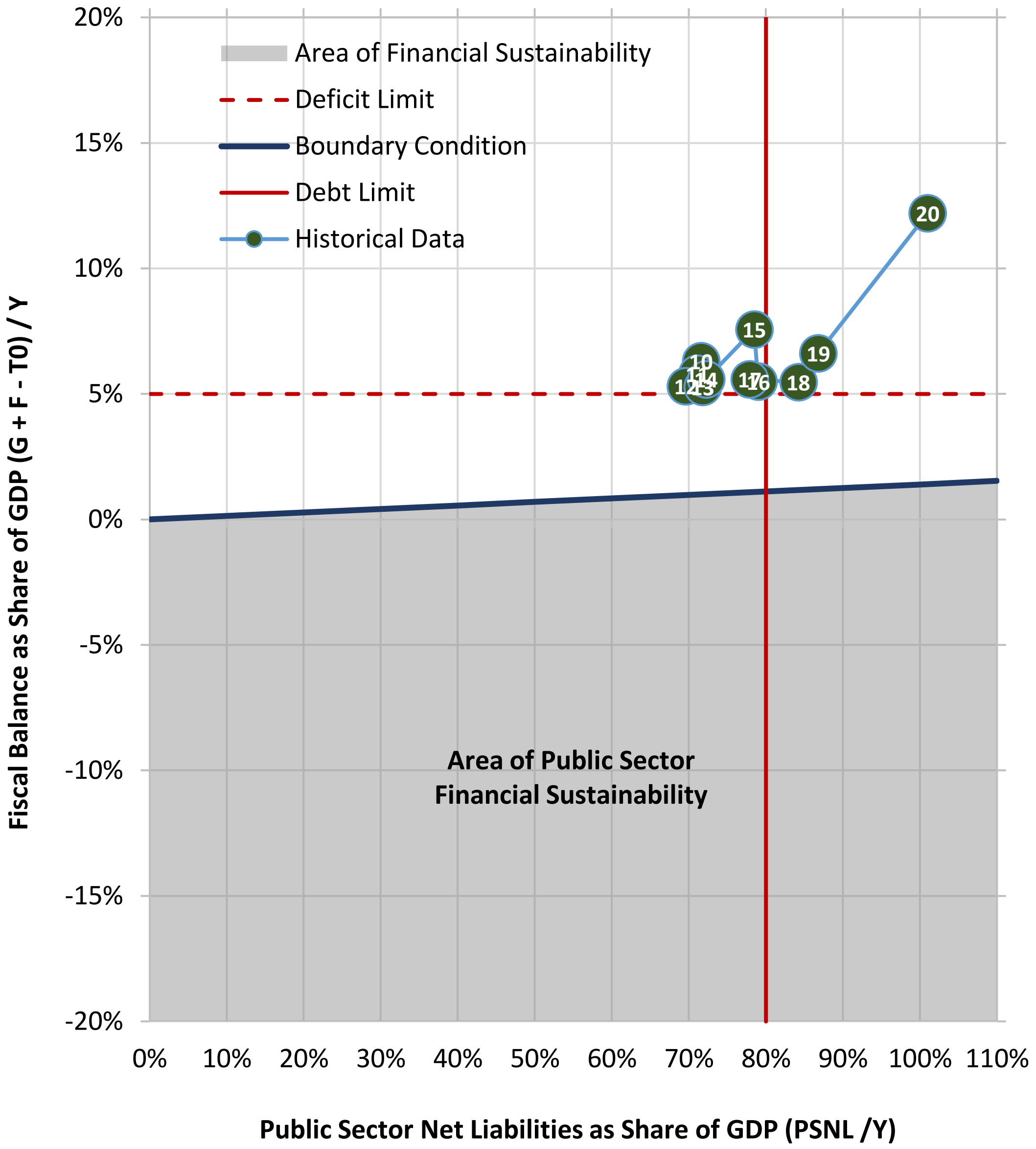



*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021)*

# Sri Lanka’s public sector financial sustainability between 2010 and 2020

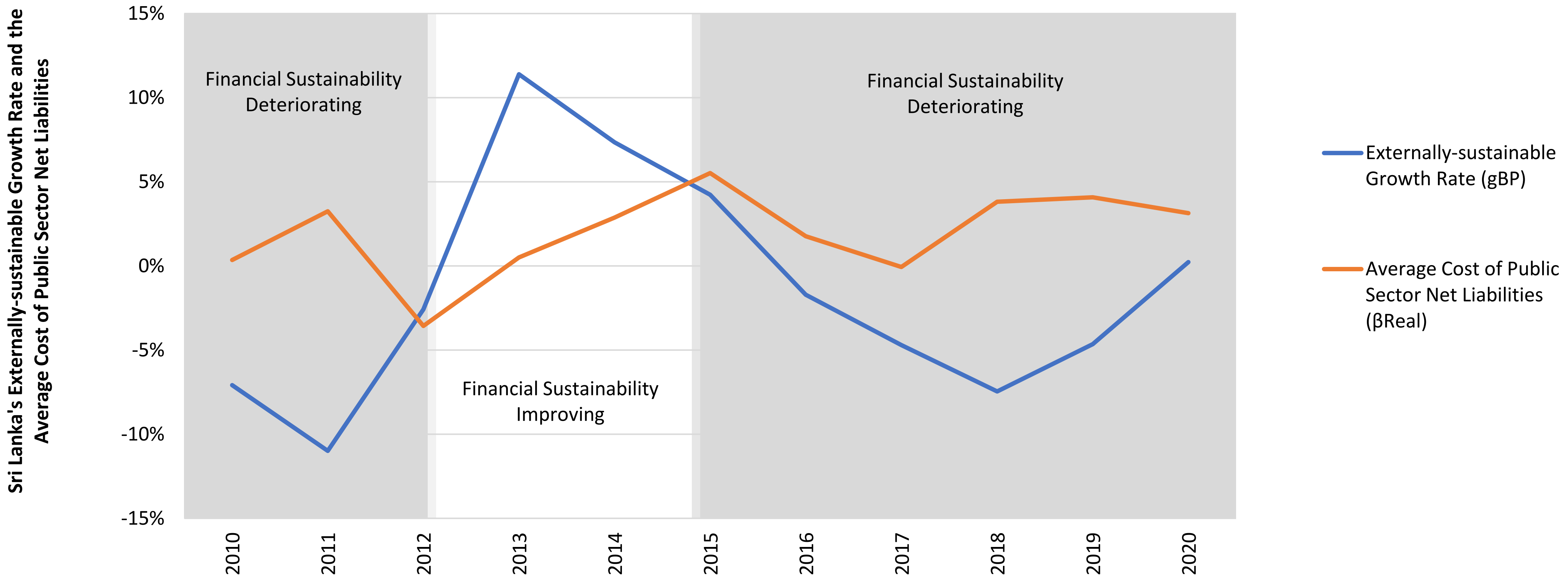
- Sri Lanka has three fiscal rules: a 5% of GDP deficit limit; an 80% of GDP debt limit, and a 15% of GDP contingent liability limit.
- Its public finances were consistently outside the area of financial sustainability between 2010 and 2020. From 2018 to 2020 it was moving further away from financial sustainability.
- This position is understated because it only reflects central government debt. Public sector gross debt was 9% of GDP higher in 2020.
- The positive gradient of the Boundary Condition indicates that the average rate of growth in real GDP was greater than the average real cost of public sector net liabilities over this period.



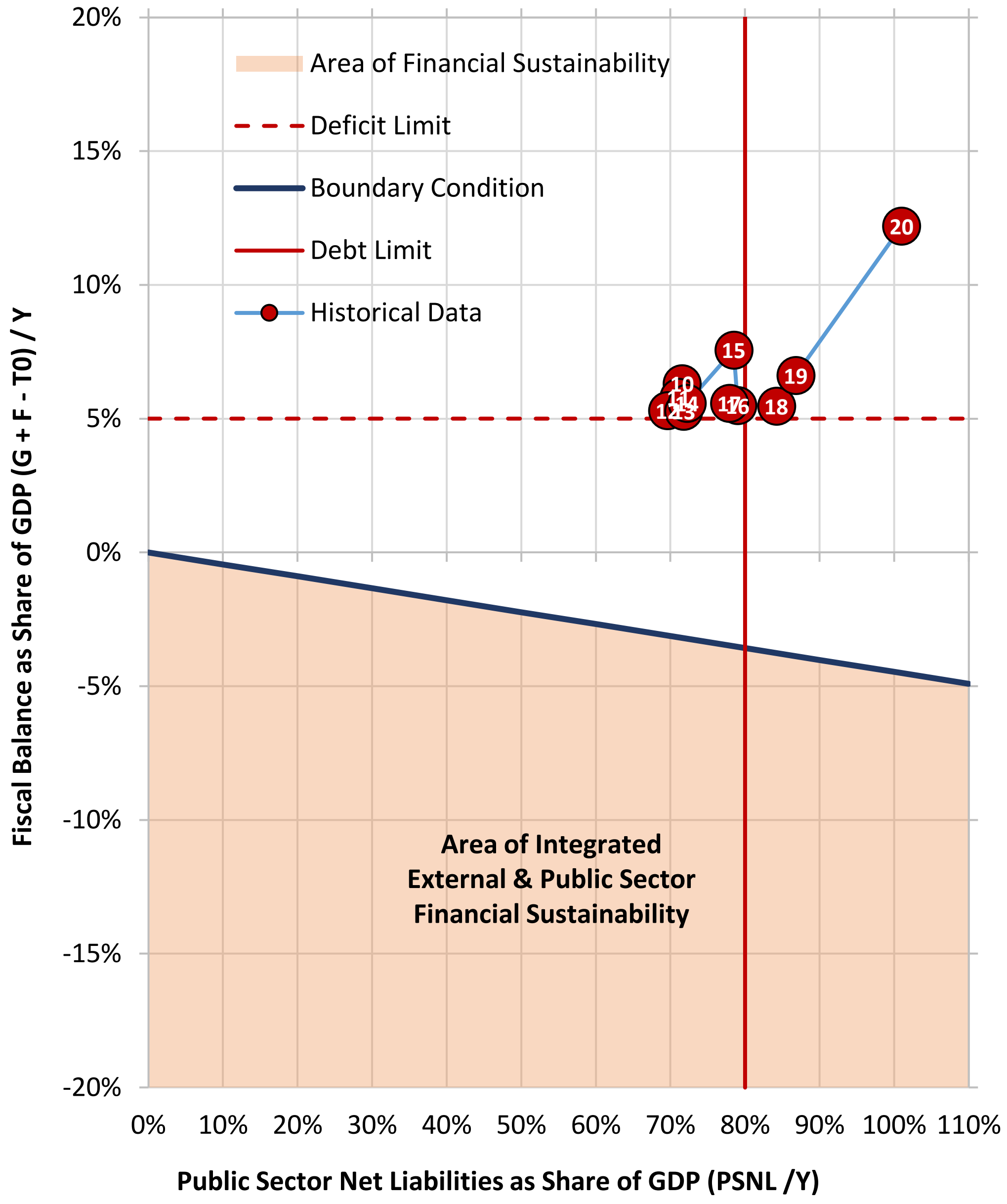

*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021), Bhering (2021)*

Sri Lanka’s integrated external and public sector financial sustainability

# Relative trends in Sri Lanka's rate of growth consistent with external sustainability and average real cost of public sector net liabilities




*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021), Bhering (2021)*




# Sri Lanka’s integrated external and public sector financial sustainability between 2010 and 2020

- The historical performance in relation to public sector finances (the numbered red dots) is the same as for public sector financial sustainability.

- However, because the average growth that is externally sustainable was less than the average actual growth in real GDP and the average real cost of public sector net liabilities, the gradient of the Boundary Condition is significantly negative. This decreases the area of integrated financial sustainability substantially and means that the country was operating even further away from what was sustainable in recent years.

*Source of data: IMF Fiscal Monitor (2021), IMF Government Finance Statistics (2021) IMF Balance of Payments and International Investment Position (BoP/IIP) (2021), Bhering (2021).*

# Policy implications

Key policy challenge: With a fixed tax to GDP ratio, increasing the capacity to service public sector net liabilities requires faster rates of economic growth – but these higher growth rates are not currently sustainable from an external solvency perspective.

## External Financial Sustainability

- Sri Lanka's economy required an average **contraction** in real GDP 1.6 percent a year between 2010 and 2019 to limit the demand for imports and make the external financial position sustainable. Instead, it averaged real GDP growth of 5.3 percent a year.
- Need to reduce import propensity (progress stalled in recent years), while simultaneously raising the rate of growth in augmented exports. Onus for such growth will be largely on expanding goods and services exports. Suggest diversification away from a high reliance on clothing and textile exports - which accounted for 44 percent of Sri Lanka's merchandise exports in 2019.
- Crowding-in of private investment through appropriate public infrastructure investments that facilitate further productivity gains for agricultural production and the diversification of manufactured exports would be desirable.

# Policy implications

Key policy challenge: With a fixed tax to GDP ratio, increasing the capacity to service public sector net liabilities requires faster rates of economic growth – but these higher growth rates are not currently sustainable from an external solvency perspective.

## Public Sector Financial Sustainability

- Average nominal cost of public sector net liabilities between 2010 and 2019 was not exceptionally high (6.9% p.a.), but the rate at which public sector liabilities were accumulated over this period resulted in a dramatic increase in public debt costs.
- High ratio of interest costs to revenue was worsened by the decline in tax revenue to GDP from 14.1 percent in 2016 to 12.9 percent in 2019. Sri Lanka's public sector has been left with diminishing resources to address its core delivery mandates.
- Efforts to increase the capacity to service public sector liabilities could also incorporate enhanced efficiencies in tax collection systems and efforts to close any tax gap that may exist – rather than simply raising rates. It is also important that the efficiency of non-interest government spending is improved, to raise productivity.