Building Economic Resilience through South-South cooperation and Targeted Strategies

Session 2: Fiscal and Debt Sustainability of Barbados

Hamza Ali Malik

Director

Macroeconomic Policy and Financing for Development Division

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Key Messages

- **Fiscal and debt management has become a major policy challenge**, given slower economic growth, increasing interest rates, large spending needs for SDGs and climate action, and rising risk of public debt distress.

- ESCAP calls for a revisit of conventional thinking and approaches to debt sustainability assessments and **proposes an ‘augmented’ approach** in *Survey* 2023.

- Strengthening fiscal position through increasing **fiscal revenues**, improving **public spending efficiency** and better **public debt management** are critical for public debt sustainability.

- **International development community** need to facilitate and accelerate coordinated debtor-creditor discussions and accelerate progress towards common international debt resolution frameworks.

A changing and difficult policy context to assess public debt distress

Rising public indebtedness amid weak and uncertain macroeconomic outlook

- Higher borrowing costs
- Weaker/volatile exchange rates
- Modest economic growth
- Geo-political uncertainties

Huge SDG financing needs

- 5% of GDP per year on average, according to ESCAP's 2019 estimates.
- Multifaceted impacts of the pandemic and ongoing wars have pushed up these investment needs further.

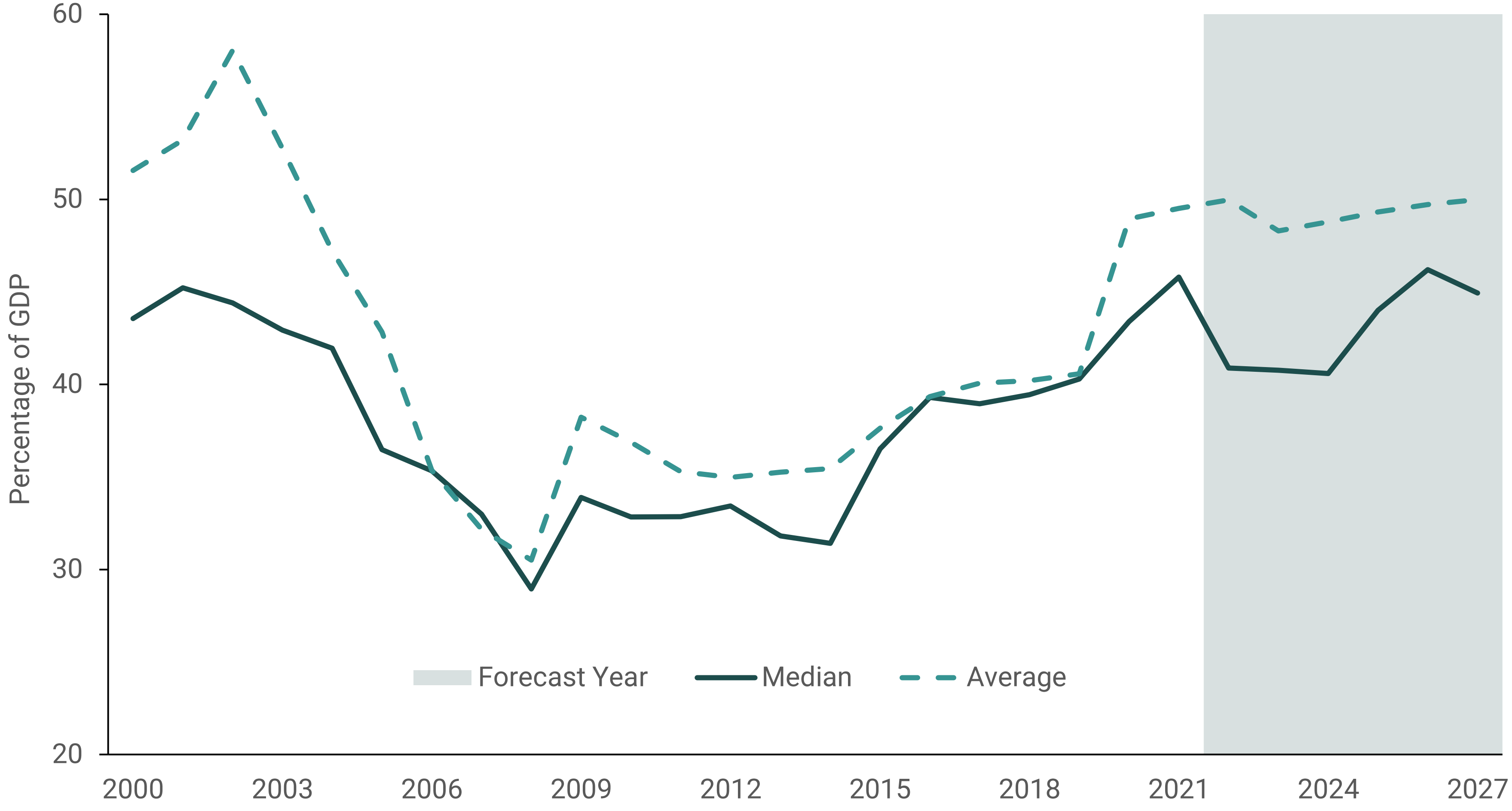
Climate risks weighing on public finances

- Huge climate mitigation and adaptation costs
- Large fiscal support amid climate change induced natural disasters
- Substantial financing requirements for transition of economies towards low-carbon development pathways

Taking stock:
Public debt profiles of Asia-Pacific economies

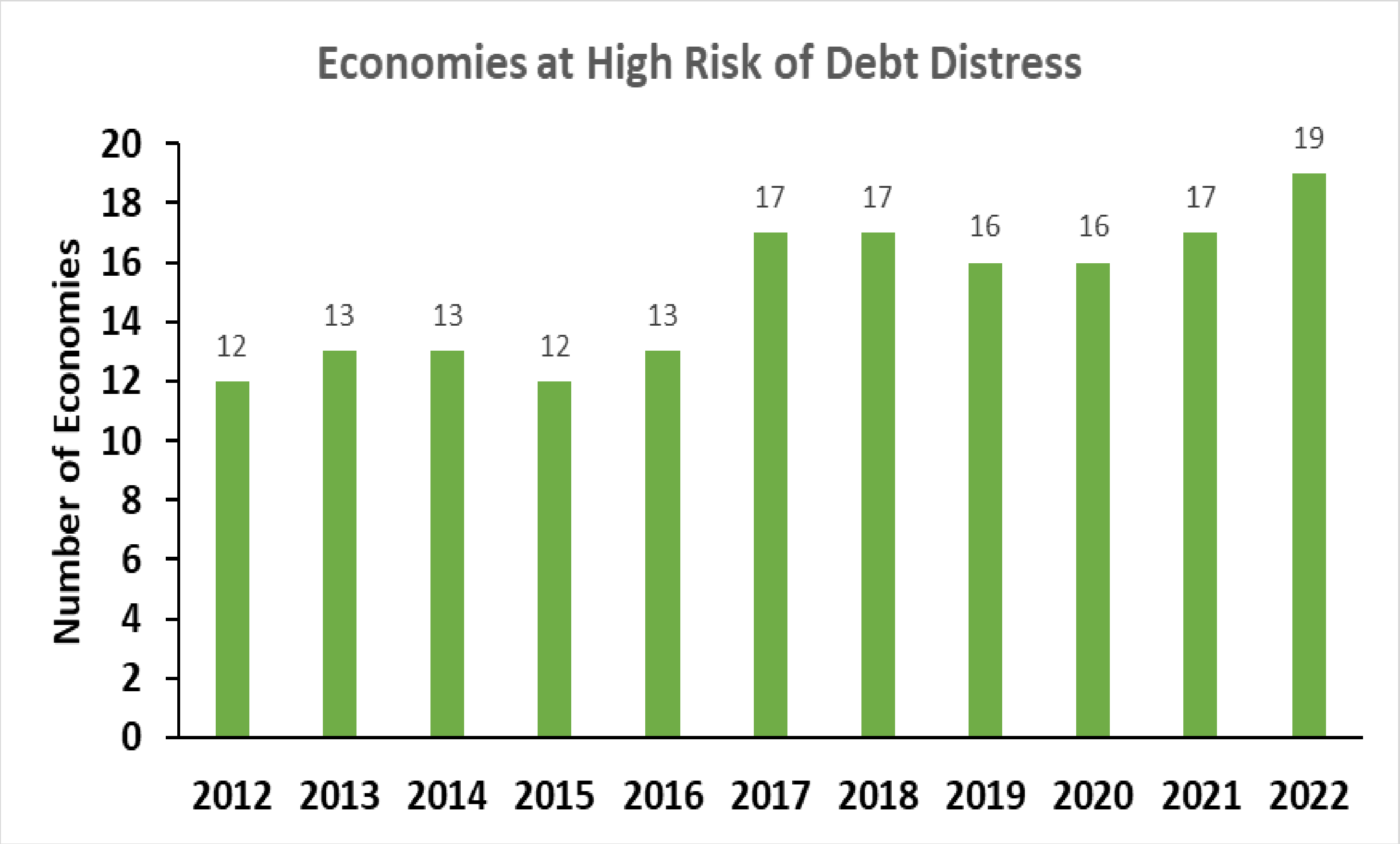
The government debt-to-GDP ratio in Asia-Pacific has increased to an **18-year high** in 2021…

General government gross debt of developing Asia-Pacific region



Source: IMF, World Economic Outlook database (October 2022).

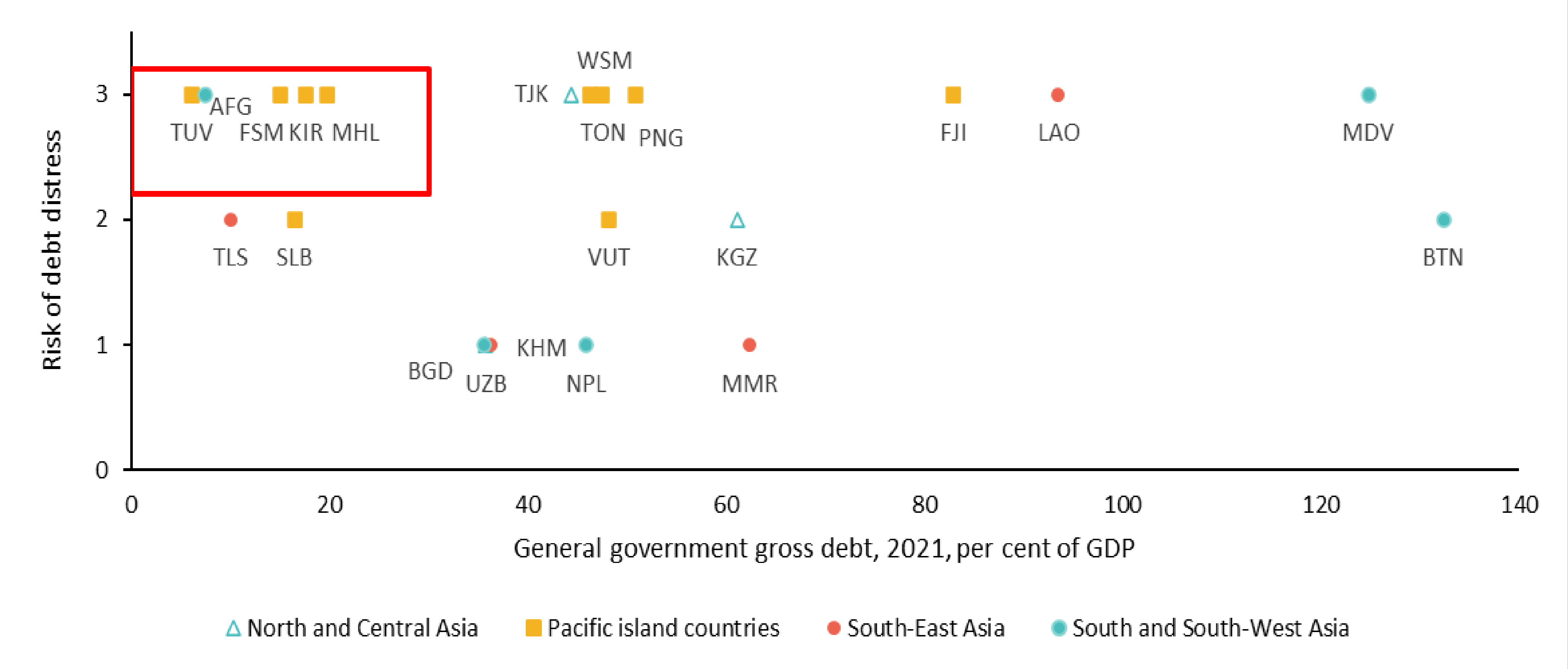
The number of countries facing a high risk of debt distress has increased



Source: Joint IMF-World Bank Debt Sustainability Analysis 2012-2022, countryeconomy.com, Moody's, Fitch Ratings, S&P Global
Notes: Debt Sustainability Analysis may not be published every year, and some countries started as late as 2015 (in the case of Micronesia). Gap years are filled with assumptions that the rating remains the same as the prior years. Highly speculative bonds are defined as credit ratings of B1 (Moody's) or B+ (Fitch & S&P) and below.

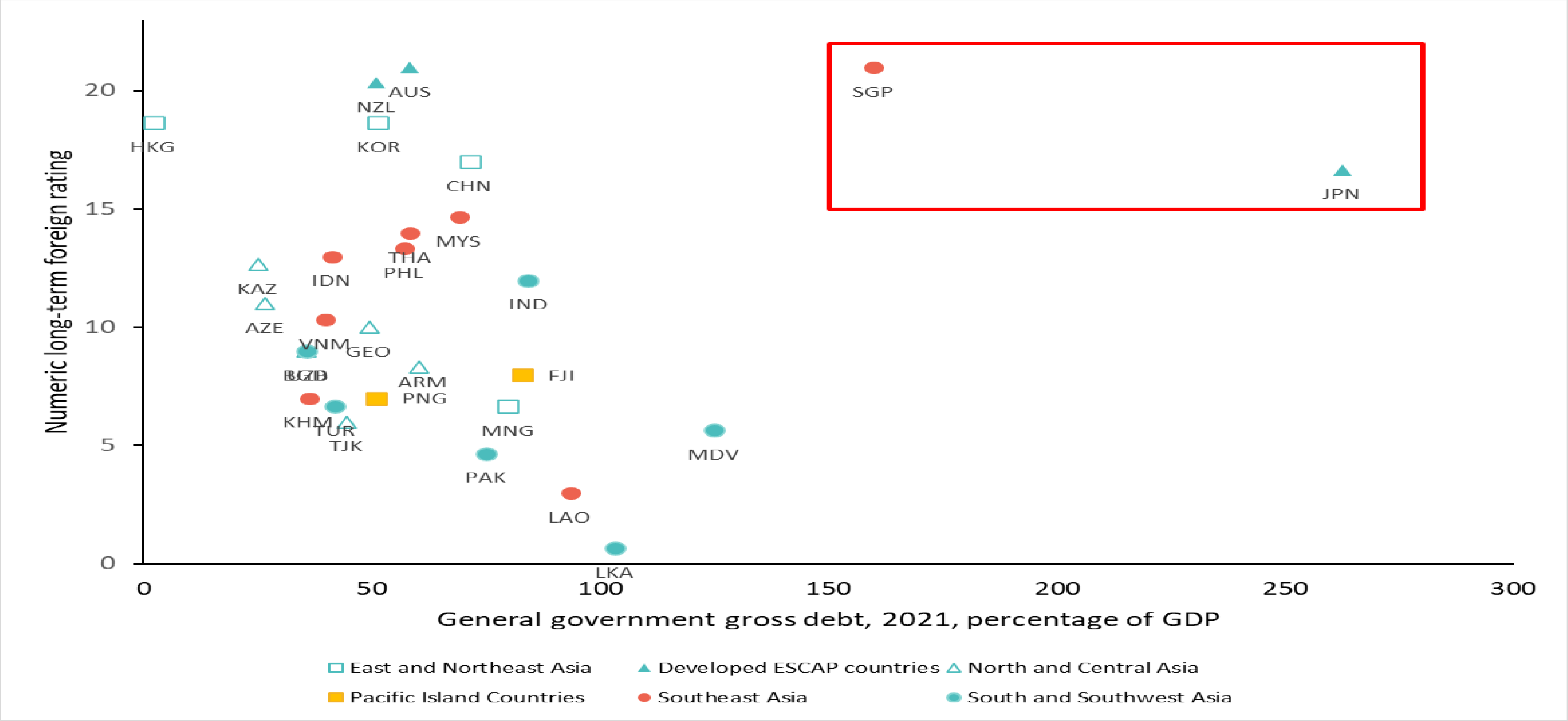
Countries	Risk assessed by	
	joint IMF-World Bank Debt Sustainability Analysis for LICs	Credit rating agencies
Afghanistan	x	
Cambodia		x
Fiji		x
Kiribati	x	
Kyrgyzstan		x
Lao People's Democratic Republic	x	x
Maldives	x	x
Marshall Islands	x	
Micronesia (Federated States of)	x	
Mongolia		x
Pakistan		x
Papua New Guinea	x	x
Russian Federation		x
Samoa	x	
Sri Lanka		x
Tajikistan	x	x
Tonga	x	
Türkiye		x
Tuvalu	x	

Point to note is that a low debt level does not automatically prevent a country from facing a high risk of debt distress …



Source: https://www.worldbank.org/en/programs/debt-toolkit/dsa, updated 15 Feb 2023, *Source*: IMF, World Economic Outlook database (October 2022). Available at www.imf.org/en/Publications/WEO/weo-database/2022/October.
Notes: 1= low risk, 2 = moderate risk and 3 = high risk

… similarly, a higher debt level does not necessarily translate into higher risk



Source: countryeconomy.com updated 15 Feb 2023, IMF World Economic Outlook (WEO) – October 2022
Notes: The numerical credit rating is the average of long-term foreign rating from Moody's, S&P, and Fitch. Numerical ratings are based on a scale of 0-21. 0 corresponds to any form of default. 21 represents the highest rating, namely Aaa (Moody's) or AAA (S&P and Fitch). "Ratings Withdrawn" is not assigned any value

A thorough examination of public debt profile from multiple perspectives is needed to assess debt distress risk

- Drivers and purpose of increasing debt
- Composition of debt
- Political stability
- Debt carrying capacity and fiscal position
- Macroeconomic strength
- Structural features
- Institutions and governance strength

Revisiting the public debt-development nexus:
time for new thinking and assessment approaches

Where do we stand and what ESCAP is proposing

Current thinking

High public debt is necessarily bad for economic growth and stability; do not appropriately consider other factors

There is a **common 'optimal' public debt level** that can be applied to different countries. Often, it is too low, contributing to suboptimal development outcomes.

Current approaches on debt sustainability analysis focus on **maintaining 'debt sustainability' in the short term,** leading to **fiscal consolidation** and limited governments' access to **financial resources for SDGs**.

New thinking

Public debt can be a powerful tool for development, if used judiciously and with a long-term horizon

"Appropriate" public debt level is **country-specific**, depending on progress and ambitions on sustainable development.

Need **long-term debt assessment approach(es)** that give due weight to sustainable development ambitions.

ESCAP’s long-term approach to public debt sustainability analysis can ‘augment’ short term-focused conventional approaches

‘Augmented’ public debt sustainability analysis

- Additional spending needs to meet SDGs
- Structural development policies
- National SDG financing strategies
- Stress tests and contingent liabilities

Application to Mongolia: policy scenarios

Additional SDG spending needs

- 17% of GDP per year on average during 2021-2030
- Transport infrastructure and climate actions each account for about 40% of total cost

Structural development policies

- **Green economy**
  - Pricing carbon emissions
  - Livestock management
- **Diversified economy**
  - Enabling business environment
  - FTA potential

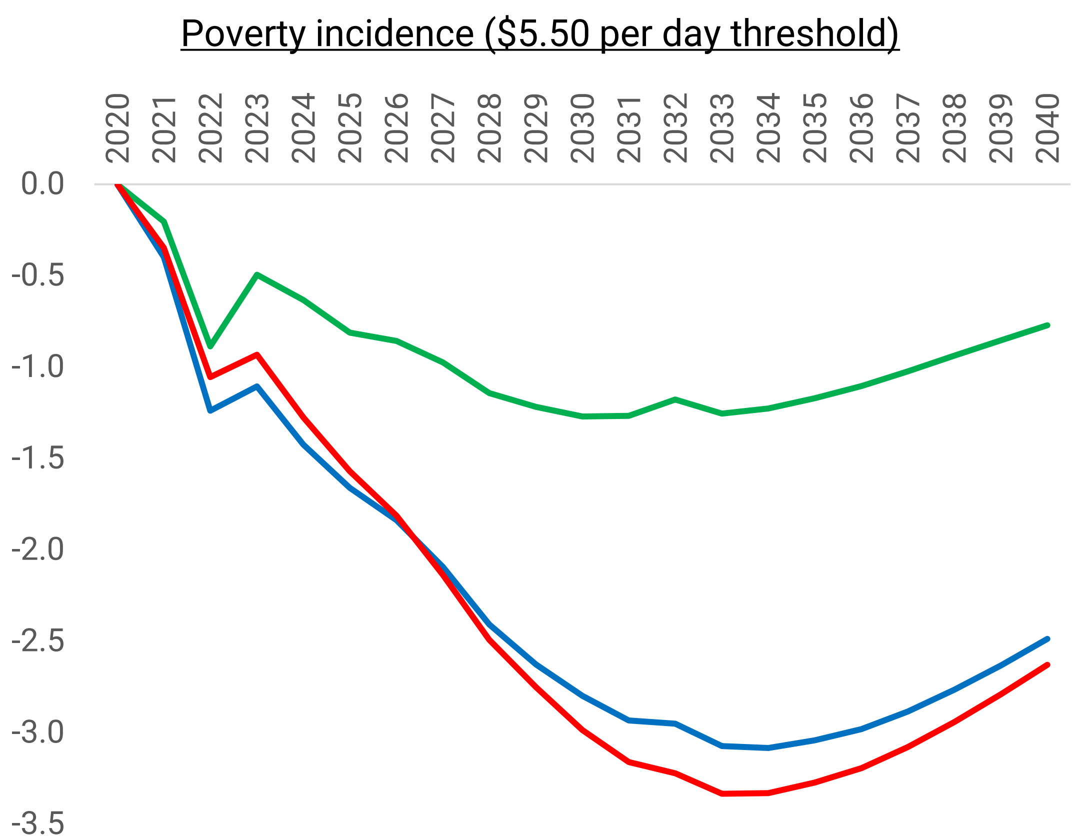
National SDG financing strategies

- **Public finance**
  - Increase fiscal resources
  - Reduce debt burden
- **Private finance**
  - PPP environment
  - Green loans

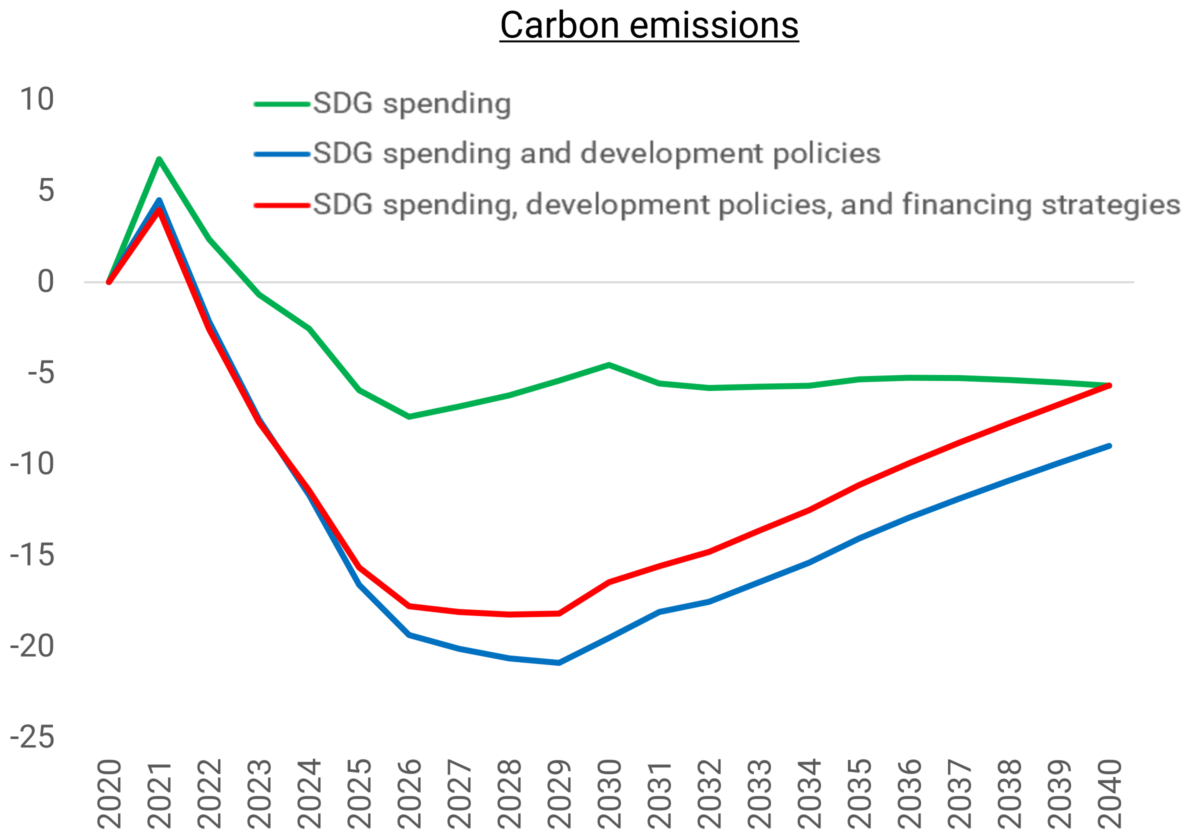
Stress tests and contingent liabilities

- **Global coal demand and prices**
- **Macroeconomic shocks**
  - Slower growth in China
  - Higher interest rate
  - Weaker currency
- **Contingent liabilities**
  - Natural disasters
  - Climate risks
  - National development bank

SDG spending and policy reforms for a more diversified, greener Mongolian economy is good for its people and the environment



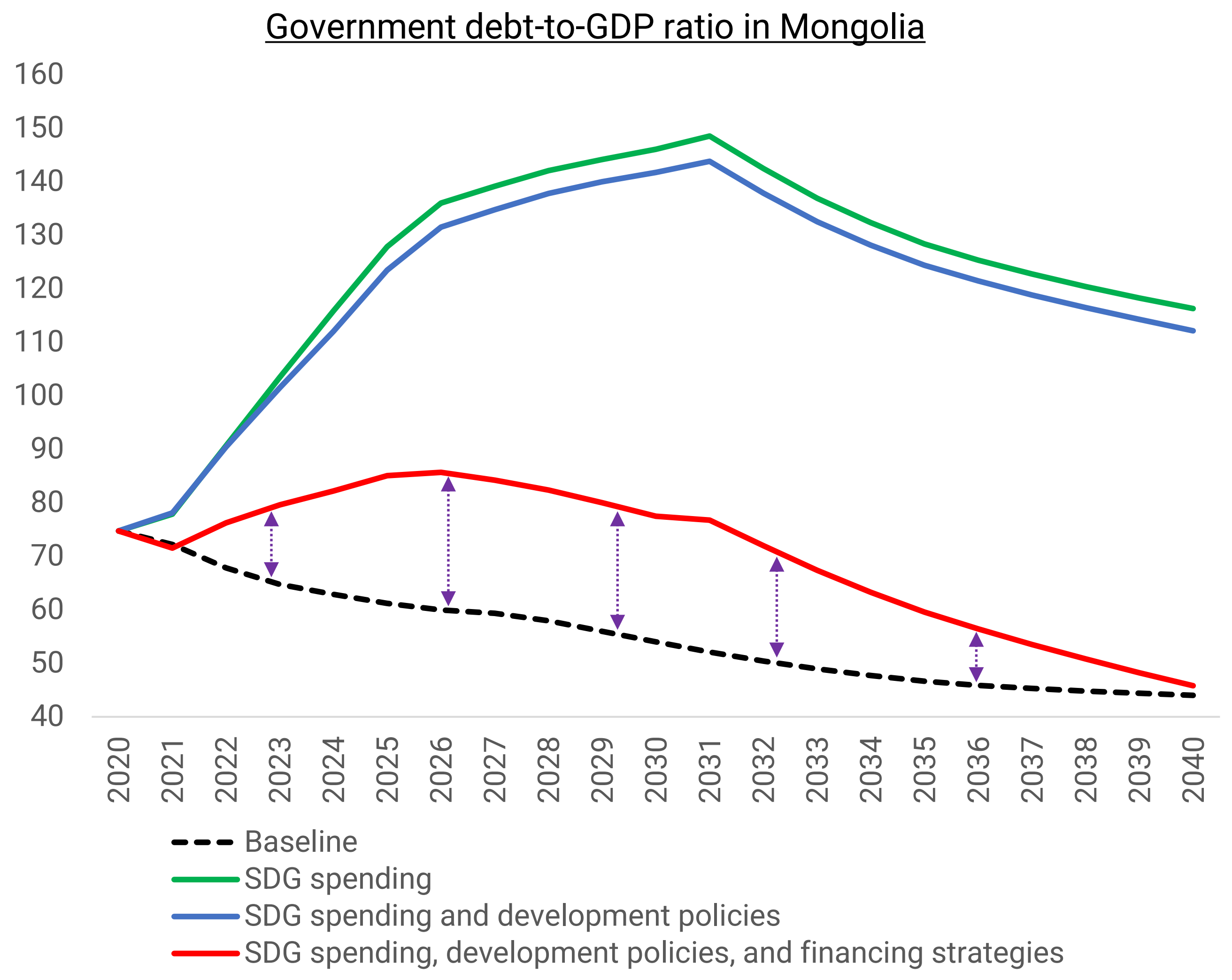
Drivers: Higher public and private spending → higher employment and labour productivity → higher household incomes and consumption → reduced poverty and inequality



Drivers: Higher environmental spending and fossil fuel prices → higher energy efficiency and renewable energy use and reduced biodiversity loss → lower carbon emissions → better air quality

Source: ESCAP.
Note: Results are shown as differences from the baseline values.

Government debt comes down in the long run … balancing 'temporarily' higher debt for large socioeconomic and environmental gains



Public debt rises initially …

Large SDG spending needs

Rising interest payments amid higher risk premium and borrowing costs

… but trends down afterwards

Higher tax revenue: carbon tax and reduced tax avoidance

Fiscal savings: carbon subsidy cancellation and spending efficiency

Lower borrowing costs: greater debt transparency

Source: ESCAP.

Policy implications and messages

- After considering the benefits of SDG investment and possible financing strategies, **public debt converges to the baseline** that assumes fiscal consolidation. But here, **people and the environment are better off**.

- All stakeholders (official/private creditors, IFIs/CRAs and financial markets) should consider public debt sustainability from **both short- (conventional) and long-term (augmented) perspectives**.

- Governments should (and can) strike a **better balance** between achieving the SDGs and maintaining public debt sustainability.

- When assessing public debt sustainability, IFIs and credit rating agencies should **go beyond government's debt service ability**, and duly consider socioeconomic and environmental benefits of investments in the SDGs.

Managing sovereign debt surges: policy options

Enhancing fiscal space and improving debt sustainability:

Immediate and short-term policy options

- **Domestic measures:**
  - By **leveraging technology and data**, enhance revenue mobilization and ensure targeted fiscal transfers and subsidy schemes.
  - Improve **public spending effectiveness and efficiency** and better alignment with sustainable development priorities.
  - Start discussions with major creditors for **debt restructuring**, and explore **innovative options** such as debt for climate swaps.
- **Multilateral considerations:**
  - **Enhanced Debt Service Suspension Initiative (DSSI-E)**: expand country coverage to middle-income countries and expand the duration/scope.
  - Move **from debt service suspension to debt restructuring**: while debt service suspension is helpful, it may lead to repeated debt distress and prolonged macroeconomic stagnation.
  - **Bring private creditors into the debt restructuring/relief discussion**: create incentives for private creditor participation in the G20 *Common Framework for Debt Treatment.*

Enhancing fiscal space and improving debt sustainability:
Long-term reforms (1)

Improve access to and reduce the cost of development financing

- **Domestic measures:**
  - Promote **domestic savings** and develop **domestic financial markets.**
  - Leverage the potential of **public development banks** and long-term funds.
  - **Mobilize private finance** for development through blended finance and public-private partnership modalities.

- **Multilateral considerations:**
  - Fulfill **international commitments** to climate and development financing.
  - Promote development of the **innovative financial instruments** and **GSS+ bond market**.
  - Strengthen cooperation to **tackle illicit financial flows**.

Enhancing fiscal space and improving debt sustainability:
Long-term reforms (2)

Reduce fiscal risks and avoid debt distress

- Domestic measures:
  - Expand **tax base** and improve **progressivity of income taxes.**
  - Adopt **prudent debt management** principles and develop medium-term debt strategies.
  - **Incorporate catastrophic risks** into fiscal planning.
- Multilateral considerations:
  - **Incorporate SDG investment requirements and climate risks into debt sustainability analysis** and sovereign credit ratings.
  - Promote the adoption of **collective action clauses** (CACs) or **state-contingent debt instruments** (SCDI) in sovereign borrowing
  - Accelerate progress towards **common international debt restructuring frameworks**.
  - Strengthen **consensus building and coordinated discussions**, including through platforms provided by the UN, among debtors and creditors to resolve debt distress.

Download *Survey 2023* at:

https://bit.ly/AP-Survey2023

Macroeconomic Policy and Financing for Development Division, ESCAP

escap-mpdd@un.org

www.unescap.org

unescap

unitednationescap

united-nations-escap

unescap

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