UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

DEBT VULNERABILITIES IN DEVELOPING COUNTRIES: A NEW DEBT TRAP?

Volume II: Policy Options and Tools

UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

DEBT VULNERABILITIES IN DEVELOPING COUNTRIES: A NEW DEBT TRAP?

Volume II: Policy Options and Tools

UNITED NATIONS
New York and Geneva, 2018

United Nations publication issued by the United Nations Conference on Trade and Development.

UNCTAD/GDS/MDP/2017/4 (Vol II)

ABOUT THE AUTHORS

David Bicchetti is an Economic Affairs Officer at UNCTAD. He joined UNCTAD's Macroeconomic Branch in 2010 where he focuses his interest on the interactions between financial markets and information flows and their influence on price discovery mechanisms. Before joining the United Nations in 2009, he worked as a researcher at the Swiss Institute of Technology in Lausanne and is the co-author of several studies on post-Kyoto protocol mechanisms and their impacts on the world economy.

David Neto is a Researcher at the Institute of Economics and Econometrics at the Geneva School of Economics and Management, *University of Geneva. He has published in leading economics and science journals, including the Oxford Bulletin of Economics and Statistics, Economic Notes and Physica A.*

Martin Guzman is an Associate Research Scholar at Columbia University Graduate School of Business, and an Associate Professor at the Department of Economics at University of Buenos Aires. He is also a member of the Institute for New Economic Thinking Research Group on "Macroeconomic Efficiency and Stability" (chaired by Prof. Joseph Stiglitz), a co-chair of Columbia Initiative for Policy Dialogue's Taskforce on Debt Restructuring and Sovereign Bankruptcy, and a non-resident Senior Fellow at the Centre for International Governance Innovation. His research fields are Macroeconomics, Sovereign Debt, and Economic Development.

Jan Kregel is director of research at the Levy Economics Institute, Director of the Levy Institute master's program in economic theory and policy, and Head of the Institute's Monetary Policy and Financial Structure program. He also holds the position of professor of development finance at Tallinn University of Technology. In 2009, Kregel served as Rapporteur of the President of the UN General Assembly's Commission on Reform of the International Financial System. He previously directed the Policy Analysis and Development Branch of the UN Financing for Development Office and was deputy secretary of the UN Committee of Experts on International Cooperation in Tax Matters. His major works include a series of books on economic theory, among them, *Rate of Profit, Distribution and Growth: Two Views* (1971); *The Theory of Economic Growth* (1972); *Theory of Capital* (1976); and *Origini e sviluppo dei mercati finanziari* (1996). In 2011, Kregel was elected to the Accademia Nazionale dei Lincei, also known as the Lincean Academy, the oldest honorific scientific organization in the world. He is a life fellow of the Royal Economic Society (UK) and an elected member of the Società Italiana degli Economisti.

CONTENTS

INTRODUCTION

Yet again, unsustainable international debt burdens haunt the developing world and are fast becoming a core obstacle to the international community delivering on its repeated promises to enable sustainable development finance.

For the best part of two decades, the driving motor of the global economy has been debt, issued on a whim and traded for speculative purposes, rather than backing productive and long-term investment, including into the structural transformation of developing economies. With the world's total gross debt-to-GDP ratio nearing 250 per cent (BIS 2017: 283) and global debt stocks surpassing their record level at the onset of the global financial crisis (US $ 142 trillions) by over US$ 80 trillion in 2017, it is little wonder that international financial markets continue to show periodic nerves, and policy-makers in lead economies struggle to stabilize an increasingly volatile, fragmented and unbalanced global economy.

Advanced economies still hold the largest share of these debt stocks. This is as it should be in a context of sluggish recovery from a global economic crisis and impending stagnation. Yet, such continued dependence of world economic growth on debt, for the most part fuelling short-term speculative rather than long-term productive investments, is a constant source of instability as well as escalating income inequities. Governments in the core economies have been unwilling to tackle the systematic removal of toxic debt burdens, accumulated in the run-up to the global financial crisis of 2007/08, from non-bank private sector balance sheets in a comprehensive and orderly manner. In addition, with an irrational addiction to fiscal austerity, in particular in Europe, this has resulted in a surge of highly volatile international flows of cheap credit emanating from an excessive reliance on expansive monetary policies in these economies.

While external debt-to-GDP ratios remain relatively low by recent historical standards, on average rising from 21 per cent in 2009 to 26 per cent by 2017, this masks much higher ratios in a growing number of individual countries, in particular in the Caribbean and African regions. Debt service and payment burdens have also risen markedly over the past few years. For all developing countries, the ratio of debt service-to-exports rose from 8.7 per cent in 2011 to 15.4 per cent in 2016, and, in poorer developing countries, debt service-to-government revenue ratio also climbed up steadily, from 5.7 per cent in 2008 to over 14 per cent by 2017. This increase in debt service burdens has hit the most vulnerable developing countries the hardest, including commodity exporters, countries dealing with large refugee inflows, and small island developing states.

Further signs of trouble on the horizon include a growing share of short- relative to long-term debt in total external debt stocks, as well as a significant slowdown in the growth of international reserves. These grew by only 4 per cent between 2009 and 2017, compared to 24 per cent between 2000 and 2008. The ratio of short-term debt to international reserves stood at just below 400 percent in 2016. While this is still substantially higher than the 230 per cent ratio at the start of the millennium, the relatively sharp decline since 2009, when this ratio stood at 580 per cent, is cause for additional concern (Report on external debt sustainability and development 2017, UN Secretary General).

The commodity price downturn that started in 2011 is, of course, a major factor in explaining the heightened dangers of sovereign debt crises across the developing world. Commodity price slumps have been accompanied by currency, banking and sovereign debt crises in vulnerable economies for centuries.