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Exploding Public and Private Debt, Declining ODA and FDI, Lower World GDP and Trade Growth—Developing Countries Facing a Conundrum

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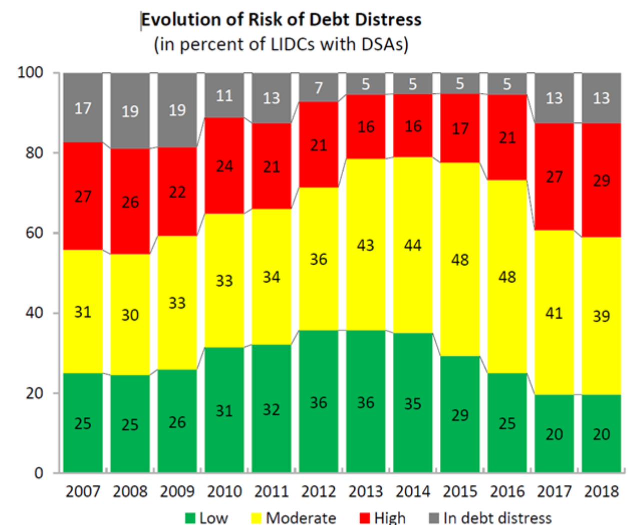
April was a month for some international institutions to publish data and forecasts to revise or confirm their economic projections made at the beginning of the year. So far, it has been bad news after bad news. The International Monetary Fund (IMF) has repeatedly cut its projections for world gross domestic product (GDP) growth of 2019. The World Bank and IMF revealed further worsened accumulation of public and private debt. The Organisation for Economic Co-operation and Development (OECD) reported declining official development assistance (ODA). The World Trade Organization (WTO) worried about decelerating international trade and intensified trade tension. The United Nations Conference on Trade and Development (UNCTAD) highlighted consecutive drops of foreign direct investment (FDI) flows. When so many dark clouds are gathering together at the same time, one can only say that the world economic prospects for 2019 are indeed gloomy. A closer examination of the performance of developing countries in these datasets would clearly show the economic conundrum that developing countries are facing.

The most dangerous sign for the world economy is the rising levels of public and private debt, and **debt sustainability** challenges for developing countries. For low-income countries (LICs), over 40 percent of them are facing a high risk of debt distress or are in debt distress, compared to less than 30% in 2012. Countries having low risk of debt distress were reduced to around 20% in 2018 from more than 35% in 2012. Public debt as a percentage of GDP in this group of countries increased from an average of 35% in 2012 to 47% in 2018. For emerging and middle-income countries, the debt situation is no better. Their government debt-to-GDP ratio kept rising and averaged almost 51 percent of GDP in 2018, which is unprecedented since the early 1980s. 20% of the countries had debt ratios exceeding 70 percent of GDP, which means they are in high risk of debt distress.[1]

Geographically speaking, the sub-Saharan region has a high concentration of countries with severe debt challenges - 16 countries were classified in 2018 as having either a high risk of debt distress (Burundi, Cabo Verde, Cameroon, Central African Republic, Chad, Ethiopia, Ghana,



Note: LIDCs– low income developing countries
DSAs—debt sustainability analyses

Source: World Bank and IMF data base. Credit: World Bank.

Abstract

Recently international institutions repeatedly cut the projections for world gross domestic product (GDP) growth of 2019, revealed further worsened accumulation of debt, reported declining official development assistance (ODA), highlighted consecutive drops of foreign direct investment (FDI) flows and showed decelerated international trade and intensified trade tension. A closer examination of the performance of developing countries in these datasets shows clearly the economic conundrum that developing countries are facing. The most dangerous sign is the rising levels of public and private debt, and debt sustainability challenges for developing countries. It is worrisome that over 40 percent of low income countries are facing a high risk of debt distress or are in debt distress. The cloudy patches over the world economy are gathering together and getting darker. It seems a storm is coming soon for those developing countries which are facing a combination of weak economic fundamentals. Yet, there seems to be limited room for policy makers to take actions as downward pressure is coming from different directions at the same time and creating constraints which would make policy measures ineffective or feeble. In some cases, policy tools used to limit negative effects of one problem could trigger negative impact on other problem(s) in hand.

Sierra Leone, Zambia) or in debt distress (Republic of the Congo, Eritrea, The Gambia, Mozambique, São Tomé and Príncipe, South Sudan, Zimbabwe). Comparing with debt to GDP ratio of LICs, the estimate of average ratio in sub-Saharan Africa for 2018 was much higher, at almost 56%. This shows that the accumulation of debt in this region has been at an even faster pace than those in LICs and middle-income countries.[2]

High levels of debt mean high cost for debt servicing for these countries. Currency depreciation against the US dollar and higher borrowing cost at the international capital market since normalization of the interest rates by the US Federal Reserve have further increased debt servicing cost in 2017, 2018 and beyond. Meanwhile financial resources that can be used to service debt including ODA, capital inflows, revenues derived from trade and faster GDP growth have all been suffering from a downward trend.

Some least developed countries (LDCs) remain heavily dependent on **ODA** and other types of concessional finance for purposes of debt servicing and covering their public expenditure. In 2017, ODA constituted more than two thirds of external financing of the LDCs.[3] However, on 10th April 2019, the OECD announced that, according to its preliminary data, foreign aid from official donors in 2018 fell 2.7% from 2017, with a declining share going to the neediest countries. The grant-equivalent ODA for the 30 members of the Development Assistance Committee (DAC) is 0.31% of their gross domestic income (GDI), less than half of the committed ratio of 0.7%. Bilateral ODA to the LDCs fell by 3% in real terms from 2017, aid to Africa fell by 4%, and humanitarian aid fell by 8%.[4]

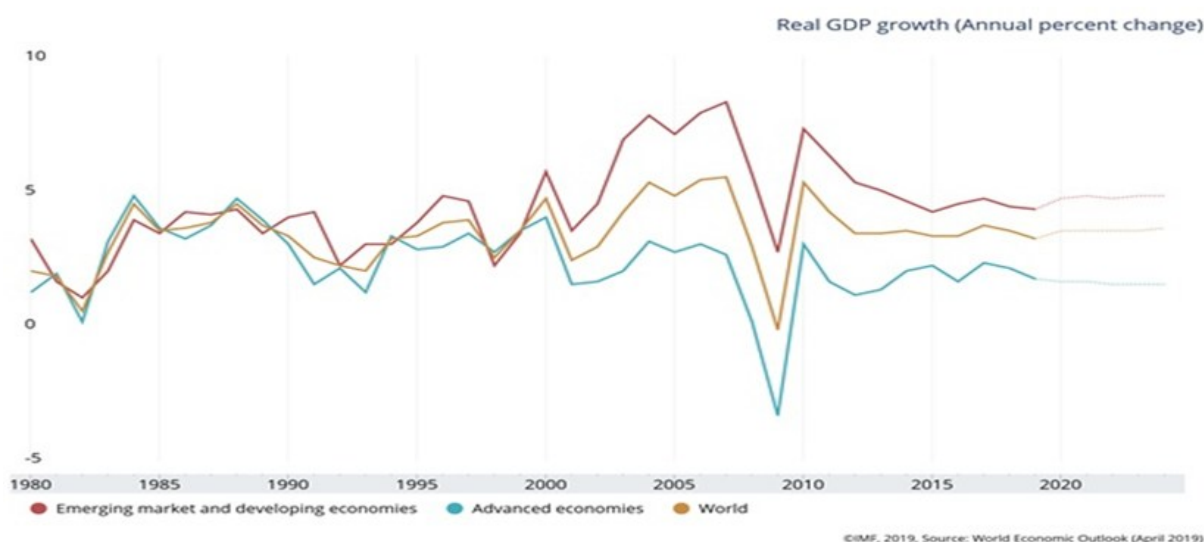
The *Global Outlook on Financing for Sustainable Development 2019* published by the OECD recently also noted specifically the drastic almost one-third decline of **FDI** to developing countries over 2016-2017, following a 12% drop from 2013-2016 in overall external finance including short and long-term private debt, FDI and portfolio investments, remittances and bilateral and multilateral official finance.[5]

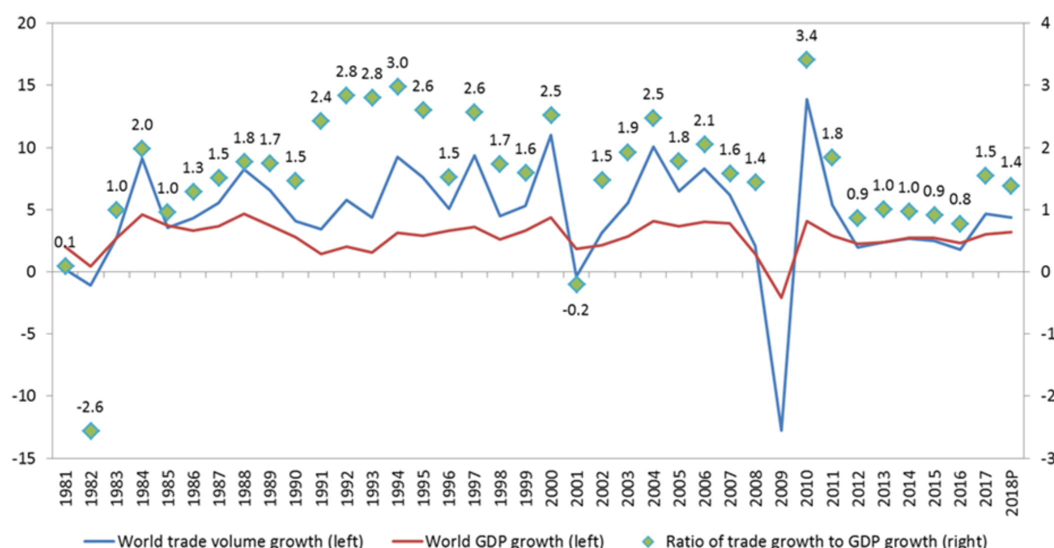
There has been a lot of emphasis on domestic resource mobilization. Yet, it is worth noting that for low-income and least-developed countries, tax revenues averaged less than half of those in OECD countries which was 34%, while the former averaged only 14%.[6] The narrow tax base, weak tax collection and illicit financial flows are among the reasons for such a big difference.

Robust **economic growth** is normally the best avenue to increase domestic and international financial resources to service public and private debt, increase investment and promote trade. Nevertheless, the IMF has recently repeatedly cut its projections for world economic growth of 2019, down from 3.5% in January[7] to 3.3% in April 2019[8]. This does not seem to be a short-term cyclical slowdown for the world economy,[9] as structural problems and imbalances and side effects of crisis management and containment of the 2008 global financial crisis are being manifested and taking their toll on the global economy.

The lower GDP growth seems to stay as the world now lacks engines of economic growth. **International trade** used to be a driver of global economic growth and for years trade growth exceeded the global GDP growth and for many years by a wide margin. Now the increasing trade tensions have been having a negative influence on the world trade. In April, the Director General of the WTO lamented that international trade has continued to decelerate. It is expected that trade growth would slow from 4.6% in 2017 to 2.6% in 2019.[10]

These negative trends and downward pressure combined leave policy makers, especially those from the developing countries, **very little wiggle room for taking counter measures** to redress the problems, making people wonder whether they have already used up all the tools in their tool kit. With current higher debt level, policy makers would be reluctant to say with confidence, like what Mr. Mario Draghi declared in 2012, that they would do "whatever it takes" to stimulate growth or to preserve the value of the currency. The reasons for their dilemma are clear. For boosting economic growth, a government can either invest and spend more or reduce taxation. However, high public and private debt levels would make these





Source: WTO data. Credit: WTO.

two options difficult to follow as they would increase fiscal deficit and make debt servicing even more burdensome. Sovereign default is something all countries would like to avoid. Slower economic growth and weak trade growth would lead to less revenue for the countries to rebuild their already reduced economic buffer owing to the global financial crisis. External financial resources like ODA and FDI could fill in some financing gaps if used properly including for debt servicing. Countries have tried different ways to avoid possible uncertainties that can increase risks of their debt repayments. To reduce currency exchange risks, they originally always used hard currencies like the dollar and Euro, and that landed some of them in trouble when the dollar appreciated; then there has been a shift to float local currency bonds, which as it turned out can also be catastrophic, as local currencies can be illiquid for local institutions because of lack of strength of the currency and domestic regulations but liquid for foreign residents holding domestic bonds as they have means to get rid of these debts. Volatilities for developing country currencies are huge owing to tidal capital flows, and change of US Fed rates. As stated in one article in The Financial Times, "One-in-8 Developing world currencies fall 20% or more against the dollar in any given year. One-in-20 Developing world currencies crash by 50% against the dollar in any given year".[11] One wonders what the world can do with the new wave of debt crisis in poor countries. At the recent Spring Meeting for the World Bank and the IMF, officials and experts expressed clearly that there is currently no appetite for another heavily indebted poor countries (HIPC) type initiative and no appetite for a world debt work out mechanism.

The wave of new data disclosed in April shows that the cloudy patches over the world economy are gathering together and getting darker. It seems a storm is coming soon for those developing countries which are facing a combination of weak economic fundamentals. Yet, there seems to be limited room for policy makers to take actions as downward pressure is coming from different directions at the same time and creating constraints which would make policy measures ineffective or feeble. In some cases, policy tools used to limit negative effects of one problem could trigger negative impact on other problem(s) in hand.

Endnotes:

[1] IMF debt database and Fiscal Monitor, April 2019.

[2] *Sub-Saharan Africa Regional Economic Outlook* (IMF, April 2019).

[3] https://www.oecd.org/development/development-aid-stable-in-2017-with-more-sent-to-poorest-countries.htm

[4] OECD, "Development aid drops in 2018, especially to neediest countries", 10 April 2019. Available from http://www.oecd.org/development/development-aid-drops-in-2018-especially-to-neediest-countries.htm.

[5] *Global Outlook on Financing for Sustainable Development 2019* (OECD, Nov. 2018).

[6] Ibid.

[7] World Economic Outlook Update, January 2019 (IMF).

[8] THE IMF MANAGING DIRECTOR'S WRITTEN STATEMENT, April 2019 at the DEVELOPMENT COMMITTEE. Available from 041019-md-statement-to-development-committee.pdf.

[9] Martin Wolf, "Why the world economy feels so fragile? Political instability will make it harder to ride out a slowdown", 8 January 2019. Available from https://www.ft.com/content/eb14cacc-1298-11e9-a581-4ff78404524e.

[10] WTO news, "Azevêdo urges finance ministers to take coordinated steps to address economic imbalances", 13 April 2019. Available from https://www.wto.org/english/news_e/news19_e/dgra_15apr19_e.htm.

[11] Steve Johnson, "Development agencies turn to local currency lending, Switch to frontier currencies aims to reduce FX risk for borrowers", 9 January 2019. Available from https://www.tcxfund.com/wp-content/uploads/2019/01/Development-agencies-turn-to-local-currency-lending.pdf.

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