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 consequive 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, etc.)

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

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%. 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 to 3.3% in April. This does not seem to be a short-term cyclical slowdown for the world economy, 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.

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
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 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).
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.
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