Fiscal & Debt Sustainability Assessment

Asian Emerging and Developing Economies (EMDEs)

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Fiscal & Debt Sustainability – Conceptual framework

- **Public debt sustainability refers to the ability of a government to stabilize debt ratios, which in turn is dependent**
  - **Real rate of growth and countries potential growth prospects**
  - **Risks of exogenous and endogenous shocks**
  - **Roll-over risk depending on political and economic policies and market conditions**

- **Fiscal sustainability emerges when the government budget can be financed**
  - **Without causing an explosive increase in the public debt over time**
  - **If the debt to GDP is either stable or declining, the country is considered to be solvent**

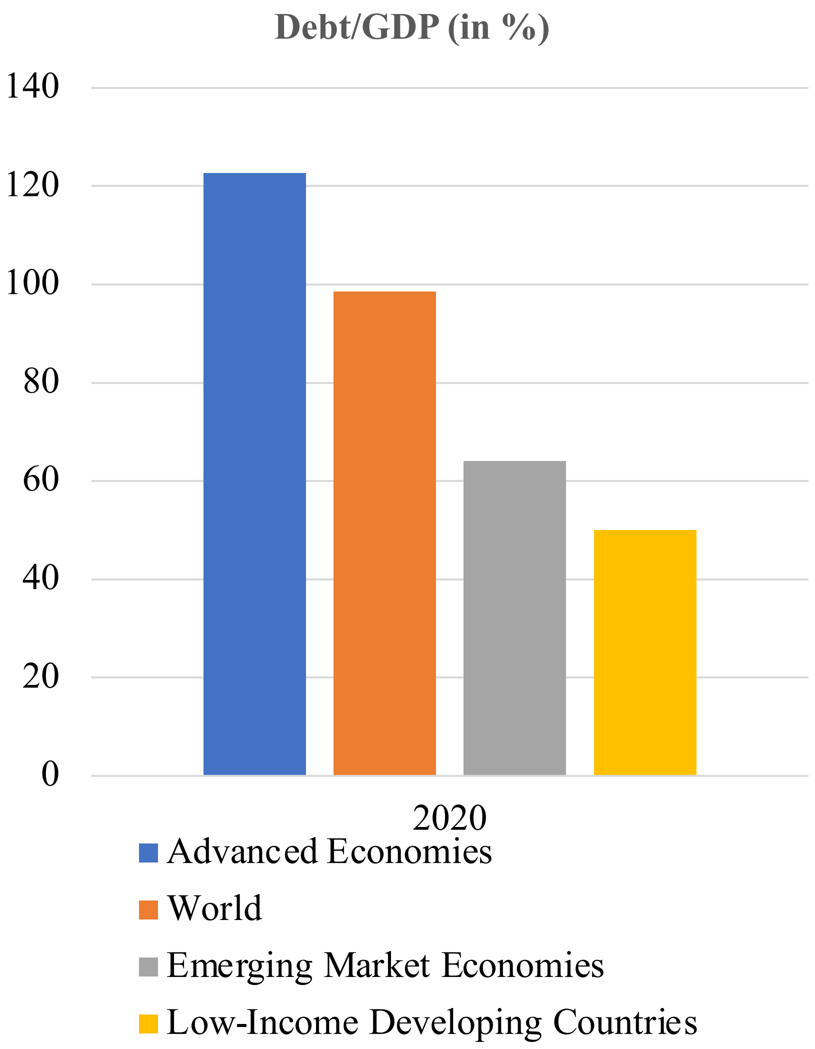
- **Public debt dynamics are driven by the primary deficit and interest rate on debt**
  - **When primary balance (noninterest spending minus revenues) is in surplus, the rate of increase in debt will be lower than the nominal interest rate**
  - **If the primary balance is zero the debt will grow at the rate of interest payment**

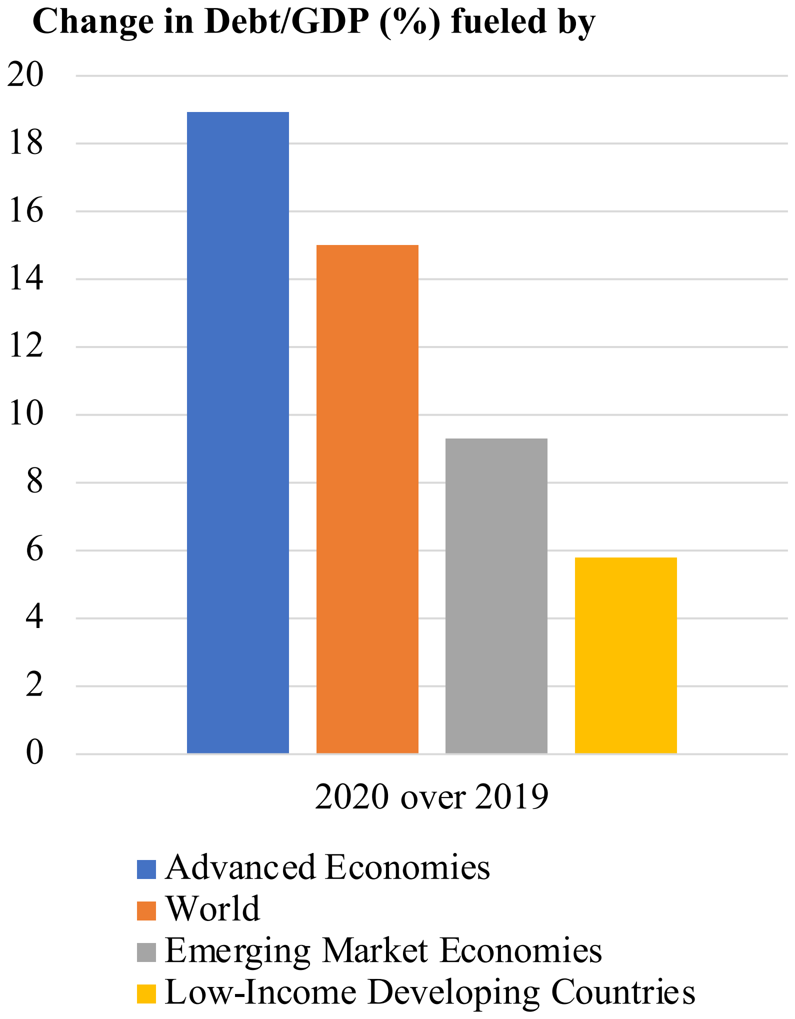
Fiscal & Debt Sustainability – Conceptual framework Continued….

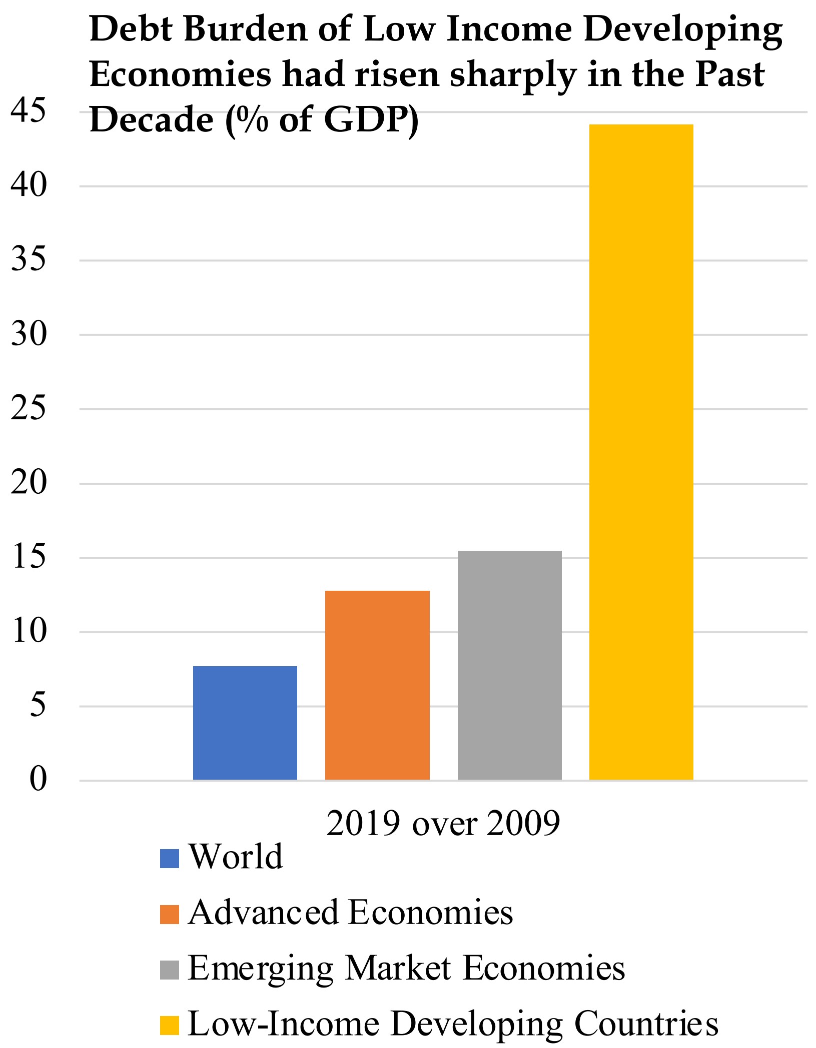
- The impact of interest payments on debt to GDP ratio depends on GDP growth
  - A negative interest rate-growth (in real terms) differential may lead to a stable debt-to-GDP ratio in the short term, even if the primary balance is negative.
  - However, such a situation may not persist in the long-term; hence stabilizing debt-to-GDP ratio will require a surplus in the primary balance
  - A large interest rate-growth differential means a country must raise higher surpluses to stabilize debt ratio.
  - Interest rate should exceed growth to ensure No Ponzi Condition – if this holds, debt to GDP ratio could be only contained by running primary surplus either by mobilizing more revenues or cutting non interest expenditures

- Composition of debt matters - Developing countries are especially vulnerable to foreign-currency dominated/external debt, as large shocks to export earnings and other capital inflows may have negative repercussions on their debt servicing ability

Pandemic Fueled Unprecedented Increase in World Debt Levels especially Advanced Economies





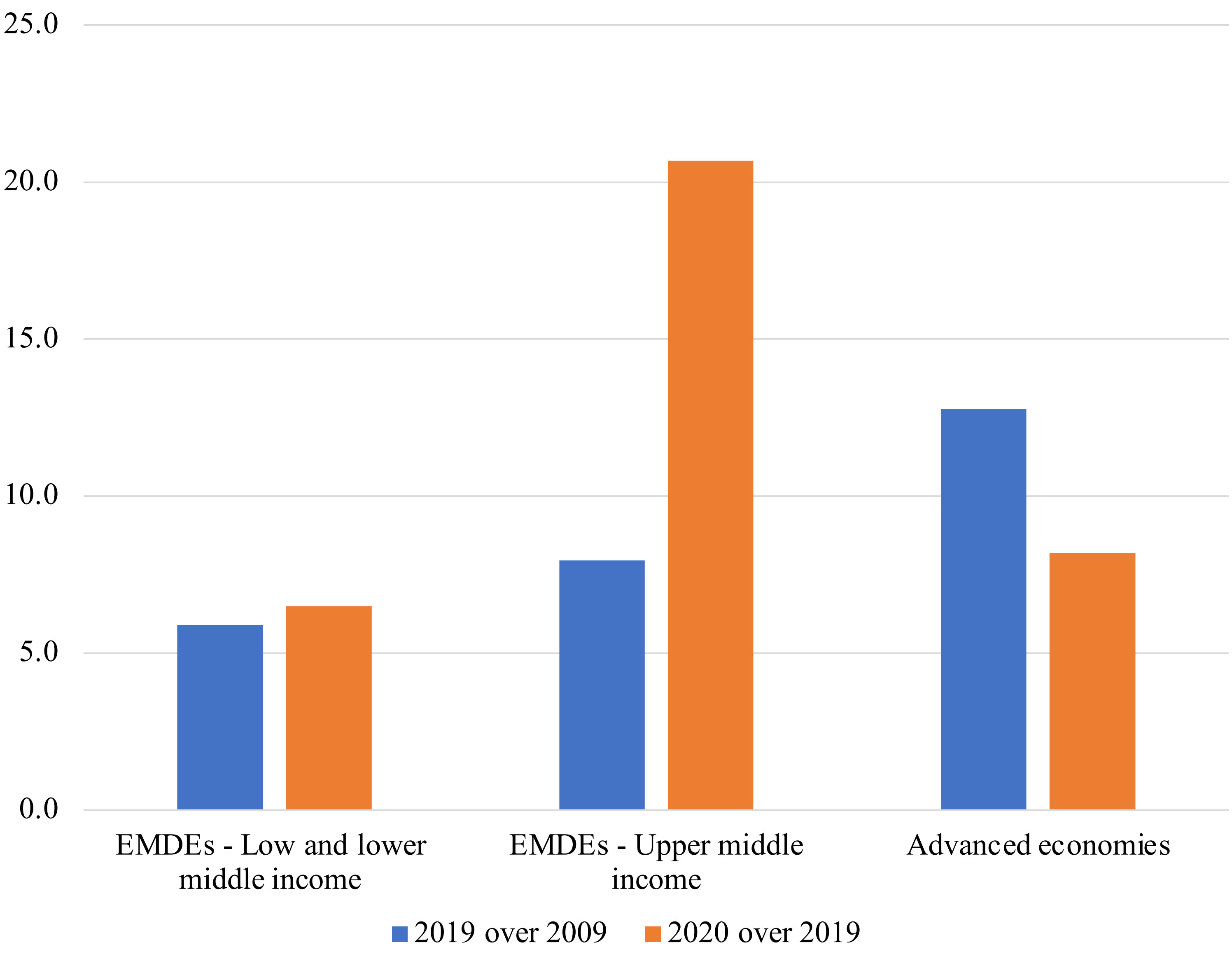


Source: Fiscal Space-Data, World Bank.

Asia-Pacific (AP) developing countries: Public Debt and Fiscal Position

- Pandemic temporary shock and liquidity shortage required domestic and external borrowings-- recovery was critical for economic rebound, job generation and alleviation of social distress – crisis pushed 89 million in AP back in extreme poverty
- Average fiscal deficit rose from 1.5% of GDP in 2019 to 6.8% of GDP in 2020 and 5.6% in 2021
- Beyond sustained economic growth momentum, public debt sustainability depends primarily on government's ability to maintain sustainable fiscal deficits over the medium term.
- Critical policy question: can Asia-Pacific countries mobilize additional financial resources to enhance fiscal space and ensure public debt sustainability while pursing the 2030 Agenda for Sustainable Development?
- The public and publicly guaranteed external debt of AP more than doubled in absolute terms, from $727 billion in 2009 to $1.47 trillion in 2019
- The average public-debt to GDP ratio grew from around 51% in 2019 to 61% in 2020 and is forecasted to rise to 63% in 2021
- AP debt profile has changed: MDBs and bilateral creditors share fell from 55% in 2009 to 35% in 2019 and commercial banks and other private creditors share fell from 26% to 15%. With the issuance of sovereign bonds grew resulting in their share rising from 19% to 50% by 2019
- Quick build-up of debt and its composition has raised concerns over debt sustainability in several countries.
- G20 debt restructuring offered DSSI that principally deferred interest payments by 20 months but only
  - 11 of 24 eligible AP countries availed DSSI equivalent to $9.5 billion and none tapped the Common Framework for Debt Treatment (CFDT);
  - 13 AP Countries are ineligible for DSSI and CFDT – 6 had highest external debt/GDP ratio (32%) with credit rating below investment grade hence their access to global bond markets is likely to be limited and remaining 7 DSSI non-eligible countries, with investment grade credit ratings, experienced the fastest growth in debt owed to bondholders which rose from $91 billion in 2009 to $623 billion in 2019, constituting almost 59.7 per cent of their total debt.

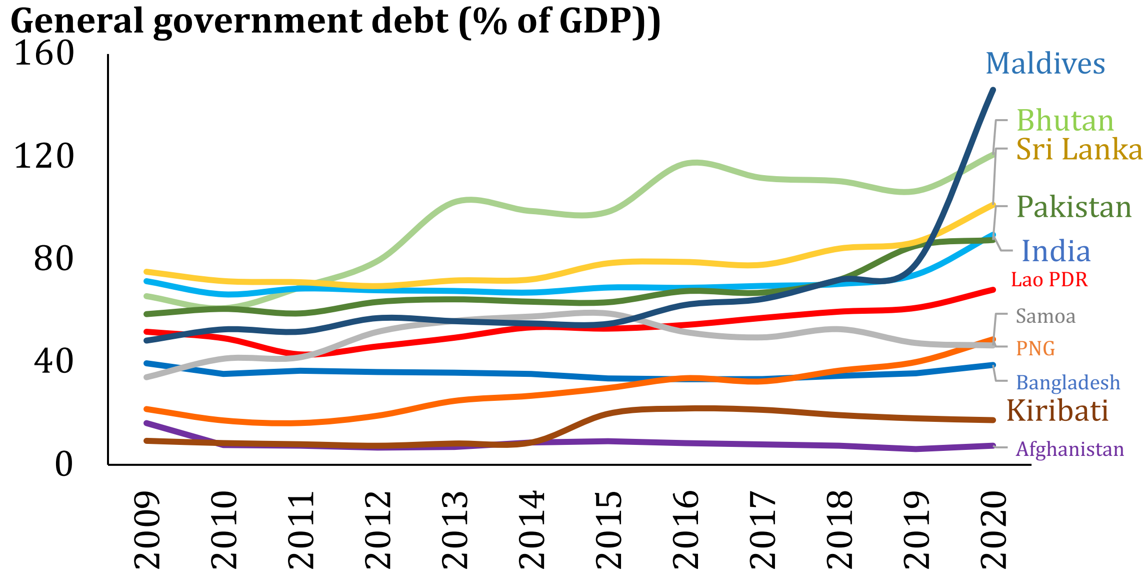
Asian EMDEs: Expansion in government debt during 2020 outpaced the increase seen in the entire decade preceding the pandemic

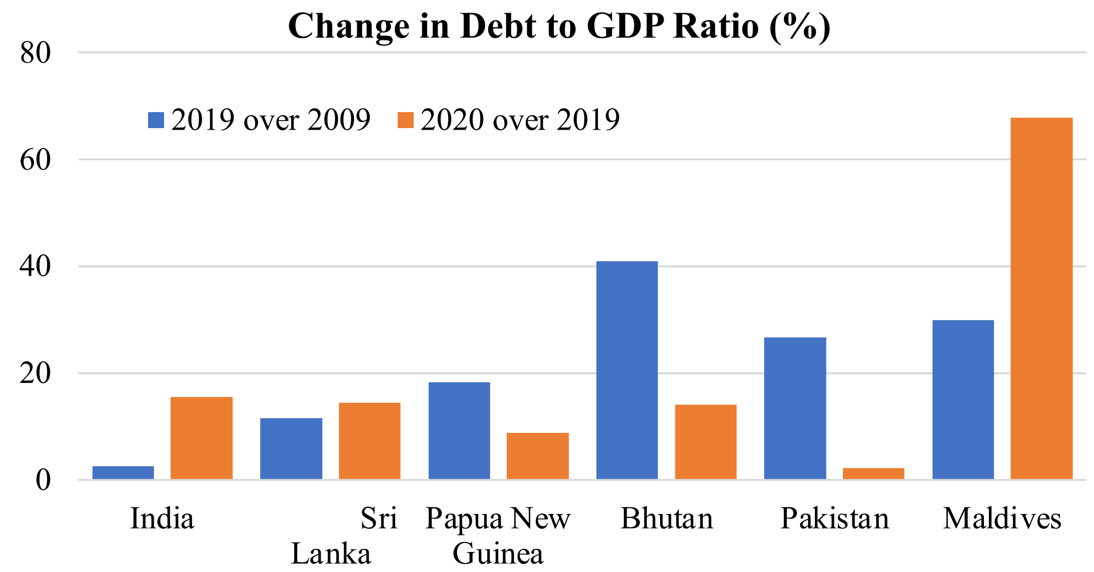


Source: Fiscal Space-Data, World Bank.

Several Asian EMDEs - Identified at Moderate to high risk of debt distress by IMF
IMF List of Debt Distressed Countries (June 2021)
Low and lower middle income
High Risk of debt distress
Afghanistan
Lao PDR
Papua New Guinea
Kiribati
Samoa
Moderate risk
Bhutan
Upper middle income
High Risk of debt distress
Maldives
Marshall Islands
Memorandum items:
Within Top-10 DSSI borrowers
Pakistan
Bangladesh

Asian EMDEs: Low and middle income economies debt had soared during the decade of 2009-19



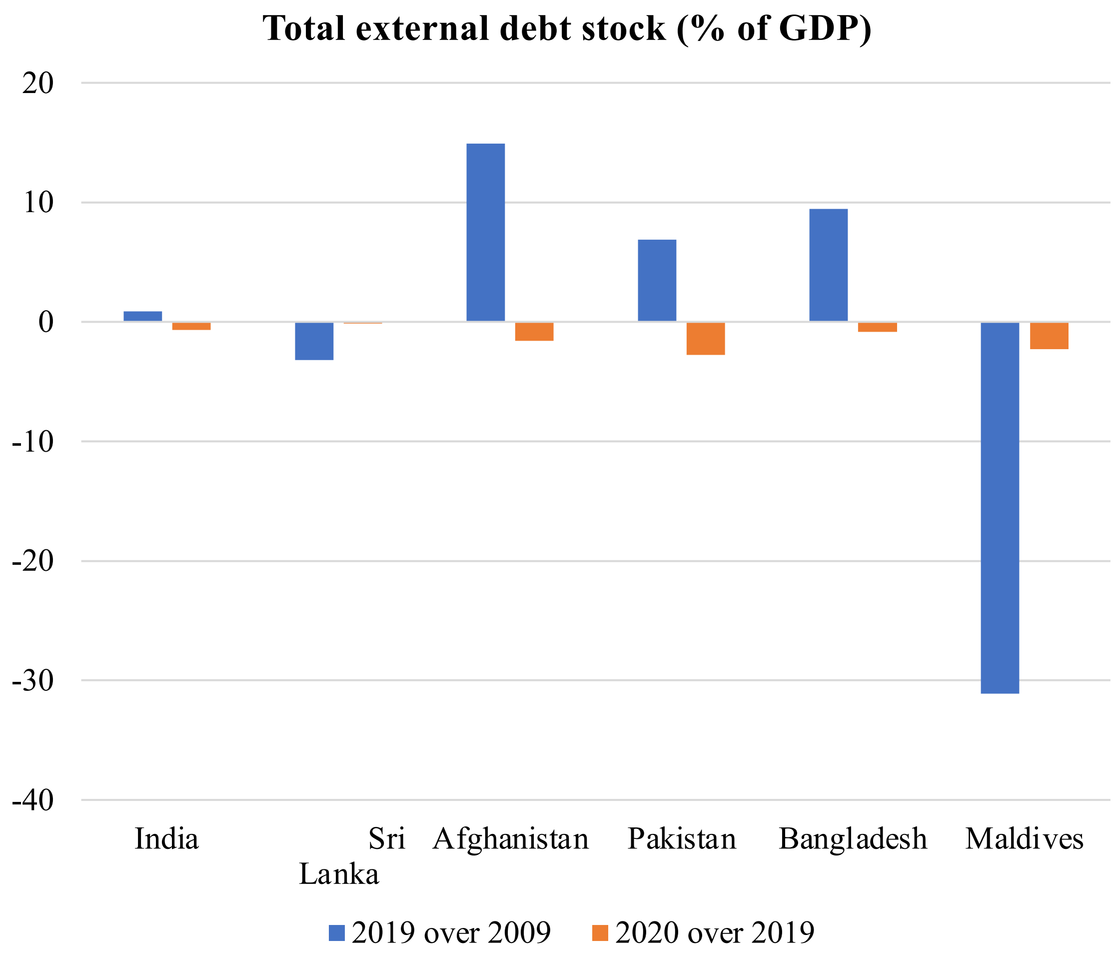


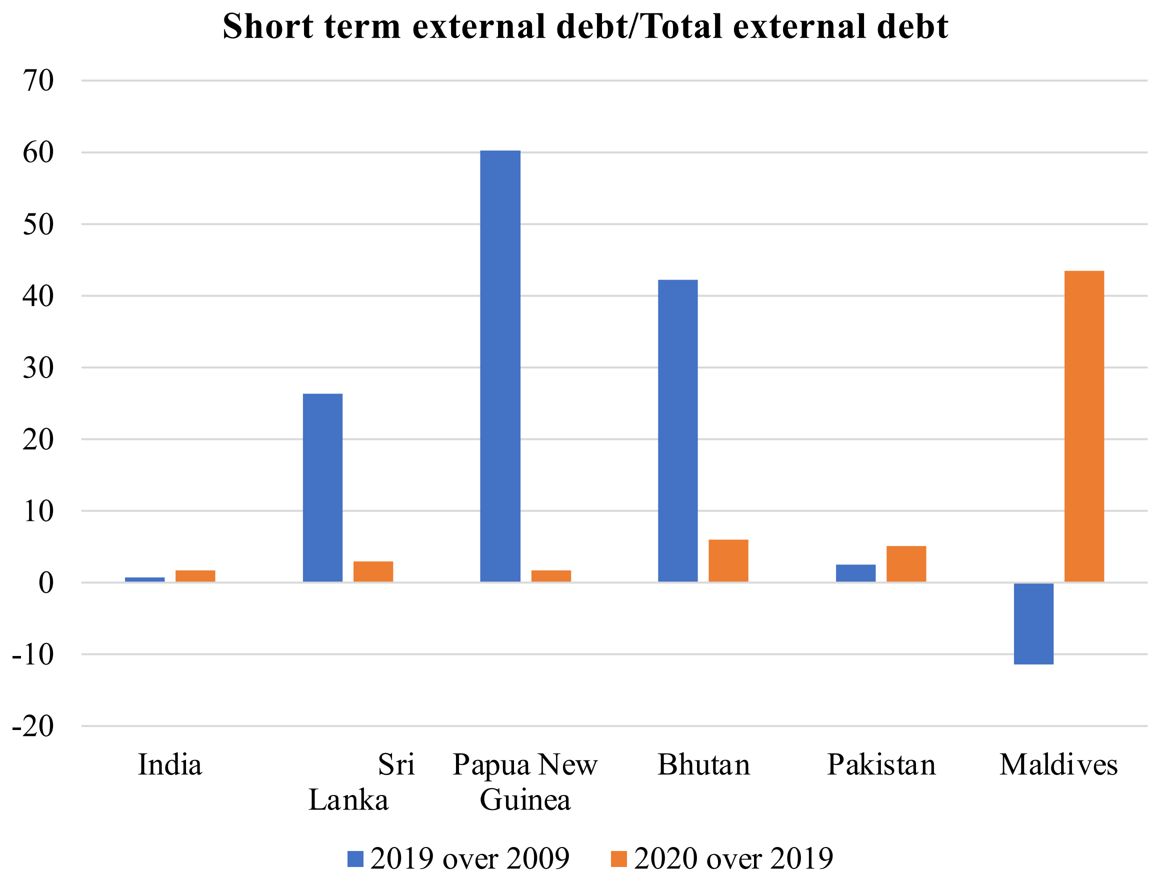
- The debt ratios in low and middle income Asian EMDEs at high risk of debt distress, Bhutan and Pakistan rose by an average 7.9, 40.9 and 26.6% of GDP during the decade of 2009-19. The indebtedness of these countries further rose by 3.1, 14.1 and 2.3% of GDP in 2020.
- In 2019, Bhutan had the highest debt-to-GDP ratio of 106.6% in the group, followed by Sri Lanka, Pakistan and India.
- The debt-to-GDP in India rose to 89.6% of GDP, recording 15.5 percentage point expansion in 2020 over the last year.
- Sri Lanka, government debt-to-GDP rose to 101.2% of GDP in 2020, from 86.8% in 2019. This large increase was on the top of 11.6 percentage point expansion in government debt during 2009-19.
- Indebtedness in Maldives – a high risk country, spiked by 67.7% of GDP during 2020, against 29.9% of GDP expansion during 2009-19.

Source: Fiscal Space-Data, World Bank.

Asian EMDE: The external debt stock declined in 2020 after witnessing almost a broad based increase during the previous decade (2009-19)

The share of short term debt in total external debt further expanded in 2020, continuing the trend of the past decade
Increase came from a number of countries including Papua New Guinea, Bhutan and Sri Lanka





Source: Fiscal Space-Data, World Bank.

External debt Sustainability … The cost structure of external debt worsened for a number of Asian EMDEs.

The share of concessional as well as multilateral creditors declined, whereas reliance on private creditor such as bond holders and commercial banks increased.

Concessional external debt stocks % of general government gross debt	2019/ 2009	2020/ 2019
A. Low and lower middle income	**-11.4**	**-0.6**
o/w		
India	-1.9	-0.1
Sri Lanka	-9.2	-0.9
High Risk of debt distress	***-9.2***	***-6.4***
Afghanistan	33.6	-18.0
Lao PDR	-50.7	-1.4
Papua New Guinea	-10.5	0.3
Kiribati	n.a	n.a
Samoa	-31.5	4.0
Moderate risk		
Bhutan	-21.2	2.2
Within Top-10 DSSI borrowers	***-18.4***	***-0.2***
Pakistan	-17.3	0.2
Bangladesh	-19.4	-0.5
B. Upper middle income	**-3.7**	**1.4**
High Risk of debt distress		
Maldives	-10.1	0.2

Source: Fiscal Space-Data, World Bank.

	Private Creditors (US$ billion)				Multilateral to external debt stock (%)	
	Bond Holders		Commercial Banks			
	2019 / 2010	2020/ 2019	2019 / 2010	2020/ 2019	2019 / 2010	2020/ 2019
East Asia and Pacific	**377**	**113**	**35**	**0.0**	**-3**	**0**
South Asia	**84**	**-11**	**18**	**1**	**-9**	**2**
Lao PDR		-0.2	0.2	0.0	-22.0	0.0
Papua New Guinea		0.0	0.6	-0.2	-2.0	4.0
Kiribiti	-	-		-	-	-
Samoa	-	-	-	-	-	-
Afghanistan					-6	-4
Bangladesh			0.0	0.0	-21.0	-3.0
Bhutan			0.0	0.0	-11.4	3.6
India	66.7	-10.0	12.8	-0.7	-6.0	1.0
Maldives			0.34	0.08	-18.50	-2.20
Pakistan	3.8	0.0	3.5	1.7	-9.0	1.0
Sri Lanka	13.1	-1.0	1.5	0.2	-13.0	1.0

External debt Sustainability …

The ability to service short term debt, improved . Apparently the covid led decline in international commodity prices, travel bans and a surge in remittances cushioned the FX reserve level in these countries.

	Short-term external debt stocks (% of reserves)		Total external debt stocks (% of reserves)	
	2019 / 2010	2020/ 2019	2019 / 2010	2020/ 2019
A. Low and lower middle income	**12.7**	**-1.2**	**146.1**	**-68.4**
o/w				
India	6.7	-5.5	-48.6	-82.8
Sri Lanka	44.0	37.9	-50.4	-101.2
High Risk of debt distress	***20.3***	***-3.5***	***529.0***	***-357.5***
Afghanistan	4.4	-0.5	-26.8	-0.2
Lao PDR	32.7	18.1	879.6	-270.9
Papua New Guinea	23.8	-28.1	734.1	-801.4
Kiribati	n.a	n.a	n.a	n.a
Samoa	n.a	n.a	55.5	-72.7
Moderate risk				
Bhutan	1.7	-2.1	130.0	-28.4
Within Top-10 DSSI borrowers	***28.9***	***-11.4***	***60.5***	***-19.8***
Pakistan	46.7	-18.4	191.7	-22.0
Bangladesh	11.1	-4.3	-70.8	-17.7
B. Upper middle income	**-15.3**	**-5.3**	**15.2**	**-33.6**
High Risk of debt distress				
Maldives	-175.1	-9.0	-150.8	-9.0

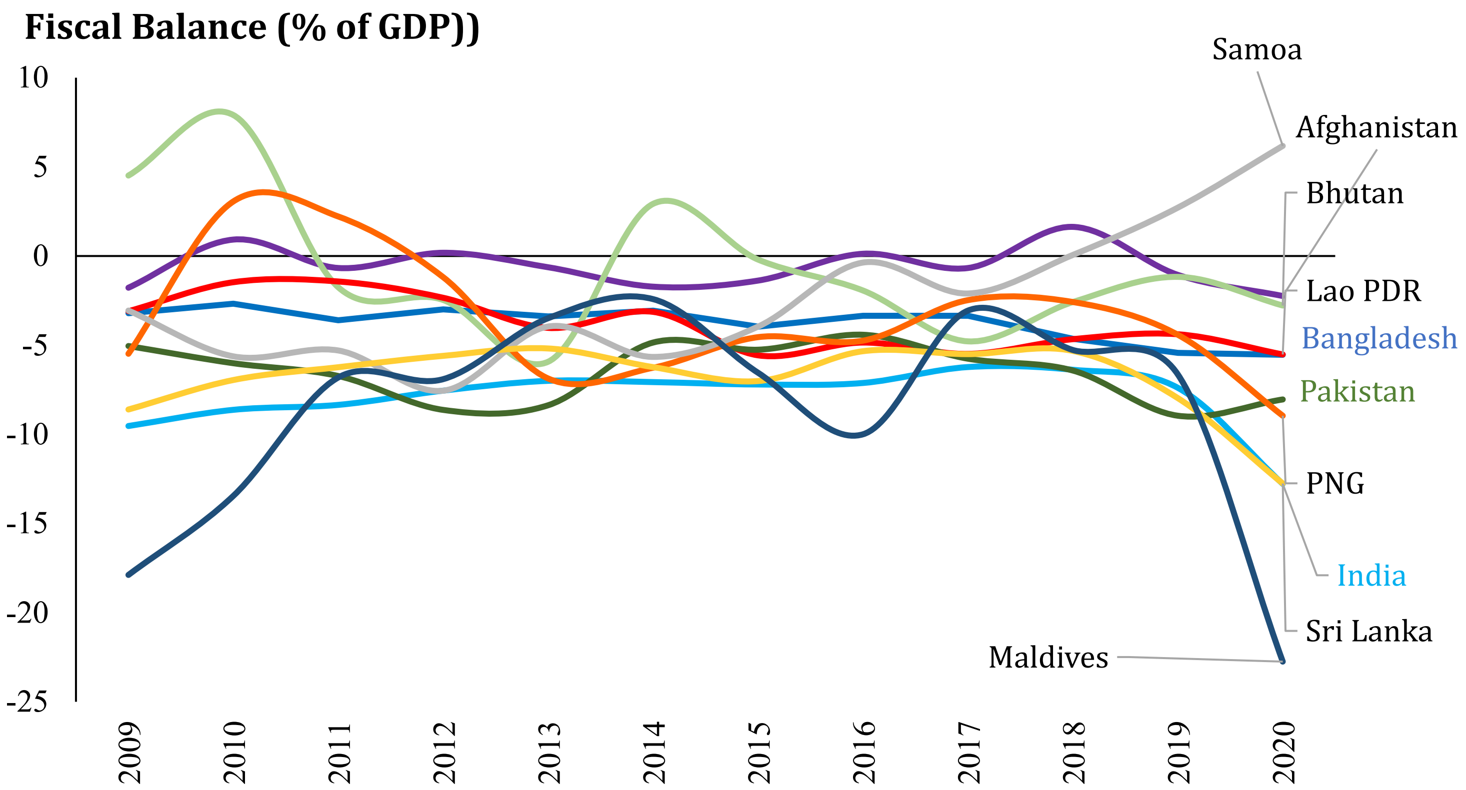
Source: Fiscal Space-Data, World Bank.

Primary balances: The relatively lower primary deficits in Asian EMDEs turned into deficits during 2020

- **The primary deficit in India more than doubled to 7.4 percent of GDP in 2020, from the decade (2009-19) average of 3.0 percent.**
- **Primary deficit in Sri Lanka spiked to 6.2 percent of GDP from an average of 1.2 percent during 2009-19.**
- **The primary deficits in upper middle income EMDE - specifically in Maldives, shot up to 20.4 percent of GDP in 2020, against the average of 5.7 percent in the decade of 2009-19.**
- **Pakistan was the only country in this group that witnessed a reduction in primary deficit during 2020, compared to last year. This shows that this economy was on the path of fiscal reforms during 2020.**

Primary balance (% of GDP)	Avg (2009-19)	2020
A. Low and lower middle income	**-0.3**	**-3.7**
o/w		
India	-3.0	-7.4
Sri Lanka	-1.2	-6.2
High Risk of debt distress	***1.7***	***-3.9***
Afghanistan	-0.4	-2.2
Lao PDR	-2.9	-4.0
Papua New Guinea	-1.4	-6.3
Kiribati	11.6	-2.9
Samoa	n.a	n.a
Moderate risk		
Bhutan	1.5	-2.3
Within Top-10 DSSI borrowers	***-1.8***	***-2.6***
Pakistan	-1.9	-1.7
Bangladesh	-1.7	-3.4
B. Upper middle income	**-1.2**	**-7.6**
High Risk of debt distress	***-1.7***	***-7.6***
Maldives	-5.7	-20.4

Fiscal balances: The average fiscal imbalances in Asian EMDEs during the decade of 2009-19 widened further in 2020



Fiscal balance (% of GDP)	Avg (2009-19)	2020
A. Low and lower middle income	**-2.2**	**-5.3**
o/w		
India	-7.5	-12.8
Sri Lanka	-6.4	-12.8
High Risk of debt distress	***0.2***	***-2.7***
Afghanistan	-0.5	-2.2
Lao PDR	-3.7	-5.5
Papua New Guinea	-3.0	-9.0
Kiribati	11.5	-3.1
Samoa	-3.2	6.2
Moderate risk		
Bhutan	-0.5	-2.8
Within Top-10 DSSI borrowers	***-5.0***	***-6.8***
Pakistan	-6.4	-8.0
Bangladesh	-3.6	-5.5
B. Upper middle income	**-2.7**	**-9.4**
High Risk of debt distress	***-2.8***	***-8.9***
Maldives	-7.5	-22.7

- **The fiscal balances in the lower middle income EMDEs propped up to 5.3 percent of GDP in 2020, from an average 2.2 percent in 2009-19.**
  - **India and Sri Lanka saw the largest expansion in fiscal deficits;**
  - **The average deficit in Pakistan rose considerably in 2020.**
- **In upper middle income EMDEs fiscal deficit jumped to 9.4 percent of GDP in 2020, mainly because of Maldives.**

Revenue positions weakened in these countries signaling fragile debt servicing capacity

- The government debt-to-tax revenues ratio for lower middle income Asian EMDEs, was over 400 percent during 2009-19, which further worsened to 498 percent in 2020. The largest deterioration was seen in Bhutan, Pakistan and Bangladesh.

- The fiscal deficit as a percent of revenues almost doubled in 2020 from the average level seen in 2009-19. This was an across the board deterioration, which was more noticeable in Pakistan, Bangladesh and Lao PDR.

- The government debt-to- tax revenues ratio for upper middle income EMDEs, rose sharply in 2020. Specifically, for Maldives the ratio deteriorated to 1101.5 percent in 2020, from 447.9 percent in 2009-19.

	General government gross debt (% of average tax revenues)		Fiscal balance (% of average tax revenues)	
	Avg (2009-19)	2020	Avg (2009-19)	2020
A. Low and lower middle income	**404.8**	**492.4**	**-23.5**	**-51.6**
o/w				
India	448.6	580.6	-48.6	-82.8
Sri Lanka	604.2	803.0	-50.4	-101.2
High Risk of debt distress	***212.6***	***266.2***	***-2.2***	***-26.1***
Afghanistan	130.5	114.3	-7.1	-34.7
Lao PDR	460.8	597.1	-32.2	-48.4
Papua New Guinea	176.7	317.7	-19.7	-58.2
Kiribati	74.4	94.3	62.2	-17.0
Samoa	220.8	207.8	-14.1	27.6
Moderate risk				
Bhutan	899.3	1170.0	-4.8	-26.9
Within Top-10 DSSI borrowers	***577.0***	***706.2***	***-57.3***	***-79.4***
Pakistan	630.2	837.0	-61.2	-76.9
Bangladesh	523.8	575.3	-53.3	-81.9
B. Upper middle income	**308.1**	**496.2**	**-18.9**	**-63.3**
High Risk of debt distress	***325.6***	***609.6***	***-22.3***	***-70.3***
Maldives	447.9	1101.5	-56.5	-171.6

Source: Government Finance Statistics

Real GDP growth and Interest payments

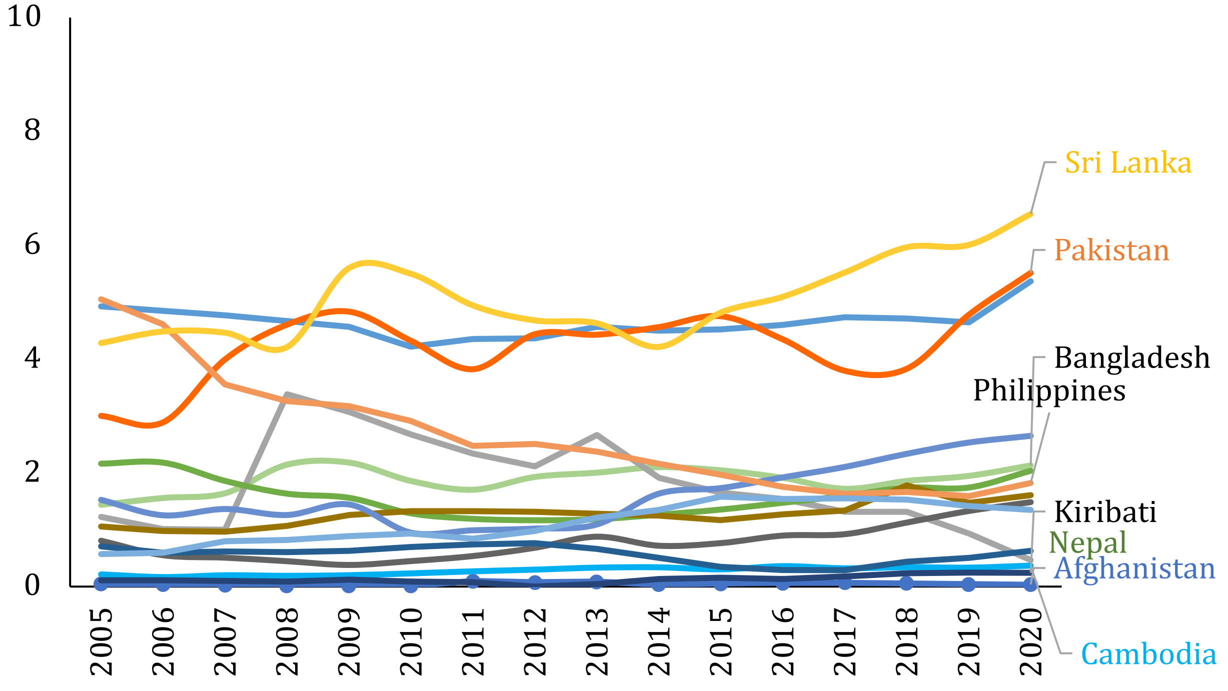
- The real economic activity, as gauged by real GDP growth contracted in almost all Asian EMDEs during 2020.
- The sharpest decline was seen in Maldives. Lao PDR, Kiribati and Pakistan witnessed only a nominal contraction in real GDP growth during 2020.
- During the decade preceding the crisis, Lao PDR, India and Bangladesh were the fastest growing economies, whereas Sri Lanka, Kiribati and Pakistan witnessed lowest growth rates during 2009-19.

Real GDP growth		
	Avg (2009-19)	2020
A. Low and lower middle income	**5.4**	**-2.7**
o/w		
India	7.1	-7.3
Sri Lanka	1.5	-2.7
High Risk of debt distress	***5.6***	***-3.3***
Afghanistan	6.3	-2.4
Lao PDR	7.2	-0.4
Papua New Guinea	5.6	-3.9
Kiribati	3.1	-0.5
Samoa	6.0	-9.6
Moderate risk		
Bhutan	6.1	-0.8
Within Top-10 DSSI borrowers	***5.1***	***1.5***
Pakistan	3.6	-0.5
Bangladesh	6.6	3.5
B. Upper middle income	**4.6**	**-10.7**
High Risk of debt distress		
Maldives	5.2	-32.0

Source: World Economic Outlook Database October 2021, IMF.

1. **The burden of interest payments in terms of GDP remained almost unchanged for the low middle income EMDEs in 2020, compared to the average of past decade.**
2. Countries with large fiscal imbalances and debt burdens had a high ratio of interest payments-to-GDP.
3. Sri Lanka had the highest interest rate burden at 5.2 percent of GDP during 2009-19, followed by 4.5 percent in India and 4.4 percent in Pakistan, which increased further in 2020.

Interest payment (% of GDP))



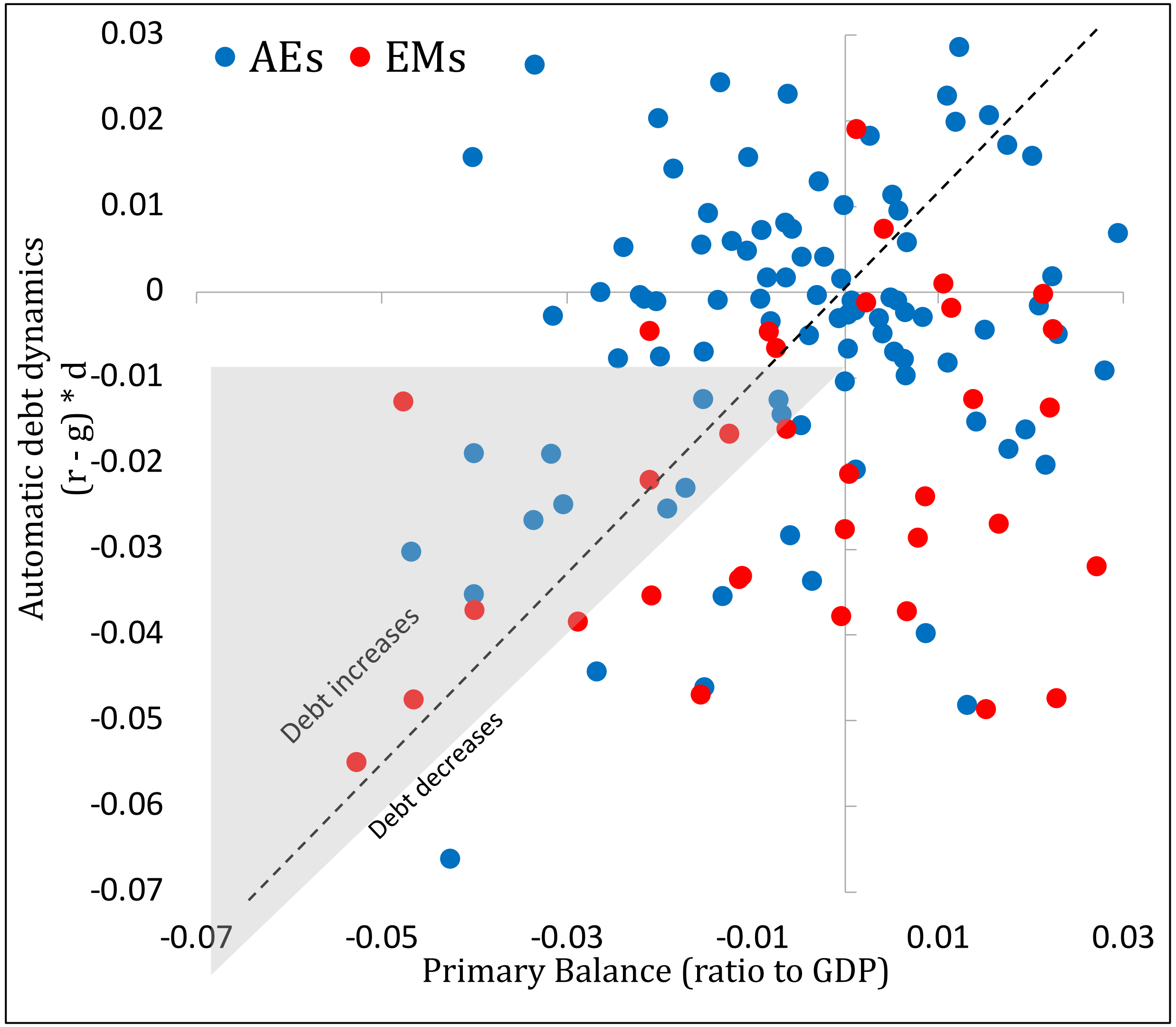
Source: Government Finance Statistics, IMF.

High debt burden in Asian EMDEs signals concerns over fiscal sustainability

- **The debt burden in some of the Asian EMDES had already deteriorated before the pandemic. The problem intensified in the pandemic year, because of revenue losses.**
- **The persistently large and deteriorating fiscal imbalances in India, Sri Lanka, Maldives and Pakistan highlight fiscal vulnerabilities.**
- **Increasing reliance on non-concessional, private external debt will raise debt servicing cost of these economies.**
- **The debt servicing capacity of Bhutan, Maldives, Pakistan, Bangladesh and India is undermined by perennial inefficiencies in the tax systems as indicated by large claims of government debt and fiscal deficit over tax revenues. These countries require to undertake serious policy efforts to improve tax revenues to contain the pace of fiscal imbalances and for stabilizing debt ratios.**
- **Large fiscal imbalances have fed into high government debt ratios. This would require a considerable fiscal adjustment to stabilize the level of debt and to bring it to pre-covid level.**
- **If this adjustment is not politically or economically feasible, the debt level may be unsustainable.**

Is negative interest rate growth differential the answer?

- A general perception is that the global recovery in the medium term will lead to large negative interest rate-growth differentials that will improve debt sustainability of these EMDEs.
    - A negative interest rate-growth differential may lead to a stable debt-to-GDP ratio, as the rate of return on debt financed investment is sufficient for debt servicing [Blanchard (2019)].
- However, research negates this argument;
- If the pace of primary deficits (new debt) exceeds debt repayment made every year, the debt stock will be on a rising trajectory. During 1990-2018, the interest-rate-growth differential was negative in 60 percent of 63 EMDEs; it was not sufficient to offset the impact of primary deficits on debt levels; so debt was on a rising trajectory in 49 percent EMDEs. [World Bank – Global economic Perspectives, June 2019].
- Historical data shows that in many advanced and in some emerging economies with large primary deficits, the debt to GDP ratios increased despite negative interest-rate growth differentials [IMF Fiscal Monitor – October 2021]



Source: IMF, April 2021 World Economic Outlook.

High debt burden has tainted the growth prospects of some these EMDEs …

- High debt-to-GDP ratio would dampen growth prospects because of
  - increase in taxation and interest rates,
  - inflation, and
  - reduced space for counter cyclical fiscal policies.

- Combination of these factors may discourage capital stock accumulation, increase volatility and will constrain economic growth and debt bearing capacity of these economy.

- Rising commodity prices and the global financial stress would increase the cost of rolling over debt;

- Looking through this lens, the sharp double digit expansion in government debt burden in Bhutan, Pakistan, Maldives, Sri Lanka and India raise concern about the sustainability of fiscal stance in these countries.

CONCLUSION

EMDEs face complex challenges in midst of high debt burden

- High debt-to-GDP ratio and limited fiscal space, as countries offered tax reliefs to revive industry and enhanced welfare spending, poses challenges as pandemic persists
- Going forward growth prospects may be tainted given need to restore fiscal sustainability and hence may need to
  - increase taxes and interest rates,
  - Contain inflation, and
  - reduce counter cyclical fiscal policies.
- Refinancing risks high due to the shorter maturity of public debt (IMF's October 2021 Fiscal Monitor) and their credit history and greater macroeconomic vulnerabilities
- Combination of these factors may discourage capital stock accumulation, increase volatility and will constrain economic growth and debt bearing capacity of these economy.
- Rising commodity prices and the global financial stress would increase the cost of rolling over debt;
- Looking through this lens, the sharp double digit expansion in government debt burden in Bhutan, Pakistan, Maldives, Sri Lanka and India raise concern about the sustainability of fiscal stance in these countries.

Regional fiscal and debt dynamics are complex

- **Strengthen debt transparency and disclosure requirements for all hidden debts and contingent liabilities**

- **Where warranted DSSI**
  - **should be extended and to facilitate their access CFDT debt restructuring should be accompanied by issuance of new bonds backed by a grant facility which picks up the hair cuts involved**
  - **needs to be accompanied by debt cancellation for high debt distress LICs,**
  - **DSSI need to go beyond LICs and beyond bilateral debt**
  - **Todate not even a single debt restructuring has occurred for high distress EMDEs under CFDT**

- **Pre-emptive debt restructuring better than restructuring after default – later results in larger economic losses than pre-emptive restructuring. NonDSSI countries are heavily dependent on sovereign bond markets as official support has fallen: those with credit ratings below investment grade are the most vulnerable group, as they do not have access to the CFDT and their access to global bond markets is limited due to their low credit ratings**

- **Debt resolution frameworks need to be supported by an effective global and regional architecture which defines principles of debt sharing burden and offers a negotiating platform --deciding on principles will be critical for this and future debt crisis.**

Reinstate or reject fiscal rules

- **Different views – with all statutory fiscal and debt limits breached to accommodate much needed pandemic policy response the validity of instituting simple fiscal and debt rules is being debated.**

- **Some advocate more emphasis on macroeconomic vigilance and scrutiny of interplay of such variables as the outlook for interest rates, economic growth, and political stability.**

- **Fiscal rules and buffers are part of prudent management. Amid the post-pandemic inflationary spurt, price stability matters more than ever if debts are to stay sustainable.**

- **Rethinking fiscal policy to address inequalities through taxes, social spending and support the green transition**

Debt Relief and Green Recovery:
Report "Securing Private-Sector Participation and Creating Policy Space for Sustainable Development"

- **The G20 Common Framework for Debt Treatments will not tackle the debt problem facing many emerging and developing economies.**

- **We recommend that IMF needs to provide an enhance debt sustainability analysis that factors more rigorously the impact of macroeconomic risks and climate risks on the horizon and includes private creditors in the debt restructuring whereby debtor countries seek bilateral haircuts and commensurate relief from private creditors based on incentives that will help copt private creditors**

- **Debtors launch Green and Inclusive Recovery Strategy which is supported by multilaterals and backed by Guarantee facility that supports sustainable and climate resilient infrastructure and helps finance implementation of Sustainable Development Goals and Paris commitments.**