Rethinking public debt assessments for the SDGs

Expert Group Meeting on Public Debt and Sustainable Financing in Asia and the Pacific

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Vatcharin Sirimaneetham

Macroeconomic Policy and Financing for Development Division
ESCAP

Context and objective

- Approaches currently used by international financial institutions and credit rating agencies often focus on short- to medium-term debt sustainability (1-5 years).

- Yet, without a complementary long-term analysis, too much emphasis could be put on reducing near-term debt distress risks at a cost of achieving the SDGs.

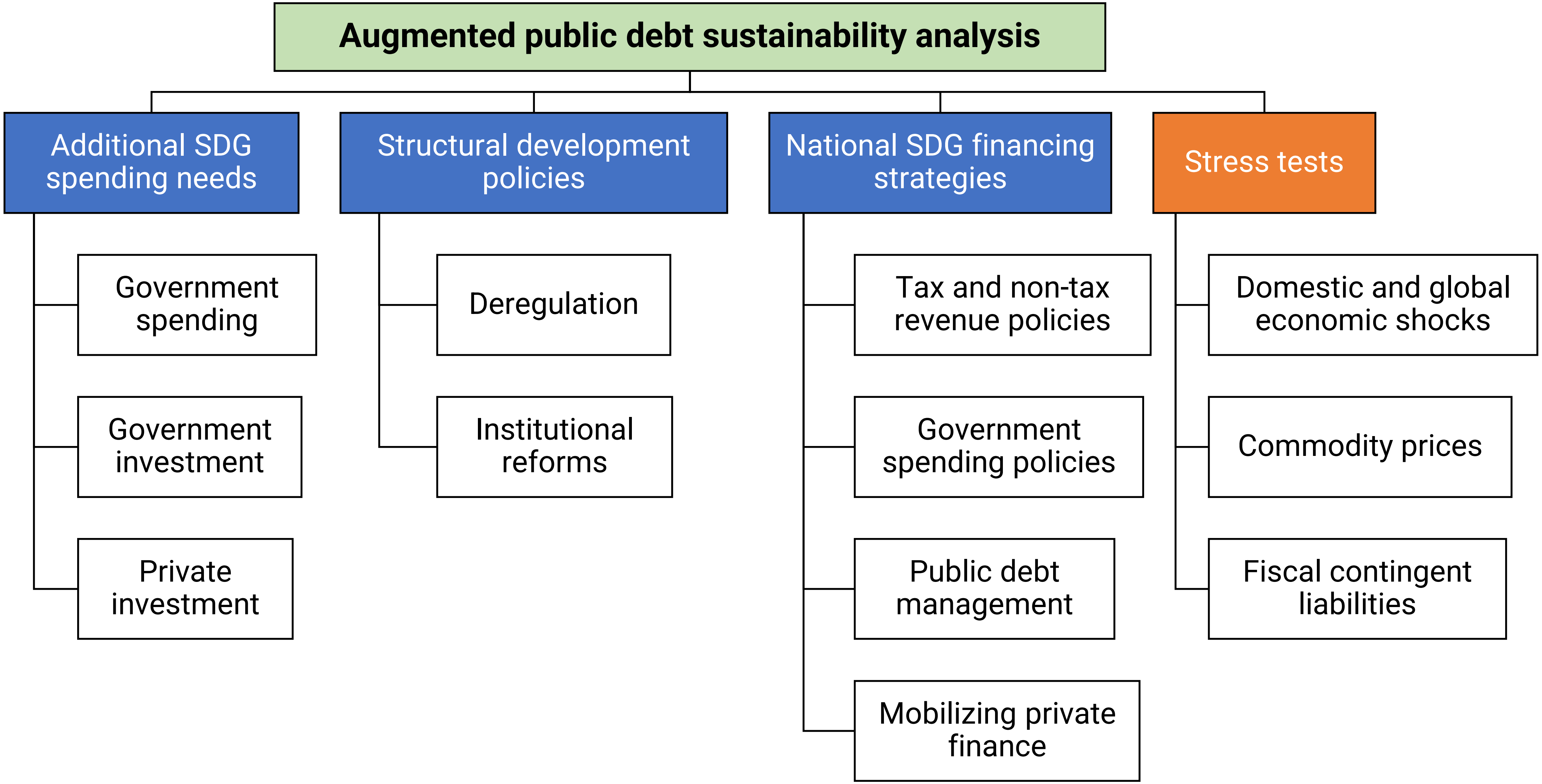
- This chapter urges policymakers and international development partners to rethink how public debt assessment should be undertaken, keeping in view the SDGs.

- Aiming to *supplement* existing approaches, ESCAP is proposing an ‘augmented’ approach to analyze long-term public debt sustainability by considering a country’s SDG spending needs, structural development policies, and national SDG financing strategies.

- The analysis will illustrate different trajectories of public debt under different scenarios of public policies and adverse shocks, thus helping governments make informed choices on how to balance short-term fiscal risks with long-term development ambitions.

The augmented public debt sustainability analysis: *conceptual framework*

Main components of the augmented DSA approach



The augmented approach incorporates climate issues through 3 channels

Investments in climate adaptation and mitigation

- Making public infrastructure more resilient to disaster shocks
- Increasing share of renewable energy in energy mix
- Enhancing energy efficiency

Post-disaster fiscal costs

- Financial assistance to affected households and businesses
- Rebuilding public infrastructure
- Government revenue loss due to output shocks
- Bailout for commercial banks and insurance companies amid surging loan defaults and climate insurance payments

Net-zero emission goals

- Bailout for commercial banks and state-owned enterprises affected by stranded assets in traditional mining and power generation industries

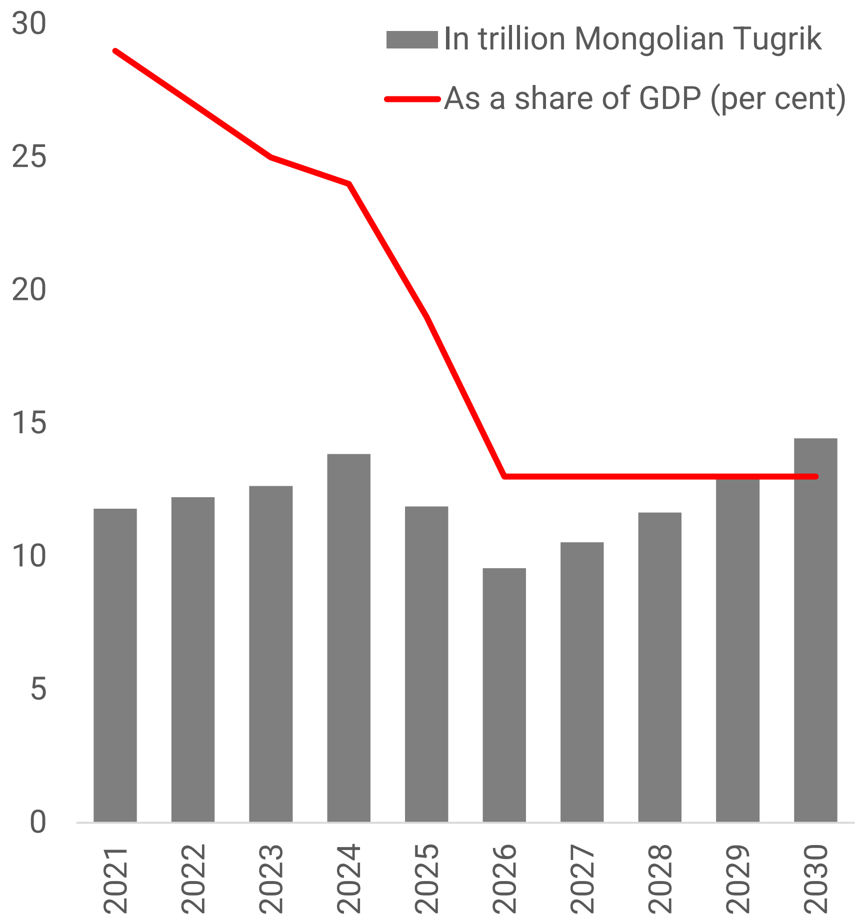
Applying the augmented debt sustainability analysis:
preliminary results for Mongolia

Mongolia: development challenges

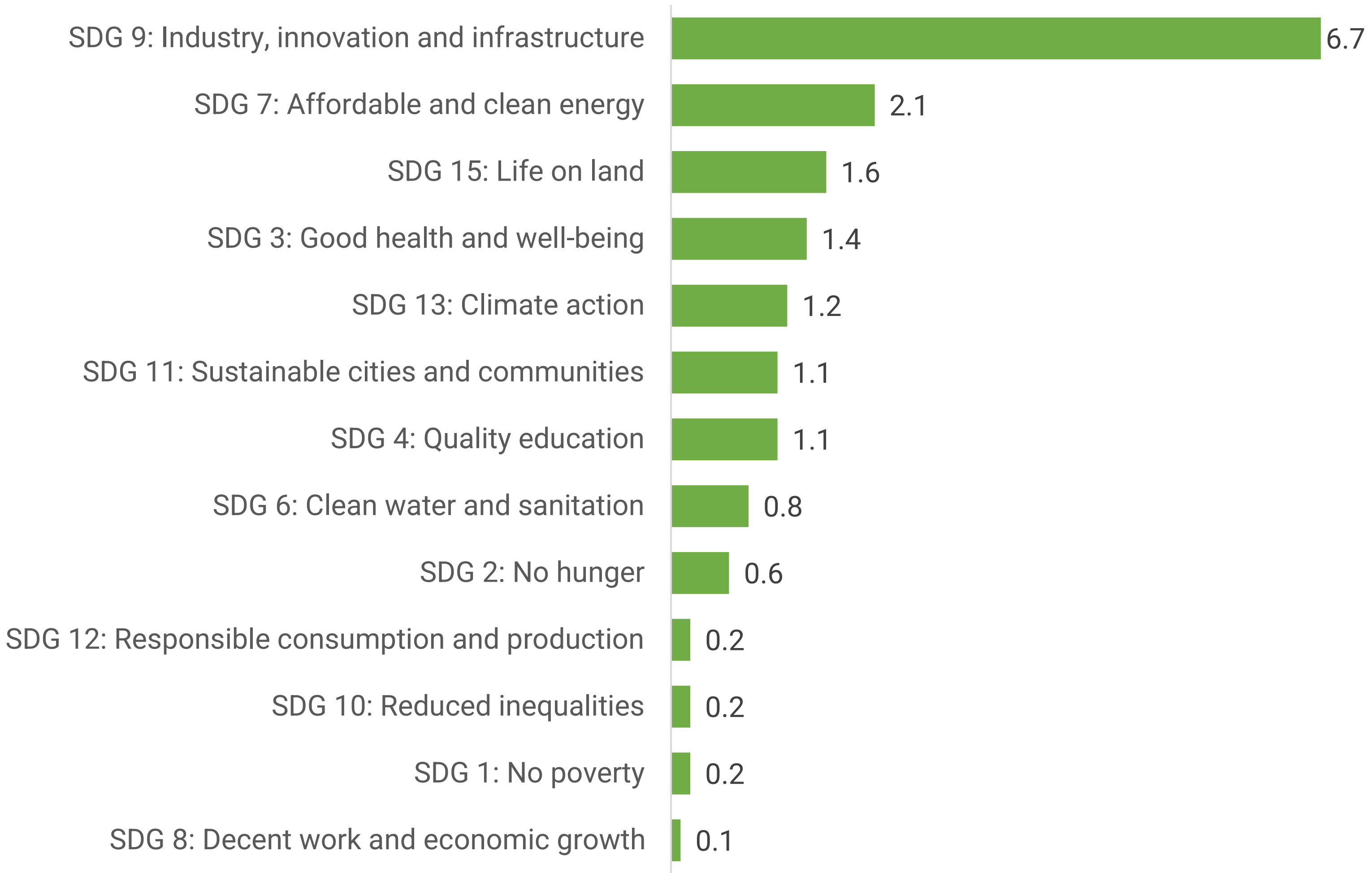
- A landlocked economy with narrow economic base and increasing reliance on mineral activities
- Volatile macroeconomic conditions and large fiscal and current account deficits
- Public financial management faces several challenges
- Large room to enhance domestic business environment
- Poverty rates and socioeconomic inequality remain high
- Air pollution and land degradation are key environmental concerns

Additional SDG spending needs are large at 17% of GDP per year

Annual SDG costs, 2021-2030

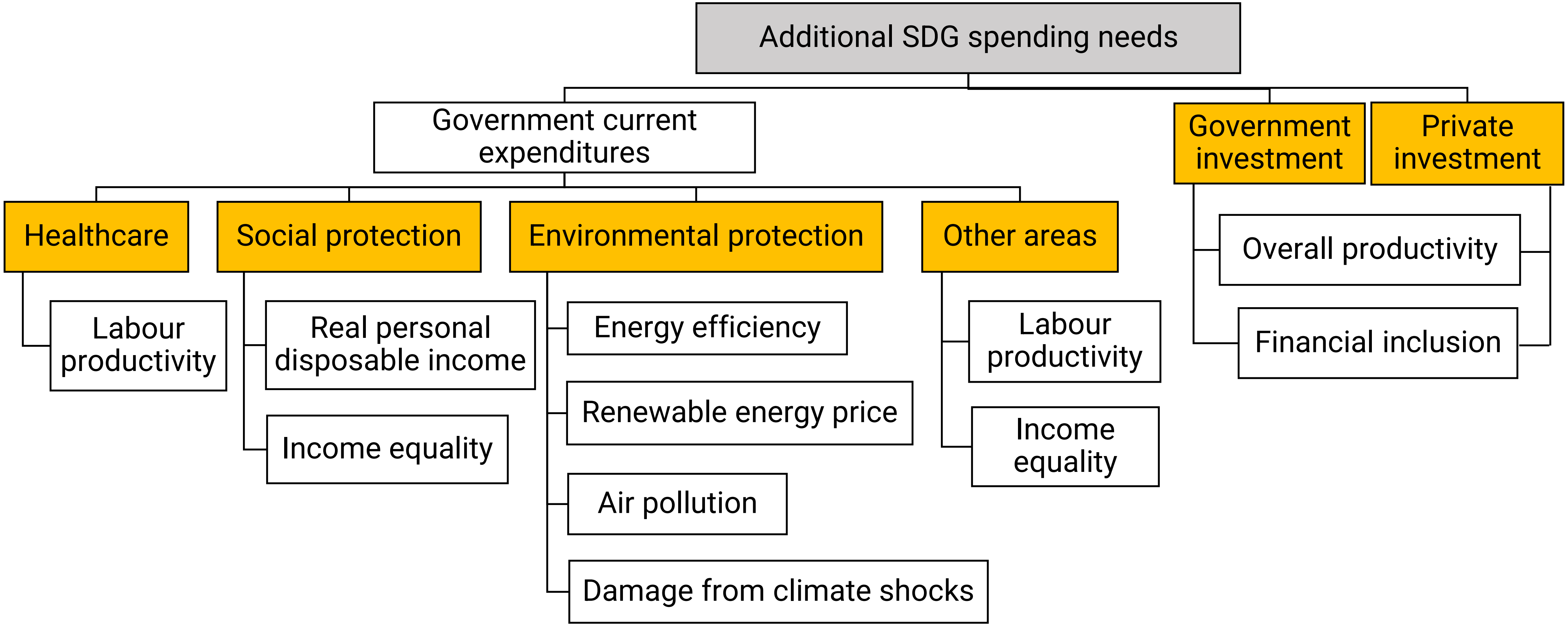


Average SDG costs by Goal, % of GDP during 2021-2030



Source: UNDP

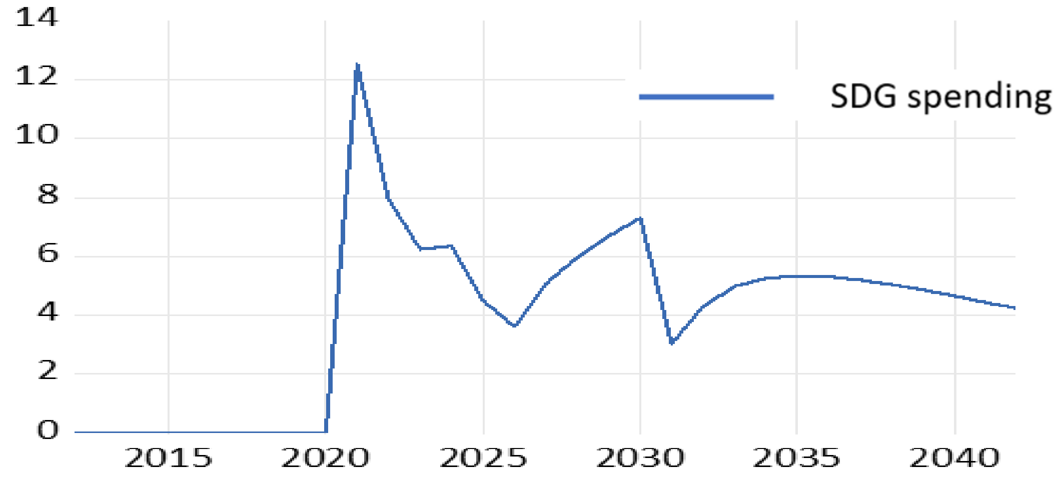
Socioeconomic and environmental gains of SDG spending: examples



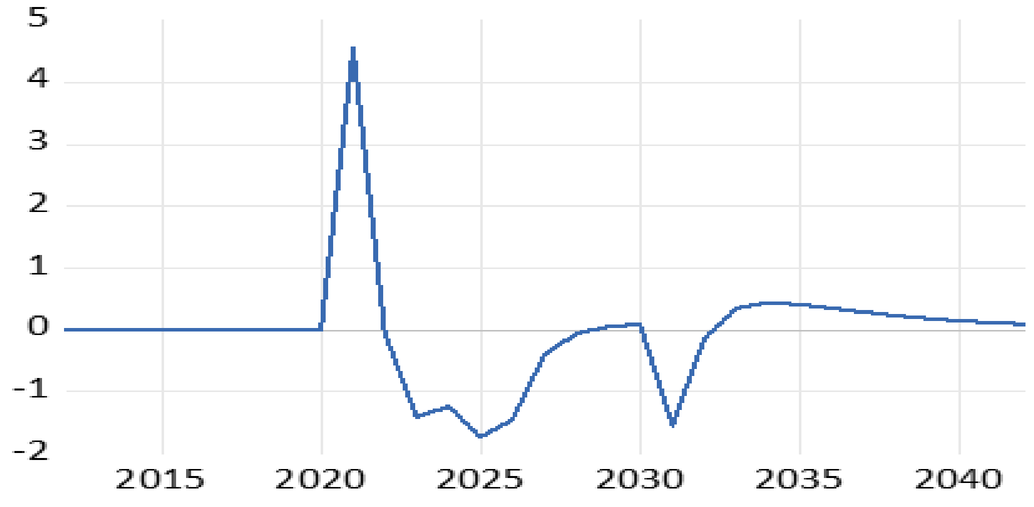
Source: ESCAP Macroeconomic Model.

SDG spending offers notable economic, social and environmental gains…

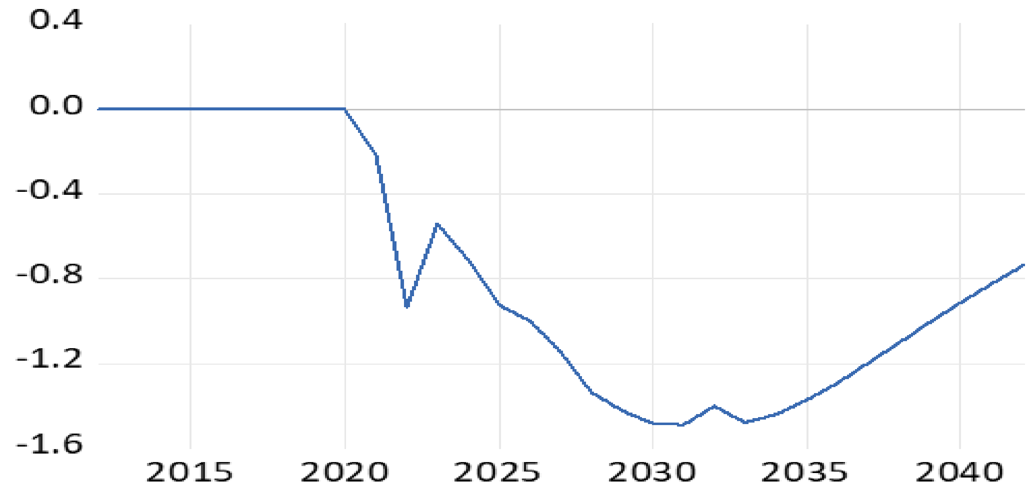
Output level (percentage change)



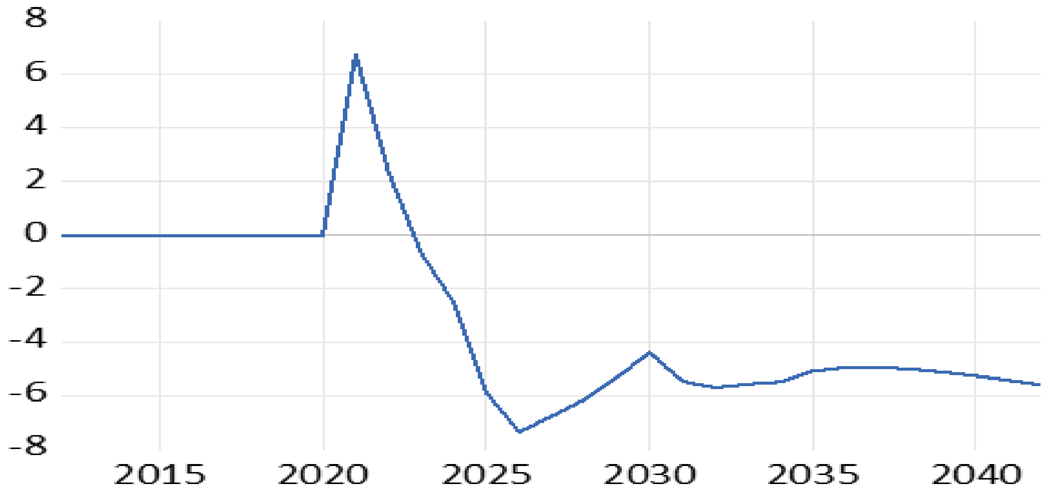
Inflation rate (percentage point change)



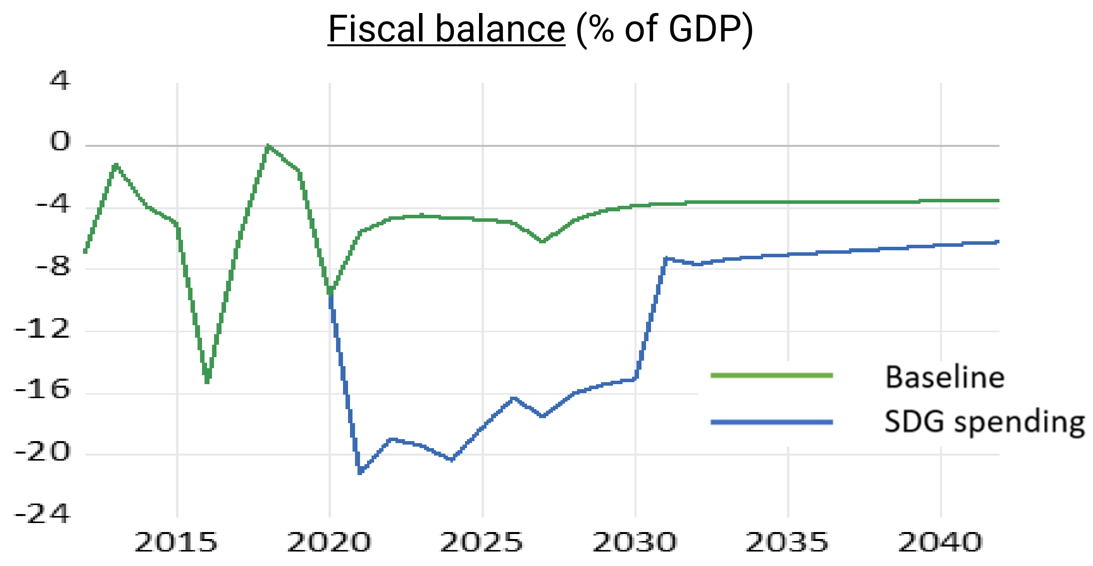
National poverty headcount ratio (percentage point change)

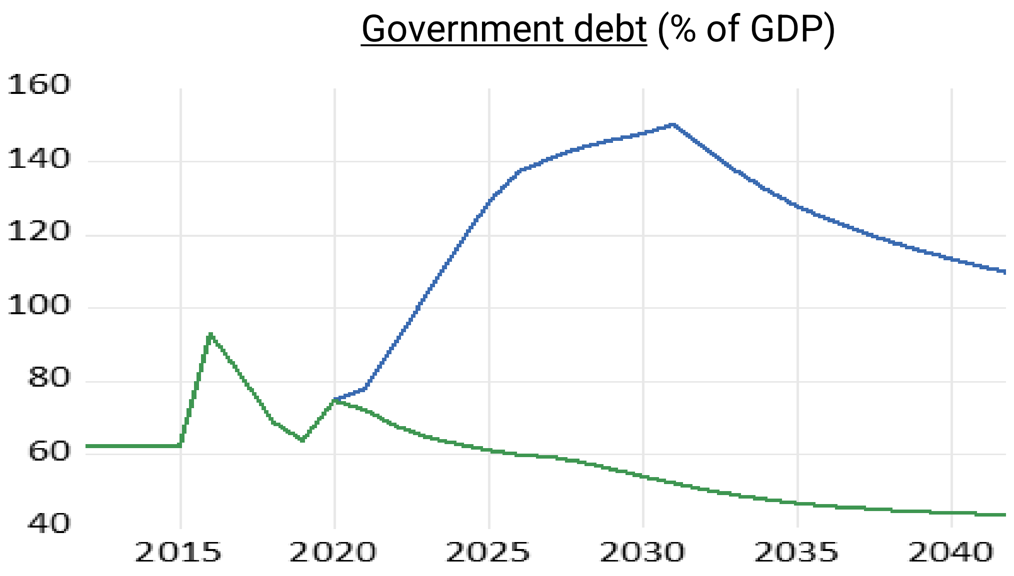


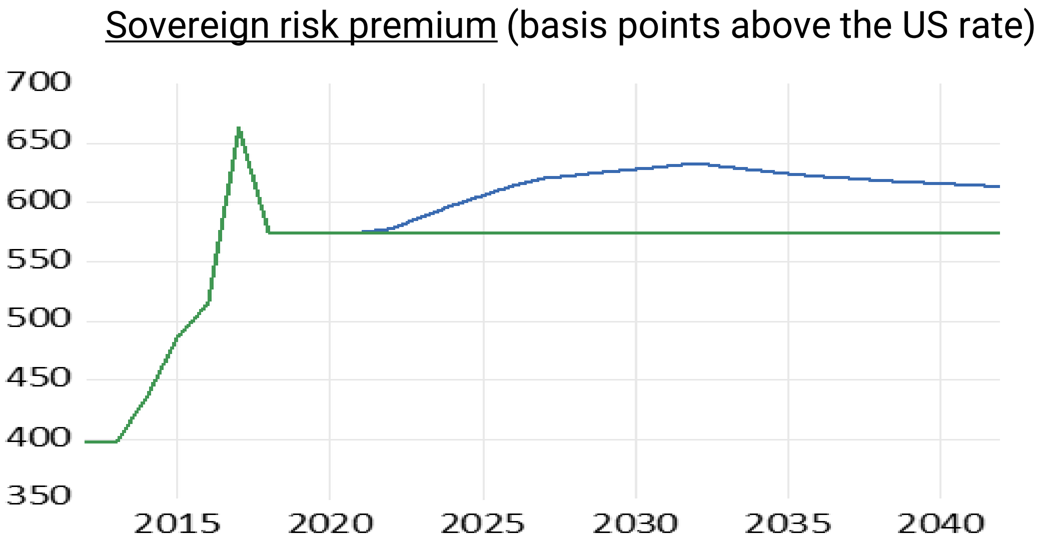
Carbon emissions (percentage change)

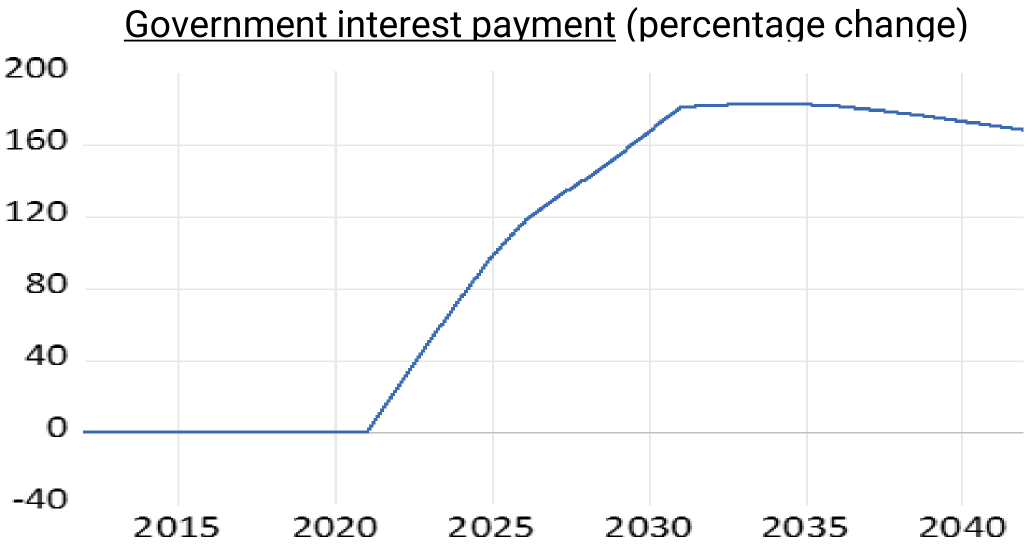


…yet, fiscal deficit widens and government debt level surges









Structural development policies: towards a *green* and *diversified* economy

Green economy

Pricing carbon emissions

- Removing energy-related subsidies
- Introducing a carbon tax
- Spending of carbon tax revenue

Improving livestock management

- Pasture restoration subsidies
- Intensive farming techniques

Diversified economy

Enhancing business environment

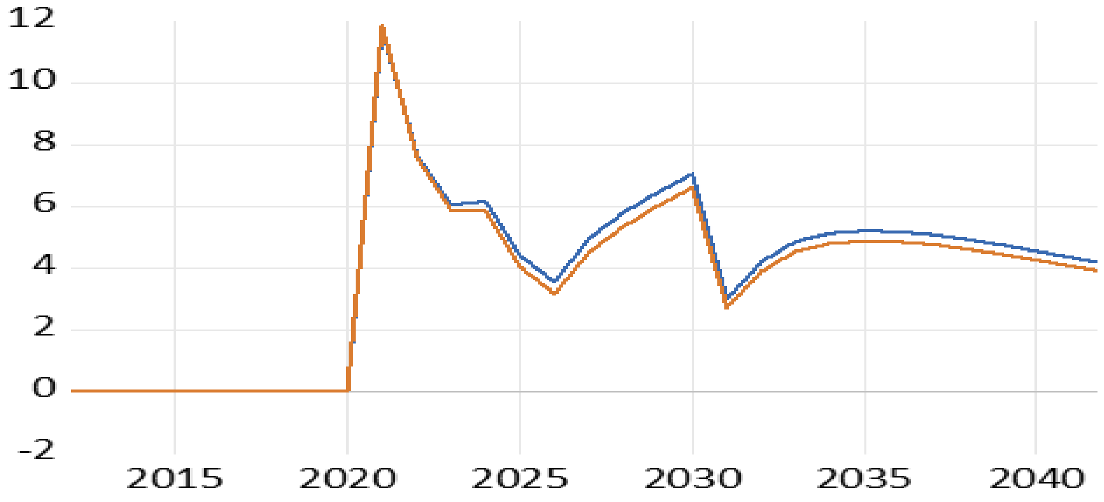
- More competitive, predictable environment
- Enhancing SME finance
- Adopting cross-border trade and facilitation measures
- Formalizing the informal economy
- Reducing corruption

Participating in free trade agreements

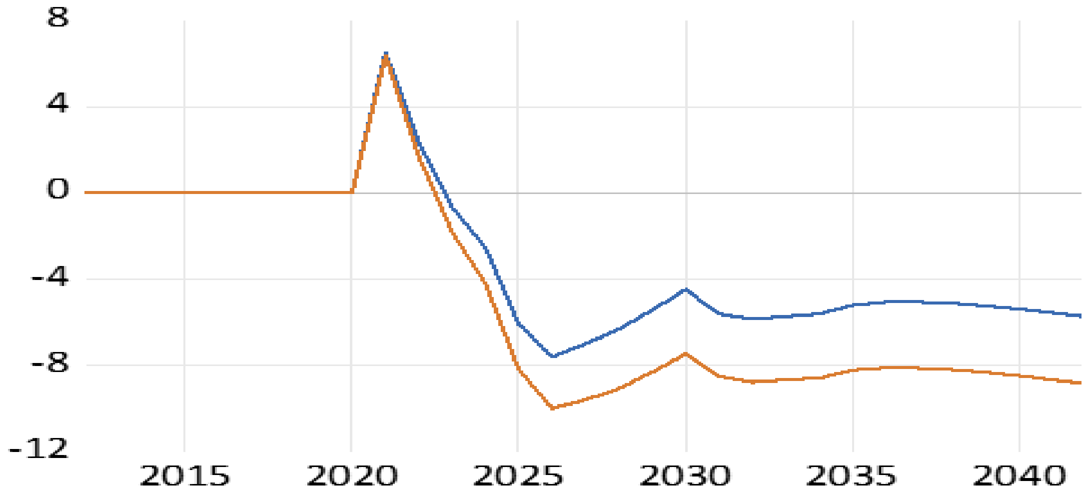
- Realizing the potential of multilateral trade and investment agreements

Green economy: subsidy savings and carbon tax revenue relieve fiscal pressure

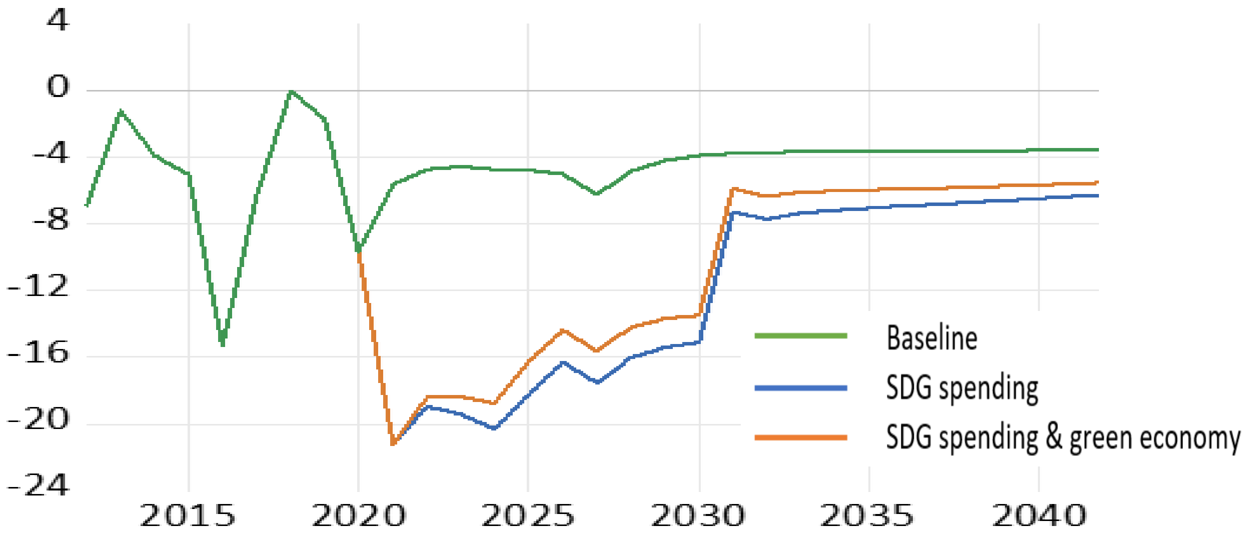
Output level (percentage change)



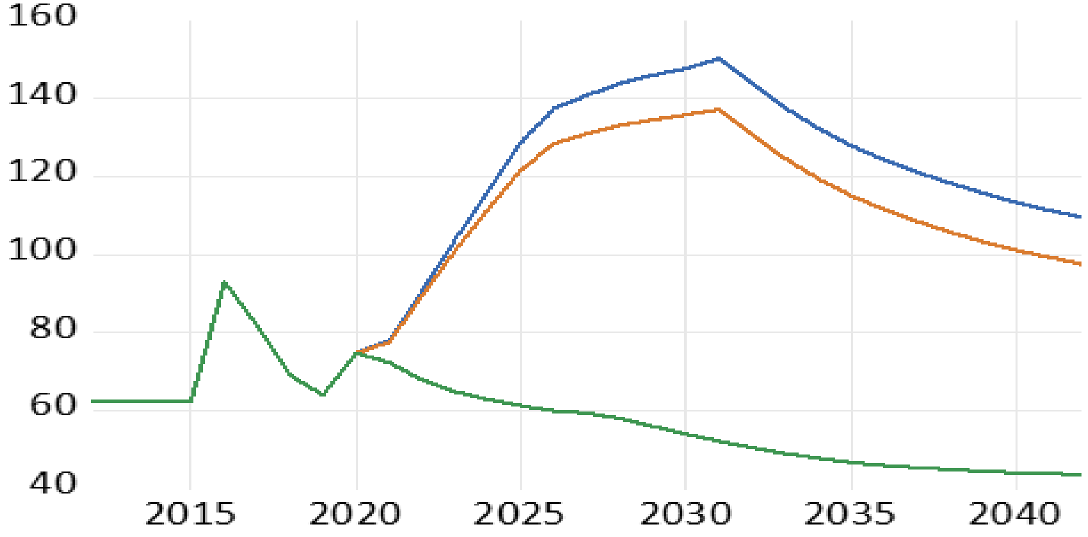
Carbon emissions (percentage change)



Fiscal balance (% of GDP)



Government debt (% of GDP)



National SDG financing strategies: boosting *fiscal space* and mobilizing *private finance* for development

Public finance

Boosting fiscal resources

- Introducing tax reforms
- Rationalizing subsidies to public pension system
- Issuing sovereign thematic bonds
- Increasing public spending efficiency

Maintaining fiscal stability

- Establishing a sovereign wealth fund
- Ensuring prudent fiscal management

Reducing public debt burden

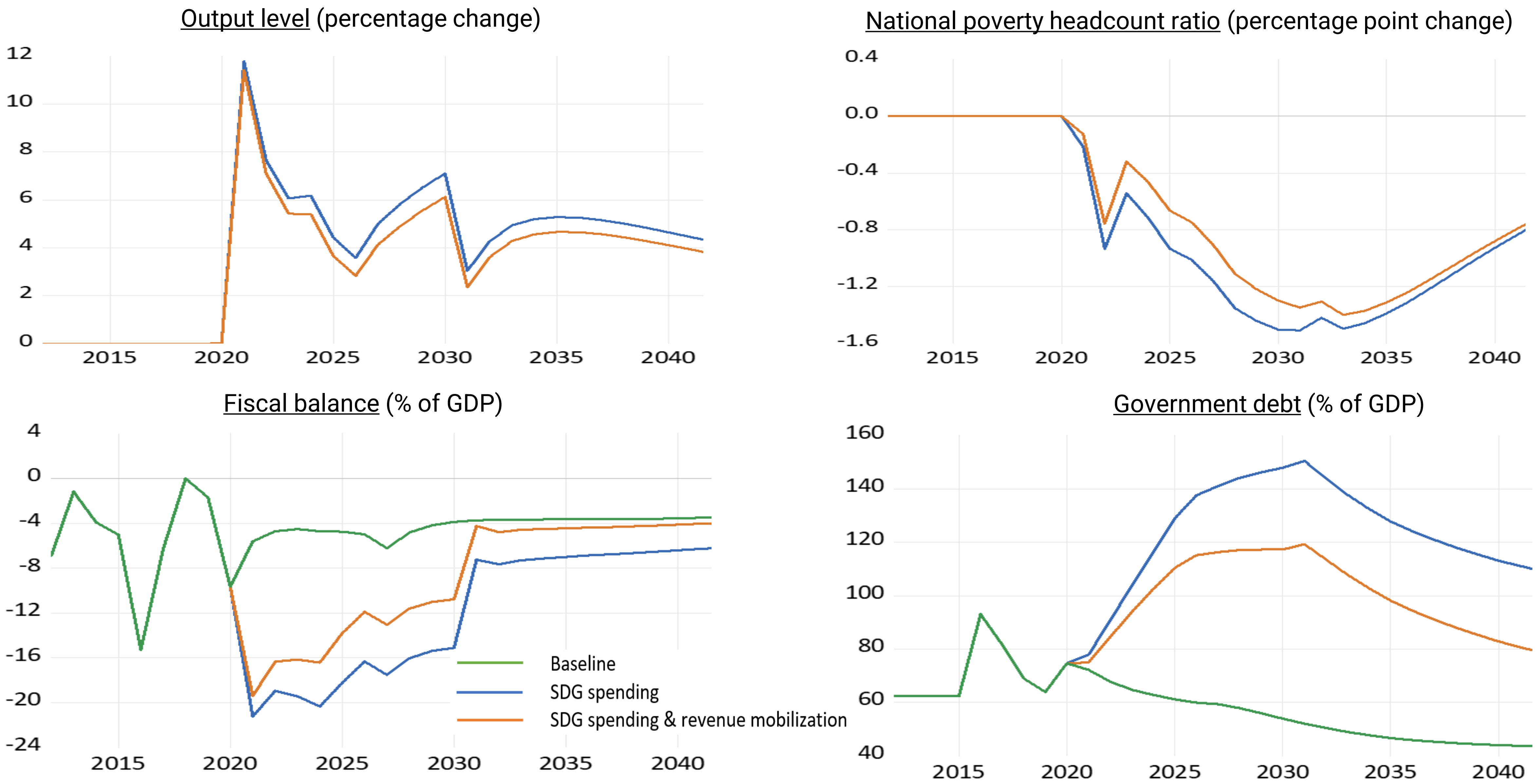
- Engaging with debt-for-climate swaps
- Improving public debt management

Private finance

Mobilizing private finance for development

- Improving policy framework on public-private partnership modality
- Aligning bank loans with sustainable development

Government revenue mobilization further reduces debt pressure



Stress tests: economic shocks and contingent liabilities

Commodity market

- Smaller global demand for and lower prices of coal

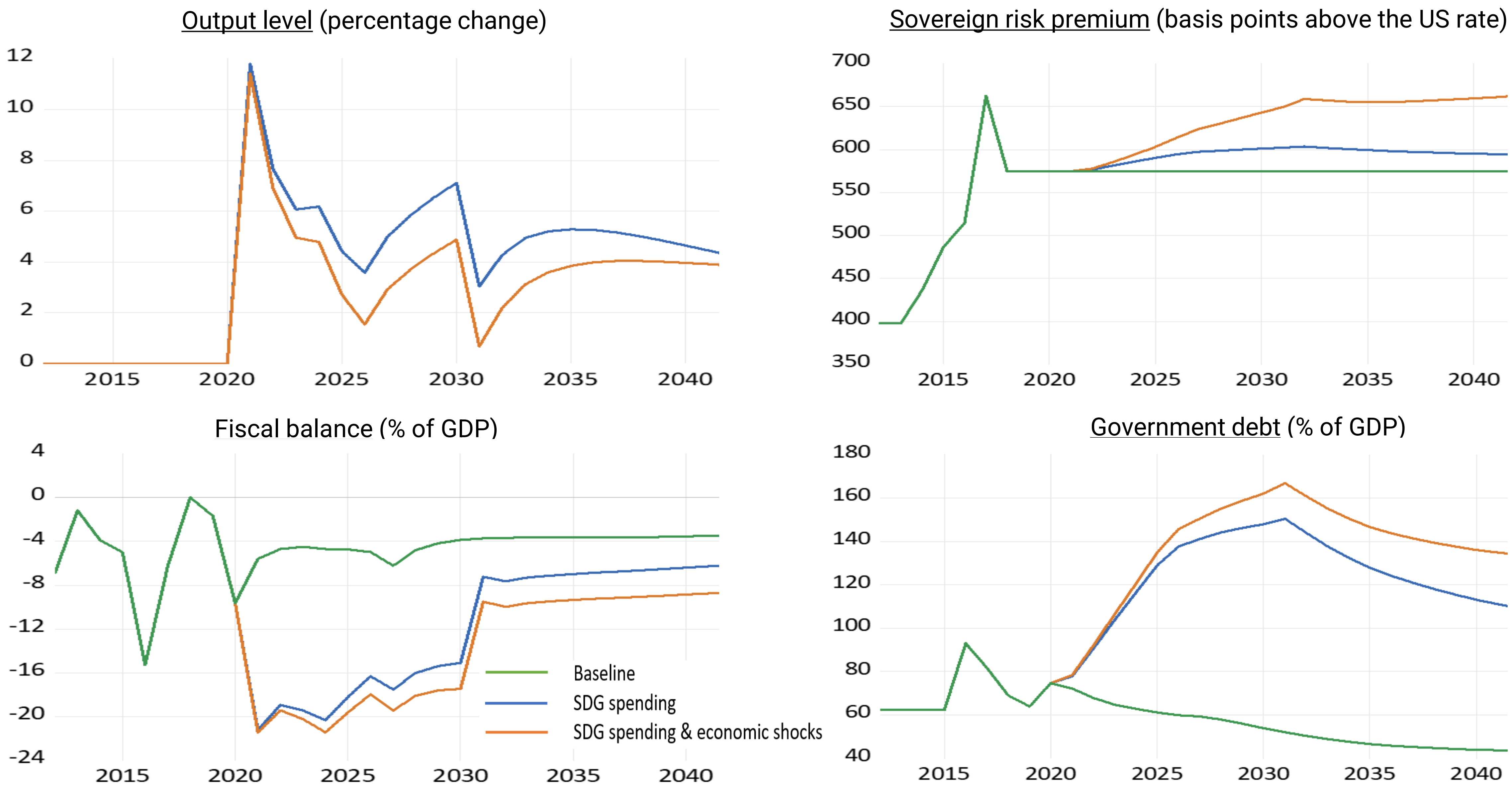
Macroeconomic shocks

- Slower output growth in China
- Weaker exchange rate
- Higher interest rates
- Heightened global economic uncertainty

Contingent liabilities

- Natural disaster shocks (dust storms, harsh winters)
- Financial bailout for commercial banks and national development banks

Lower coal demand and falling risk appetite raise government debt further



Next steps and key question

- Refine assumptions and carry out more scenarios for Mongolia
- Add an analysis on the second pilot country, likely Bangladesh
- Draw some policy implications, e.g.
  - **Navigating a balance between debt sustainability and development ambitions.** Financing strategies, including fiscal rules, often have unintended social and environmental costs.
  - **Private investors will play a significant role.** Public indebtedness could ease notably with active private participation in infrastructure projects (now assuming only 15-25% of total infrastructure investment)
- Is ESCAP's proposal on 'augmented' public debt sustainability analysis conceptually sound and implementable in the context of developing Asia-Pacific economies? How can it be improved?

Thank you

Macroeconomic Policy and Financing for Development Division

https://www.unescap.org/our-work/macroeconomic-policy-financing-development

sirimaneetham@un.org