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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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

- **Augmented public debt sustainability analysis**
  - **Additional SDG spending needs**
    - Government spending
    - Government investment
    - Private investment
  - **Structural development policies**
    - Deregulation
    - Institutional reforms
  - **National SDG financing strategies**
    - Tax and non-tax revenue policies
    - Government spending policies
    - Public debt management
    - Mobilizing private finance
  - **Stress tests**
    - Domestic and global economic shocks
    - Commodity prices
    - Fiscal contingent liabilities
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**

In trillion Mongolian Tugrik

As a share of GDP (per cent)

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

- **SDG 9: Industry, innovation and infrastructure**: 6.7%
- **SDG 7: Affordable and clean energy**: 2.1%
- **SDG 15: Life on land**: 1.6%
- **SDG 3: Good health and well-being**: 1.4%
- **SDG 13: Climate action**: 1.2%
- **SDG 11: Sustainable cities and communities**: 1.1%
- **SDG 4: Quality education**: 1.1%
- **SDG 6: Clean water and sanitation**: 0.8%
- **SDG 2: No hunger**: 0.6%
- **SDG 12: Responsible consumption and production**: 0.2%
- **SDG 10: Reduced inequalities**: 0.2%
- **SDG 1: No poverty**: 0.2%
- **SDG 8: Decent work and economic growth**: 0.1%

Source: UNDP
Socioeconomic and environmental gains of SDG spending: examples

**Additional SDG spending needs**

**Government current expenditures**

- Healthcare
  - Labour productivity
  - Real personal disposable income
  - Income equality
- Social protection
  - Income equality
- Environmental protection
  - Energy efficiency
  - Renewable energy price
  - Air pollution
  - Damage from climate shocks
- Other areas
  - Labour productivity
  - Income equality
  - Financial inclusion

**Government investment**

**Private investment**

**Overall productivity**

Source: ESCAP Macroeconomic Model.
SDG spending offers notable economic, social and environmental gains...

**Output level (percentage change)**

- SDG spending

**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

- Fiscal balance (% of GDP)
- Government debt (% of GDP)
- Sovereign risk premium (basis points above the US rate)
- Government interest payment (percentage change)
**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

- **Output level (percentage change)**
- **National poverty headcount ratio (percentage point change)**
- **Fiscal balance (% of GDP)**
- **Government debt (% of GDP)**

The diagrams illustrate the impact of government revenue mobilization on various indicators over time. The charts show changes in output level, national poverty headcount ratio, fiscal balance, and government debt, with specific changes highlighted for baseline, SDG spending, and SDG spending & revenue mobilization scenarios.
## Stress tests: economic shocks and contingent liabilities

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<th>Commodity market</th>
<th>Macroeconomic shocks</th>
<th>Contingent liabilities</th>
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| • Smaller global demand for and lower prices of coal | • Slower output growth in China  
• Weaker exchange rate  
• Higher interest rates  
• Heightened global economic uncertainty | • 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

Output level (percentage change)

Sovereign risk premium (basis points above the US rate)

Fiscal balance (% of GDP)

Government debt (% of GDP)

Baseline
SDG spending
SDG spending & economic shocks
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

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