Economic and Social Survey of Asia and the Pacific 2023

Rethinking Public Debt for the Sustainable Development Goals

HIGHLIGHTS

ESCAP 75
MOVING FORWARD TOGETHER

FOREWORD

António Guterres

Secretary-General of the United Nations

Our world is facing a rising tide of trouble.

The continuing war in Ukraine and a cost-of-living crisis have increased poverty and inequality, and deepened the socioeconomic scars left behind by the COVID-19 pandemic. Historically high inflation is undermining economic stability, while rising interest rates are adding to the fiscal and debt stress of developing economies at precisely the moment when they should be stepping up investments in the Sustainable Development Goals.

For Asia and the Pacific — home to 4.3 billion people, or three out of every five people on Earth — these crises are threatening to reverse years of development gains and hindering investments in an inclusive and sustainable future.

Growing post-pandemic public debt, together with weaker economic growth prospects and higher interest rates, have considerably increased the risk of public debt distress across the region.

The *Economic and Social Survey of Asia and the Pacific 2023* highlights a fundamental truth: recovery and development depend on equitably and sustainably managing debt, massive investments in the Sustainable Development Goals, and transforming the international financial system to make it fairer and more resilient.

This is why I have called for a fundamental reform of the international financial architecture and an SDG Stimulus to increase financing at the scale required to deliver on the 2030 Agenda for Sustainable Development.

Throughout, the United Nations will continue standing with countries across Asia and the Pacific to help them invest in a sustainable, inclusive and resilient future for their people.

KEY TAKEAWAYS

Economic activity in Asia and the Pacific is expected to remain weak amid high inflation, tighter financial conditions, fiscal stress and rising geopolitical risks. After a weak economic performance in 2022, average GDP growth is expected to rise moderately in 2023; however, this outlook remains uncertain and uneven across the region.

In going forward, fiscal policy management in support of the Sustainable Development Goals is a significant challenge. Required investment needs to attain the SDGs and climate ambitions are paramount. At the same time, rising government debt levels, higher financing costs and an uncertain economic outlook mean that the risk of public debt distress would be considerable in coming years.

There is a need to rethink the public debt-development nexus to effectively pursue sustainable development under current difficult economic conditions. The view that high debt levels are necessarily detrimental to economic growth has been challenged in recent years. At the same time, there is no consensus on the optimum level of public debt, and thresholds used for developing countries are often quite low.

A country's SDG investment needs and financing strategies and its structural development policies need to be incorporated into debt sustainability analysis. The *Survey* for 2023 proposes an augmented approach to analyse public debt sustainability in the long term, which supplements the current exclusive focus on reducing near-term debt distress that can compromise efforts to promote sustainable development.

While efficient fiscal and debt management can help ease debt distress, timely debt restructuring and effective debt resolution mechanisms are also needed. Ensuring fiscal transparency, productive public investments and effective resource mobilization is critical, same as pre-emptive, swift and adequate sovereign debt restructuring.

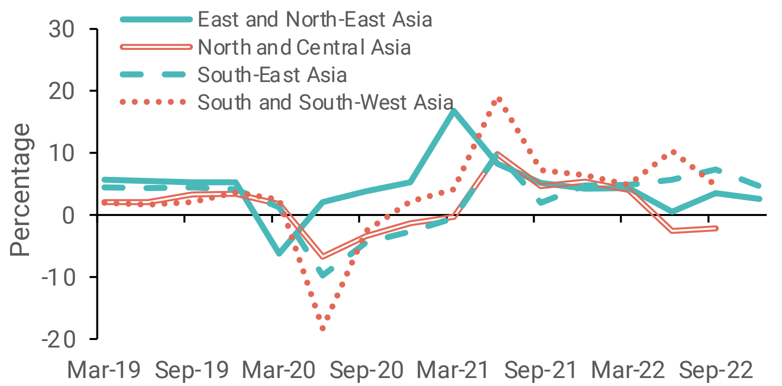
CHAPTER 1

MACROECONOMIC PERFORMANCE AND OUTLOOK IN ASIA AND THE PACIFIC

Growth moderated in 2022 and prospects remain weak in 2023-2024 amid a global slowdown, high inflation and war-induced uncertainty.

1

Quarterly real GDP growth in developing Asia-Pacific economies



Source: ESCAP, based on CEIC, accessed on 15 February 2023.

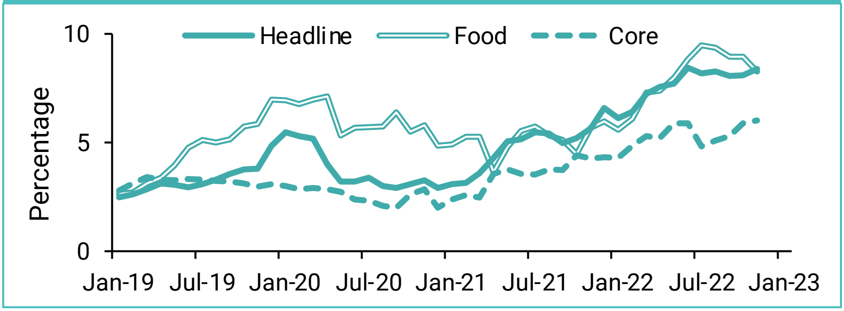
Note: Subregional aggregates are weighted averages based on 28 economies in Asia and the Pacific for which quarterly GDP data are available.

2

The rapid rise in inflation in 2022 due to both supply and demand factors have led to a high cost of living with large impacts on low-income households.

Rising price levels are driven by pandemic-related supply chain disruptions, the lagged effects of pandemic-related expansionary fiscal and monetary measures and the Ukraine war-related supply chain disruptions which led to rapid increases in prices for food, fuel and key commodities. Persisting inflation will require further monetary tightening. However, central banks must balance between maintaining price stability and supporting economic recovery.

Headline, core and food price inflation



Source: ESCAP, based on CEIC.

The risk of debt distress rises along with rising interest rates, which limits the scale of fiscal responses under the current economic downturn, as well as effective pursuit of SDGs.

3

Rapidly growing fiscal deficits have their mirror reflection in swiftly growing debt. Not surprisingly, several economies are and will be facing rising public debt sustainability challenges in the years to come, especially as rising interest rates push up debt servicing costs amid already tight fiscal space and weak economic growth prospects.

4

In going forward, countries need to ensure economic and financial stability through timely interest rate adjustments yet deploying targeted fiscal measures to address the higher cost of living. At the same time, long-term efforts are needed to ensure food and energy security.

CHAPTER 1

Infographics

MACROECONOMIC PERFORMANCE AND OUTLOOK FOR ASIA AND THE PACIFIC

WEAK GROWTH PROSPECTS

Economic growth outlook remains weak in 2023-2024 amid global slowdown, high inflation, and war-induced uncertainties.

Real GDP Growth

2021	7.3
2022	3.3
2023	4.2
2024	4.7

INFLATION PERSISTENCE AND POVERTY

Higher food and energy prices affect the poor more than others.

Inflation rate

2021	3.4
2022	7.6
2023	5.9
2024	4.4

GOING FORWARD, addressing the cost-of-living crisis requires timely monetary policy response, targeted fiscal support and sustained efforts to ensure food security.

CENTRAL BANKS FACING A DIFFICULT BALANCE

Ensuring price and economic stability while supporting post-pandemic economic recovery.

RISING RISK OF DEBT DISTRESS

Rising interest rates and lower growth is constraining fiscal and debt position, making it difficult to pursue SDGs and climate ambitions.

CHAPTER 2

REVISITING THE PUBLIC DEBT-DEVELOPMENT NEXUS

Eight years into implementing the 2030 Agenda for Sustainable Development, the Asia-Pacific region is not on track to achieve any of the Sustainable Development Goals.

1

Urgent action is therefore needed if countries are to come even close to achieving these Goals. In parallel with the SDGs, climate-related financing needs are expected to put significant strains on countries' public finances. Importantly, countries most exposed to climate change and facing the highest sustainable development needs are also those with the most limited fiscal space. Fiscal space cannot be increased only by raising tax revenues, as that would hamper economic growth and worsen inequality.

2

Since fiscal firepower will be key for countries to advance the 2030 Agenda, this complex and challenging situation calls for a rethink on the interaction between public debt and development financing.

The view that high debt levels are necessarily detrimental to economic growth has been challenged in recent years. On the other hand, development deficits and climate risks, if left unaddressed, will have serious implications for growth and the sustainability of public finance.

Public debt can be a powerful sustainable development tool, if used judiciously and with a long-term horizon.

3

The quantity and quality of debt-funded spending for development can be enhanced. In this regard, there is no consensus on the optimum level of public debt, and thresholds used for developing countries, which do not account for SDG financing needs, are often quite low. Therefore, the conventional debt sustainability assessment tools need a revamping to incorporate the impact of climate change and SDG investments on public finances and how this should impact debt assessments.

Infographics

REVISITING THE NEXUS BETWEEN PUBLIC DEBT AND DEVELOPMENT

1 Conventional Thinking

High public debt level **undermines economic growth and stability**.

There is a **common optimum public debt level** for different countries.

Bold **fiscal consolidation** is needed to reduce near-term fiscal risks.

2 Changing context in Asia and the Pacific

Huge spending needs to attain SDGs and climate goals.

Limited progress towards achieving the SDGs.

Rising climate risks weigh on public finances.

Rising public debt level amid weak economic prospects.

3 Revisiting the debt-development nexus

Public debt can be a powerful tool for development, if used judiciously.

Appropriate **public debt level is country-specific**, keeping in view the SDGs.

The optimal **public debt thresholds** advocated by international financial institutions **are too low**.

Need to **revamp conventional debt assessment tools** that have short-term horizon.

CHAPTER 3

PUBLIC DEBT PROFILES OF ASIA-PACIFIC ECONOMIES

Even before the COVID-19 pandemic, the Asia-Pacific region faced rising levels of government debt.

1

The average government debt-to-GDP ratio in developing countries in Asia and the Pacific was at an 11-year high of 40.6 per cent in 2019. Driven by large stimulus packages and declining government revenues, the pandemic pushed the region's average level of government debt up to 49.5 per cent of GDP in 2021, with two thirds of regional economies reaching the highest level of such debt since 2008.

2

An increasing number of countries in the region have been rated as facing a high risk of debt distress.

Based on the joint World Bank-IMF Debt Sustainability Framework for Low-income Countries or equivalent credit rating scores, 19 countries are rated at high risk of debt distress which thus would limit their development investment capacities.

A higher debt level does not necessarily translate into higher risk of debt distress, while some countries with low levels of debt can still face a high risk of debt distress. A thorough examination of public debt profile from multiple perspectives is needed to assess debt distress risk.

3

First, political stability is key. Second, debt-carrying capacity and fiscal position play an important role. Third, drivers and purposes of increasing debt are critical. Fourth, the composition of debt matters. Lastly, the conventional public debt sustainability analysis goes beyond debt and fiscal assessment.

CHAPTER 3

Infographics

PUBLIC DEBT PROFILE OF ASIA-PACIFIC ECONOMIES

Public debt in **2/3 of economies reached its highest level** since 2008.

The number of countries rated at **high risk** of debt distress **is increasing**.

19 countries are currently rated at **high risk of debt distress**,* but level of public debt is not the sole factor impacting public debt sustainability.

PUBLIC DEBT DISTRESS DEPENDS ON SEVERAL FACTORS:

MAIN DRIVERS AND PURPOSE

- Primary deficit
- Interest rate-growth differential
- Exchange rate

COMPOSITION

- External vs domestic debt
- Creditor profiles
- Foreign currency exposure
- Concessionality

Half of developing Asia-Pacific economies rely heavily on external debt

Rise of unconventional creditors

OTHER FACTORS

- Political stability
- Debt carrying capacity and fiscal position
- Macroeconomic strength
- Structural features
- Institutions and governance strength

**Based on the joint World Bank-IMF Debt Sustainability Framework for Low-Income Countries or equivalent credit ratings assessed by credit rating agencies.*

CHAPTER 4

RETHINKING PUBLIC DEBT SUSTAINABILITY FOR ACHIEVING THE SUSTAINABLE DEVELOPMENT GOALS

It is time for the policymakers and the international development community to rethink how this analysis should be undertaken amid an urgent need to pursue implementation of the 2030 Agenda for Sustainable Development and the rapidly changing global economic context.

1

As the current approach of public debt sustainability analysis heavily focuses on maintaining sustainable debt in the short term, it undermines Governments' ability to access financial resources and is inconsistent with a long-term journey towards implementation of the 2030 Agenda.

2

Given the lack of a long-term, holistic approach to assess public debt sustainability, the *Survey* for 2023 proposes an 'augmented' approach, which duly incorporates a country's SDG investment needs, a Government's structural development policies that go beyond financial investments, and national SDG financing strategies.

The analysis illustrates different trajectories of government debt level under different policy scenarios and adverse shocks. This helps policymakers to make an informed choice on how to strike a balance between maintaining public debt sustainability and achieving the SDGs.

While it is illustrated in the *Survey* that the benefits of SDG investment and economic reforms would help bring government debt down in the long run, a critical issue is whether relevant stakeholders (official and private creditors, credit rating agencies and financial markets in general) would be willing to understand and accept the transition period of a higher government debt level.

CHAPTER 4

Infographics

RETHINKING PUBLIC DEBT SUSTAINABILITY ANALYSIS FOR THE SUSTAINABLE DEVELOPMENT GOALS

WHERE WE STAND

Current approaches on public debt sustainability analysis focus on reducing near-term debt distress risks, thus undermining Governments' access to financial resources.

TIME TO RETHINK

Amid shrinking fiscal space and large spending needs to attain the SDGs and climate ambitions, it is time to revisit how public debt sustainability should be analysed.

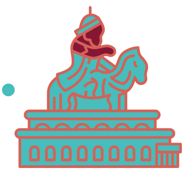
Economic and Social Survey of Asia and the Pacific 2023

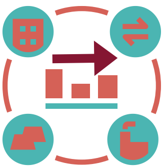
OUR PROPOSAL

ESCAP proposes an **augmented** approach that duly incorporates a country's SDG spending needs and financing strategies and structural development policies.

PROMISING EVIDENCE FOR MONGOLIA AS A PILOT COUNTRY

Government debt would eventually converge to the baseline level that assumes fiscal consolidation, but people and the environment are much better off here.





WHAT DOES THIS MEAN FOR ALL STAKEHOLDERS?

Creditors, credit rating agencies and markets should consider not only short-term perspectives. Debtors should strike a balance between the SDGs and debt sustainability.

CHAPTER 5

MANAGING SOVEREIGN DEBT SURGES: POLICY CONSIDERATIONS AND OPTIONS

Post-pandemic macroeconomic realities catch Asia-Pacific countries in a policy dilemma, with mounting sovereign borrowing costs and debt sustainability concerns on one side and persistent demand for public investment in economic recovery and sustainable development on the other. **1**

However, while not easy, opportunities for a better balance between fiscal prudence and long-term development considerations do exist.

2 **Three policy actions can enhance sovereign debt sustainability without sacrificing essential sustainable development spending.**

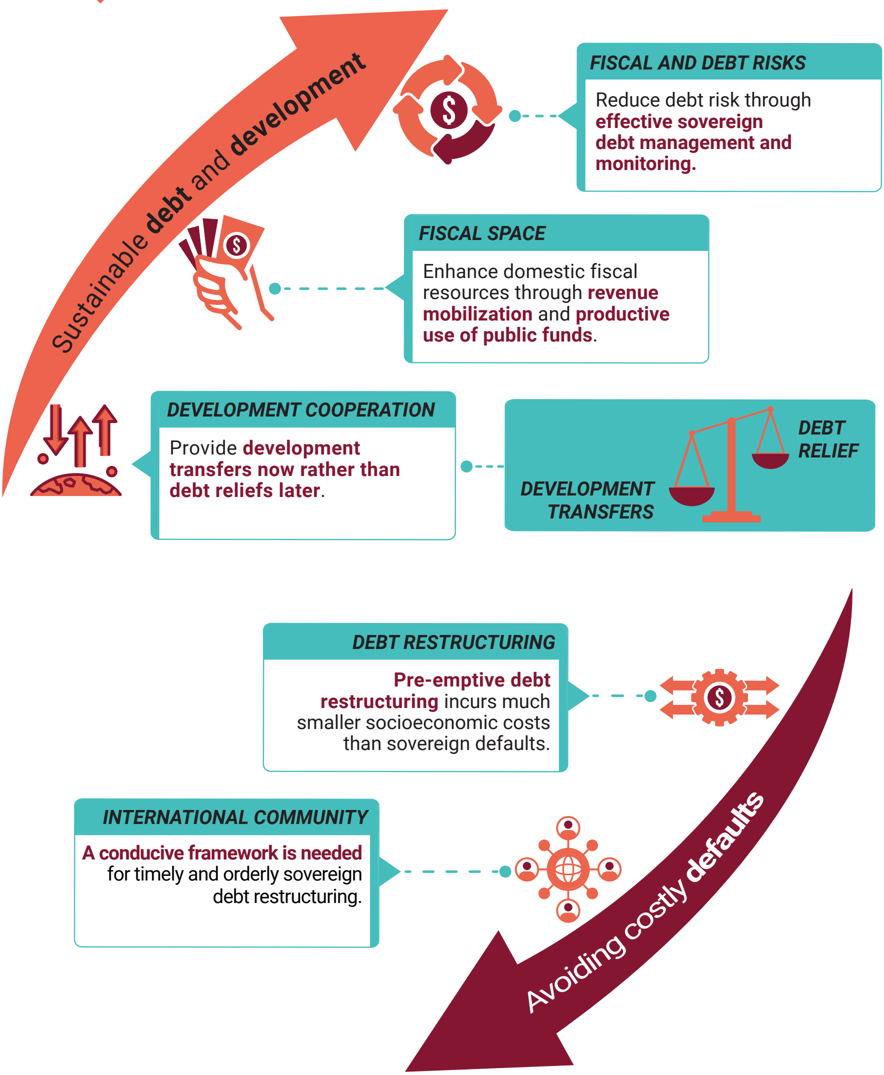
First, effective sovereign debt management and monitoring can reduce both debt distress risk and sovereign borrowing costs. **Second**, productive public investment and efficient public spending can boost debt sustainability and enhance development pay-offs. **Third**, strengthened domestic public revenue mobilization and significant increases in international development transfers can play a key role in addressing chronic debt overhang.

Preparation for timely and orderly sovereign debt restructuring is needed for worst-case scenarios. **3**

First, the G20 Common Framework for Debt Treatments should live up to its expectations as the only umbrella platform for international sovereign debt restructuring that brings together traditional and emerging market official creditors. **Second**, universal adoption of enhanced collective actions clauses in sovereign borrowing contracts can be accelerated, while recent innovations, such as “anti-vulture laws”, state-contingent debt instruments or debt for climate swaps, should be promoted. **Third**, international consensus-building on a common set of guidelines and standard practices for sovereign debt restructuring should be accelerated.

Infographics

POLICY OPTIONS FOR MANAGING PUBLIC DEBT SURGE



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Credits to Jastyn Alain Limon and Infinite Vision.

Post-pandemic recovery in developing Asia-Pacific economies in 2022 suffered severe impacts from the war in Ukraine and the global economic slowdown later in the year. Economic growth in 2023 is expected to remain weighed down by continuing geopolitical risks, recession fears and record-high inflation, although China's reopening is a positive development.

The region's growing public debt burden is likely to worsen with higher financing costs and slowing economies, making it difficult to step up public investment to power Asian and Pacific progress towards achieving the Sustainable Development Goals. Public debt can be a powerful development tool; the Economic and Social Survey of Asia and the Pacific 2023 argues and calls for rethinking debt sustainability. A large public debt is not necessarily detrimental to economic growth while fiscal consolidation and debt defaults can cause long-lasting damage to economic productivity.

The Survey proposes an "augmented" debt sustainability assessment approach to supplement the focus of international financial institutions and credit rating agencies on reducing near-term debt distress. National financing needs and structural development policies to achieve the Goals should be taken into account in determining a country's public debt sustainability. Inclusion of the socioeconomic and environmental benefits of public investment has been found to result in public debt reduction over the long term.

Sovereign debt restructuring is recommended for countries with elevated debt distress; accelerated progress is needed towards establishing common international debt restructuring frameworks, involving official and private creditors.

"...recovery and development depend on equitably and sustainably managing debt, massive investments in the Sustainable Development Goals and transforming the international financial system to make it fairer and more resilient."

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Secretary-General of the United Nations

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