Committee: Economic and Financial Committee

Issue: External debt sustainability and development

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Position: Deputy Chair

INTRODUCTION

External debt is a very common term used amongst economists. It refers to loans raised from outside a country in order to fulfill needs within an established community that the government cannot cover with its own budget. External debt types include money borrowed by one state from the government of another and foreign-owned corporate stocks and bills accumulated by citizens of one nation through a company that also operates in a foreign country[1]. In recent years, the extensive global financial unrest as the root of evil, has expedited the liberalization of universal movement of capital that is speculated to have an impact on national financial systems, as well as contributing to recession and debtor crisis.[2] In 2018, the World Bank issued their annual report, which stated that "net financial inflows climbed to $1.1 trillion", a number that has not been reported since 2013. For European countries, the accumulated average of external debt was recorded at 2.3%, while China scored 9.3% by the end of 2018. These are some indicative statistics to help

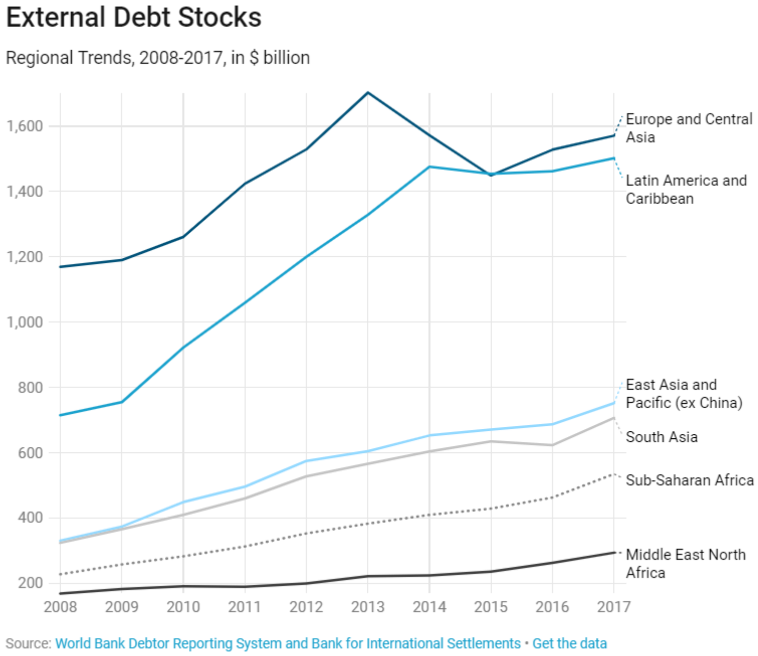

Figure 1, "Debtor Reporting System", World Bank, 2017

[1] "Definition of External Debt | What Is External Debt? External Debt Meaning." *The Economic Times*, https://economictimes.indiatimes.com/definition/external-debt

[2] *Imf.Org*, 2019, https://www.imf.org/external/pubs/ft/wp/2015/wp1588.pdf

comprehend the contemporary scale of the problem. [3]External obligations, of course, halt development for a very profound reason, that governments focus neither on speeding up development nor on encouraging sustainability. There could be a very reasonable solution for a fairer distribution of budget in order to meet development in all sectors of the industry, but for countries with external debt, there is no budget available. Debt that reaches such an extent that an inability to pay back previously acquired loans is reached is deemed as unsustainable, and it is strongly correlated with a country's GDP. Unsustainable debt leads to the unsustainable use of resources and, therefore, to an unsustainable society that is a part of the global goal of eliminating unsustainable means of living.

DEFINITION OF KEY TERMS

External debt [4]

As defined by the European Central Bank, external debt of a country represents the external liabilities and assets that are borrowed for a foreign lender with regard to banks, institutions, businesses and the government. Financial derivative contracts and equity transactions, however, are not included in external debt accounts.

Debt Relief [5]

Debt relief or debt cancellation is the forgiveness of a country's debt.

Recession

Six months of a country's failing GDP.

Sovereign Default [6]

[3] "International Debt Statistics 2019: External Debt Stocks at End-2017 Stood at over $7 Trillion." *World Bank Blogs*, https://blogs.worldbank.org/opendata/international-debt-statistics-2019-external-debt-stocks-end-2017-stood-over-7-trillion

[4] "Definition of External Debt | What Is External Debt? External Debt Meaning." *The Economic Times*, https://economictimes.indiatimes.com/definition/external-debt

[5] "DEBT RELIEF | Meaning in the Cambridge English Dictionary." *Cambridge Dictionary*, https://dictionary.cambridge.org/dictionary/english/debt-relief

[6] Kenton, Will. "Sovereign Default." *Investopedia*, Investopedia, 12 Mar. 2019, https://www.investopedia.com/terms/s/sovereign-default.asp

When a country fails to meet their assigned deadline for repaying debts, escaping liabilities without legal punishment, since countries are not subject to bankruptcy laws and are not held accountable for not being able to improve their liquidity positions.

External Debt Sustainability[7]

The IMF defines external debt sustainability as the ability of a country to meet its financial obligations without compromising national development goals

Gross Domestic Product (GDP)

A general measurement of a country's economic activity. It stands for Gross Domestic Product and refers to all the monetary activities of a nation over a specific period of time.

BACKGROUND INFORMATION

The Dawes Plan

External debt is not new. It is an economic phenomenon that has been around since the First World War. The Dawes Plan, the first major project that dealt with external debt, was put into action. What the Dawes Plan stated was that the constant borrowing of loans by indebted Germany from the US would be given as war reparations to Britain and France, and then Britain and France would pay the US back from money lent to them to support their military forces. This circle would continue for some years, until 1929 when it stopped being effective and a smaller scale plan was implemented, namely the Young Plan, that seemed to be working until the outbreak of the Second World War. The 1929 Wall Street crash also played a major role in external debt sustainability, since the US was of the biggest creditors in the interwar era, and the crash affected European countries and Japan which were solely basing their trade activity on US exchange of resources. One of the biggest debt crises that history recorded is the 1980s Latin American debt crisis. The crisis changed the US monetary policy significantly and increased interest rates in federal reserves. It is estimated that by 2008 the developing countries of the South repaid "a cumulative amount of US$7673.7 billion in external debt service", which would have been enough to pay their initial debt. Due to reckless debt management, Latin American countries increased their debt to US $3330 billion in 2006,

[7] World Bank, *Debt Sustainability,* https://siteresources.worldbank.org/DEC/Resources/KraayNehruDebtSustainabilityWBER.pdf

according to IMF, and as per today, these counties are left with a debt that is five times larger than in the 80s.[8] The main reason for this insane amount of loans waiting to be repaid is the creditor average return which is set by these countries and represents a percentage of 3.7% of national income.

The Brady Plan[9]

Growing polarization, abuse of the capitalist system and a series of financial crises all over the world increased that percentage to 6.2%, an amount that is very hard to repay if your country is going through a recession. The countries of the South were all considered to be emerging markets that would endorse the global economy, and they would do so if they were not covered in debt. This is where the Brady Plan, one of the most successful economic frameworks that dealt with LEDCs, less economically developed countries, and the global market, is implemented,. It was set up in 1990 following the Latin American debt crisis. Through the years 1980-1990 debtor nations and their national banks came up with numerous rescheduling systems, attempts to restore their sovereign debt and face their liquidity problems. The Brady plan was a risky move since it primarily dealt with US domestic economic stabilization - the implementation of such an international context might either have failed or proven fatal for the worldwide economy. The Brady Plan issued the following: firstly,all bank creditors would propose debt relief in exchange for larger collectability within the type of principal and interest collateral, secondly debt relief required to be linked to some assurance of economic reform and lastly, the issued debt ought to be extremely tradable, to permit creditors to diversify risk throughout the monetary and investment community. The rescheduling methods evolved on an individual basis, every one of the Brady issues was distinctive and tailor-made for each type of external debt. The only limitation was that these restrictions limited debtors to a minimum of 2 basic choices: the transfer of loans for either Par Bonds or Discount Bonds. The difference is that Par Bonds were issued by the exchange of loans for equity, with a constant and fixed below-the market interest rate, without reducing long-term loans. The Discount Bonds, on the other hand, were issued by the discounted

[8] Net Oxygen Sàrl. "Developing Countries' External Debt." - *Il N'y a Pas Un Monde Développé Et Un Monde Sous-Développé Mais Un Seul Monde Mal Développé*, 11 Nov. 2015, https://www.cetim.ch/developing-countries%E2%80%99-external-debt/

[9] *EM Background*, https://www.emta.org/template.aspx?id=35

exchange of equity between countries. The two systems were denominated in US dollars and additionally secured top-quality investment appraisals. The Brady Plan that expressed concerns with regard to the sustainability of sovereign external debt was proven to be very successful in various aspects. It enabled nations to negotiate substantial reductions that satisfied their national needs and succeeded in dispersing sovereign risk from commercial national banks. Lastly, it supported countless emerging markets to pursue economic reforms like strengthening microeconomic performance and privatizing the nature of companies, with the assistance of the new system, and access international capital markets in order to meet their needs. By all means, the Brady Plan was successful in targeting and solving many of the economic issues up until 2006. It paved the way to wider economic development and democratization of the markets and facilitated the re-appearance of LEDCs that dealt with the debt crisis, to the rising market economy.

United Nations Conference on Trade and Development (UNCTAD) [10]

While all this was taking place, the UN also launched UNCTAD in 1972. Up until today, UNCTAD holds annual debt Management Conferences that target technical assistance in developing countries. Moreover, in the 1970s it was granted access to the Paris Club, a club consisting of major creditor countries like the US, Japan and Switzerland, that came up with suitable debt treatments for indebted countries. It provides debt management services with the vision that they would improve their management of public liabilities through strengthening institutional capacity. Apart from that, the UNCTAD plays an important role in informing the world about debt issues, through the preparation of an annual report to the GA, including the Secretary-General, and it includes the latest statistics of emerging policy issues when it comes to sovereign debt. Its document "Selected Issues Relating to the Establishment of Common Norms in Future Debt Renegotiations" proposed extreme principles for debt re-evaluation and scheduling, including a detailed proposal for coming up with unique techniques that would favor each nation specifically.

[10] "Debt and Development Finances." *Unctad*,https://debt-and-finance.unctad.org/Pages/History.aspx

Heavily Indebted Poor Countries (HIPC) Initiative [11]

The Initiative was established in 1999 as a suggestion by the IDA and the IMF. It is a platform that enables nations to sign up and qualify for bigger debt reliefs. Its main principles are to strengthen debt cancellation and poverty eradication efforts. Due to the increasing world poverty, HIPC's debt service is estimated to be around $44 billion USD, but the Initiative has helped at least 29 countries to pay their debts between 1999 and 2005, while also increasing their poverty expenditures from 5% to 7%, reaching an amount of $15 billion USD, which is five times more than the debt-service payments they provide. The sustainable management of debt department has set a number of goals to be achieved by the UNCTAD, namely the tracking of reforms imposed to HIPCs through an annual report, the reduction of public finances and ensuring participating creditors reduce foreign dependence.

UN landmark resolution in 2015 [12]

In 2015, the United Nations adopted a groundbreaking resolution that was submitted in 2014 by South Africa, the preceding chair of the Group of 77, and China as a developing country. Initiated by Argentina, sovereign debt increases in those countries targeted what economists call "vulture funds", referring to investment assets which issue bonds at a discount on the secondary markets, in order to be used for repayments, with the main creditors being British and US courts. The resolution re-assessed the geopolitical motive in developing countries in order to help them increase the stability and management of their sovereign debt, by strengthening the international financial system. Although the resolution does not target establishing a new legal mechanism, it outlines nine principles that should be taken into account when addressing sovereign debt, namely good faith, sovereignty, transparency, impartiality, sovereign immunity, legitimacy, equitable treatment, sustainability and majority restructuring. These principles, if implemented, could lead to a win-win situation for developing countries, with regard to debtors and creditors. UNCTAD also argued that it was

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[11] "Heavily Indebted Poor Country (HIPC) Initiative." *World Bank*, http://www.worldbank.org/en/topic/debt/brief/hipc

[12] "Committee for the Abolition of Illegitimate Debt." *UN Adopts Landmark Debt Resolution on Principles for Sovereign Debt Restructuring*, http://www.cadtm.org/UN-adopts-landmark-debt-resolution

quite unusual that no international measures had ever been proposed, in order to apply to as many countries as they could, when times of economic crisis affected the whole globe.

Effects of External Debt

The effects of external debt can prove to be very destructive for a country's economy. Excessive lending and borrowing can lead to what economists refer to as "over-confidence", where there is constant borrowing for domestic use, and equally constant lending without careful evaluation of possible problems arising. Effects of this kind of constant borrowing vary from the inability to service huge stocks of external debt, to posing as a worldwide threat by rising interest rates globally, due to "polarization of external debt positions", as stated by the Organization for Economic Co-operation and Development (OECD). It can also result in the sudden devaluation of a country's exchange rate that automatically increases the value of interest payments in USD. External debt also affects trade, as the commodity prices decline posing a threat to export earnings due to the immediate decline in terms of trade. This can also reduce the GDP of a country as a result of a recession, due to the fact that the monetary payments are only considered as outflows and not inflows, and in that way, economic development is not possible. In all cases, external debt acts as a chain reaction, with the one effect cumulatively leading to the other. The struggle of a country to repay its interest payments will lead to it borrowing and then having to repay, but then the amount of funds the government has to invest in improving domestically is insufficient and the country ends up underdeveloped. This is what has happened to a lot of Sub Saharan Africa countries.Due to constant rises in external debt ratios, the creditors are reluctant to offer cheaper rates, because they will simply not be enough to help repay foreign investors. [13]

MAJOR COUNTRIES AND ORGANISATIONS INVOLVED

IMF [14]

[13] Pettinger, Tejvan. "Problems of External Debt." *Economics Help*, https://www.economicshelp.org/blog/14874/debt/problems-of-external-debt/

[14] "External Debt Statistics Guide and the IMF." *International Monetary Fund*, https://www.imf.org/external/np/sta/ed/ed.htm

Apart from the HIPC initiative, the International Monetary Fund has also developed an annual report, the Debt Sustainability Analysis, widely referred to as the DSA. Through the DSA, the IMF is able to assess the current worldwide debt situation every year. It can also identify weak spots in the debt-combating strategies of each country and suggest a suitable alternative policy.

World Bank [15]

The World Bank has developed an institute with a separate legal identity, called the IDA, standing for the International Development Association. The association specifically targets borrowing countries that have not received debt relief and assists them with health services, water, sanitation, and education programs. Apart from helping these countries in the essential sectors, the IDA also acts as a stable source of funding of the development priorities of borrowing countries, in order to support the economy and eventually relieve the country of its financial obligations.

Indonesia [16]

The trade war between Indonesia, China, and the US seems to have had quite an impact on Indonesian asset position, disturbing economic resilience and external macroeconomic sustainability. However, the trade war, combined with Indonesia's external debt, did not stop these countries from continuing to work on meeting their development goals, as the Indonesian President pressured local corporations to suggest policy alternations to overcome the shortages brought about by the trade war and pending financial repayments to China, and to focus on development.

China [17]

China contributes to rising worldwide debt. It is widely known that the Chinese government does not believe in transparency when issuing loans. Lending to other countries is speculated to be higher than reported, resulting in what is referred to as "hidden debt". It is affecting

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[15] International Monetary Fund, et al. "External Debt: Definition, Statistical Coverage, and Methodology." *External Debt: Definition, Statistical Coverage, and Methodology (English) | The World Bank*, 1 July 2010, http://documents.worldbank.org/curated/en/193061468782370806/External-debt-definition-statistical-coverage-and-methodology

[16] "Indonesia's Foreign Reserves Drop by $4b After External Debt Payment." *Jakarta Globe*, https://jakartaglobe.id/context/indonesias-foreign-reserves-drop-by-4b-after-external-debt-payment

[17] Weizent. "China's Loans to Other Countries Are Causing 'Hidden' Debt. That May Be a Problem." *CNBC*, CNBC, 12 June 2019, https://www.cnbc.com/2019/06/12/chinas-loans-causing-hidden-debt-risk-to-economies.html

investors on a great scale because they are thought to have lower debt levels than what they appear to have. It affects the annual DSA and the borrowing strategies are not deemed effective.

Ghana [18]

Ghana relies heavily on foreign investors, a significant action that counteracts a country's ability to maintain a stable economy. Total external debt in Ghana and its constant rise reflect the exchange rate performance of the country. Ghana's investments in foreign stocks halts national developments, which is critical for Ghana, and this results in income shortfalls while the borrowing requirement is constantly increasing.

Kenya [19]

Kenya is in Sub-Saharan Africa, and it is a country classified as an HIPC. Its external debts have made it extremely difficult for it to develop internally, and its debt dates back to 1990. Since 2018, its debt has risen to 5.5 trillion, a level that should be urgently confronted. The World Bank issued a 75 million dollar loan and although it claims it is not enough to cover Kenya's skyrocketing debt, it is budgetary support at the expense of other projects that should have been funded. Most of the funds need to be used in infrastructure development to facilitate more jobs for Kenyans and transportation of goods, so the country can develop without asking for more small interest loans.

TIMELINE OF EVENTS

Date	Description of event
1924	The first big-scale external debt arrangement, called the Dawes Plan, focusing on how Germany should proceed with paying WW1 reparations.
1929	The Young Plan, the second big reparation attempt since the above failed, managed to reduce Germany's debt slightly more.

[18] Jones, Tim. "Ghana's Debt Situation Worsens as Lenders Continue to Be Bailed Out." *Jubilee Debt Campaign UK*, 21 May 2018, https://jubileedebt.org.uk/blog/ghanas-debt-situation-worsens-as-lenders-continue-to-be-bailed-ou

[19] "World Bank Grants Kenya $750m Loan." *The East African*, 30 May 2019, https://www.theeastafrican.co.ke/business/Kenya-debt-rises-as-World-Bank-approves-loan/2560-5137536-142domr/index.html

1953	The London Agreement dealt with leftover debt from WW2 and restored European economy by decreasing German debt to 3%.
1996	The HIPC Initiative was launched by the IMF and the World Bank, a plan to help poor countries to be relieved from unsustainable debts.
2005	The Multilateral Debt Relief Initiative was proposed by the Group of 8 and aimed at canceling 100% of their debt imposed on HIPCs.
2008-2009	Global Financial Crisis
2013	Swelling fiscal deficits drown Sub-Saharan Africa and the Paris Club addresses the "OECD Principles and Guidelines to Promote Sustainable Lending Practices in the Provision of Official Export Credits to Low-Income Countries"
2015	UNCTAD issues a major report on debt sustainability and development that explains in depth the roots of the problem and deals with regulating debt service or the private sector since the financial crisis.

UN INVOLVEMENT: RELEVANT RESOLUTIONS, TREATIES, AND EVENTS

Resolution 72/204, 2018: [20] Stresses global collaboration and the creation of flexible regulatory measures, particularly focusing on the implementation of the Paris Agreement. It further emphasizes the importance of underpinning growth through debt sustainability and reminds that every country should contribute to a case-by-case basis to prevent the global economy from collapsing.

Resolution 69/313, 2015: [21] assist developing countries in attaining long-term debt sustainability through concentrated policies aimed at fostering debt financing, continue to support HIPCs to complete related processes. Further addresses that there should be cohesive

[20] *Untitled document,* https://undocs.org/A/RES/69/313
[21] *Untitled document,* https://undocs.org/A/RES/71/216

sustainable development strategies owned by each nation, in order to finance research and pro-poor initiatives.

Resolution 71/216, 2016: [22] Underlines the importance of having multiple reports synthesized by multiple media in order to better understand the debt position of a country, and to make the indicative means more effective in employing the best sustainability means. It also addresses creditors to provide flexibility to debtor nations, particularly affected by natural disasters, e.g. Indonesia, and to take into account their socio-economic conditions.

PREVIOUS ATTEMPTS TO SOLVE THE ISSUE

Establishment of the Paris Club [23]

The Paris Club was established in 1958. It is a strategic instrument that along with the IMF and World Bank, tried to help developing countries "maintain a grip on the world's stability". Every time, the Club would try to renegotiate the debt issued by developing countries if they had trouble paying it off. The Paris Club, however, was considered a failure, since they only managed to sign 30 agreements. Between 1981 and 2005, 83 debtor countries signed and others like Senegal, Madagascar, and DRC ended up appearing more than 15 times but their debts were never cleared. Overall, the Club managed to cancel over $500 billion USD.

1994 Naples Terms [24]

The Naples Terms were a set of policies introduced by the Club. The terms stated that poor countries and the most indebted ones could have their debt erased by at least 50% and sometimes by 67% at net present value (NPV). Later on, they agreed that every cancelation would start at 67% after investigating the NPV. The project paid off and as of July 2007, more than 35 countries have benefited from the terms.

Debt Reduction Facility: [25]

[22] *Untitled document,* https://undocs.org/A/RES/72/204
[23] *What Is the Paris Club*? http://www.cadtm.org/spip.php?page=imprimer&id_article=13507

[24] *Untitled Document*, https://vi.unctad.org/debt/debt/m3/Naples.htm
[25] *Factsheet The Multilateral Debt Relief Initiative*, https://www.imf.org/external/np/exr/facts/mdri.htm

The World Bank set up a new facility of $100 million in 1989, in order to provide funds to poor countries that were adjusting structurally in order to endorse the commercial exchange of debt for a small percentage of face value. It failed because only debtor countries were in need of it and already had access to IDA and the number of funds available for distribution was $10 million.

Debt Cancellation [26]

In July 2012, the United Nations introduced Index Loan Repayments, a plan where the interest rate is equivalent to a country's growth resulting from exports. This way, the balance between debtors and creditors would reduced to reasonable levels. The country would eventually increase its GDP and would be able to pay back their debts.

POSSIBLE SOLUTIONS

Reporting

The primary responsibility for targeting debt vulnerabilities within a country lies with borrowers. Economically weakened countries are able to take determined action to prevent their fragile economies from collapsing. Countries are able to have a sound macro-economic policy framework established. Also, to make sure that risks are detected and self-addressed, countries will need to strengthen debt recording, observation, and reportage, and enhance their debt management capacity and understanding. Building the capability to spot and manage business enterprise risks from contingent liabilities will be important as several countries are embarking on massive public infrastructure investments through SOEs and are making hyperbolic use of PPPs. New borrowing policies ought to be thought of as just investment and come with incredibly high rates of debt and victimization business enterprise risk management tools. Lowering debt vulnerabilities will also hinge on enhancing domestic revenue development, raising the potency of public defrayment and therefore the implementation of prudent business enterprise and

[26] https://unstats.un.org/unsd/nationalaccount/docs/External_debt_statistics_guide.pdf

medium-term debt management, while building external and fiscal buffers and promoting growth-enhancing structural reforms.

Strengthening debt transparency

By strengthening debt transparency, countries will have a more complete picture of their debt. It will grant the government access to IMF data that is collected or already disseminated from within this framework- accessibility and the use of data will be encouraged so that countries can compile their statistical standards. It will also encourage countries to reach out to their creditors. A platform such as the one trying to be created by the IMF will act as a mediator between creditor and debtor and will help with the disclosure of lending initiatives. Also, the need to strengthen information-sharing and transparency is to ensure that DSAs are based on comprehensive, objective and reliable data, including an assessment of national public and private debt. This ensures the achievement of development goals and, above all, endorses the mutual exchange of information on a voluntary basis, and the borrowing and lending among all creditors and borrowers.

Mobilizing resources in indebted countries

By mobilizing resources in indebted countries, internal growth and independence from external sources of finance are supported. This could be possible by sending voluntary bodies in HIPCs consisting of scientists, economists and engineers to help with infrastructure by teaching locals how to manage their businesses. Scientists can help with internal development by any means they have available within the country, and economists can help the country manage their debt in a way that it would not require external loans.

Securitization of Debt

In order to free world markets from the debt trap, we need to focus on banks that value their corporate reputation way more than the promotion of integrity of the national system, from unthoughtfully granting non-repayable loans. Through granting these loans, banks imply that it is not possible for a country to repay part of the loan, although it is legally acceptable, but should repay it in one go. The act of securitizing refers to the portion of the loan that can be repaid, or sold to the open market, in a way that converts the loan to a bond that is backed by outstanding debt. Banks can regulate their loan action this way and determine the NPV of unpaid loans in HIPCs.

Privatization[27]

Shrinking the public sector of a country means shrinking public expenses that publically-run projects would require. By reducing the size of the public sector, indebted nations strengthen their capital output and stimulate growth. Apart from growth, privatization helps with strengthening the liquidity of a nation because there are more available shares that can facilitate development.

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