MUNESCO

Forum: Executive Board 2
Issue: The question of decreasing external debt to elevate growth and development
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Introduction

External debt is basically the kind of debt in which the lending party is not a part of the borrower's economy. As economic welfare is a crucial aspect of development and as debt can help countries proceed with their measures until they become fully developed and in many cases external debt is considered as a step for development. Although to a certain extent it is considered to have a positive impact on development, after it exceeds its threshold and creates a situation which is called "debt overhang", the debt starts to negatively impact the development. In these cases, states end up in a situation where they borrow more and more to deal with their debts and even if they don't borrow, they generally can't improve their economies to have a state of economic welfare. Additionally, when the country seeks for ways out of the overhang, their development inevitably delays as states -especially the developing ones- can't deal with such a complicated issue whilst improving their policies on their own. That is why external debt is an issue that should be properly managed in order to advance development.

Definition of Key Terms

External debt: External debt is defined as "the outstanding amount of those actual current, and not contingent, liabilities that require payment(s) of principal and/or interest by the debtor at some point(s) in the future and that are owed to non-residents by residents of an economy" [1] In other words when a state borrows money from another party which is not a resident of the state or which does not participate in that state's economy, the situation is defined as external debt.

Debt sustainability: In a situation where debt is sustainable "a borrower is expected to be able to continue servicing its debts without an unrealistically large future correction to the balance of income and expenditure" [2]

Non-financial corporate debt: Non-financial corporate debt is a kind of debt when the borrower is not a financial institution but rather a non-financial one like a government agency.

Debt overhang: Generally it is considered that a certain amount of debt is actually beneficial for sustainable growth. However after the debt to GDP ratio exceeds a certain amount debt causes a delay in development. This point is defined as the threshold for debt overhang.

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[1] https://www.imf.org/external/pubs/ft/eds/Eng/Guide/file2.pdf

[2] https://www.imf.org/external/pubs/ft/wp/2002/wp0269.pdf

It is stated by Kofi Annan in 2005 that "the level of debt that allows a country to achieve the Millennium Development Goals and reach 2015 without an increase in debt ratios"[3]

Sustainable Development: sustainable development can be considered as development and economic growth that doesn't have a negative social or environmental impact or more specifically the kind of development that complies with the Sustainable Development Goals.

Economic Welfare: Generally the term economic welfare is used to define the sustainability of a state's/ individual's economy. According to UN standards and definitions, the statistical data that defines economic welfare is measured by taking into consideration "the total output, including the investments, the Gross National Product and deductions like environmental damage"[4] As developing states aim to have a state of economic welfare, they tend to borrow money. However, in cases of debt overhang the debt basically becomes an obstacle that eliminates economic welfare.

Background Information

After the first half of 1990s, when many developing states borrowed money from non-residents, in the second half of the decade, policy makers and public observers came to the realization that external debt had a negative effect on development.

Before 1990s, it was believed that in order to develop, the developing countries had to owe non-residents a certain amount of money which would be paid back after their goals were achieved. Since the existence of the relation between development and external debt was recognized, however, a great amount of research has been conducted and today the concept of external debt for development is much more complicated than just burrowing endlessly and paying back in the future.

[3] https://undocs.org/A/73/180

[4] https://unstats.un.org/unsd/environmentgl/gesform.asp?getitem=745

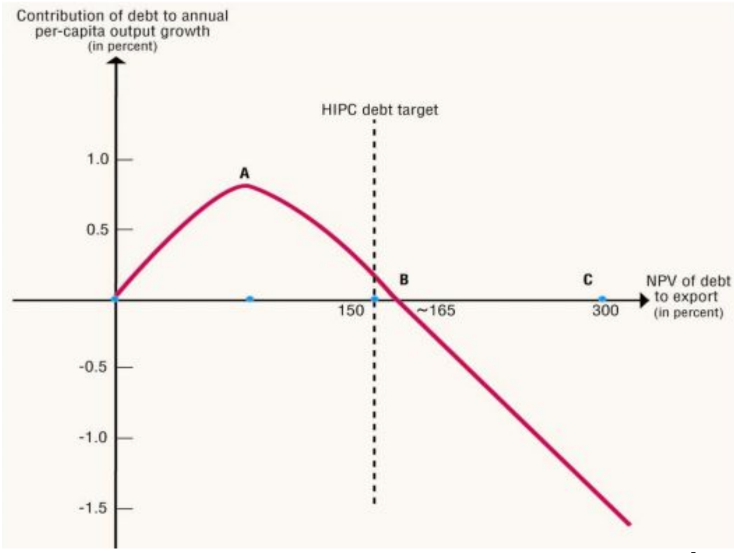

Figure 1. The relation between development and debt [5]

The relation between external debt and development is now known to be non-linear, which means that it can neither be said that development is always enhanced as debt increases nor it always delays. As seen in the Figure 1 until some point debt has a positive effect on development yet after that point it starts to affect growth negatively. This point that changes the effect is the threshold that is explained in the previous part. As it can also be observed in the figure, until there is a debt overhang, the situation is healthy, maybe even inevitable for development, but after the debt overhang it becomes a problem with its severe consequences.

Causes of the developing countries' need for external debt and why they end up in an overhang:

It wouldn't be very accurate to say that only developing countries deal with external debt as developed ones deal with them as well. However, inarguably developing countries are the ones that tend to end up in an overhang and they are also the ones that struggle more trying to avoid it. Hence, it is crucial to address the reasons why developing countries need external debt and the reasons why they seem to burrow more and more as time passes by.

First of all, developing countries usually try to become a part of global market and thus their integration to the market is hasty. This makes their economies more vulnerable to fluctuate rapidly in certain scenarios. Also as they are in the process of becoming an important part of the global market their economic policies are easily affected by the ones of developed states. Additionally, developing countries are not the only states that are trying to achieve Sustainable Development Goals (SDGs) meaning that even the most developed countries are in the need to develop more especially economically whether it is increasing the wages or encouraging investments. These efforts of developed countries often rely on the vulnerability of the developing ones. Last but not the least, with conditions like the volatile commodity prices, it can without a doubt be said that the

[5] https://pdfs.semanticscholar.org/58f7/5ac1edb5332517c1bf75397c50caf7f7e272.pdf

current economic environment does not facilitate the growth of developing countries causing them to need external debt.

For these reasons and many more internal ones, developing countries end up owing money to a non-resident party. As the conditions trigger them to do, they continue burrowing more and more and in the end they reach a debt overhang. Once they exceed the threshold, it is almost impossible for them not to end up in a debt crisis considering problems such as being unable to print the required currency in order to repay the debt.

Debt overhang and how countries can save themselves:

According to the basic principles of debt as a concept, it is regarded that when debt is being repaid, not all budget of the borrower must be used and some income must be saved. In case of an external debt, this situation requires an increase in GDP. This becomes a hardship in case of a debt overhang as in that case the debt only affects development negatively.

That is why in debt overhang situations governments should seek for ways to decrease their expenditures or increase their income. The most common ways that are used are:
-reducing government expenditures such as public wages
-raising taxes
-increasing GDP
-privatization

However, as it can be comprehended, some of these ways may lead to negative public response, which may lead to more delay in development. All in all, debt overhang is a situation that is very problematic and although countries can get out of it, getting out of it comes with its own hardships and even if they get out they most probably delay their development in one way or another.

Timeline of Major Events

1950s	Paris Club was established after the World War II which may be considered as the first attempt to create an international framework that applied for external debt
1970s	The UNCTAD started working on issues that concerned debt
1982	Mexico was the first country to suspend its loans for paying back its debts and this caused a debt crisis.

1993	The World Bank released a list of countries that were struggling with debt
1990s	The relation between external dept and development was recognized.
December 21, 2001	The first GA resolution upon external debt and development was established.
November 18, 2004	Witth the cooperation of the IMF and the World Bank, the World Bank Quarterly External Debt Statistics was established.
March 30, 2006	The Joint External Debt Hub was developed by the World Bank, IMF, OECD and BIS
2013	The most recent External Debt Statistics Guideline was published

Major Countries and Organizations Involved

Small Island Developing States (SIDs):

SIDs are definitely affected by the issue significantly. As these countries generally have middle-incomes they tend to get involved with external debt. Yet they also have one more thing in common: their geographical conditions are risky and likely to be affected by climate change. Thus, they are vulnerable for natural hazards. In case of a natural hazard, these countries also tend to seek for emergency loans. To conclude, SIDs are a high risk group for debt overhang.

International Monetary Fund (IMF):

Being one of the major contributors of “External Debt Statistics: Guide of Compilers and Users”, IMF is an organization that is predominantly involved in the issue. IMF mainly accumulates and provides reliable statistics regarding external debt and additionally it is also an organization that takes part in the promotion of sustainable development as it fosters inclusion, aims to tackle corruption, tries to reduce poverty and unemployment, engages in environmental actions and last but not the least financially supports the implementation of these goals as a whole.

IMF also works with other organizations such as the World Bank, BIS and OECD in order to provide more reliable data and ease the access to these data.

World Bank:

Just like IMF, World Bank is also one of the contributors of the External Debt Statistics Guideline. The World Bank controls the “World Bank Quarterly External Debt Statistics”, a database that was launched by the IMF and itself, and also provides data for the Joint External Debt Hub.

World Bank also aids the implementation of SDGs by financing them and prioritizing social and environmental criteria set in SDGs while deciding upon its strategies.

Paris Club:

Although not all governments are a part of it and although it doesn’t cover the debts involving private parties, Paris Club is an important institution regarding the issue. Paris Club aims to facilitate debt restructuring for countries who are going through a debt crisis.

UNCTAD:

UNCTAD is one of the most relevant UN agencies that works on external debt and development. UNCTAD has an Ad hoc Group of Experts on External Debt Problems of Developing Countries. Moreover, it has set principles for sovereign lending and borrowing which explains the responsibilities of the parties in detail.

Previous Attempts to Solve the Issue

General Assembly Resolutions

A/RES/56/184(2001), A/RES/57/240 (2002)on “Enhancing international cooperation towards a durable solution to the external debt problems of developing countries”

These resolutions recognized the negative effect of debt on sustainable development, highlighted the importance of debt relief and sustainable debt financing including the responsibilities of both parties and requested cooperation between developing and developed states. Additionally post-conflict situations were underlined.

A/RES/58/203(2003), A/RES/59/223 (2004), A/RES/60/187(2005), A/RES/61/188(2006) on “External debt crisis and development”

These resolutions welcomed the World Trade Organization on Trade, Debt and Finance, sought the help of IMF and the World Bank and asked developing states to follow the programme on debt relief by developing their policies while emphasizing key aspects of the issue.

A/RES/62/186(2007),A/RES/63/206 (2008), on “Towards a durable solution to the debt problems of developing countries”

These resolutions stressed the significance of transparent information exchange and recognized that domestic debt can be an alternative solution for external debt.

A/RES/64/191(2009),A/RES/65/144(2010), A/RES/66/189(2011), A/RES/67/198 (2012), A/RES/68/202 (2013),A/RES/69/207 (2014),A/RES/70/190(2015), A/RES/71/216 (2016),A/RES/72/204 (2017) on "External debt sustainability and development"

These resolutions specified the factors that contribute to long-term debt sustainability including economic growth and trade, emphasized that several indicators which are transparent should be used in order to determine debt sustainability, asked for ECOSOC to hold a meeting, underlined the Debt Sustainability Framework for Low-Income Countries and highlighted collaboration.

A/RES/69/247 on "Towards the establishment of a multilateral legal framework for sovereign debt restructuring processes"
(2014)
As the name suggests, this resolution basically aims to create a legal framework and its clauses set the details for the process.
A/RES/69/319 on "Basic Principles on Sovereign Debt Restructuring Processes"
(2015)
This resolution designates the principles on sovereign debt restructuring processes including the rights of states, transparency, impartiality, equitable treatment, legitimacy, sustainability and sovereign immunity.
Secretary General's Reports on
23 July 2002, 15 September 2003, 13 August 2004, 27 July 2005, 14 July 2006, 26 July 2007, 24 July 2009, 21 July 2010, 20 July 2011, 24 July 2012, 26 July 2013, 22 July 2014, 2 August 2016, 31 July 2017, 16 July 2018
These reports basically explain the situation in the specific year they were released in and the issue itself. Moreover, these reports describe the economy in general aside from external debt situation.

Possible Solutions

-There can be country-based strategies/ action plans which can be developed by the government, IMF, UNDP and experts. These plans would enable specific coping mechanisms according to the financial, social and environmental situation of the country and in cases like SIDs less problems may occur.

-Databases can be improved in order to gather more data on unusual cases such as hidden debt

-A new expert group under UNDP and UNCTAT can be established in order to help the member states in case of a debt overhang.

- UNDP or another relevant UN body could help states that got out of a debt overhang to maintain their economically healthy situation

- Public awareness campaigns and campaigns in general can be held in order to encourage individuals to donate to UN funds that promote sustainable development so that developing states can have more UN based options for financial support before they end up borrowing themselves.

-UNCTAD can work with developing member states in order to get more involved in global trade and just like the action plan for sustainable development they can have a seperate strategy for trade.

Useful Links For Further Research

https://debt-and-finance.unctad.org/Pages/Responsible-Sovereign-Financing.aspx
https://unctad.org/en/pages/gds/Debt%20and%20Development%20Finance/Debt-and-Development-Finance.aspx
https://www.un.org/esa/ffd/documents/general-assembly/general-assembly-external-debt.html

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