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Arab NGO Network for Development
شبكة المنظمات العربية غير الحكومية للتنمية

First Advisory Committee Meeting

Arab Voices for a Progressive Financing for Development: Realities and Prospects of a Debt Crisis in the Arab Region

Sunday, March 3rd 2024

1) Concept Note

A. Background

Low- and middle-income countries continue to reel under heavy debt burdens, which undermine their capacity to create the conditions necessary for the realization of economic and social rights as well as the right to development. This is because debt repayment in many poorer countries is often carried out at the expense of spending on education, health, food or even decent work and housing.

Globally, the onset of the Covid-19 pandemic in 2020 and the Russia-Ukraine war in 2022 have been responsible for much of the increase in public debt in recent years. On the fiscal side, unprecedented expansionary fiscal policies have been pursued by countries around the world to address the multi-faceted effects of the pandemic at a time when tax revenues were in a state of decline due to the ensuing slump in economic activity. On the monetary side, the inflationary pressures and higher cost of living created by the war have led to the tightening of monetary policy (higher interest rates) in developed economies. As a consequence, many developing countries witnessed capital flight, which led to currency depreciations and increased borrowing costs. These economic conditions have come at a time when large financing is needed to effectively pursue the Sustainable Development Goals (SDGs) and climate ambitions, adding additional strains on fiscal and debt positions of countries.

B. Regional Context

In the Arab region, public debt has increased sharply over the last decade, reaching USD 1.4 trillion in 2020, equivalent to nearly 60 per cent[1] of the region's GDP (UNESCWA, 2023). The region's middle-income countries (MICs)—Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia—held over half of its sovereign debt, which stood at 87 per cent of their GDP in 2021. On the other hand, the region's least developed countries (LDCs)—Comoros, Djibouti, Mauritania, Somalia, the Sudan and Yemen—face serious debt-related risks, despite having received some degree of debt relief[2] earlier during this decade. The amount of resources allocated to debt

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[1] According to UNCTAD (2023), this figure has increased to USD 1.5 trillion in 2022, around half of regional GDP. The decline in the regional debt-to-GDP ratio between 2020 and 2022 is attributed to the robust economic growth among the region's oil exporting countries amid the high oil prices in 2022, namely the GCC countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE).

[2] UNESCWA (2023) points out that Sudan has seen 90 per cent of its debt (about $50 billion) being cancelled in 2021.

service has also increased over the previous decade relative to both exports and government revenues in countries of the region. According to UNCTAD (2023), for at least half of Arab countries, external debt service amounted to more than 9.3% of exports and 9.4% of government revenues in 2021. This adds to the liquidity challenges in the region, and limits the ability of the state to engage in development spending.

Another aspect of the public debt profile in the region is that that the composition of Arab countries' external debt has changed significantly over the years. The rise of external debt of Arab countries—especially MICSs—has been accompanied by a shift from official to private creditors, notably commercial banks, and to international financial institutions (IFIs).

Importantly, the increasing role of private creditors in the region's debt landscape not only means costlier external debt service, but also augments risks related to exchange rate fluctuations or negative trade balance shocks. This is because private creditors have the tendency to withdraw their investments at the earliest signs of an impending crisis, putting pressure on national currencies. But also, private creditors may have fewer incentives to provide flexible terms or to participate in debt restructuring agreements during times of economic distress, constraining a country's policy space and limiting its ability to implement counter-cyclical policy measures.

C. Current Debt Sustainability Frameworks

Creditors often attribute the occurrence of debt crises in developing countries to poor debt management and policy choices on the part of national governments. However, this narrative is losing ground. External factors such as high interest rates, global price volatility, deteriorating terms of trade, as well as profligate lending during times of excess liquidity in the global financial system have contributed significantly to the evolution of debt crises. According to UNCTAD (2023a), the existing international financial system is out of sync with development priorities of developing nations, and it is largely marked by resource asymmetries between borrowers and lenders. It forces many of the countries facing a financing gap for the SDGs to take on more debt, exacerbating the debt burden on these nations.

In an attempt to alleviate the asymmetries inherent in the global debt architecture, the UN General Assembly adopted in 2015 a resolution on the Basic Principles on Sovereign Debt Restructuring Processes. The resolution establishes a set of guidelines aimed at making the process of sovereign debt restructuring more orderly, fair, and efficient. It also emphasizes the importance of sovereign debt restructuring as a tool for countries to overcome financial crises, and it advocates for a process that respects the sovereignty of the indebted nation while ensuring that the interests of both the debtors and creditors are fairly considered.

At the moment, there exists a handful of debt sustainability approaches that are generally used by multilateral organizations with the aim of providing a framework for assessing the sustainability of public and external debt of countries. The predominant approaches are as follows:

1) IMF DSA for market-access countries (MACs)
2) Joint IMF and World Bank debt sustainability framework (DSF) for low-income countries (LICs)
3) UNCTAD long-term debt sustainability planning tool for investment requirements for the Sustainable Development Goals (SDGs)
4) UNESCWA Climate/SDGs Debt Swap Mechanism

The first two approaches are supported by the G20 and Paris Club, which is the group of 22 major creditor countries. According to the UNDP (2020), most Arab countries have access to international capital markets, meaning their debts are reviewed under the IMF DSA for MACs. On the other hand, the IMF and World Bank DSF for LICs applies to only four[3] Arab countries. These approaches, especially the IMF DSA for MACs, are seen to be biased primarily to creditor interests, and they view debt from a financial and accounting perspective while failing to equate longer term development goals to repayment risks. On the other hand, UNCTAD's approach differs from the IMF and World Bank approaches in that it links debt sustainability to development finance requirements—that is, SDG-related investment requirements. Regionally, UNESCWA's Climate/SDGs Debt Swap Mechanism calls for redirecting resources from foreign debt servicing into investments in climate-resilient projects, where the debt swap amount allocated for these projects counts towards the creditors' official development assistance (ODA) disbursement or climate finance pledges.

[3] According to the new World Bank country classifications by income level (2022-2023), the four LICs of the Arab region are: i) Federal Republic of Somalia; ii) Republic of Sudan; iii) Syrian Arab Republic; and iv) Republic of Yemen.

2) Objectives of the First Advisory Committee Meeting

Public debt can be an important driver of sustainable development if it is deployed for the purpose of supporting investments in people and the planet. A key concern today is how Arab countries can achieve post-pandemic social and economic recovery and pursue the SDGs in the longer-term while ensuring public debt sustainability through managing short-term debt distress and strengthening their fiscal and debt positions.

What is needed is a reassessment[4] of how these countries can navigate the complexities of sovereign debt—an objective that is difficult to achieve short of an inclusive, rights-based approach to public debt sustainability that places development at its center.

In view of the contextual challenges and key issues at stake, the Arab NGO Network for Development (ANND) is organizing a one-day meeting for the advisory board of the project *Arab Voices for a Progressive Financing for Development*. The meeting aims to deepen the conversation about debt and its dynamics among various stakeholders, namely civil society organizations (CSOs) in the Arab region, by highlighting the key challenges to debt sustainability in the region and exploring the existing frameworks to debt management in terms of the debtor country's ability to effectively pursue the SDGs and climate ambitions. The discussion shall tackle the following questions, *inter alia*:

1. What are the major sovereign debt trends in the Arab region vis-à-vis the rest of the world?

2. What are the key challenges to debt sustainability in the Arab region: poor debt management; the structure of the international financial system; global economic conditions such as high interest rates, price volatility, and deteriorating terms of trade; imprudent lending, among others?

3. Does creditor heterogeneity, or the changing composition of debt, raise further challenges to the fair sharing of the burden of debt restructuring among heavily-indebted Arab countries?

4. What are the existing global frameworks to make debt more sustainable, and do they strike a balance between creditor and debtor interests? What should be the role of the international development community, including multilateral and bilateral creditors, in terms of accelerating progress towards a common international debt resolution mechanism and restructuring framework?

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[4] This would entail a careful re-evaluation of the determinants of unsustainable sovereign debt including, but not limited to, changing market conditions, health and demographics, climate change, geopolitical realignments and instability, as well as the implications of sovereign debt on policy space in debtor countries.

5. What is the scope and depth of debt relief that creditors should be willing to accept? And is there a way around austerity-laden conditionality for Arab countries to navigate their debt crises?

6. How can domestic resource mobilization play a better role in contributing to debt sustainability in both the short- to medium-term and the long-term?

7. How can civil society play a more active role in terms of contributing to the development of a more comprehensive global debt sustainability framework?

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