Liquidity shortage and debt

Obstacles to recovery in the Arab region

UNITED NATIONS
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ESCWA
Shared Prosperity Dignified Life

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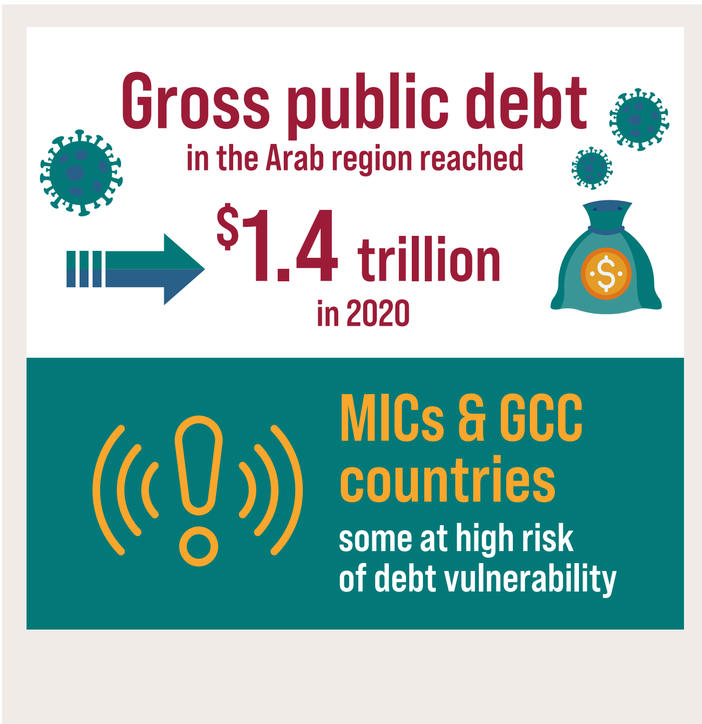
I. Overview of gross public debt in the Arab region

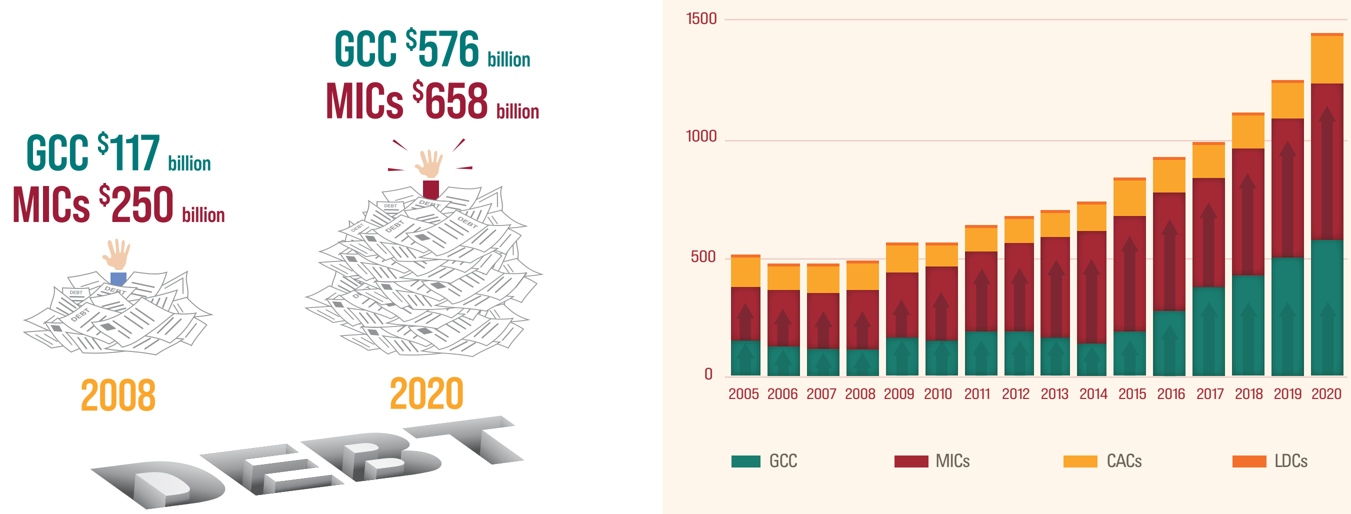
COVID-19 has pushed gross public debt in the Arab region to a historic high of $1.4 trillion, putting some of the middle-income countries (MICs) and Gulf Cooperation Council (GCC) countries at high risk of debt vulnerability. The 2010s have witnessed an unprecedented rise in public debt worldwide as well as in the Arab region. In 2020, global public debt reached a staggering 100 per cent of global gross domestic product (GDP), compared to 65 per cent of global GDP in 2008.[1] In the Arab region, public debt reached 60 per cent of GDP in 2020,[2] up from 25 per cent of GDP in 2008.



1 United Nations (2021). Financing for Sustainable Development Report 2021. (New York).

2 The region total excludes the Sudan, which received debt relief in 2021, and the State of Palestine, Somalia and the Syrian Arab Republic due to the lack of data.

Figure 1. General government gross debt (billions of dollars)



The gross public debt in high-income GCC countries jumped by a factor of almost five during the decade – from about $117 billion in 2008 to an estimated $576 billion in 2020 (figure 1). As a share of GDP, it increased from 10 per cent to 41 per cent between 2008 and 2020.

The MICs[3] hold close to half of the region's sovereign debt. Between 2008 and 2020, their total public debt increased from nearly $250 billion to $658 billion. Notably, their debt-to-GDP ratio increased from 47 per cent in 2008 to 91 per cent in 2020.

The least developed countries (LDCs) in the region such as Comoros, Djibouti and Mauritania[4] remain at risk of debt distress due to the adverse impact of COVID-19, although they received temporary debt relief under the Debt Service Suspension Initiative (DSSI). The outstanding debt of these LDCs is estimated to be 52 per cent of their GDP, or $6.6 billion in 2020 as compared to nearly $3 billion in 2009.

Public debt in conflict-affected countries (CACs) in the region, such as Iraq, Libya and Yemen, has increased to about $190 billion by 2020, 88 per cent of their aggregate GDP. COVID-19 compounded the underlying development challenges and further increased debt in these countries.

Overall, the high level of debt and increasing trend puts the region at risk of debt unsustainability, especially since regional GDP growth has remained sluggish and fell below zero in 2020 (figure 2).

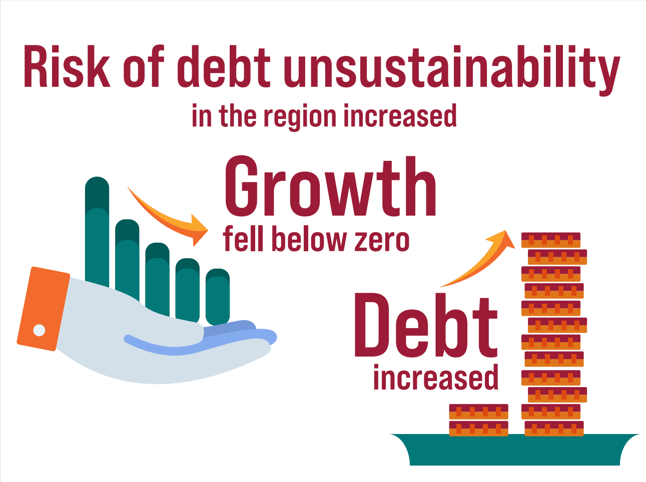
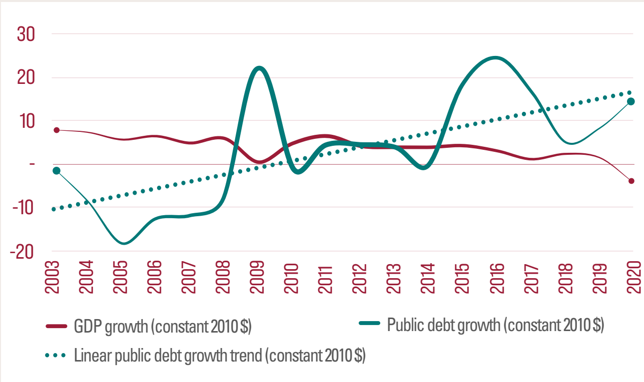


Figure 2. GDP growth vs. growth of public debt in the Arab region



3 Six MICs in the region: Algeria, Egypt, Jordan, Lebanon, Morocco and Tunisia.

4 Other LDCs such as Somalia, the Sudan and Yemen were also at risk of debt distress. There is no data for Somalia. The Sudan has received significant debt relief in 2021 cancelling 90 per cent of its debt (about $50 billion). Yemen is discussed in the paragraph on conflict-affected countries.

Debt service

in MICs is consuming

$20 billion

which is almost

11%

of their export

External public debt

increased by about

$111 billion

in the Arab region between 2008 and 2020

II. Increasing external public debt and debt service in the Arab region

External public debt increased by about $111 billion for the MICs in the region between 2008 and 2020, and COVID-19 further increased the needs of countries for external liquidity. In 2020, to meet emergency external liquidity requirements for imports, Egypt, Jordan and Tunisia taken together have borrowed over $10 billion under IMF's short- and medium-term lending mechanisms.

The profile of external public debt has been changing in the MICs with more borrowing from private creditors, while the share of concessional borrowing from official creditors (bilateral and multilateral creditors) is declining (figures 3 and 4). This recent pattern suggests not only higher external debt service burden but also higher risks associated with external debt servicing either due to exchange rate shocks or due to any negative shock to trade balance.

Debt service in the MICs in the region consumes over $20 billion, which is nearly 11 per cent of their export earnings in 2019. The share is much higher than the average of the world developing MICs (6.4 per cent). This high debt service burden poses additional liquidity challenges and strains fiscal space which could have otherwise been invested in essential public services, including in health services and in financing the SDGs.

The DSSI and the subsequent establishment of the Common Framework for Debt Treatments beyond the DSSI are important initial steps in facilitating debt relief efforts for the LDCs in the region. However, the MICs that are facing high debt burdens remain ineligible to benefit from the initiatives.

Figure 3. Concessional debt share from official creditors to MICs (percentage)

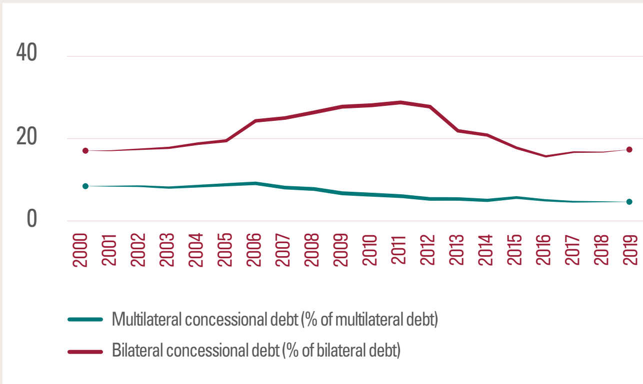
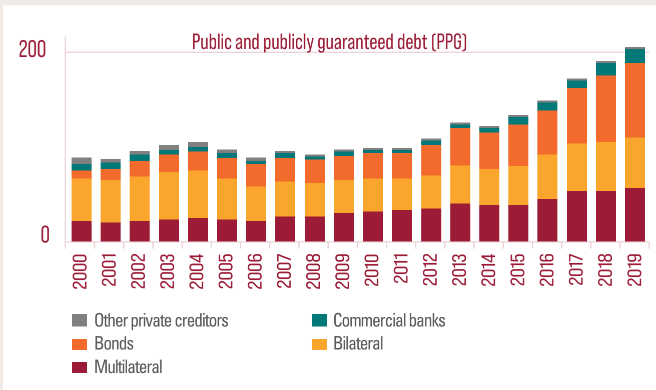


Figure 4. Size of external public debt by creditor type (billions of dollars) – MICs



Primary
balance
in 2020

GCC	↘	-11%
MICs	↘	-3%
LDCs	↘	-11%

Current account
balance
in 2020

GCC	↘	-1.3%
MICs	↘	-6%
LDCs	↘	-37%

III. Structural drivers of public debt accumulation in the Arab region

Fiscal and monetary policies fall short of creating debt sustainability across the region. The primary balances of the GCC countries, on average, turned negative after the drop in oil revenues since 2014, and the deficits widened in 2020 due to COVID-19, reaching 11 per cent of GDP (figure 5). Primary balances in the MICs and LDCs remained negative over the past decade, reaching -3 per cent and -11 per cent of GDP, respectively, in 2020. Negative primary balance led to increased debt finance and rollover of debt outstanding.

For the GCC countries, on average, the current account balance has declined over the years. It turned negative in 2015 and 2016. Following the adverse impact of COVID-19 it was negative in 2020 as well (figure 6). The fiscal shortfalls have contributed to increasing public debt by $385 billion between 2015 and 2020 in the GCC countries. Persistent current account deficits in the MICs and LDCs add to the liquidity challenge in foreign currency and drive their external borrowing. In 2020, the current account deficit reached 6 per cent of GDP for the MICs and around 37 per cent of GDP for the LDCs.[5]

Figure 5. Primary balance (percentage of GDP)

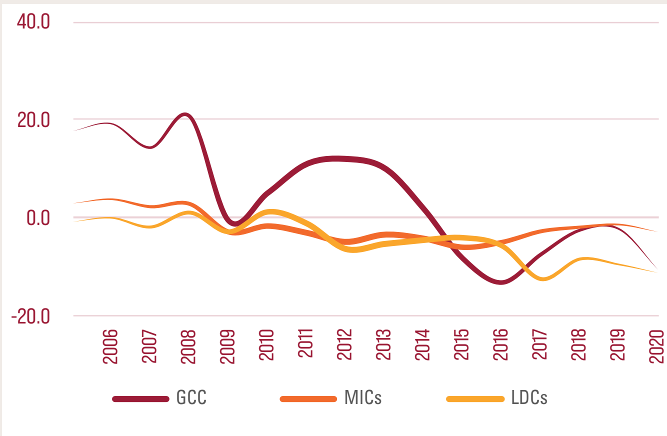
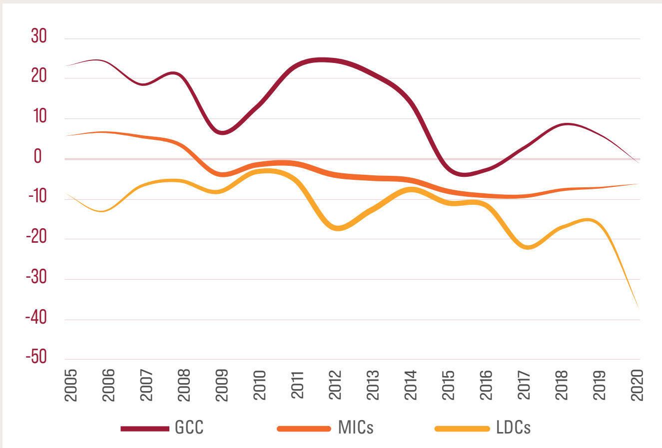


Figure 6. Current account balances (percentage of GDP)

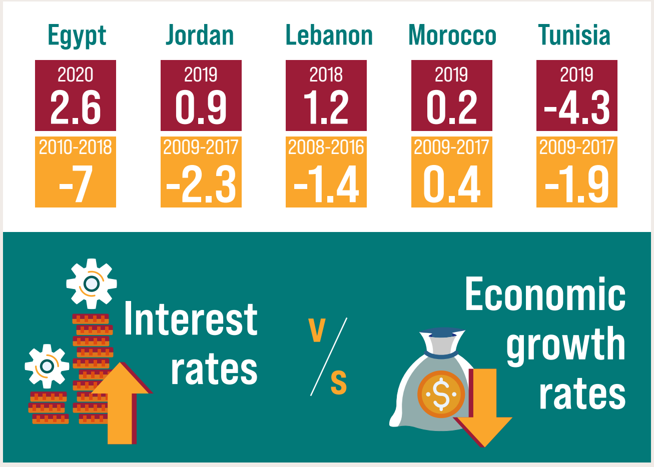


5 The high current account deficit for LDCs in 2020 was largely influenced by the Sudan. The average for LDCs excluding the Sudan was 8 per cent.

Lack of effective monetary policy is another major reason for debt accumulation across the MICs in the region.[6] Most countries, except Tunisia, witnessed interest rates higher than their economic growth rates during 2019 and 2020, as shown by the positive interest rate-growth rate differentials (IRGDs) (figure 7). Historically, Egypt and Tunisia had done well in reducing debt due to favourable IRGDs, but IRGDs have become less favourable in recent years. Lebanon and Jordan are examples in the region where sizable positive IRGDs contributed to accumulation of debt stocks.

6 *Economic and Social Commission for Western Asia, (2020). Fiscal Policy Response to Public Debt and Debt Sustainability in Arab Countries.*

Figure 7. Interest rate-growth rate differential (percentage points, nominal)



Arab Governments
have extended
$95 billion
(4% of their GDP of 2020)

Governments worldwide
have extended
$19 trillion
(22% of their GDP of 2020)

IV. Limited fiscal space constrained COVID-19 policy responses

Governments worldwide have extended about $19 trillion to support people and economy, which is 22 per cent of global output of 2020. With limited fiscal space, Arab Governments have extended $95 billion, which is 4 per cent of their GDP of 2020.[7] The Global Stimulus Tracker estimates that the fiscal stimulus in the Arab region is significantly low in order to mitigate the impact of losses in income, loss of jobs, and the stringent measures adopted to fight COVID-19, as compared to the global average that is led by large fiscal stimulus by high-income countries (figures 8a and 8b). This unequal pattern in fiscal stimulus indicates that the pace of

7 *United Nations Policy Brief on "COVID-19 Social Protection and Economic Policy Responses of Governments: Lessons for Social Protection Readiness and Building Forward Better".*

inclusive recovery is expected to be much slower for the region than that of the developed world. Furthermore, increasing liquidity constraints will make the path to recovery from COVID-19 more challenging for the region. The Global Stimulus Tracker estimates that the region requires an additional $462 billion toward achieving a resilient and fast recovery path at par with other regions. Without additional financing support, the region would be at the risk of suffering from deep and long-lasting adverse effects of the pandemic.

The new issue of special drawing rights (SDRs) is a useful liquidity support but it remains skewed toward benefitting high-income countries more than developing countries, based on existing quotas of distribution of SDRs. Out of $650 billion, the Arab region will receive $37.3 billion, with the low- and middle-income countries in the region (15 out of total 21 Arab States) receiving only about $15 billion (figure 9). Overall, new SDR allocations to the region are far below what is required (estimated $462 billion) to catch up to global average fiscal support of Governments as a share of GDP.

Figure 8a. Arab region indicators

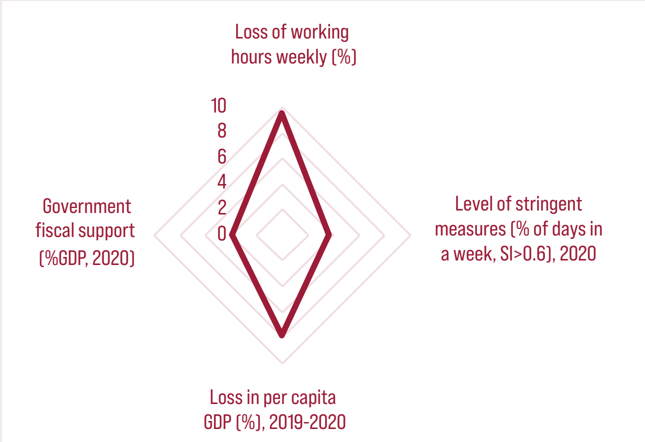


Figure 8b. Global indicators

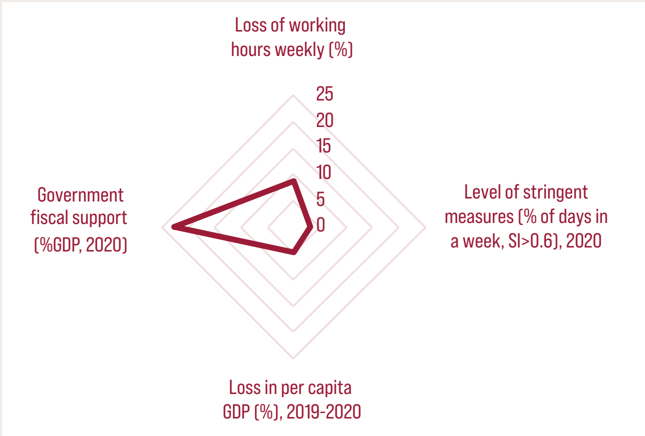
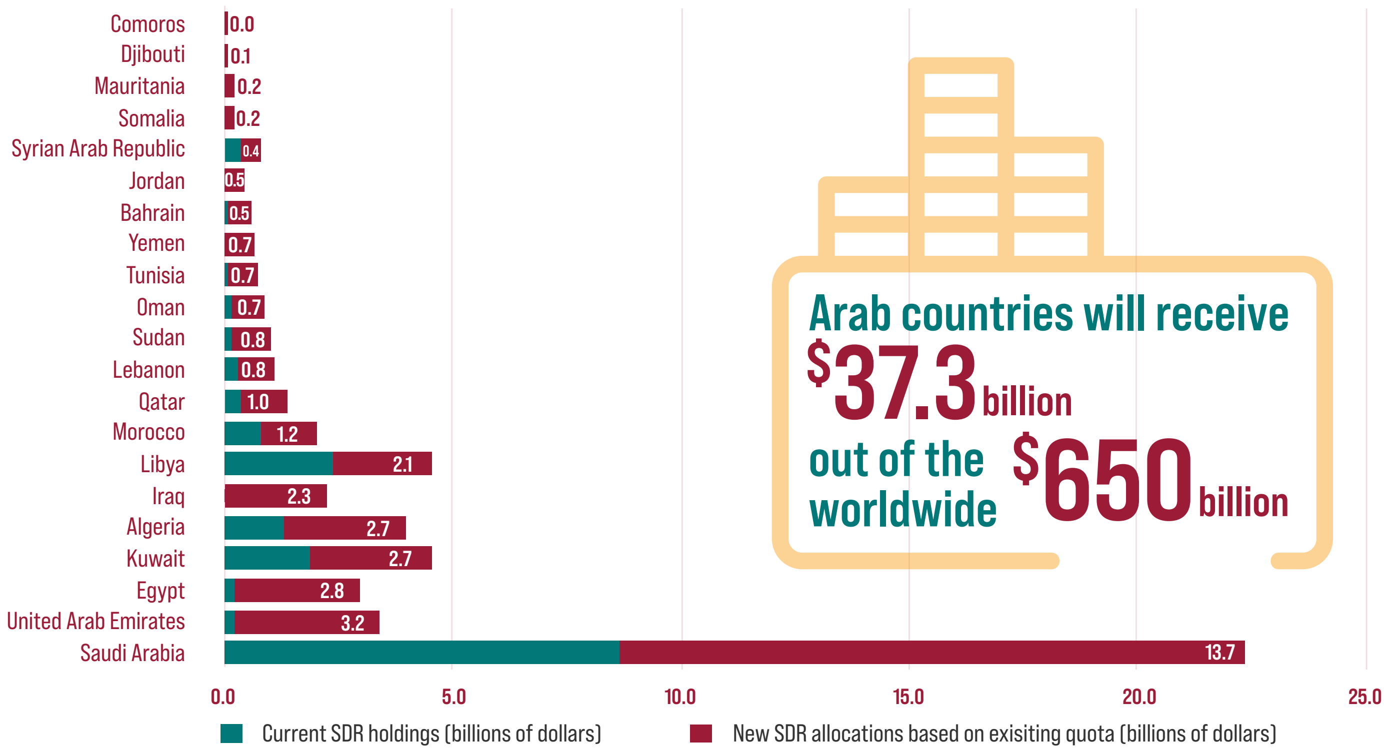


Figure 9. Current SDR holdings and new SDR allocations based on existing quotas



V. Policy recommendations

Overcoming the increasing debt sustainability challenges requires advancing immediate to near-term and long-term policy support to foster a resilient recovery from COVID-19 and build forward better in enhancing sustainable financing for the SDGs. While the set of policy measures are applicable to all countries across the region, the priority is for the middle-income countries, which account for the largest share of debt in the region and face increasing risks to debt unsustainability. The GCC countries facing an alarming rise in debt should also act to ensure debt sustainability. The time is now.

Global policy measures

Official creditors are called upon to extend the period and scope of moratoriums on debt service payments under the G20 DSSI till the end of 2022, considering the prolonged impact of COVID-19; they also need to consider broadening the scope of the DSSI to include all highly indebted developing countries, including middle-income countries with high debt burdens.

Multilateral development banks and international financial institutions are called upon to participate in the DSSI and create mechanisms to enhance private sector participation in the DSSI debt reprofiling, debt buy-back and debt swap mechanisms.

IMF member States should consider the adoption of mechanisms to rechannel unused SDRs from advanced to developing countries on the basis of their need, going beyond the existing quota system which favours high-income countries above others. The rechannelling of SDRs must consider equity and inclusive global recovery captured through indicators of vulnerabilities and needs, including trade and balance of payments imbalances, crisis situations and financial needs for recovery from the pandemic.

Developed countries are called upon to bridge the inequality gap in fiscal stimulus between developing and developed countries by improving official development assistance (ODA) to finance recovery from the pandemic, fulfilling the commitments to financing the SDGs and contributing to inclusive global recovery.

Improve access to concessional finance from official creditors to revert the declining trends to developing countries, especially MICs.

Build upon existing principles, mechanisms and initiatives such as the United Nations Basic Principles on Sovereign Debt Restructurings and the G20 Common Framework for Debt Treatments and establish a multilateral sovereign debt forum, as called upon by the Secretary-General, to foster greater coordination among creditors and debtors toward sustainable sovereign debt resolutions and debt relief to promote SDG financing.

Regional policy measures

ESCWA calls upon member States to establish a debt management support group at the regional level, the Arab Debt Management Group (ADMG), to promote peer learning and share lessons on improved debt management practices toward improving macroeconomic stability and fiscal space for financing the SDGs.

National policy measures

Improve debt management practices through improved debt data quality and risk analysis of debt instruments, including modelling scenarios of debt sustainability such as working out debt stabilizing scenarios over the medium term, directing debt toward productive purposes, taking into account any need for augmenting existing borrowing or new borrowing to help expand the fiscal space to finance the SDGs and boost economic growth.

Develop a conducive monetary policy that ensures the necessary conditions to maximize the value of fiscal measures and ensure better fiscal-monetary policy coordination.

Improve overall public finance management through effective medium-term expenditure frameworks and medium-term revenue frameworks.

Operationalize innovative debt relief instruments, such as the ESCWA Climate/SDGs Debt Swap/Donor Nexus Initiative, to improve financing for climate and accelerating the SDGs, including benefitting countries that do not necessarily have unsustainable debt burdens.

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