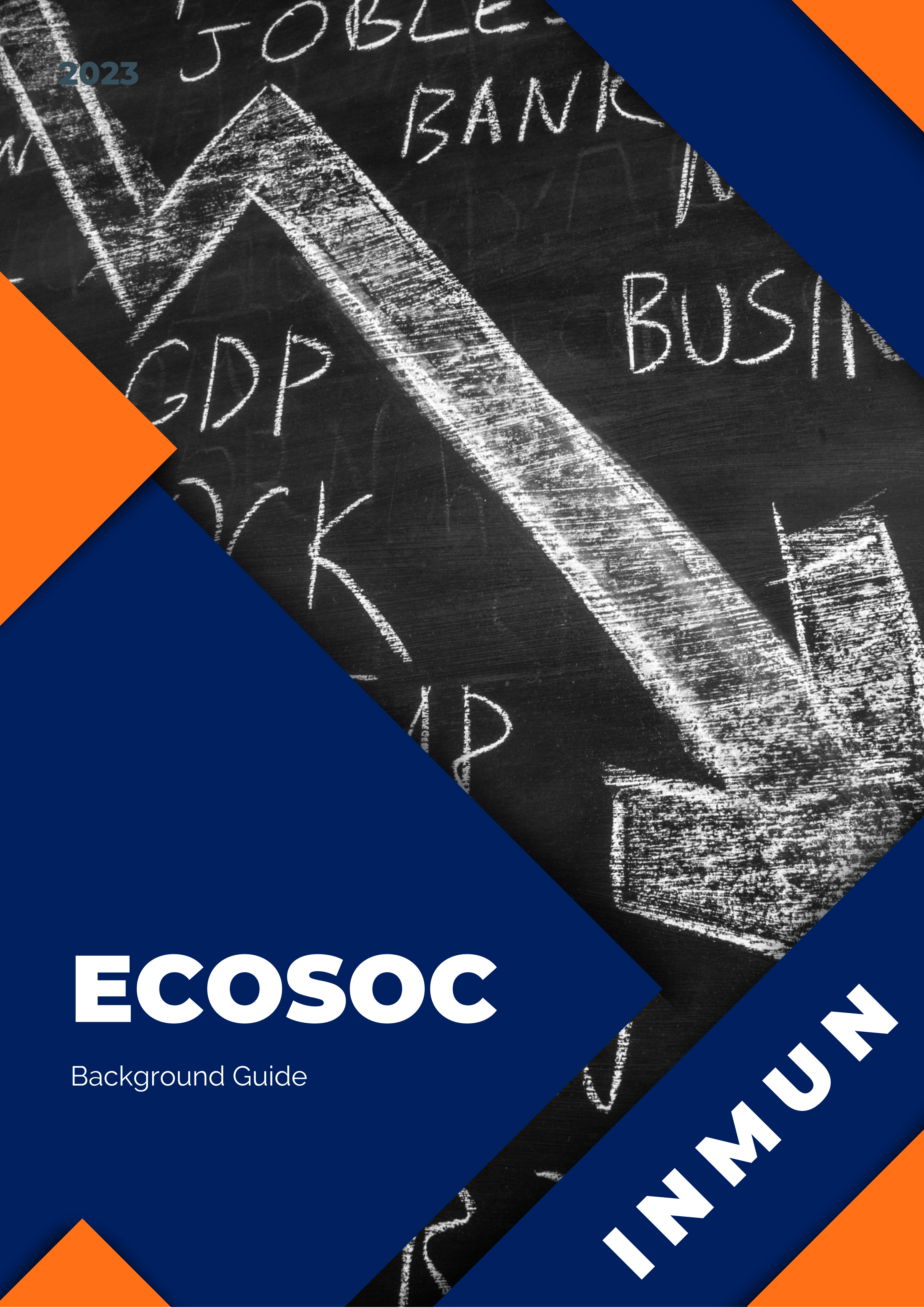
2023



ECOSOC

Background Guide

INMUN

Letter From The Director

Greetings Delegates,

First and foremost, welcome to INMUN 2023! My name is Siddharth Dey, and I'm delighted to serve as the director for ECOSOC. I'm currently a second year student at Erasmus University Rotterdam studying economics and econometrics, but as an Inventure Academy alumni, it gives me great pleasure to return for INMUN. I'm proud to have an amazing Assistant Director by my side in Pratyush Mittal. He is in the 12th grade and is a passionate MUNner in his own right.

My own MUN journey began in the 9th grade, and MUNs were something I passionately pursued throughout highschool. I see MUNs as a great opportunity to broaden your perspectives, deepen your understanding of pertinent global issues, and learn essential life skills such as negotiation, teamwork and public speaking. Having been a delegate in more than 20 MUNs, and a part of 4 executive boards, I'm confident I'll be able to guide you all through a fun and exciting three days of debate and collaboration.

Given the technical complexity of our agenda, I strongly suggest you read this background guide and the research papers and publications I have cited in their entirety to get a clear picture of the problem. But I urge you to view the background guide NOT as a source of research, but as a determinant of how the trajectory of debate in council must go. I strongly suggest that you carry out research beyond the contents of the background guide to have a fruitful experience in committee.

Best,
Siddharth Dey

Introduction

Founded on 23rd January 1946, the Economic and Social Council (ECOSOC), working under the overall authority of the General Assembly, coordinates the economic and social efforts of the United Nations and the UN family of organizations. Naturally, this means that the ECOSOC deals with a wide array of issues, but UN charter specifically mandates it promote higher standards of living, full employment, and economic and social progress; identify solutions to international economic, social and health problems; facilitate international cultural and educational cooperation; and encourage universal respect for human rights and fundamental freedoms.

To work towards its mandate, General Assembly resolution A/RES/72/305 (2018) defines the ECOSOC's functions to include being a convener, serving as a central platform for discussion on economic, social and related issues, coordinating the activities of the United Nations development system as well as monitoring the implementation of internationally agreed development goals. Finally, with the responsibility of consulting with non-governmental organizations (NGOs), the ECOSOC also serves to maintain the vital link between the United Nations and civil society.

Currently, the Council has 54 members, elected by the General Assembly for three-year terms. While it meets throughout the year, the main session is held in July in which a high-level meeting of Ministers discuss major economic, social and humanitarian issues.

In order to successfully debate our agenda at a nuanced level, it's first important to fully grasp the concept of public debt and the indicators that surround it. Public debt, also known as sovereign debt or government debt, is the cumulative financial liabilities of the government sector. In essence, when governments want to spend beyond what they can (or want to) raise from public taxation, they borrow money through debt instruments, such as loans, bonds and bills, for the continuity of public services. The amount the government has to repay - which generally includes principal and interest - as a result of such borrowing activity is known as public debt. Another way to look at government debt is the accumulation of budget deficits over multiple fiscal years. This definition has one very important consequence : public debt obligations supersede regime changes, in that a nation's total sovereign debt is not linked to the particular regime that acquired it.

Further, one must note that public debt is composed of two components : domestic and external debt. Domestic debt refers to the part of sovereign debt that is owed to domestic lenders, and it is a form of fiat creation of money in which the government obtains finance not by creating it de novo, but by borrowing it. Thus, for example, when governments take out loans from domestic financial institutions, such as private banks, it contributes to their domestic public debt. On the other hand, external debt is simply the complement to domestic debt, and refers to the portion of public debt that is borrowed from foreign sources. When acquiring external debt, most nations will borrow from foreign governments, international capital markets or international financial institutions (IFIs), such as the International Monetary Fund (IMF) and the World Bank.

Why do countries borrow?

The principal source of government finance is always tax revenues. Unfortunately, though, tax revenue is cyclical in that the amount the government receives from both indirect and direct taxation is directly proportional to the state of the economy. Therefore, when an economy is in a recession, tax revenues decline, but public expenditure levels generally stay the same or tend to increase. In such situations, instead of cutting public spending or drastically increasing taxes, most governments choose to borrow money (and run a deficit) to meet existing commitments. This policy approach is known as "tax-smoothing", and it's well established in the literature on fiscal policy.

Furthermore, in times of recession, such as the initial year of the COVID-19 pandemic, governments will often adopt an expansionary fiscal policy by reducing taxes and increasing public spending in hopes to stimulate growth and consumer confidence. This fiscal stimulus is often financed by issuing sovereign debt. Investment in capital expenditure, whether it be physical or human, is also a common cause for borrowing, but its details are beyond the scope of committee.

Indicators of debt sustainability

Lending and borrowing are integral parts of the global financial ecosystem, and countries are always going to borrow, ergo public debt will realistically never be sitting at zero. Consequently, the crux of the matter lies not in eliminating debt, but bounding it within sustainable levels. Not only is this notion absolutely essential for debate in committee, but it's also commonly a matter of concern for bodies like the ECOFIN, IMF, African Development Bank, and World Bank.

According to the IMF, a sovereign's public debt is sustainable when "the government is able to meet all its current and future payment obligations without exceptional financial assistance or going into default." In performing debt sustainability analysis (DSA), analysts will often look at whether debt servicing policies are feasible and consistent with maintaining growth potential or development progress. The nature of debt is also a matter of concern - debt borrowed from private lenders and international financial markets, as opposed to sovereign lenders, is commonly considered less sustainable due to issues with possible debt restructuring.

While the IMF uses an intricate and holistic framework to determine a nation's debt sustainability level, a few common indicators are often used in wider literature to understand the broader picture. The most popular being the Debt-to-GDP ratio, which is obtained by dividing a country's total public debt by its GDP in the given year. By comparing what a country owes with its national output, the debt-to-GDP ratio indicates that particular country's ability to pay back its debts. According to the World Bank, countries whose debt-to-GDP ratio exceed 77% for prolonged periods of time begin experiencing noticeable slowdowns in economic growth. Namely, every percentage point of debt above this level costs countries 0.017 percentage points in economic growth. Other important indicators may include a country's foreign debt to export revenue ratio or government debt to current fiscal revenue ratio.

The global debt crisis

By the end of 2022, global public debt - comprising general government domestic and external debt - sat at record high of 92 trillion US Dollars, growing more than 5 times since the year 2000 from 17 trillion US Dollars. In the same timeframe, global GDP struggled to keep pace with debt, only growing 3 fold from its value in 2000.

At the moment, about 60% of low income developing countries are either in high risk or in complete debt distress, with most having applied or applying for formal debt restructuring. Over the past three years, Ghana, Sri Lanka and Zambia have already defaulted in their external debt obligations, and Pakistan and Egypt stand on the verge of default. The problem is also not just limited to the developing world : The United States and China are also predicted to see their public debt levels surpass pre-pandemic levels. In fact, the problem is so severe that 3.3 billion people live in countries that spend more on interest payments than on education or health.

Comparative analysis of developing nations' debt levels with their ability to generate foreign exchange revenue through exports also highlights further dangers. According to the UNCTAD, in developing nations, the share of external public debt to export revenue increased from 71% in 2010 to 112% in 2021. During the same period, external public debt service as a share of exports increased from 3.9% to 7.4%. For some historical reference, the 1953 London Agreement on the post-war German economy limited the portion of export revenue that could be spent on external debt servicing to 5% in order to ensure long term sustainability.

Causes

One of the principal reasons behind the materializing crisis is the covid-19 pandemic. As the pandemic struck in early 2020, most nations faced an unexpected surge in the necessity for healthcare investment, unemployment benefits for furloughed workers, grants for small and medium sized enterprises (SMEs) and fiscal injections to offset the impact of lockdowns. However, most emerging markets and developing economies (EMDEs), along with several developed economies, seemed to lack the fiscal space needed to fund such policies. For example, the UNESCAP found that several developing Asian and Pacific nations lacked the fiscal space to "sustain necessary countercyclical measures and invest in priority areas."

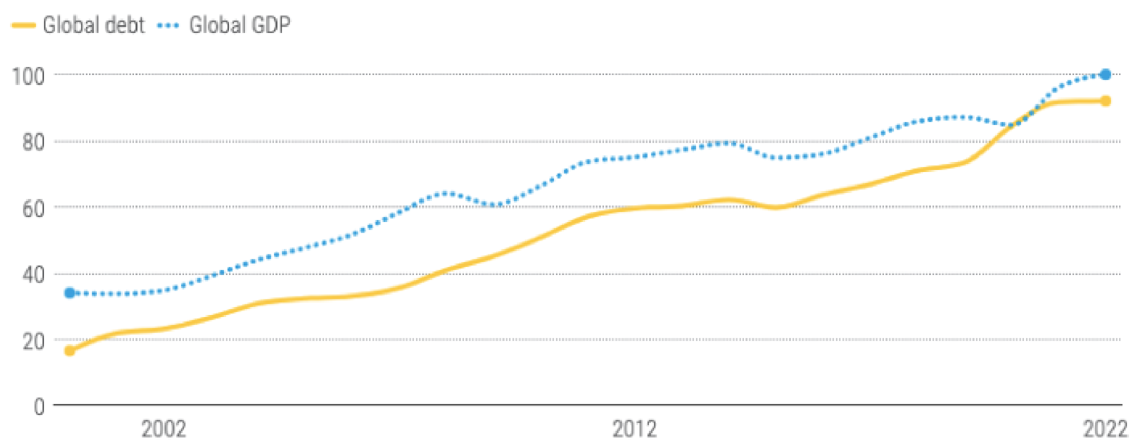
The lack of fiscal space can perhaps be best explained by declining tax revenues in the years prior to the crisis. For instance, in 2017, of the 124 countries eligible for official development assistance (ODA), 46 had a tax-to-GDP ratio below 15%, which is widely considered a benchmark to promote sustainable economic growth. Furthermore, findings from the OECD Global Outlook on Financing for Sustainable Development 2021 also suggests that national savings - an important domestic financial resource - as a percentage of GDP had remained significantly smaller in low-income countries when compared to middle-income countries and developed nations.

Anyhow, with limited fiscal space, collapsing government revenues (particularly for commodity exporters and tourism and other services-dependent countries), and a considerable surge in spending needs, a majority of EMDEs were completely reliant on external loans to muster the storm. As a result, the global public debt grew by 19.5 trillion US dollars within 2020 and 2021. In this regard, the IMF was one of the prominent lenders, distributing nearly 110,188.38 million in financial assistance and debt service relief through the means of several lending instruments such as Catastrophe Containment and Relief Trust (CCRT), Rapid Financing Instrument (RFI) and the Rapid Credit Facility (RCF).

Causes

As the pandemic eased with the entrance of 2022, the global economy saw some short lived respite with global debt levels seeing some decline (see Figure 1). However, any progress was quickly undone with the triple whammy of rising inflation, tightening monetary policy, and the Russian invasion of Ukraine. To begin with, as global economies rebounded from the COVID-19 propagated recession, demand side pressure pushed up global inflation rates significantly to 8.75%. This tightened up government budgets because rising import bills drained hard currency from many vulnerable places, deteriorating their capacity to service foreign debts.

Figure 1 : Global Debt vs. Global GDP



Notes: Figures represent nominal values in current USD. Public debt refers to general government domestic and external debt throughout the document. General government consists of central, state and local governments and the social security funds controlled by these units.

Credit : UNCTAD

Causes

The rise in inflation was compounded with tighter monetary policies in the Western world, via global hikes in interest rates, which led to increasing debt servicing costs and an outflow of capital from developing nations as investors tried to capitalize on higher government securities (G-secs) returns. The American case is worth a closer look - through 2022, the Federal Bank increased the federal funds rate by 425 points, which, by attracting hot money flows, caused the American dollar to see strong appreciation. As approximately half of all cross-border loans and international debt securities are denominated in US dollars, the stronger US dollar meant a rise in the real debt stock for the developing world.

Finally, the full scale invasion of Ukraine also shot up global commodity and food prices, causing, for all intents and purposes, a cost of living crisis. In 2022, gas prices in Europe increased more than four-fold since 2021, and the conflict also pushed up global food prices on the world market despite some easings after the Black Sea grain deal. For low income countries, especially those that import food and energy, this has translated into strained government budgets through rising import costs and depressed growth prospects owing to reduced investment. According to the October issue of the IMF's Global Economic Outlook, growth rates slowed down to 3.2% in 2022, which is the weakest it has been since 2001 except for the global financial crisis and the acute phase of the COVID-19 pandemic. The blend of slowing growth rates and declining foreign reserves has left many developing nations unable to meet existing debt obligations.

Overall, the combination of these three factors has backed many nations into an impossible corner : rising debt stock, declining foreign reserves, outflow of international capital, and constantly increasing loan rates.

Development vs Debt

One of the formative consequences of high levels of indebtedness in the developing world is the increasingly difficult choice between debt servicing and investment in development. Currently, 50% of developing countries direct more than 1.5% of GDP and 6.9% of government revenues toward interest payments, which is a sharp increase from last decade. In fact, the number of countries in which interest spending represents 10% or more of public revenues increased from 29 in 2010 to 55 in 2020!

This rapid increase in interest payments has had a noticeable impact on investment and development spending. For example, in developing countries, the nominal percentage change in interest payments between 2010-2012 and 2019-2021 was 60.4%, while education and investment lagged behind at 40.8% and 41.1%, respectively. Further, in Latin America and the Caribbean, developing countries are spending more government funds on interest payments rather than investment. Similarly, in Asia and Oceania, interest payments receive more funds than healthcare.

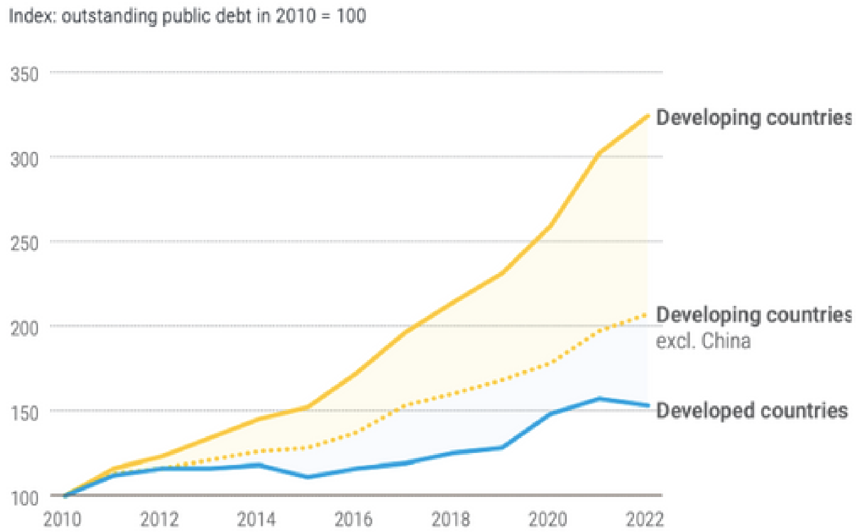
Such spending patterns have grave long-term consequences. Lack of adequate spending in investment will hamper long term growth prospects, which, amid one of the most internationally synchronous episodes of monetary and fiscal policy tightening, risks the global economy seeping back into a recession. Depressed growth outlooks also mean that developing countries risk entering into a circular debt trap : if they can't generate enough money to sustainably pay off debts, additional borrowing sometimes remains the only option. Needless to say, this is a short-sighted policy option that only makes the problem worse, but we have seen it deployed before in the aftermath of the global financial crisis. Furthermore, as we learned from the COVID-19 pandemic, insufficient expenditure on healthcare leaves countries vulnerable to health shocks, which only exponentiates the growth rate of the crisis.

Development vs Debt

As a simulation of the ECOSOC, we must also look at the impact of rising debt on the attainability of the Sustainable Development Goals (SDGs). On the whole, rising external debt obligations has been interminably draining resources from critical sectors such as healthcare, education, and renewable energy, which are all main tenets of the SDGs. Moreover, with the pandemic undoing several years of progress in sustainable economic development, spending needs have only risen. Precisely, we seem to be falling prey to the "scissor effect," as described by OECD.

The concern of development vs. debt also becomes more severe when we analyze the distribution of debt globally. To begin with, not only is the level of debt growing at a faster pace in the developing world (see Figure 2), but EMDEs are also paying much higher interest on loans (even without considering the costs of exchange rate fluctuations). For instance, on average, African countries borrow at rates that are four times higher than those of the United States and even eight times higher than those of Germany (see Figure 3). High borrowing costs impair financing capability for essential investments, which in turn undermines debt sustainability and advancement of sustainable development.

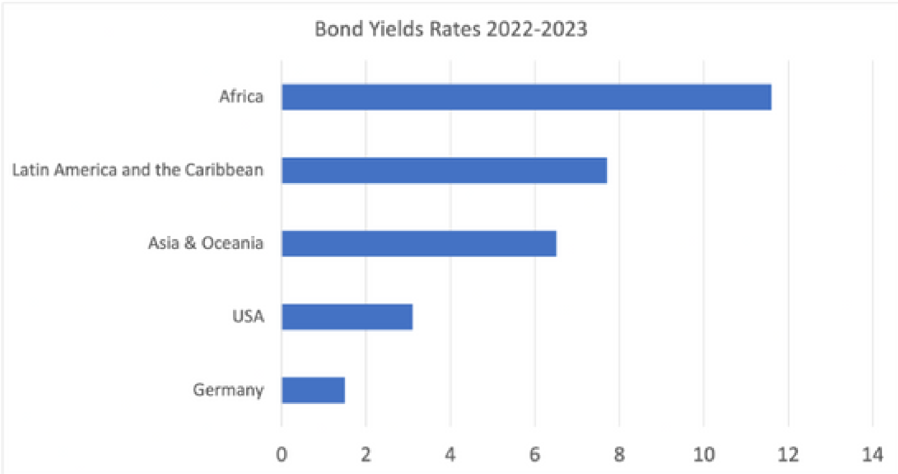
Figure 2 : Public Debt Levels 2010-2022



Source: UN Global Crisis Response Group calculations based on IMF World Economic Outlook (April 2023).

Credit : UNCTAD

Figure 3 : Average Global Bond Yield Rates



Source : average JPM EMBI Global Diversified USD bond yields per region with the 10 year bond yields of Germany, and the United States from January 2022 to May 2023.

Concerns on debt composition

In addition to the rate at which public debt is growing in the developing world, the composition of lenders has also become a matter of disquietude. Over the last ten years, the segment of public external debt owed to private lenders, such as bondholders and lenders, has significantly risen across the world. In 2021, 62% of developing countries' total external debt was owed to private creditors. Furthermore, the share of external debt owed by low-income and middle-income countries to the Paris Club creditors dropped from 28 percent in 2006 to 11 percent in 2020. Principally, China, India and Eurobonds - international bonds denominated in a currency other than that of the issuing country - have taken the place of historically traditional lenders.

This change in debt composition presents two general concerns. (1) Albeit easier, borrowing from private sources is universally more expensive than concessional financing from bilateral, multilateral or international sources. (2) A wider variety of creditors means that when it comes to debt restructuring, it's exceedingly difficult to reach an agreement that satisfies all parties. This lengthens the negotiation process, leaving countries on the verge of default extremely vulnerable to any potential external shocks.

In terms of middle-income countries, such as India, Brazil, and Egypt, the general consensus has been that they are better insulated from external shocks because most of their public debt is denominated in the local currency. However, this is a misleading notion; these countries have built this insulation by opting to borrow from local banks. For instance, public debt as a share of total bank assets is at 26% in Brazil and 29% in India, and above 40% in Egypt and Pakistan. This means that the interest-paying capability of the government is closely linked to domestic financial stability in these countries. Thus, should these governments ever face any credit stress, they risk a complete banking crisis!

Working towards sustainable debt restructuring

Debt restructuring refers to a process whereby a country's existing contractual debt liabilities are reworked with more amicable terms in order to help a deafluting (or nearly defaulting) nation pay back its obligations. Restructuring is an extremely arduous process that requires the agreement of domestic and foreign creditors, and involves burden sharing between different parties. As it involves significant economic costs, reputational risks, and coordination challenges, restructuring is often the last resort, and pursued only if fiscal consolidation and growth-friendly structural reforms fail to improve a nation's debt burden.

In the past, restructuring efforts were generally led by the IMF and Paris Club lenders. However, in the fall of 2020, the G-20 put forth the "common framework" to integrate a wider variety of creditors, such as China, India, Saudi Arabia and a growing number of private institutions, in the negotiation process in an attempt to fasten restructuring efforts. Yet the common framework has struggled to attain results. Three years since its inception, only Zambia, Chad, Ethiopia and Ghana have appealed for its use with only Zambia successfully reaching an agreement after extremely long negotiations.

Along with more and more developing countries entering the high risk zone for debt distress, there is an immediate need to address the failings of the common framework. The chief dilemma is that the common framework follows the Paris Club's restructuring model wherein multilateral development banks (MDBs) receive a preferred status, while sovereign and private lenders are forced to take damaging haircuts. China, which has quickly grown to be the largest bilateral lender, has been an adamant opponent to this approach, arguing that MDBs should also share the losses with bilateral and private lenders.

Further, in the current structure, sovereign lenders negotiate deals with the indebted nation with help of the IMF, and private creditors are simply expected to match these terms without any say in the negotiation process. However, with the growth of private creditors as a prominent source of finance, they have had the power to hold up negotiations citing that process is glaringly unfair. Clearly, the common framework needs to be reworked to be more inclusive, and listen to the voices of upcoming creditors that wield great strength, if it wishes to obtain results.

- What policy measures can be taken to systematically and sustainably reduce the debt burden of EMDEs?
- How can private creditors be introduced into the international dialogue in order to reduce the risks of borrowing from them?
- How can we reignite interest and funding for the Sustainable Development Goals?
- What composition of debt will best promote long term debt sustainability in developing nations?
- How can the G-20's "common framework" be reworded to function more efficiently?
- What is the role of non Paris Club lenders in ensuring global debt sustainability?

Closing Remarks

- Dear delegates, we hope this Background Guide has been helpful to you. For any and all queries, please feel free to contact us:

- Director

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Citations

[1] https://www.un.org/ecosoc/en

[2] A government's budget balance is the difference between the government's expenditure and income measured over one fiscal year. The budget is said to be in deficit if expenditure exceeds income.

[3] Precise definitions vary depending on which institutions you ask, but we recommend looking at the *External Debt Statistics : Guide for Compilers and Users* (jointly published by the BIS, Eurostat, IMF, OECD, Paris Club, UNCTAD and the World Bank) for a more robust definition.

[4] Increases may be driven by more people applying for unemployment benefits or rations, for instance.

[5] For further details on tax-smoothing, please refer to : Cashin, Paul, Nilss Olekalns, and Ratna Sahay. *Tax Smoothing in a Financially Repressed Economy - Evidence from India*, 1998. https://doi.org/10.5089/9781451854466.001.

[6] International Monetary Fund. *Guidance Note on the Bank-Fund Debt Sustainability Framework for Low Income Countries*. Policy Papers, 2018. https://doi.org/10.5089/9781498307260.007.

[7] Caner, Mehmet, Thomas J. Grennes, and Friederike (Fritzi) N. Köhler-Geib. "Finding the Tipping Point - When Sovereign Debt Turns Bad." *SSRN Electronic Journal*, 2010. https://doi.org/10.2139/ssrn.1612407.

[8] This metric is consequential because a considerable majority of external debt servicing happens in the American dollar, which means that countries need a strong and steady flow of foreign reserves to meet debt obligations.

[9] We follow the IMF's debt distress classification. For more details, please refer : https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf

[10] IMF. "Restructuring Debt of Poorer Nations Requires More Efficient Coordination," April 7, 2022. https://www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination.

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[13] Gaspar, Vitor, Laura Jaramillo, and Mr Philippe Wingender. "Tax capacity and growth: Is there a Tipping point?." IMF Working Paper No. 16/234, International Monetary Fund, 2016.

[14] Organisation for Economic Co-Operation and Development. "The Impact of the Coronavirus (COVID-19) Crisis on Development Finance." 24 June 2020. www.oecd.org/coronavirus/policy-responses/the-impact-of-the-coronavirus-covid-19-crisis-on-development-finance-9de00b3b/#section-d1e973.

[15] In local currency terms.

[16] IMF. "How Countries Should Respond to the Strong Dollar," October 14, 2022. https://www.imf.org/en/Blogs/Articles/2022/10/14/how-countries-should-respond-to-the-strong-dollar.

[17] Zambia, Sri Lanka and Pakistan are some of the most glaring cases.

[18] The interest rates on loans from international financial markets and private lenders is closely linked to the domestic interest rates set by leading global economies.

[19] McKinsey & Company. "How Secure Is the Global Financial System a Decade after the Crisis?," September 13, 2018. https://www.mckinsey.com/industries/financial-services/our-insights/how-secure-is-the-global-financial-system-a-decade-after-the-crisis.

[20] OECD. "Global Outlook on Financing for Sustainable Development 2019," November 12, 2018. https://doi.org/10.1787/9789264307995-en.

[21] Over 2006 to 2011, the share of external debt owed by low- and middle-income countries to China increased from 2% to 18%. Over the same period, the share of Eurobonds sold to private lending institutions rose from 3 percent to 11 percent.

[22] The IMF estimates that only 16% of emerging-market public debt is denominated in foreign currencies.