Policy Brief

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Sustainable Development Goals in the Debt Trap

EXECUTIVE SUMMARY

A series of slow and fast burning debt crises in low-income countries seriously threaten the implementation of the Sustainable Development Goals (SDGs). The Covid-19 pandemic came to exacerbate an already unsustainable situation. The stakes are very high. If no immediate action is taken, many low-income countries will be at a worse position in 2030 in comparison to where they were in 2015. They will not only have a larger percentage of their population living in extreme poverty but also significantly weakened capacity to escape poverty. To help these countries escape their debt traps we should further integrate current 'attainment to SDGs' metrics with Debt Sustainability Analysis (DSA) and criteria for assessing vulnerability and accessing concessional funding. We also need to create new sources of funding and institutional arrangements able to address these crises in an orderly way. This policy brief provides an assessment of the impact of debt distress dynamics on the implementation of social and environmental SDG targets in low-income countries, and considers dynamic linkages and feedback loops between different SDGs. Our analysis is based on average historical data of more than 400 financial crises during the period 1970-2017 (Antoniades, Widiarto, Antonarakis, 2019). It does not aim to estimate the unprecedented impact of the current pandemic.

RECOMMENDATIONS

- Integrate further current 'attainment to SDGs' metrics with international criteria for 'assessing vulnerability' and 'concessional funding'.
- Use the SDG Target 17.4 to develop a new framework for IMF-WB Debt Sustainability Analysis on the basis of the need to meet the SDGs.
- Create a dedicated SDG-related debt relief and concessional lending fund, that could partly be capitalised by the creation of a new international digital, special purpose currency, or 'safe asset', linked to IMF's Special Drawing Rights (SDRs).
- Use IMF's SDRs as a scalable and targeted financing mechanism aimed at promoting socio-environmental sustainability.
- Establish a rules-based sovereign debt restructuring mechanism.
- Implement a coordinated quantitative easing (QE) programme supporting SDG attainment related assets, within the framework of decarbonising the global/national economies and tackling climate change.
- Implement changes in central banks' assets eligibility criteria and collateral frameworks, aiming to support and create more attractive SDG attainment related assets.

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CONTEXT

World hunger is on the rise for the third consecutive year (SDG 2). Almost half of all low-income countries (34 out of 73 countries), a population of 412 million people, was already in debt distress or in high-risk for debt distress before the pandemic. Twenty-three more low-income countries, a population of 334 million people, were classified as in moderate risk for debt distress (see also Zhang, 2018). The governments of most of these countries redirect a substantial portion of their revenues towards servicing their debt. According to UNCTAD (2018 [PDF 705KB]) in poorer economies, interest payments as a percentage of revenues more than doubled from 5.7% in 2008 to 14% in 2017. For sub-Saharan Africa, where more than half of the global poor live, this number increases to 18.5%. Some of the most extreme cases include Ghana and Zambia that in 2017 gave respectively 27% and 24% of their revenues for debt payments (Wold Bank Data). Instead of increasing public spending to meet their Sustainable Development Goals (SDGs) targets, a significant part of poor countries are reducing it (see also Jubilee Debt Campaign, 2020). The Covid-19 pandemic comes to exacerbate these distressing pre-existing trends.

KEY FINDINGS

With regard to SDG 1, on extreme poverty eradication, our results point to a significant impact able to reverse the significant progress that has been achieved hitherto. In particular, we estimate that financial crisis episodes are associated with increases of approximately 10% in people in extreme poverty in low-income countries (Table 1).

If we apply this to the group of countries already in debt distress, this would mean an increase of 11.8 million people in extreme poverty. If we add to this the countries in high risk of debt distress then the estimated increases in people in extreme poverty reach 40.7 million people. Caution here is important. Not all these countries are facing the same degree of financial pressures, and the population size of each country matters. But the above numbers indicate clearly that the situation with regard to extreme poverty would get significantly worse, even before the new pandemic shock. The high concentration of extreme poor matters too (Katayama & Wadhwa, 2019). More than half of this population, globally 736 million people, live in sub-Saharan Africa, where the majority of countries in debt distress and at high risk for debt distress are located (Table 2). Ethiopia and the Democratic Republic of Congo, where 4% and 7% of the global population of extreme poor live were, respectively, already in high-risk and moderate-risk for debt distress, before the pandemic crisis. Our results are both in line with recent evidence from the World Bank that poverty reduction has slowed down (2018 [PDF 5MB] and 2019 [PDF 17MB]), and ODI's pre-pandemic estimates that increased its earlier projections on people to be in extreme poverty by 2030 by 30 million (2019 [PDF 2MB]).

Income poverty (US $1.90) is just one facet of poverty dynamics. Our results indicate that the impact of financial distress is even more pronounced on education (SDG 4). This is critical for SDG implementation on the whole, as education is the most important lever both for escaping poverty and for developing the human capital that is required for meeting most SDG targets. Our results for low-income countries point not only to significant numbers of children dropping out from primary school, 5.8% of the respective age group, but also a severe reduction in government education

TABLE 1: ESTIMATED IMPACT OF FINANCIAL CRISES ON LOW-INCOME COUNTRIES

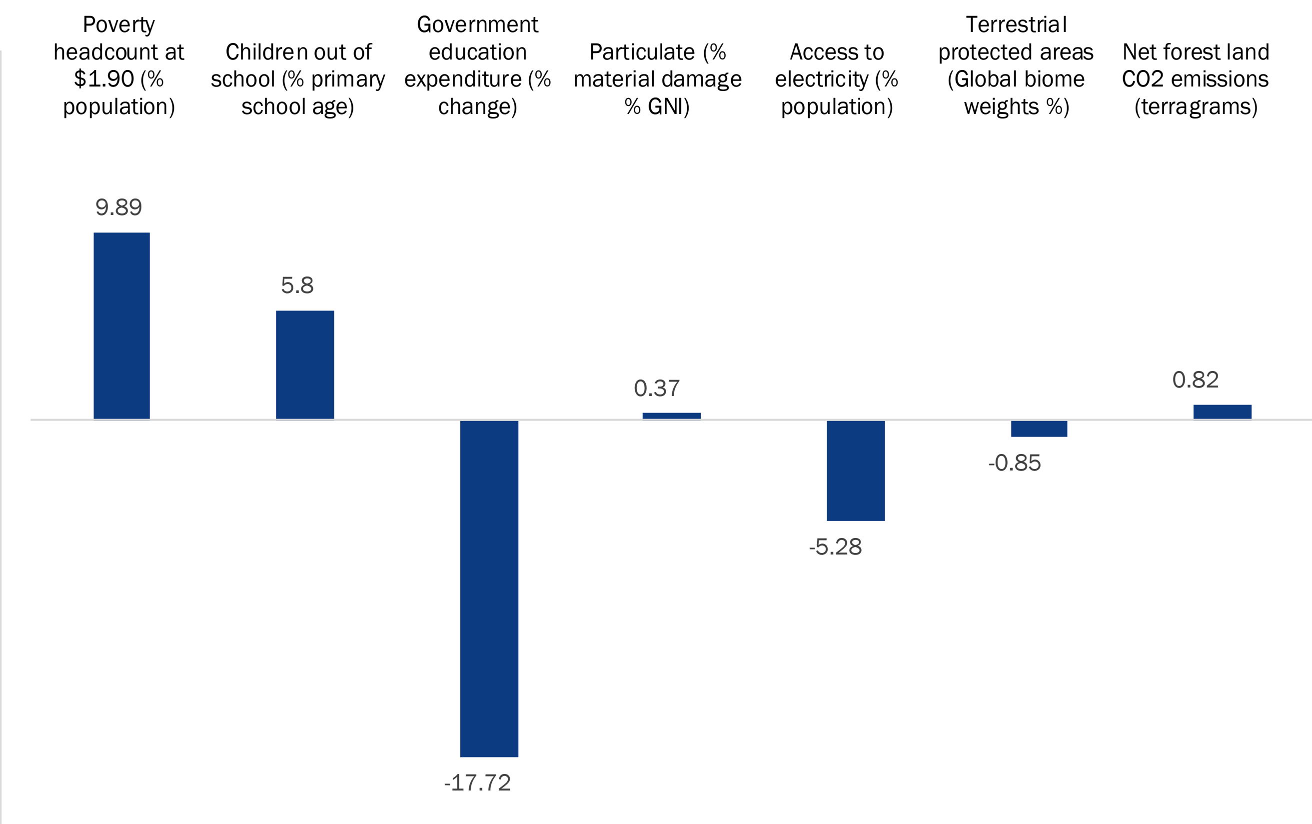


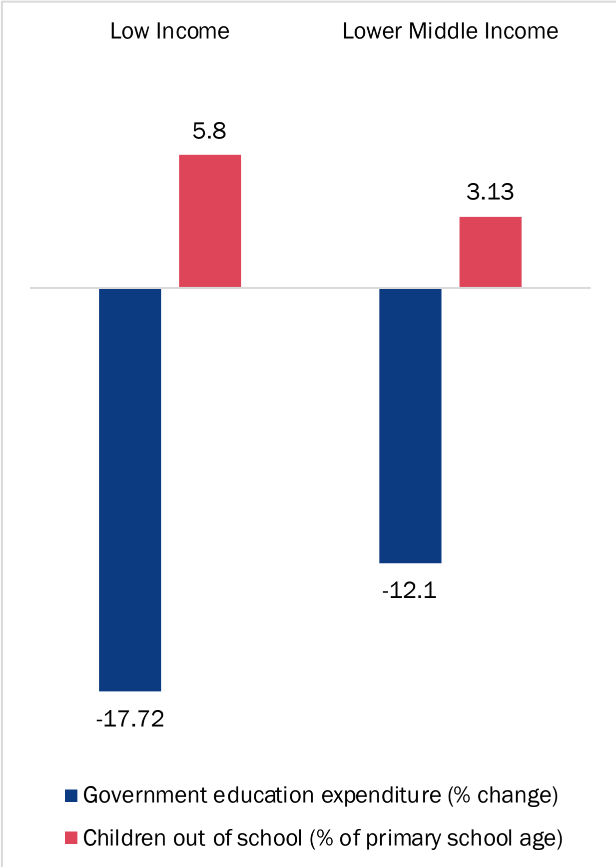
TABLE 2: LIST OF LOW-INCOME COUNTRIES IN DEBT DISTRESS OR AT HIGH RISK OF DEBT DISTRESS (AS OF 30 APRIL 2020)

	Population (thousands)	Poverty headcount at $1.90 (% population
Ethiopia * **	109,224.56	30.8
Sudan	41,801.53	14.9
Afghanistan * **	37,172.39	NA
Ghana *	29,767.11	13.3
Mozambique * **	29,495.96	62.4
Cameroon *	25,216.24	23.8
Zambia	17,351.82	57.5
Chad *	15,477.75	38.4
Somalia	15,008.15	NA
Zimbabwe	14,439.02	21.4
Burundi	11,175.38	71.8
Haiti * **	11,123.18	25
South Sudan	10,975.92	42.7
Tajikistan * **	9,100.84	4.8
Sierra Leone * **	7,650.15	52.2
Lao PDR	7,061.51	22.7
Congo, Republic	5,244.36	37
Central African Rep. * **	4,666.38	66.3
Mauritania * **	4,403.32	6
Gambia * **	2,280.10	10.1
Djibouti * **	958.92	17.1
Cabo Verde *	543.77	8.1
Maldives *	515.7	7.3
São Tomé & Príncipe * **	211.03	32.3
Samoa *	196.13	1.1
Kiribati	115.85	12.9
Micronesia	112.64	15.4
Grenada *	111.45	NA
St. Vincent & Grenadines *	110.21	NA
Tonga	103.2	1
Dominica *	71.63	NA
Marshall Islands	58.41	NA
Tuvalu	11.51	3.3

*Notes: Countries ordered according to population size. In red colour, countries in debt crisis. In black colour, countries at high risk of debt crisis. In blue highlight, countries in Sub-Saharan Africa. * Indicates funding from the IMF's Rapid Credit Facility (except in Ethiopia's case which refers to the Rapid Financing Instrument). ** Indicates concessional funding from the IMF's Catastrophe Containment and Relief Trust, since April 2020. Sources: IMF, World Bank, imfmonitor.org.*

spending of 17.7%. The respective numbers for lower-middle income countries are slightly lower but equally significant, 3.13% and 12.1% respectively (Table 3). If we are looking for one indicator to explain the persistent pattern of poverty in poor countries, this must be it!

TABLE 3: ESTIMATED IMPACT OF FINANCIAL CRISES ON LOW-INCOME COUNTRIES' EDUCATION DYNAMICS



The situation is most pronounced in sub-Saharan Africa where the participation rate in early childhood and primary education is only 41% (against 70% internationally in 2016) (SDG 4). Thus, the success or failure of SDGs may be determined here.

Another significant factor cross-cutting and conditioning the implementation of SDGs is access to energy (impacting on income poverty, health, education, access to clear water etc), with access to electricity being a leading indicator (SDG 7). According to our estimates, in times of financial crisis, 5.28% of the population in low-income countries loses access to electricity (Table 1). Applied in the countries already in debt distress or at high risk of debt distress, before the pandemic, this would be 21.7 million people. Further worrying signs that we may start regressing from the progress that has been achieved in this area, and the potential negative knock-on effect that this may have on SDG implementation as a whole.

Environmental poverty is another important aspect of the poverty dynamics associated with financial crises in low-income countries. The indicator 'adjusted savings: particulate emission damage' measures damage in low-income countries, in terms of foregone labour income due to premature death caused by exposure to $PM_{2.5}$. Periods of financial crises are associated with an increase of 0.37 particulate emission damage as a percentage of gross national income (for instance, in Ethiopia, Ghana and Mozambique this would be respectively 310.1, 237.8 and 53.4 million US$), indicating a significant negative impact on population health and productivity (Table 1).

Indicators related to forests and protected land also suffer. We observe a negative percentage change of 0.85 on terrestrial protected areas measured in global biome weights (Table 1), a key indicator for measuring biodiversity and natural resource exploitation. We also observe 0.82 terragrams more CO_2 emitted from forest removals during financial crises for low-income countries. This is similar in magnitude to the total yearly emissions of countries such as Eritrea, Somalia, and Chad (GCP, 2019). The reasons for environmental destruction vary from region to region, but include increases in forest product exports, illegal logging, commodity driven agriculture, and population pressures into natural and protected land. Much environmental degradation, e.g. biodiversity loss, carbon emission, air pollution, are not local phenomena, signalling that environmental poverty somewhere is environmental poverty everywhere.

RECOMMENDATIONS AND BEYOND

Low-income countries are the priority target group of SDGs, in the pledge of the global community 'not to leave anyone behind'. Our estimates clearly indicate that no discussion on meeting the SDGs can be credible without seriously accounting for the current issue of debt crises, debt distress and debt exposure in low-income countries. In the current conditions, these countries are more likely to be in a worse position in 2030 in comparison to 2015, the starting year of SDGs even before accounting for the unprecedented negative impact of the Covid-19 pandemic. The key to avoid such a disastrous outcome for global development, stability and sustainability is to link debt sustainability with SDG targets, and, in broader terms, to integrate further current 'attainment to SDGs' metrics with criteria for 'assessing vulnerability' and 'concessional funding'. Part of the framework to do this already exists in SDG 17, Partnerships for the Goals. Target 17.4 foresees global action to '[a]ssist developing countries in attaining long term debt sustainability through coordinated policies aimed at fostering debt financing, debt relief and debt restructuring, as appropriate, and address the external debt of highly indebted poor countries to reduce debt distress'. In this framework, the IMF and the World Bank have an important role to play, by effectively integrating the SDG targets in their debt sustainability framework for low-income countries, and proactively and pre-emptively leading and coordinating the global policy that is urgently needed in the framework of SDG Target 17.4. The target here is not to achieve debt sustainability at any cost (semper primus), but to develop a debt sustainability analysis on the basis of the need to meet the SDGs.

Funding remains a key issue here. The contribution of private capital markets and blended finance is necessary to meet the SDGs. But it is not a sufficient condition and there should be a limit on the financialisation of basic human rights and global commons; otherwise our interventions become part of the problem, reproducing and exacerbating unsustainable patterns and damaging the resilience of our societies. To trigger the transformation that is required to meet the SDGs, new thinking, new policy frameworks and new instruments will be needed. Ideas are already on the table – a powerful list was recently put together by UNCTAD (2019) (including most points below), but several more transformations are already happening on the ground (e.g. UNDP, 2019) or have been suggested (e.g. Cahn & Ibrahim, 2016, Plant, 2020 [PDF 5MB]). These include:

- Creating a dedicated SDG-related debt relief and concessional lending fund, that could partly be capitalised by the creation of a new international digital, special purpose currency, or 'safe asset', linked to the IMF's Special Drawing Rights.
- Using IMF's Special Drawing Rights (SDRs) as a scalable and targeted financing mechanism aimed at promoting socio-environmental sustainability.
- Implementing a coordinated quantitative easing (QE) programme supporting SDG attainment related assets, within the framework of decarbonising the global/national economies and tackling climate change, led by International Financial Institutions (IFIs) and central banks.
- Implementing changes in central banks' assets eligibility criteria and collateral frameworks, aiming to support and create more attractive SDG attainment related assets.
- Establishing a rules-based sovereign debt restructuring mechanism (a long-lasting demand).

One thing is for sure, without breaking away from the existing policy frameworks it is highly unlikely that we will manage to trigger the transformation that is required not to leave the global poor and hungry behind and to create a new sustainable global socio-environmental order.

The current pandemic not only adds unprecedented urgency to this task, but also creates evidence that it is the best shot we have to transition to a socio-environmentally sustainable system.

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