Joint IMF-CEF-AFESD Seminar on Tackling MENA Countries’ High Debt: Challenges and Policy Priorities

11 June 2024

A DEVELOPMENT PERSPECTIVE FOR ADDRESSING DEBT-OVERHANG IN HIGHLY INDEBTED ARAB COUNTRIES

Mahmoud Sami Nabi, AFESD

OUTLINE

1. **The debt-overhang in highly-indebted Arab countries (HIAC)**
2. **Addressing debt-overhang within a holistic development approach**
3. **AF new strategy's focus on priority areas of development in Arab countries**
4. **AF's call for an Arab Debt Relief Initiative (ADRI)**

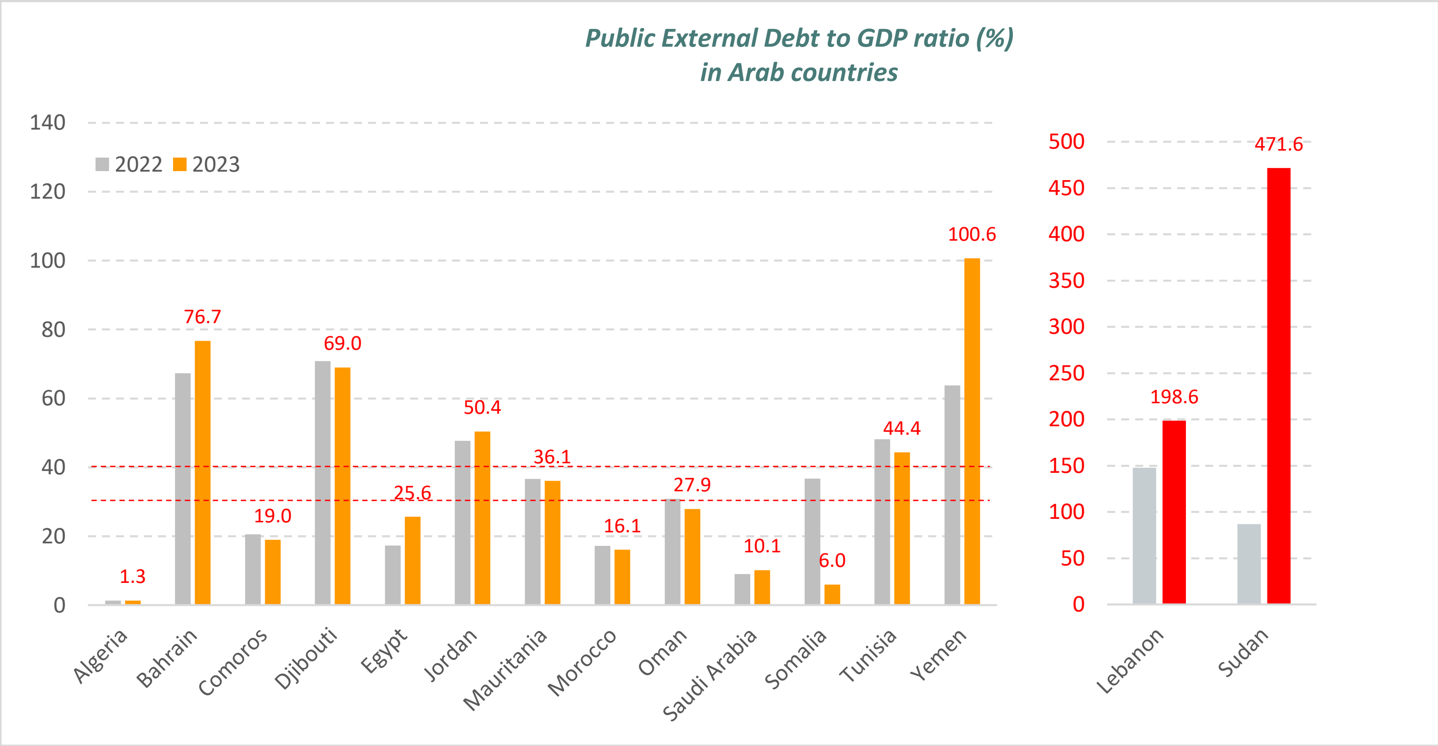
Disclaimer: The views expressed in this presentation are those of the author and do not necessarily reflect the views of the Arab Fund for Economic and Social Development (AFESD).

1. The debt-overhang in the Highly-Indebted Arab Countries (HIAC)

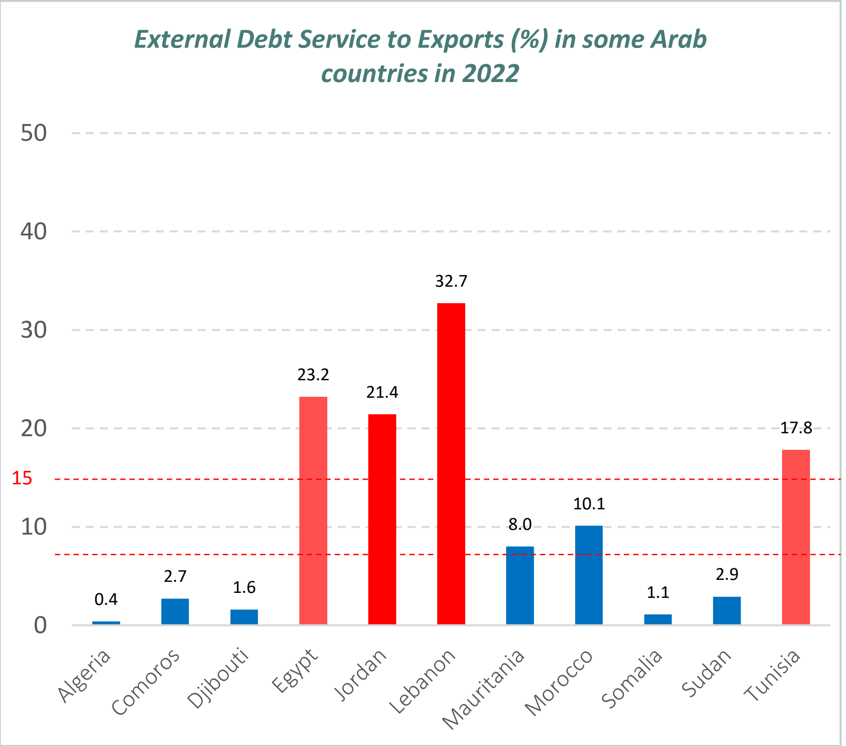
High increase of the external debt of borrowing Arab countries (1) during the last decade in which they were exposed to a succession of diverse disruptions (COVID-19 pandemic, conflicts, energy and food price volatility, droughts and floods, tightening financial conditions): The average total external debt to GDP increased from 35.7% in 2015 to 59.2% in 2022.

11 Highly-Indebted Arab Countries (HIAC) (out of 22)

- **Actual default: Lebanon, Palestine, Sudan, Syria, and Yemen.**
- **Warning external indebtedness: Bahrain, Djibouti, Egypt, Jordan, Mauritania, and Tunisia.**



Source: Database of the Joint Arab Economic Report (Preliminary data for 2023).



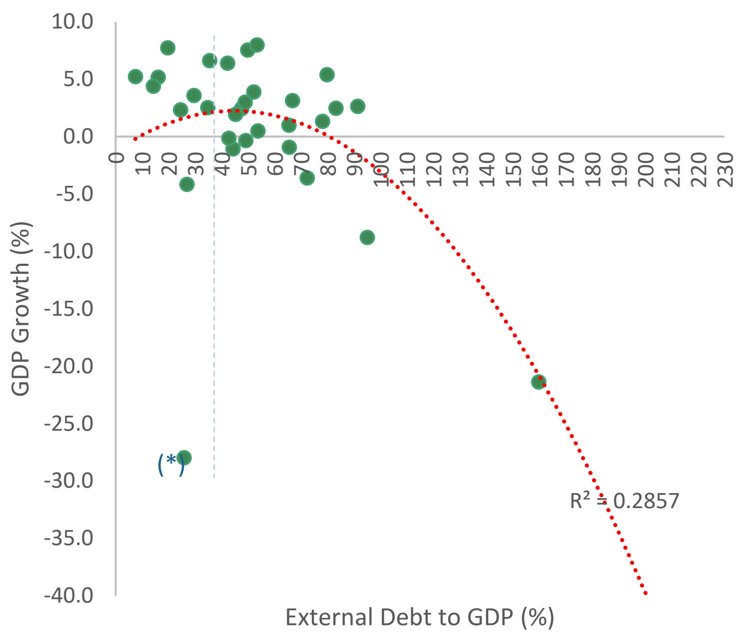
Source: International Debt Statistics.

(1) Bahrain, Comoros, Djibouti, Egypt, Jordan, Lebanon, Mauritania, Morocco, Oman, Saudia Arabia, Sudan, Syria, Tunisia, and Yemen.

• *The debt-overhang of the High-Indebted Arab Countries (HIAC)…*

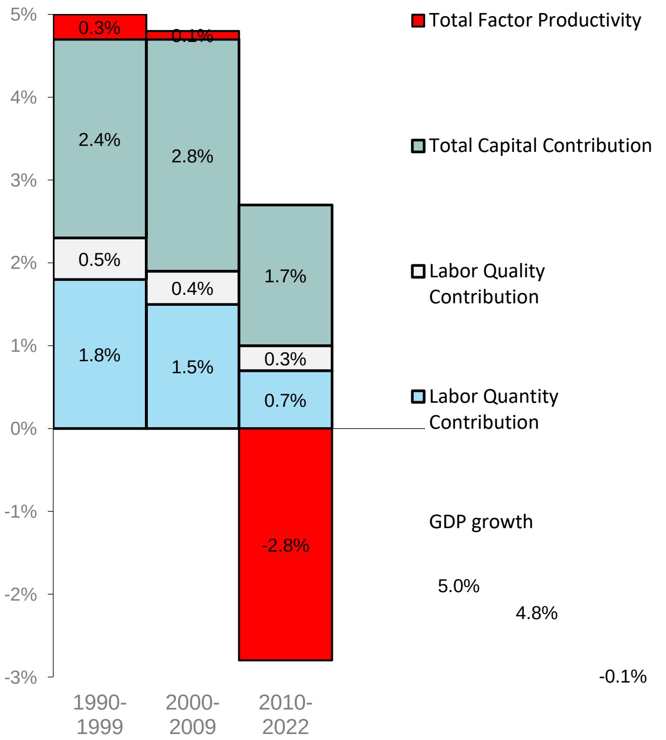
The excessive debt reduces the supply of new loans, dampens new investments and increase the size of informal sector (in anticipation/subsequent of/to higher tax) and discourages policy efforts to undertake costly economic reforms (2), (3), (4)).

The inverted-U relationship between debt and growth in HIAC (2015,2020,2022)



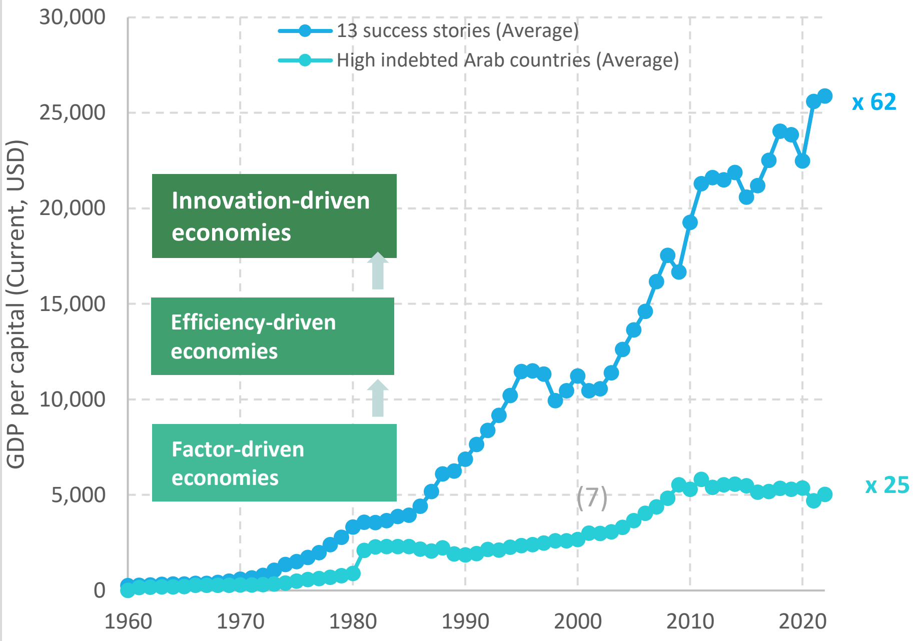
Source: The author based on data retrieved from the database of the Joint Arab Economic Report 2023 and the World Development Indicators. Considered countries: Djibouti, Egypt, Jordan, Lebanon, Mauritania, Sudan, Syria, Tunisia, Yemen

Evolution of the GDP growth determinants in 7 HIAC



Source: Based on the data pf The Conference Board Total Economy Database™ - Growth Accounting and Total Factor Productivity, 1990-2022. Countries: Bahrain, Egypt, Jordan, Lebanon, Syria, Tunisia, and Yemen

Evolution of the GDP per capita (average, Current USD) of 13 success stories (7), (8) and the HIAC



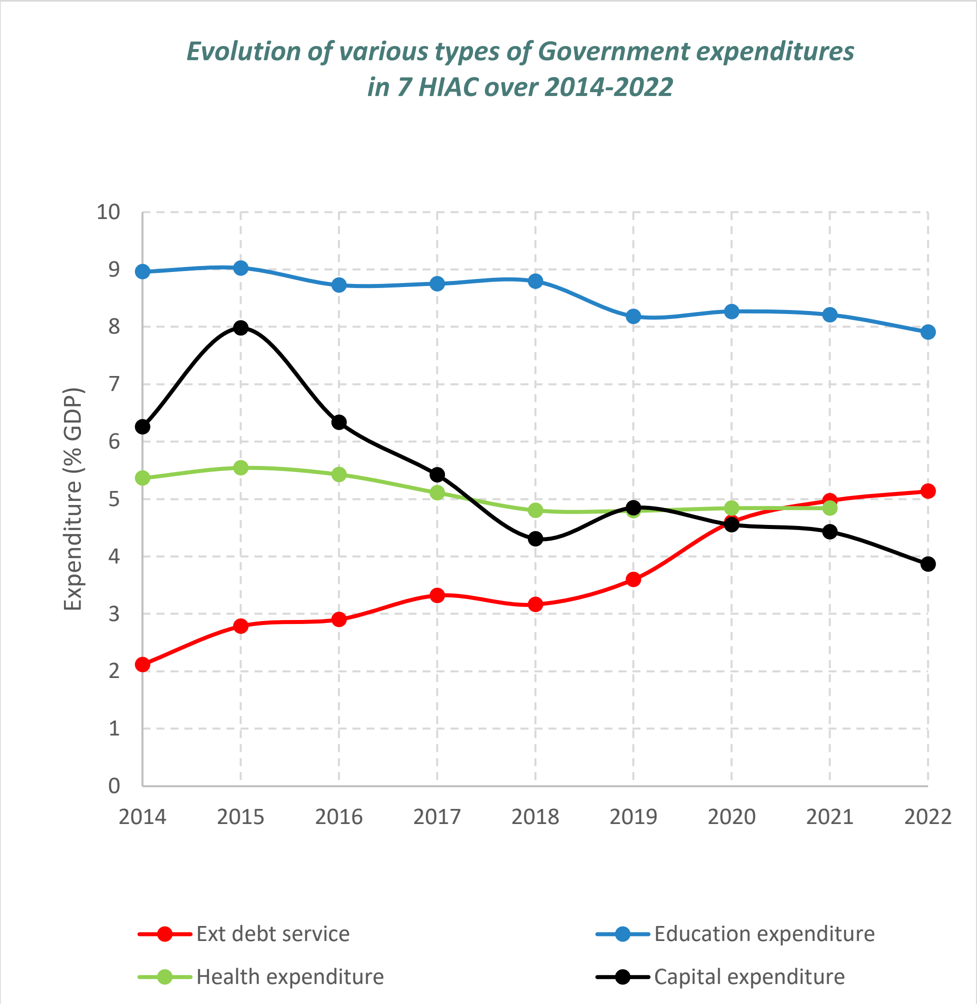
Source: World Development Indicators

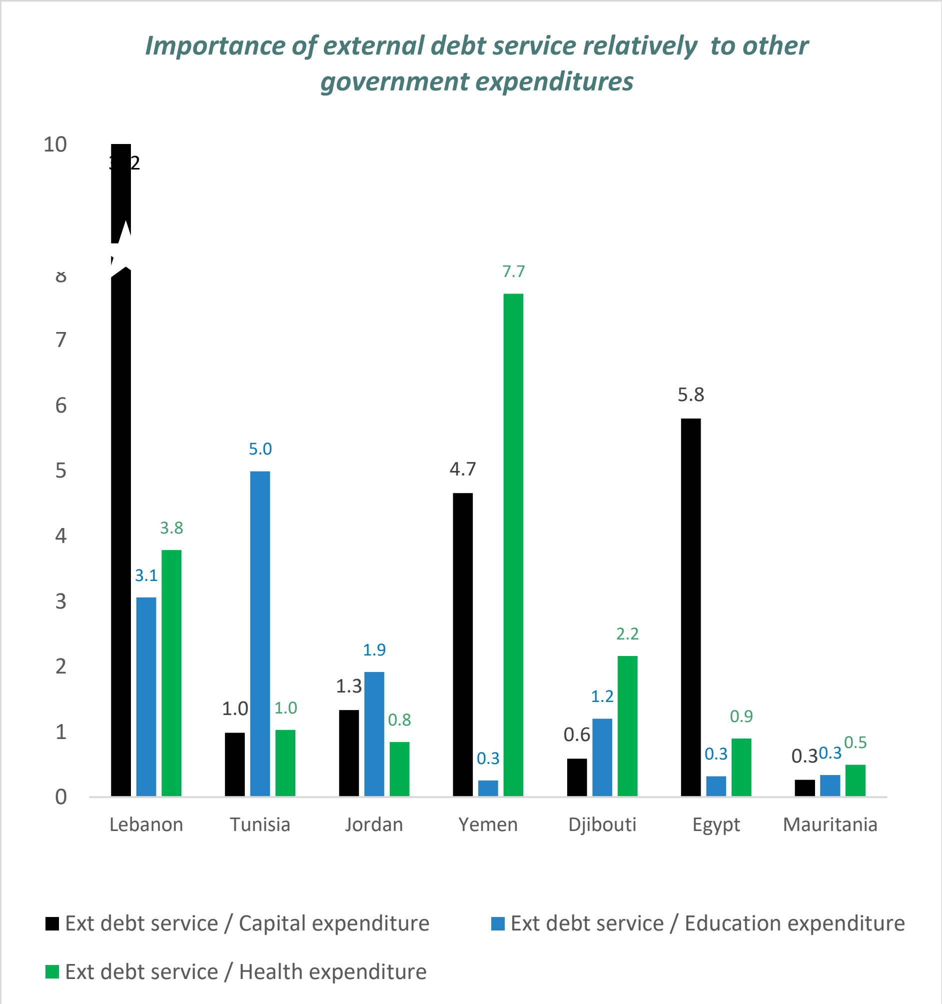
(*) Inverted-U relationship between debt and growth (turning point at 35-40%) (5). The external debt dampens the economic growth through two channels: **weak physical capital accumulation** (1/3 on average) and **negative effects on total factor productivity** (2/3 on average) (6).

TFP is the dominant factor accounting for the difference in development levels (9) (e.g. 75% of South Korea's growth during 1960-2005 is attributable to TFP. (10))

(2) Krugman (1988) ;(3) Sachs (1989); (4) Drine and Nabi (2010); (5) Patillo et al (2002) ; (6) Pattillo et al. (2004); (7) Botswana, Brazil, China, Hong Kong, Indonesia, Japan, Malaysia, Malta, Oman, Singapore, South Korea. Taiwan, Thailand.; (8) Commission on Growth and Development(2008); (9) Hulten and Isaksson (2007); (10) Suh and Chen (2007).

…is reducing the fiscal space in HIAC at the expense of education, health and capital expenditure.





Sources: Databases of the Joint Arab Economic Report, 2023 and the World Development Indicators (12).

(12) The author is thankful to Moez Romdhani for their cooperation in generating the data.

- ***Most of the HIAC have registered slow progress in achieving the SDGs and face huge climate finance gap***

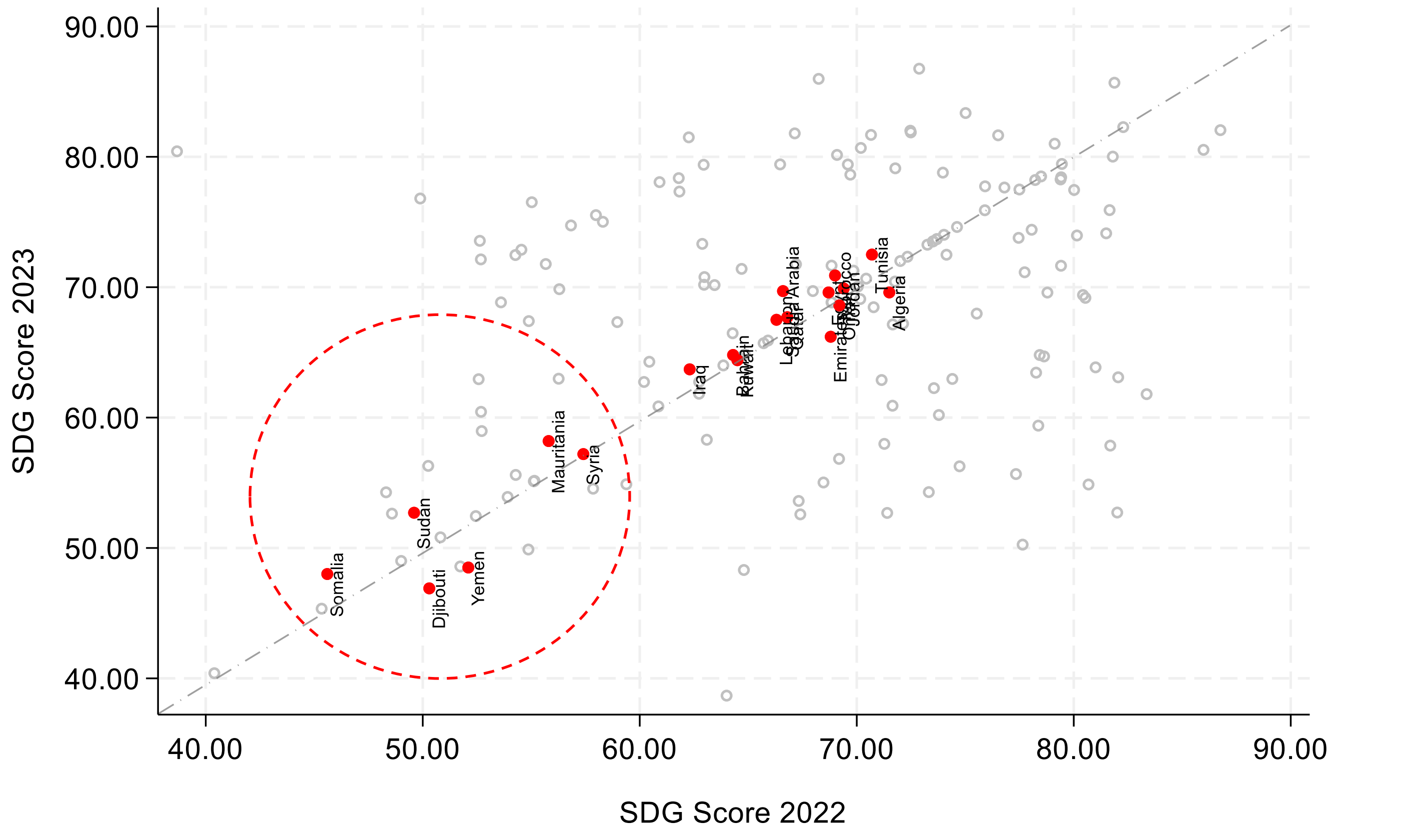
- ***Huge financing gap:***

The financing needs of 11 Arab countries (13) for the implementation of their nationally determined commitments (NDC) for mitigating the greenhouse gas emissions and for adapting to climate impacts:

$ 71.2 billion per year until 2030

>> $3.5 billion per year on average... (14)

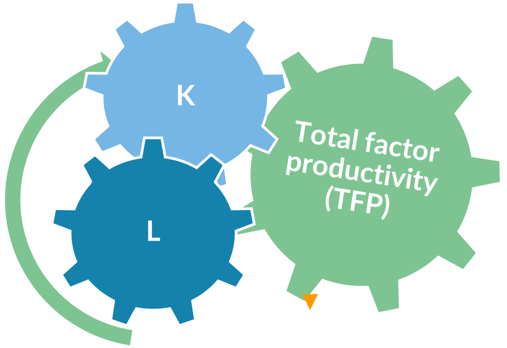
Evolution of the Arab countries SDG Scores from 2022 to 2023



Source: Data retrieved from the Sustainable Development Report 2023 (sdgindex.org)

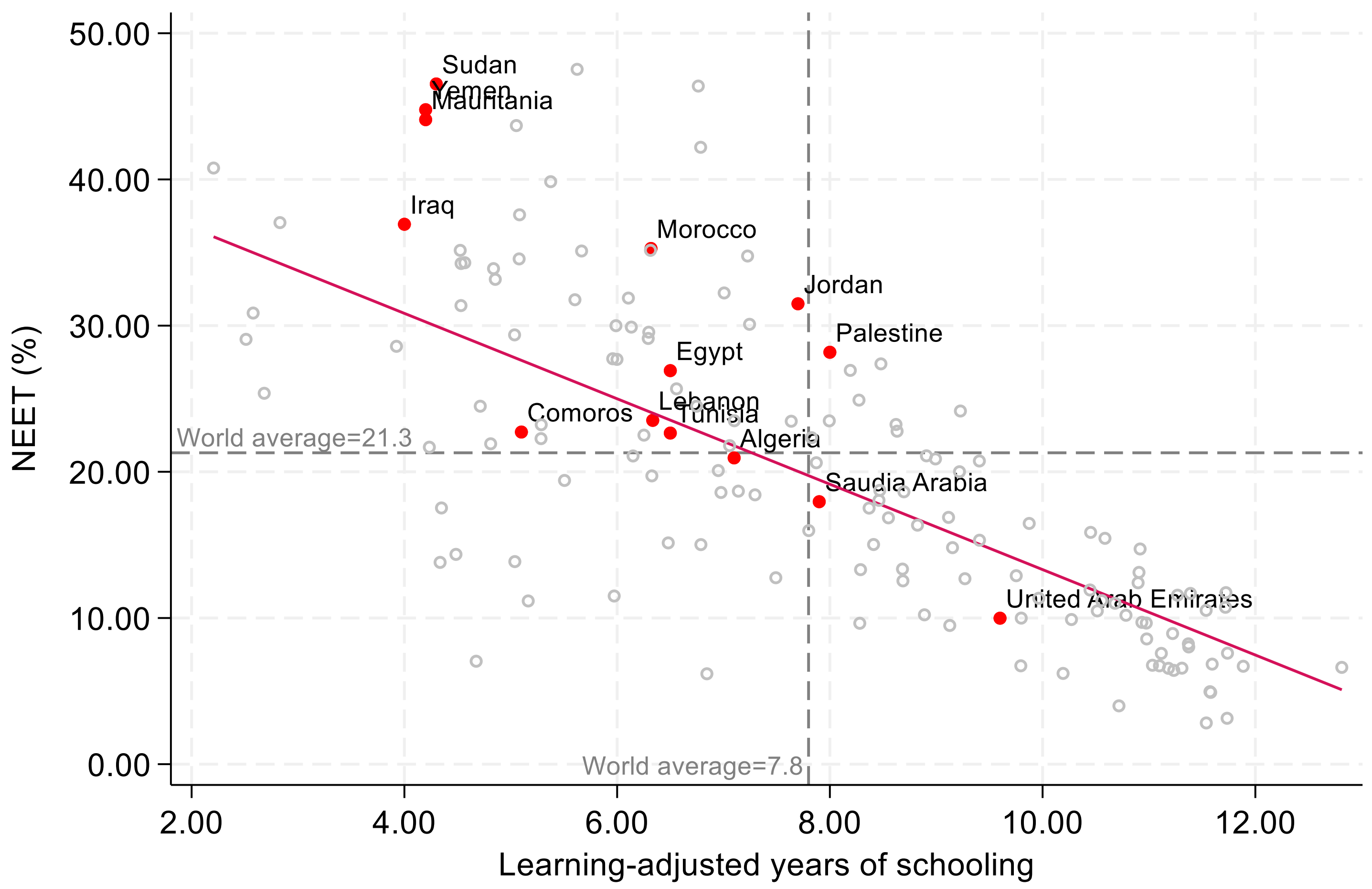
(13) Comoros, Djibouti, Egypt, Iraq, Jordan, Mauritania, Morocco, Palestine, Somalia, Sudan, and Tunisia.
(14) https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2021/

- ***Developing Human capital is crucial for an inclusive economic growth in the HIDC …***
  - *"Human capital is the primary factor driving the wealth disparity between high and low-income nations, eclipsing the contributions of both natural resources and physical assets."* (15)



Human capital (quality of education)
Market efficiency **Infrastructure**
Innovation
institutions (16), (17).

Youth not in Education, Employment or Training (NEET) (% of youth population) and Learning-adjusted years of schooling in Arab Countries and the world



(15) Patrinos et al. (2024); (16) Kim and Loayza (2019); (17) Makdisi, Fattah, and Limam (2007) .

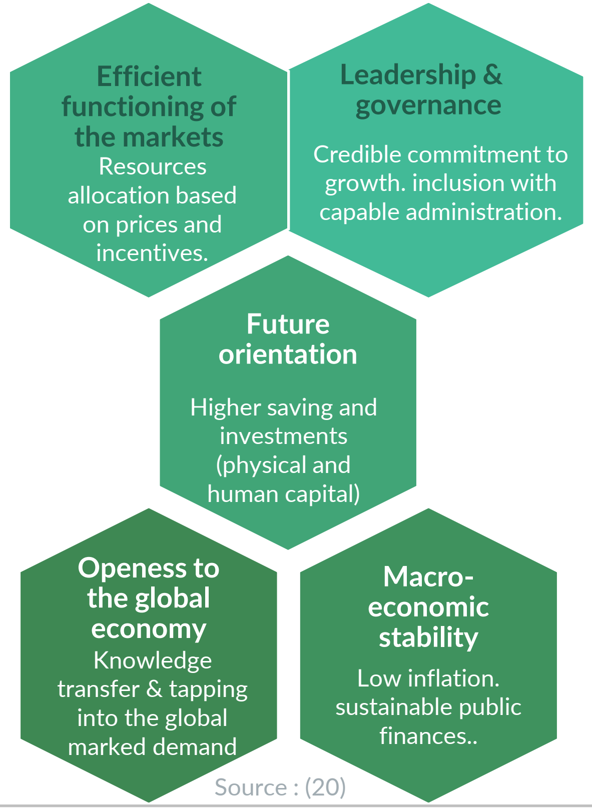
Sources: Data retrieved from the Human Capital Index, 2020 and the World Development Indicators

2. Addressing debt-overhang within a holistic development approach

Macroeconomic stability is a necessary but insufficient component of any successful development strategy.

- «*Hannibal reformed the tax system and stabilized the economy* enabling ***Carthage*** to reinvent itself from an imperial capital into a flourishing commercial hub.» (18)

- *Main determinants of high and sustained growth in the postwar period of 13 success stories* (19)



Source : (20)

- "..***Governments were also fiscally responsible***.
Many ran budget deficits for extended periods; some nursed high ratios of debt to GDP. But this public debt did not get out of hand, not least because *the economy grew faster than the stock of public liabilities*." (20)

(18) Mulligan (2015).
(19) Botswana, Brazil, China, Hong Kong, Indonesia, Japan, Malaysia, Malta, Oman, Singapore, South Korea, Taiwan, Thailand.
(20) Commission on Growth and Development(2008).

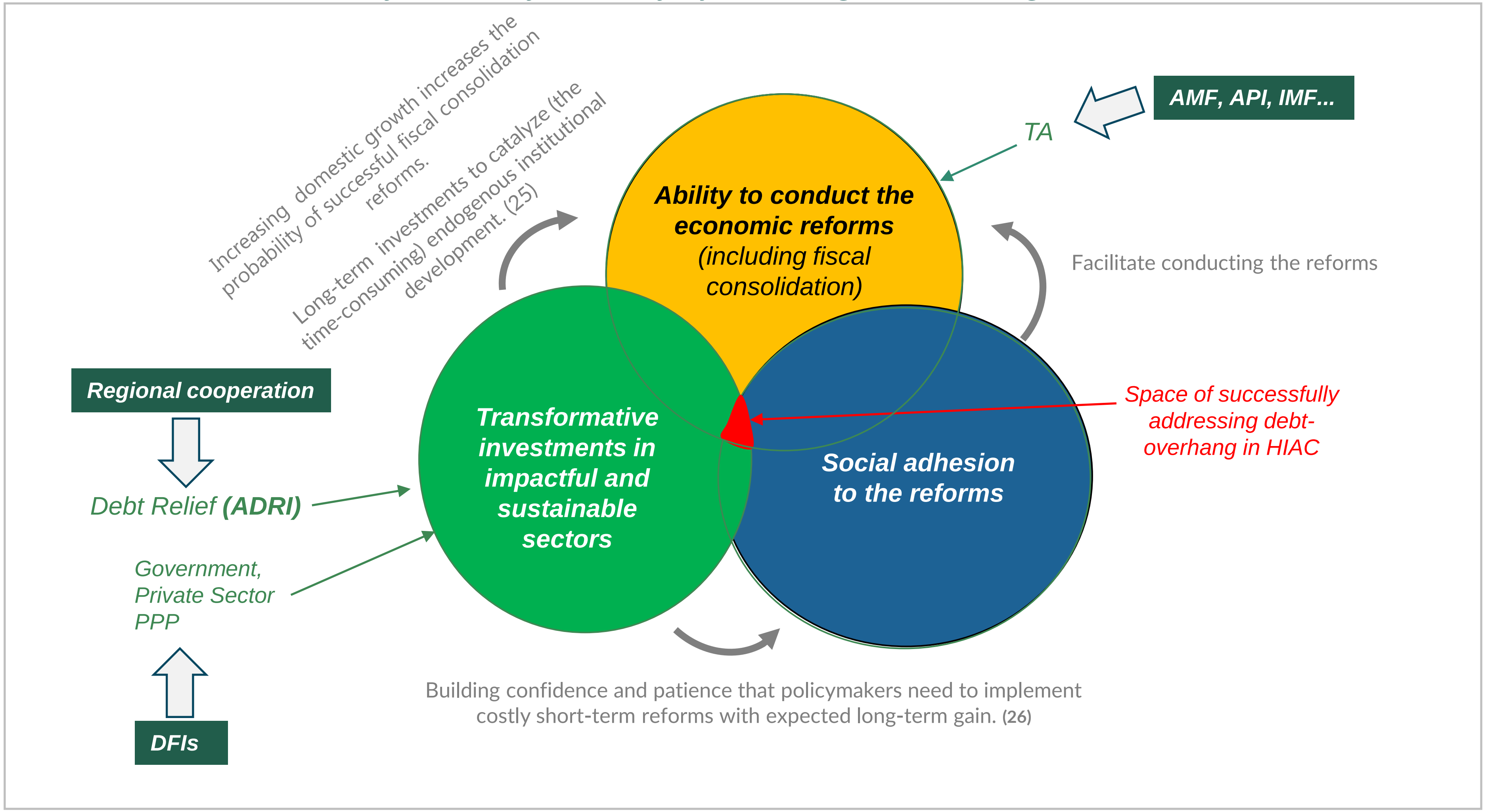
Lessons learnt from countries' experiences

- *Ibn Khaldun (1332–1406): The rise and fall of societies are the results of **dynamic interrelationships between social, moral, economic, political, historical and demographic factors**.* (21)
- *Acemoglu and Robinson (2012): "All successful sustained experiences of economic growth feature **inclusive economic institutions** that create broad based incentives and opportunities in societies."* (22)
- *"Struggling with debt, **Puerto Rico**'s government needed a comprehensive plan to reduce its liabilities and restore economic prosperity…What Puerto Rico needed was a plan to reduce debts to a sustainable level, ensure adequate investment in the people and resources the economy needs, and create a viable path forward for economic growth, opportunity, and hope... »* (23)
- *« **Jamaica** stands out for reducing its debt from 144 percent of GDP to 72 percent over the last decade, a record achieved by running large, persistent primary budget surpluses. Well-designed fiscal rules combined with social partnership agreements making for fiscal ownership are at the root of its achievement. »* (24)

(21) Chapra (2008); (22) Acemoglu and Robinson (2012); (23) Malhorta et al. (2022) ; (24) Arslanalp et al. (2024).

- *Addressing Debt-overhang in HIAC requires a policy agenda that* ***combines fiscal consolidation with transformative investments and growth-boosting reforms.***

A holistic framework for successfully addressing debt-overhang in HIAC



Source: The author inspired by (27).

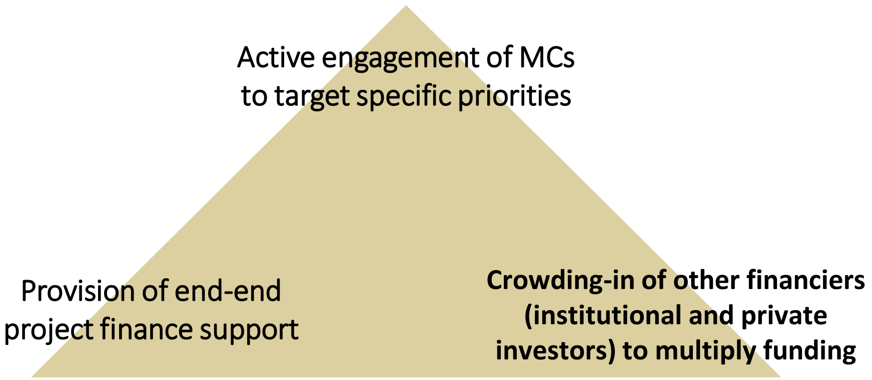
(25) Acemoglu (2006); (26) Easterly et al. (2006); (27) Andrews et al (2010).

3. AF new strategy's focus on priority areas of development in Arab countries

- ***The AF will continue supporting the development paths of its Member Countries and responding to their specific needs and priorities*** with focus on 5 priority areas and 5 cross-cutting themes:

AF new strategy's priority development areas and drivers

Social infrastructure	Economic infrastructure
Education	Water
Healthcare	Energy
	Transport and Logistics



Cross-cutting objectives

- **Create jobs and economic growth**
- Reduce inequalities
- Support adaptation and resilience
- Enable regional integration and collaboration
- Support technology, innovation and digital transformation

4. AF’s call for an Arab Debt Relief Initiative (ADRI)

- ***Debt defaults are looming large and debt sustainability*** *issues represent a constraint for channeling needed funding to crucial development projects in the HIAC.*

Regional and international cooperation is needed *to* ***avoid prolonged stunted growth levels and enable the Regional financial institutions’ development reengagement .***

The AF is calling for an Arab Debt Relief Initiative (ADRI):

- ***Grounded in a comprehensive approach to development*** tied to ***economic reforms*** (targeting macroeconomic soundness, the modernization of the public sector, the unleashing of the private sector potential), and ***building resilience towards climate change-related risks*** (including water and food security), whilst ***leveraging on digital transformation***.
- ***Based on FASTER principles***: ***F***easibility (Progressivity), ***A***chievability, ***S***olidarity & Cooperation, ***T***ransparency, ***E***nforceability, and ***R***eengagement.

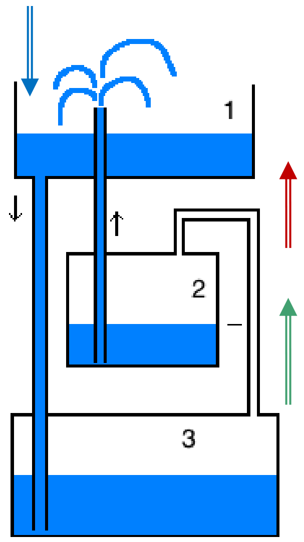
“The debt overhang acts as a tax on economic reform. This adverse incentive effect can be overcome only by reducing the debt that is due, so that more of the benefits of economic reform accrue to the country trying to act responsibly. In this sense, the possibility of getting a debt reduction will act as a spur to economic reform, not as a disincentive. Moreover, in most proposals, debt reduction is tied to an internationally supervised program of economic reform in the debtor country. Countries that don't adjust don't get the debt reduction.” (28)

“The analysis shows that debt forgiveness offers favourable prospects in terms of debt sustainability and economic outcomes than debt rescheduling. ” (29)

(28) Sachs (1989) ; (29) Ahiadorme (2023).

- ## ***The suggested framework for the ADRI*** *(inspired by the Heron Fountain)*

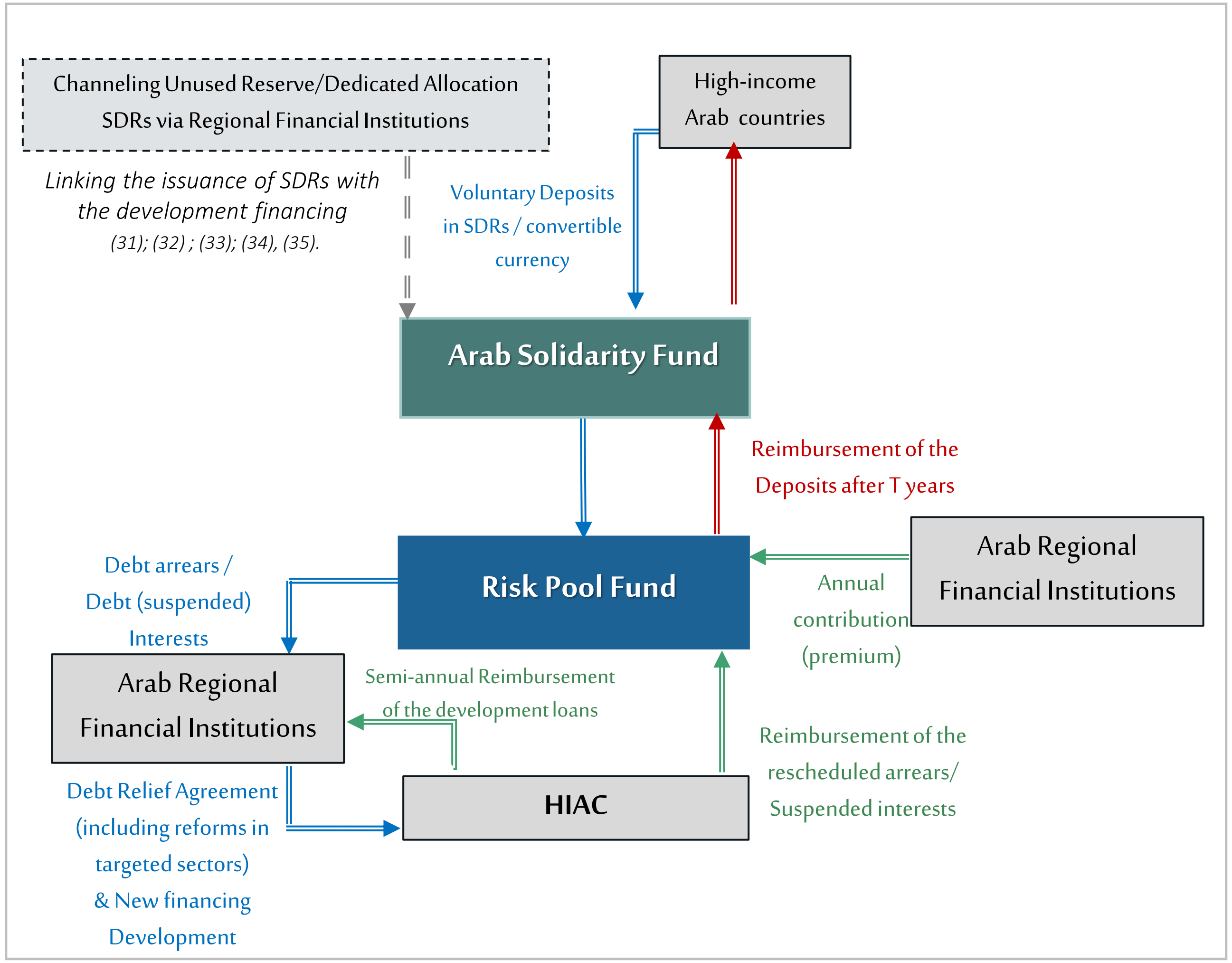
Heron Fountain's principle



Source: https://ucscphysicsdemo.sites.ucsc.edu/

Invented by the 1st century AD inventor, mathematician, and physicist Hero of Alexandria, "Heron's Fountain is an apparatus which responds when liquid water is added to the fountain basin and generates a water jet from the fountain head" (30)

A Heron-fountain-inspired framework for an Arab Debt Relief Initiative (ADRI)



Source: The author based on (36)

(30) Abcarian et al. (2019); (31) Stiglitz et al. (2009); (32) ESCWA (2021); (33) Ghosh and Nabi (2020); (34) Ghosh (2023); (35) Paduano (2024); (36) Nabi et al. (2024).

References

- Abcarian et al. (2019) "Discharge Coefficient Measurements Using Heron's Fountain," Journal of Civil Engineering and Architecture 13, 195-203.
- Aghion and Howitt (2009) "Economics of Growth," MIT Press.
- Ahiadorme (2023), "Unpleasant surprises? Debt relief and risk of sovereign default", Journal of Financial Economic Policy, Vol. 15 No. 1, pp. 47-74.
- AMF, AFESD, LAS, and OAPEC (2023) "Joint Arab Economic Report," Arab Monetary Fund, https://www.arabfund.org/Default.aspx?pageId=212
- Andrews, McConnell and Wescott (2010) "Development as leadership-led change – A report for the global leadership initiative and the World Bank Institute (WBI)," Harvard Kennedy School, Faculty Research Working Paper Series, RWP10-009.
- API and INP (2023) "Climate Change and Sustainable Development in the Arab States," Arab Development Report, Seventh Edition, 2023.
- Arezki and Mohieldin (2022) "Preventing Developing-Economy Debt Disasters," Project Syndicate, https://www.project-syndicate.org/commentary/rising-food-and-energy-prices-mean-developing-economy-debt-crises-by-rabah-arezki-and-mahmoud-mohieldin-2022-04
- Arslanalp, Eichengreen, and Henry (2024) "Sustained Debt Reduction: The Jamaica Exception,"NBER Working Paper No. 32465.
- Baghdadi and Labidi (2023), "Public debt, growth and stabilization in Tunisia: A new narrative for a structural reform agenda", Economic Research Forum Working Paper n°1653.
- Chapra (2008) "Ibn Khaldun's theory of development: Does it help explain the low performance of the present-day Muslim world?" The Journal of Socioeconomics, Vol. 37, No. 2, 836–886.
- Commission on Growth and Development (2008) "The Growth Report Strategies for Sustained Growth and Inclusive Development," IBRD-World Bank.
- Drine and Nabi (2010) "Public external debt, informality and production efficiency in developing countries," Economic Modelling, Volume 27, Issue 2, 2010, pp 487-495.
- Easterly, W., J. Ritzan and M. Woolcock (2006) "Social cohesion, institutions, and growth," Economics and Politics, Vol. 18, No. 2, July 2006, 103–120.
- ESCWA (2021) "Special Drawing Rights and Arab Countries Financing for Development in the Era of COVID-19 and Beyond," Policy Biref E/ESCWA/CL3.SEP/2021/POLICY BRIEF.1
- Ghosh (2023) "Building a Better SDR," - Project Syndicate, https://www.project-syndicate.org/commentary/imf-must-clarify-role-approved-uses-of-special-drawing-rights-by-jayati-ghosh-2023-05
- Ghosh and Nabi (2020) "Open letter from Economists" https://sites.google.com/view/open-letter-from-economists
- Hulten and Isaksson (2007) "Why Development Levels Differ: The Sources of Differential Economic Growth in a Panel of High and Low Income Countries," NBER Working Paper 13469.
- Kim and Loayza (2019) "*Productivtiy Growth: Pattenrs and determinants across the World*." Policy Research Working Paper 8852. The World Bank.
- Krugman (1988), "Financing vs. Forgiving a Debt Overhang," Journal of Development Economics, Vol. 29 (November), pp. 253–68.
- Makdisi, Fattah, and Limam (2007) "Determinants of Growth in the MENA Countries," in: Explaining Growth in the Middle East, ed. J. Nugent and Hashem Pesaran, Elsevier.
- Malhorta, Chepenik, and Santambrogio (2022), "How a government struggling with debt navigated towards a brighter future," Case Study, EY, https://www.ey.com/en_au/restructuring-turnaround/how-an-insolvent-government-found-a-path-to-a-brighter-future
- Mohieldin (2024) "War, Debt and Hard Currency," presentation at the Institute of National Planning in Cairo, Egypt on the 27th of December 2023 and the Anwar Gargash Diplomatic Academy in Abu Dhabi, UAE on the 14th of February 2024.
- Mulligan. B. (2015) Edited. Life of Hannibal. Cornélius Népos (110 BC– 25 BC). Open Book Publishers.
- Nabi, Al-Rashid, Romdhani, Suliman (2024) "Arab Fund and the Financing of Development in Arab Countries: Ways to mitigate the Debt Crisis and New Financial Instruments, Forthcoming in AFESD Policy Paper.
- Nabi (2021) "Tunisia after the 2011's revolution: Economic deterioration should. and could have been avoided." Journal of Policy Modeling, Volume 43, Issue 5, September–October 2021, Pages 1094-1109.
- Nabi (2019a) "The Economic Reforms' Agenda and Bottlenecks," In: Making the Tunisian Resurgence. Palgrave Macmillan, Singapore. https://doi.org/10.1007/978-981-13-3771-0_3
- Nabi (2019b) " Toward an Inclusive Development Strategy," In: Making the Tunisian Resurgence. Palgrave Macmillan, Singapore. https://doi.org/10.1007/978-981-13-3771-0_4
- Nabi, M.S. (2019c). Daring New Financial Channels for Development and Social Inclusion. In: Making the Tunisian Resurgence. Palgrave Macmillan, Singapore. https://doi.org/10.1007/978-981-13-3771-0_6
- Nabli and Nugent (2022). Tunisia's Economic Development: Why Better than Most of the Middle East but Not East Asia. The Routledge Political Economy of the Middle East and North Africa Series.
- Paduano (2024), "A State of Play on SDRs: What To Make of 2023, What to Watch in 2024," FDL short notes January 2024, Finance for Development Lab.
- Patrinos, Angel-Urdinola and Tanaka (2024) "How effective education spending can reduce poverty and boost earnings," Education for Global Development, World Bank Blogs.
- Pattillo, Poirson Ward, and Ricci (2002), "External Debt and Growth," IMF Working Paper No. 02/69.
- Pattillo, Poirson, and Ricci (2004), "What Are the Channels Through Which External Debt Affects Growth?" IMF Working Papers. 04.
- Sachs (1989a) "The Debt Overhang of Developing Countries," in Debt Stabilization and Development: Essays in Memory of Carlos Diaz Alejandro, ed. By Guillermo Calvo and others (Oxford, Basil Blackwell)
- Sachs (1989b) "New approaches to the Latin American Debt Crisis," Essays in International Finance, Princeton Univers.
- Schwab and Porter (2008) "The Global Competitiveness Report 2008-2009," World Economic Forum.
- Stiglitz, Bougrov, Boutros-Ghali, Fitoussi, Goodhart, Johnson, (2009) "Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System," United Nations, New York.
- Suh and Chen (2007) "Korea as a Knowledge Economy: Evolutionary Process and Lessons Learned," World Bank Institute Development Studies, The World Bank.

شكراً

Thank you

AFESD's contributions to the SDGs in Arab countries

The Arab Fund has been devoting its efforts for nearly fifty years of operations, to meeting the economic and social development needs of its member countries, by financing public and private development investment projects through concessional loans, covering various economic and social activities and providing grants and institutional support. Since 1974, a total of 712 loans, amounting to about 37 billion US Dollars were provided in addition to grants amounting to about 889 million USD, and the specific grants and aid of about 749 million USD dedicated to Palestine.

A Better World

Contributions of the Arab Fund for Economic and Social Development in satisfying Arab development needs and achieving SDGs

Operations Department, Arab Fund for Economic and Social Development

For nearly fifty years, the Arab Fund has been devoting its efforts to meeting the economic and social development needs of its member countries. Its activities have catalyzed the progress of Arab countries in achieving several Sustainable Development Goals (SDGs) for more than four decades, well before the arrival of the United Nations document in 2015, specifying the 17 SDGs to be met by the year 2030. The Fund has contributed both directly and indirectly to achieving these goals by financing public and private development investment projects through concessional loans, covering various economic and social activities and providing grants and institutional support to member states.

Since the start of its financing operations in 1974 until the end of March 2023, the Arab Fund has granted 710 loans, amounting to approximately US$ 36,983m. The Fund also provided grants amounting to about US$ 852.7m, in addition to grants and aid for the Urgent Programme to Support the Palestinian People or general grants amounting to approximately US$ 720m. Arab Fund grants were made to all Arab countries, either directly or through joint projects, and comprised public sector grants, joint Arab action grants, and grants directed to non-government organizations.

People and society

The Arab Fund has been actively helping Arab countries to achieve the goals and objectives of the first six SDGs. To combat poverty, the Fund has financed 90 loans, amounting to around US$ 3.05 bn, that were concentrated in social development projects, rural development, public works, small and micro projects that generate job opportunities, social welfare programmes, integrated and inclusive development,

Merowe Dam on the River Nile in northern Sudan