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MIDDLE-INCOME COUNTRIES: SINKING IN DEBTS WITH NO LIFELINE?

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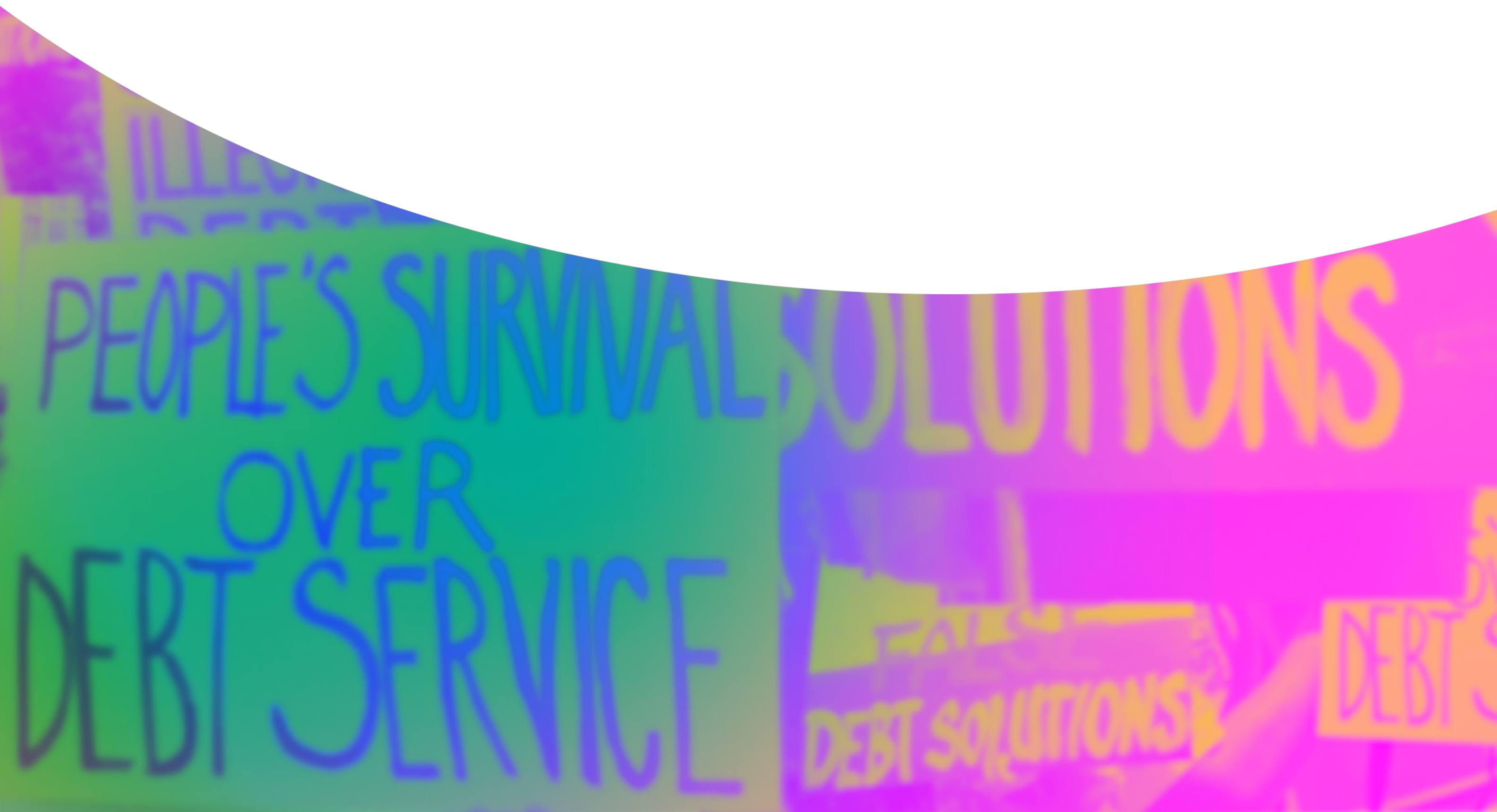

Middle-income countries: Sinking in debts with no lifeline?

Middle-income countries (MICs) are home to 75% of the world's population and 62% of the world's poor. Their economies collectively represent about a third of global GDP and a major engine of global growth. External debts reached historic highs in 2020 at $8.52 trillion which is 98% of all developing countries' debts, and equivalent to 121.9% of the value of exports. As much as $3.32 trillion (54.22%) of these are long-term sovereign or public debts and yet MICs have largely been left out in recent debt relief initiatives. In the face of sluggish post-pandemic recovery, the global economic impact of the war in Ukraine, and climate emergency, MICs need urgent, substantial, and fair debt reduction to protect the welfare and rights of millions of its citizens.

World Bank 2023 Income Classification		
Category	GNI per Capita in 2021	No.
Low-income economies	$1,085 or less	28
Lower middle-income economies	between $1,086 and $4,255	54
Upper middle-income economies	between $4,256 and $13,205	54
High-income economies	$13,205 or more	81

Every year, the World Bank classifies economies into four income groups based on their Gross National Income (GNI) per capita. We refer to MICs as those territories in the two middle tiers: the lower- and upper-middle-income economies. The group includes countries like India, Argentina, Ghana, Tunisia, Peru, South Africa, Indonesia, Philippines. For sure, MICs share the common challenge of transforming their economies to sustain developmental gains and avoiding the "middle-income trap." However, this categorization glosses over the diversity in size and structure of their economy, geography, levels of inequalities, among others.

As foreign debts rose steadily over the years, continued debt service payments drained MICs' economies by the trillions. From 2015-2020, MICs paid creditors over $5.83 trillion or 13.9% of their exports. Former UNCTAD Acting Secretary-General Isabelle Durrant said that even before the pandemic, "debt sustainability in middle-income countries was under pressure but the pandemic has worsened the situation considerably."

Debt distress and debt vulnerability are not exclusive to low-income countries as two-thirds of the 73 emerging markets were rated by UNDP in 2021 as "non-investment grade." All six of the countries that defaulted on their debts in 2020 are in fact MICs. This includes Zambia which has since been downgraded to lower-income status. The G20's Debt Service Suspension Initiative (DSSI) has offered temporary relief by delaying payments by a few months until 2021. It was offered to low-income and select MICs only. Even if DSSI was extended to more MICs however, it would not have delivered the needed benefits anyway because it has no binding commitment to cover private creditors.

MICs owe 65% of their $3.32 trillion long-term external public debts to private creditors, ex., commercial banks, investors in government bonds. Last month, a lawsuit was filed by one of Sri Lanka's private lenders, the Hamilton Reserve Bank, who holds Sri Lankan international sovereign bonds. Hamilton Reserve Bank is reportedly demanding the full payment on their $250 million bond holding. Unlike official creditors (ie., other governments), lending by private creditors carry less favourable terms: higher interest rates, shorter maturity periods and significantly less grant element. In 2020, average interest rate of new loan commitments from private creditors is 4.5% compared to that of official creditors' 1.4%. The recent trend of rising interest rates will make it harder for MICs to tap cheap loans from private sources.

Over reliance on private lending also puts pressure on MICs to maintain a "good debtor" image to protect credit ratings. This entails prioritising debt service and austerity measures, more often at the expense needed public investments on essential services, social protection, and subsidies to vulnerable citizens. It also means avoiding participation in debt relief schemes and debt restructuring for fear of shattering "investor confidence" of prospective lenders.

Sri Lanka collapsed under the weight of its debt burden, defaulting for the first time last May when it failed to pay interest due in the amount of $70 million. As of 2020, Sri Lanka's external debt is $56.34 billion, equivalent to 71.8% of its GNI; eighty percent of that are public debts, excluding government's domestic borrowings.

Many blamed external shocks, poor domestic policies and corruption for Sri Lanka's financial woes but it is important to also underscore the culpability of creditors for their irresponsible lending practices not only in this country but elsewhere. Multilateral creditors led by the International Monetary Fund (IMF) and the World Bank have pushed neoliberal structural reforms as part of their lending conditionalities and used misleading "debt sustainability" analyses which led to vulnerable domestic economies highly dependent on foreign markets, foreign investments and debts.

MICs are not immune to the devastating impacts of the climate emergency. Pakistan experienced extremely heavy rainfall in September, the wettest downpour since 1961, which caused wide-spread flooding. Aside from the massive damage to lives and property—including 2 million houses damaged/destroyed, 1,500 casualties, 12,900 injured—food security and nutrition situation in the entire country is expected to deteriorate. Before the floods, public debt was already unsustainable at $242 billion in 2021 which grew by $7 billion from 2020. Foreign lenders were paid $5 billion in July to December 2021 alone. Continued debt service, along with the estimated $392 million that Pakistan will have to pay IMF in surcharges for 2021-30, will divert funds for humanitarian relief and climate resilience. The failure of rich countries to deliver on their climate finance commitments further hurts the chances of Pakistan and other MICs which are vulnerable to climate-induced catastrophes to scale up their climate adaptation and resilience-building.

New IMF programs in Sri Lanka and Pakistan are starting this year in response to the worsening socioeconomic conditions due to unsustainable debts. IMF programs are notorious for their harsh austerity conditionalities of fiscal belt-tightening that often entail cutting back spending on essential services and subsidies for the poor, and of course prioritising debt service. These conditionalities can only worsen poverty and fuel greater inequality.

MICs are facing a widening financing gap as they struggle to mobilise sufficient resources for achieving the Sustainable Development Goals (SDGs). For 2020-2025, UNCTAD estimated the financing gap of $7.43 billion for lower MICs and $9.67 billion for upper MICs. Meeting these development financing shortall while simultaneously dealing with global food and fuel crises, rising interest rates, mounting debts, and climate emergencies will be hard, if not impossible for MICs to achieve.

MICs need system-changing solutions to tackle their debt vulnerabilities. In the short-term, they will benefit from debt service standstill for all those in debt distressed and creating fair mechanisms to compel private creditors to participate in debt restructuring. The IMF-World Bank's debt sustainability assessment must be transformed into an instrument for providing debt treatments to enable borrowing countries to fulfil their obligations to achieve the SDGs and realise rights, and not only a means to measure their capacity to pay and borrow more.

Broader structural reforms in the global financial architecture can alleviate systemic debt problems not only of MICs but all countries with unsustainable debts. To this end, a UN-led multilateral debt workout mechanism must be pursued to facilitate debt reduction starting with cancellation of all illegitimate debts. The initiative should enact binding rules for responsible lending and borrowing, and enforce accessible, fair and transparent mechanisms for debt treatments for all countries needing lasting debt relief. ∎