SRI VENKATESWARA INTERNSHIP PROGRAMME FOR RESEARCH IN ACADEMICS (SRI VIPRA)

SVP-2354
"DEBT CRISIS IN DEVELOPING ECONOMIES"

Sri Venkateswara College
University of Delhi
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SRIVIPRA SVP 2354

Title: Debt Crisis in Emerging Economies

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Signature of coordinator and mentor

Certificate

This is to certify that the aforementioned students from Sri Venkateswara College have participated in the research project entitled "DEBT CRISES IN DEVELOPING COUNTRIES". The participants have carried out the research project work under my guidance and supervision from June 15 2023 to September 15 2023. The work carried out is original and carried out in a hybrid mode.

Acknowledgements

From the student members of the team

The SRI VIPRA Research Internship has surely been a very valuable and enriching experience for all of us.

In the short span of time we spent together, we were able to enhance our research skills by learning how to work with international economic databases using Microsoft Excel. Furthermore, we received a brief but thorough introduction to the standards of generating a research publication, including the use of referencing, citations, and the skill of writing fluid language This endeavor also gave us the opportunity to acquaint ourselves with a variety of macroeconomic literature sourced from (renowned) economic journals as well as reputed international institutions.

We would like to express our heartfelt gratitude to Dr. Krishnakumar for being our mentor during this research internship. As a result of his patient and consistent guidance, we have been able to learn a lot over the course of two short months.

As a humble being, he has been in constant touch with all of us by personally tracking each and everyone’s work and making sure that everyone contributes equally to the project. He made us walk that extra mile and in the course of our working, often reminded us of reaching the stage of perfection through continuous learning and practice. We feel lucky to have been mentored by him since this exposure at college level has enlightened us a lot about the fundamentals of macroeconomics and was really an enriching experience.

Timeline of the Project

In order to facilitate discussions and track progress our team had frequent meetings over google meet. The dates and agenda of the meetings are as below:

6 pm on 15 June: Introductory Meeting

6 pm on 22 June: Introduction to Economic Databases

6 pm on 28 June: Extraction of World Bank Database

6 pm on 29 June: Extraction of International Monetary Fund Database

6 pm on 06 July: Introduction to International Debt Statistics, Presentations on International Development Association and Bridgetown Initiative

6 pm on 13 July: Country wise part presentations begin, discussion on MDRI, DSSI, HIPC and common agreement

6 pm on 20 July, 27 July, 03 August, 04 August, 10 August, 17 August- online meetings for discussion and deliberation on research on various countries.

Following 24 August 2023 the team had offline presentations.

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Introduction

The unfavourable terms of trade and the rising debt-servicing ratio has pushed a number of economies to a precarious situation that they have not been able to spend on basic social needs. All of the same has been due to the low rates of growth of the global economy too. The release of SDRs in 2021, the largest of its kind in the history of IMF in modern times, have played an important role in providing at least some relief for the developing countries. In this work, the external balance sheets of a number of developing economies are explored using databases of the IMF as well as International Debt Statistics of the World Bank. In this study are explorations on four African, three Asian and two Latin American countries. The world has been witness to a number of movements like the Jubilee Campaign as well as concerted efforts from the part of the international community towards addressing these major concerns on the debt front. Four important facts stand out: (i) the rising share of private non-guaranteed and non-concessional debt of the developing countries, (ii) the rising debt servicing ratio of developing countries on account of terms of trade losses and well as exchange rate depreciation, (iii) the declining share of multilateral lending, coupled with the rise of lending from many developing countries like China and (iv) the increasing contribution of environmental issues to the growing debt crisis.

The African economies under study are Egypt, Ghana, Tanzania and Zambia. Mahek Gupta draws attention to the unprecedented situation in the external debt front with respect to Egypt. Not affected as much by the Covid-19 epidemic, Egypt seems to be severely affected by the tensions due to the war in Ukraine. The skyrocketing prices of oil and food has worsened the terms of trade of Egypt and pushed it to unsustainable debt servicing ratios. Worst is the fact that a section of policymakers are even suggesting issuance of bonds on the basis of the receivables of Suez Canal as a way out of the crisis. Haripriya Muralidhar traces for us the debt situation in Ghana. The west African economy of Ghana has been through difficult times in the recent past. This is despite the economy being resourceful in gold and cocoa. The unfavourable prices of the same coupled with the dumsorcrisis on electricity supply front has plunged the parameters of the economy on the external debt scenario to a precarious situation. The ostentatious expenditure on projects of unproductive nature has pushed the government finances also to disarray. Priyanshi

Talwar draws attention to the Tanzanian economy the currency of which had depreciated from 1138(in 2008) to 2508 Tanzanian shilling to the dollar at present , with its implications on debt servicing ratios. Heavily reliant on remittances from abroad on the current account, Tanzania exports a number of commodities including gold and has important tourism spots of Africa like Mt. Kilimanjaro. But, the huge outflow on the primary income exposes the limits set to the growth prospects of an economy largely dependent on foreign capital. Greeshma Kasturi draws attention to the debt dynamics of the Zambian economy of which the fortunes have been inextricably linked to the price of copper. The rise of the vulture funds which resort to the purchase of developing country bonds at low prices only to resort to protracted processes of litigation in various courts towards extracting higher returns has been an important matter of concern in the dialogue on debt. This caught international attention precisely due to the issue being highlighted in the Zambia case. This entry of the private creditors of such nature has been met with opposition in different social and economic policy circles ever since.

The Asian economies under study are Lebanon, Pakistan and Sri Lanka. Vishavjeet Singh Kamboj tracks the Middle Eastern/ Mediterranean country in crisis, Lebanon, which had to give up the exchange rate peg due to combination of unfavourable circumstances. The economic conditions of Lebanon deteriorated not as much due to COVID-19 as due to the Ukraine crisis resulting the rise in the price of food and fuel, both of which have been important imports of Lebanon. Adya Rastogi draws attention to the overarching impact of the Belt and Road Initiative on the economy of Pakistan, it seems that the period after the global financial crisis, this was a big gamble that Pakistan took. But this debt driven strategy seems not to be working in the country caught between declining remittances, rising price of oil and most importantly the Covid-19 pandemic. Worst is the recent environmental crisis in the form of the floods inundating at least one-third of the area of Pakistan. Aizza Gupta draws attention to theisland country of Sri Lanka which over the years has made remarkable achievements in the front of human development index. It seems that the debt financed growth coupled with the unfavourable external economic environment has pushed the Sri Lankan economy to an abyss. Much ought to be done to restore matters to normalcy in this island country faced by rising prices, depreciating exchange rate and dwindling earnings on the external front.

The issue of debt crisis always brings back to memory the Latin American debt crisis of the 1980s. In this study, we have three countries being covered from Latin America: Argentina, Brazil and Mexico. Siddhanth Pandita tracks the debt situation of Argentina in context of unprecedented inflation rocking the country. The Central Bank is forced to resort to increase in interest rate in this circumstance to save the exchange rate from deteriorating further. Over the years the peso has been witness to steep depreciation with its exchange rate depreciating from 100.03 to a dollar in November 2021 to 350 per $ at present. Given the foreign currency denominated nature of the external debt, the external situation, particularly with respect to debt parameters, has been witness to deterioration. Yaswanth Kanuri tracks the Brazilian economy. He highlights the fact that increasingly the creditors of Brazil are from the category other than multilateral or bilateral. Increasingly, they are from the "other creditors", implying that there is an increasing share of its debt being held by private creditors. Brazil which has a positive balance on trade witnesses its current account being susceptible to prices of commodities. The monetary policies of United States has had a significant impact on the state of capital flows as well as exchange rate of Brazil. The depreciation of the exchange rate has had a perceptible impact on the debt servicing ratio of Brazil. Nupur Mehra brings to us the debt situation of Mexico. After a steep decline in the share of the private non-guaranteed debt till 2012, Mexico has witnessed the same rising from 36% to 41%. However PPG continues to be on the rise in absolute terms. Heavily dependent on remittances on the current account, Mexico has its foreign exchange reserves built up on the basis of capital inflows which have been debt creating in nature. In the 2014 to 2016 period, there has been steep depreciation of the peso right during the time while there was reversal of the unconventional monetary policies by the United States. Neither has the free trade pact under NAFTA been working favorably for Mexico, nor has it been able to catch up with the growing economies of east Asia.

Indeed the contemporary debt crisis has thrown up new concerns of interest for policymakers and researchers. This ranges from the debt sustainability initiatives to different instruments like the debt for nature swaps. Other than the mainstream initiatives with respect to debt resolution, there have also been efforts at drawing attention to the plight of liquidity through the Bridgetown Initiative. There has also been a large conscientisation among the people worldwide about the issues relating to vulture funds. Much needs to be done though.

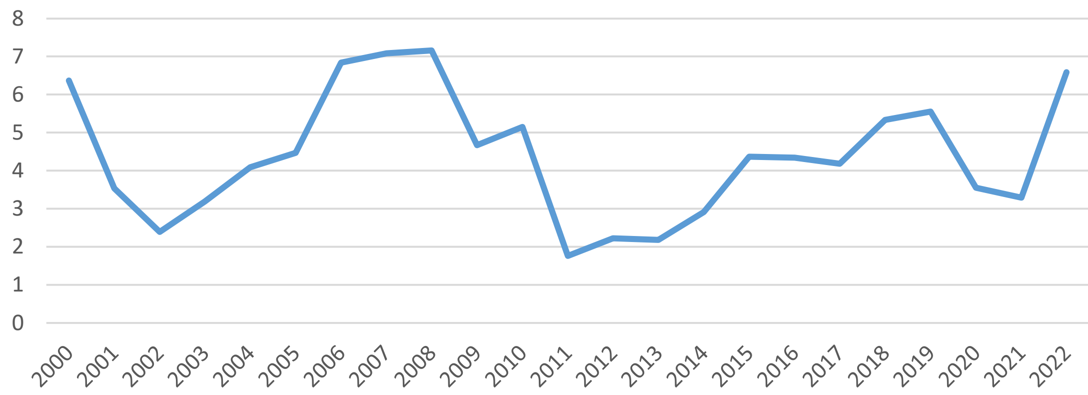
Chapter 1

Egypt

Egypt, officially the Arab Republic of Egypt, is a transcontinental country spanning the north east corner of Africa and the Sinai Peninsula in the southwest corner of Asia. With 110,990 million inhabitants (14th-most populated country in the world) it is the third-most Populated in Africa)

Since 2000, the pace of structural reforms (including fiscal and monetary policies, taxation, privatization and new business legislation) helped Egypt move towards a more market-oriented economy and prompted increased foreign investment.

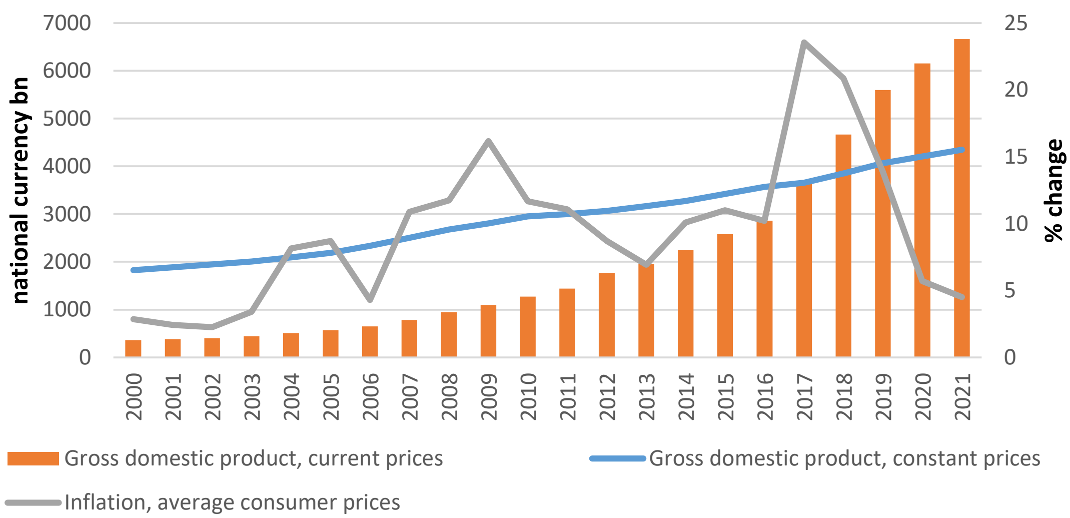
The transformation to an open market economy is influencing Egypt in different ways: more business is in the hands of the private sector, markets are liberalized through bilateral trade agreements and attractive investment opportunities have been created in a variety of sectors that reflect the diversity of the Egyptian economy. Results of this policy are already visible: economic growth has increased from 3% in 2003 to 7.2% in 2007 (Figure 1-1).



Source: World Bank Database

Figure 1-1: Real annual growth rate of Egypt (in %)

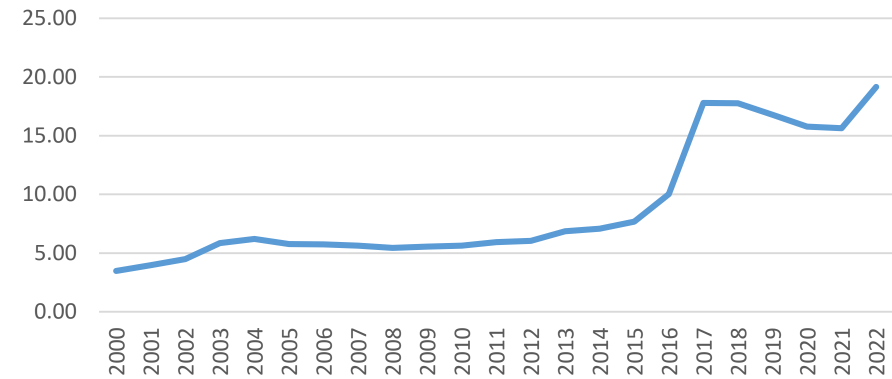
The reforms and policies have strengthened macroeconomic annual economic growth rate saw a steady rise in Egypt following 2004 It launched bold reforms in 2004 that (economic reforms, liberalization) along with a favorable external environment, triggered an acceleration of growth to 7 percent in 2006. However, after this initial impetus of growth during period 2001-06 (Figure 1-1) this was followed by a period of high volatility.



Source: IMF World Economic Outlook Database April 2023

Figure 1-2: GDP and Inflation for Egypt

The inflation rate has been fluctuating dropping to 2.4 percent in 2001 and 2002. More recently, in 2017, inflation once again increased to 23.5 percent (which was also previously experienced in 1987). This occurred after the Central Bank decided to float the Egyptian pound (*Figure 1-3*)

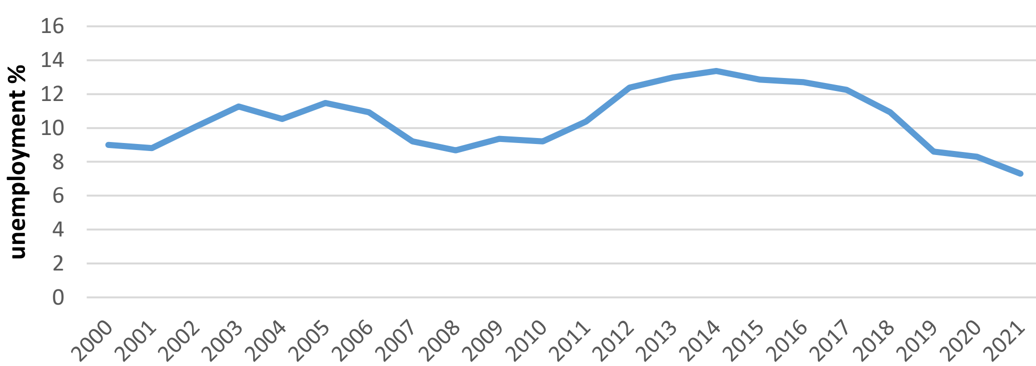


Source: IMF International Financial Statistics

Figure 1-3: Egyptian pound per U.S.D, Period Average

Egypt risks fuelling its record inflation and putting more pressure on the Egyptian pound if it does not slow an expansion of the money supply which bankers and analysts say has been used to plug widening budget deficits.

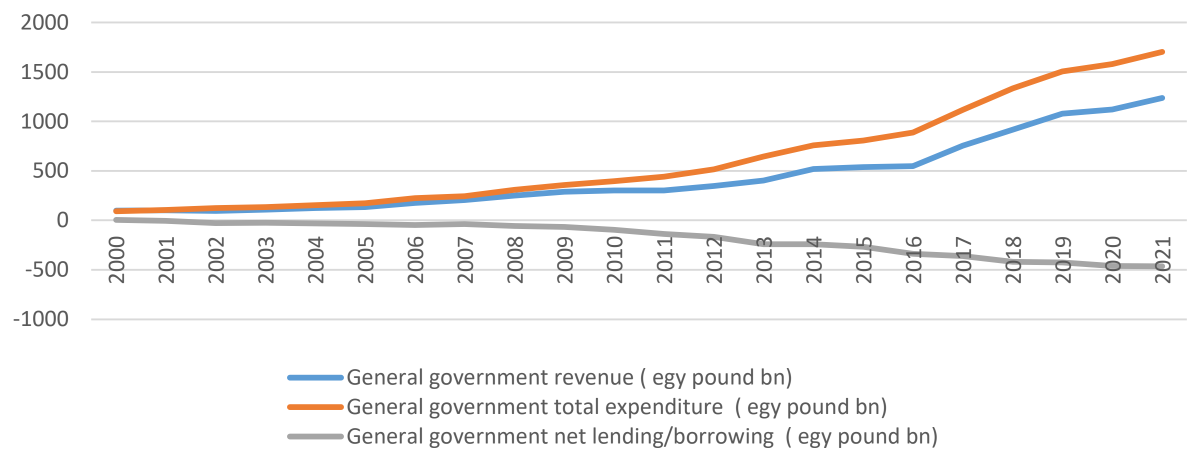
Currency depreciation allowed on recommendation of IMF has caused the currency to depreciate to 20 Egyptian pound per U.S.D in 2022.



Source: IMF World Economic Outlook Database April 2023

Figure 1-4: Unemployment rate for Egypt

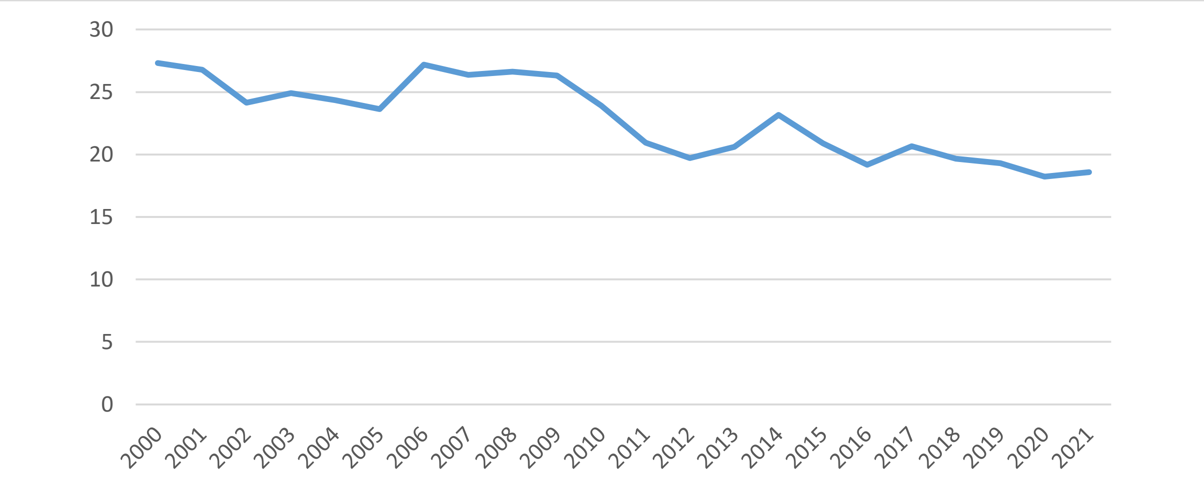
The unemployment rate was decreasing since the peak of 2013. The Egyptian government's initiatives to combat unemployment and spur economic growth have encompassed infrastructure investment, economic reforms, youth employment programs, support for small and medium-sized enterprises, and agricultural initiatives. (Arab News, 2023)



Source: WEO Database April 2023

Figure 1-5: Government Finances for Egypt in Egyptian Pound

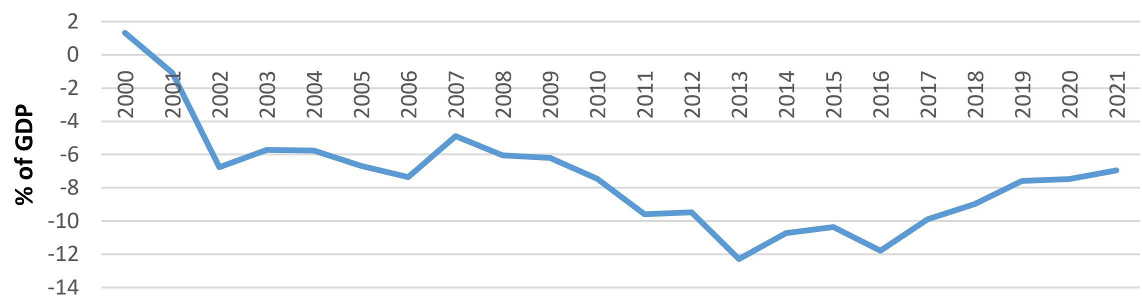
The general government expenditure remained above the revenue with the gap between the two increasing over the period of time. This rising expenditure over revenue is financed by increasing borrowing as shown by the grey line.



Source:IMF World Economic Outlook Database April 2023

Figure 1-6: General Government Revenue as a % of GDP for Egypt

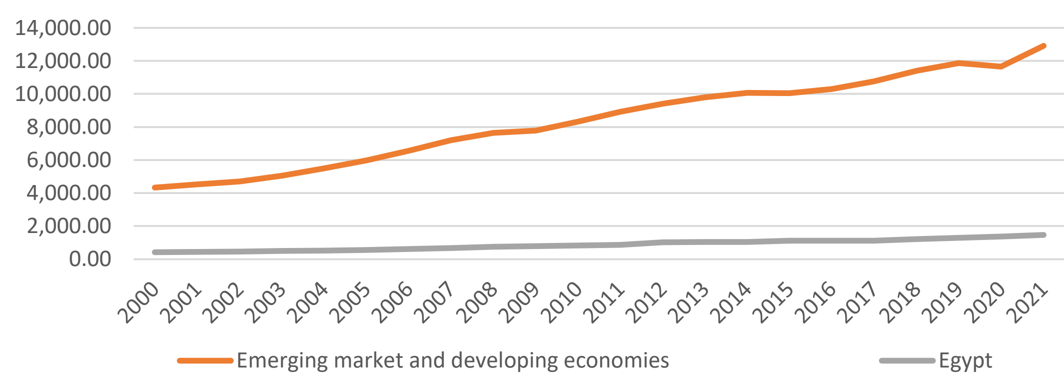
The general government revenue mainly encompassing taxes along with other government income has been declining as a share of GDP, which implies tax has been increasing at a slower rate than GDP. In such a case the government has to fall towards other sources of revenue. In order to increase the revenue as a % of GDP, the Egyptian government will have to raise more taxes which can be done using incentivizing techniques and making tax compliance easier for its citizens.



Source: IMF World Economic Outlook Database April 2023

Figure 1-7: General government net lending/ borrowing (% of GDP) for Egypt

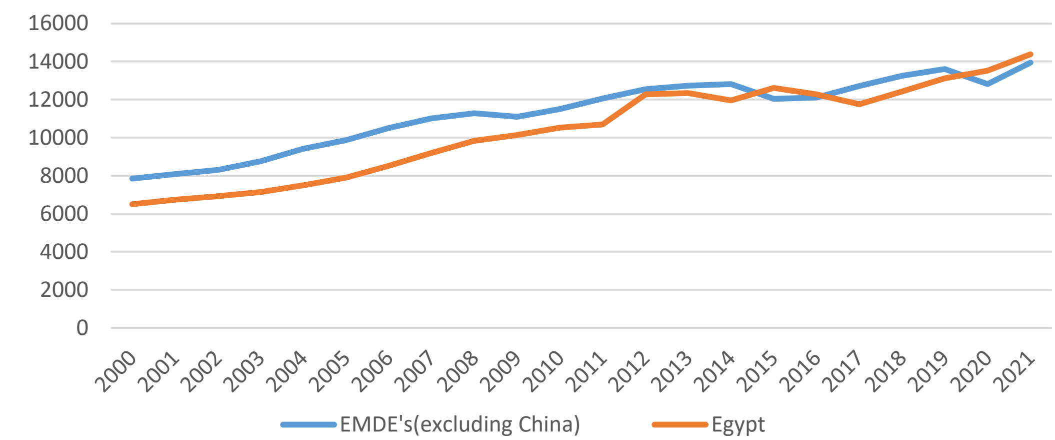
The general government has been borrowing consistently for the period of 2001-2021. There has been steep increase in the net borrowing of the government from 2009 to 2013 and a steady fall in net borrowing from 2016 to 2021. Further it can be seen that the period of betterment, that is, a decrease in net borrowing of the general government is associated with an improvement in the constant growth rate (Figure 1-1)



Source: IMF World Economic Outlook Database April 2023

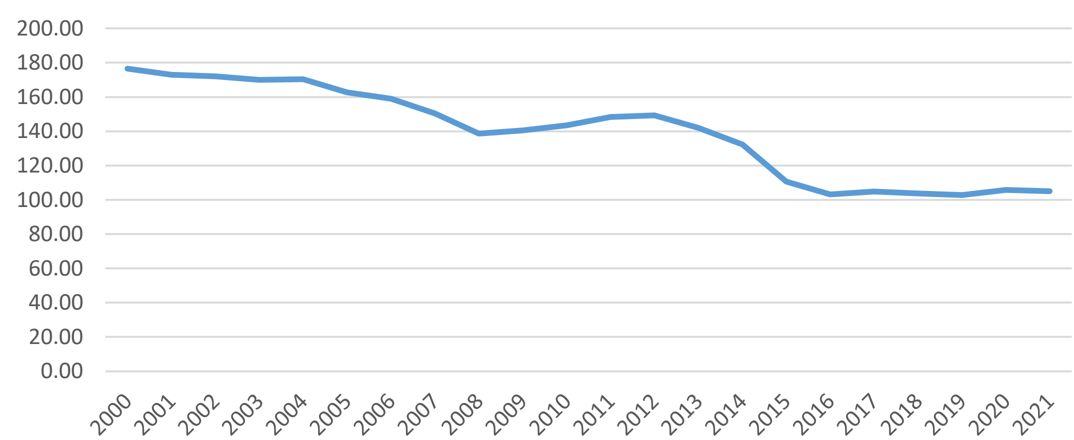
Figure 1-8: GDP per capita, current prices (PPP USD) for Egypt

The per capita GDP of Egypt at PPP international dollars has seen a steady increase since the early 2000s. However, even after this increase Egypt's GDP per Capita (PPP USD) has been lower then emerging market and developing economies and this gap has been increasing with GDP per capita diverging between the two. This huge divergence between the two has been observed because of China's PPP GDP per capita being an outlier in the Emerging and Developing Market Economies. On excluding china (Figure 1-9) this gap becomes converging with Egypt overtaking EMDE'S PPP GDP per capita in 2021.



Source: IMF World Economic Outlook Database April 2023 and Author's Calculations

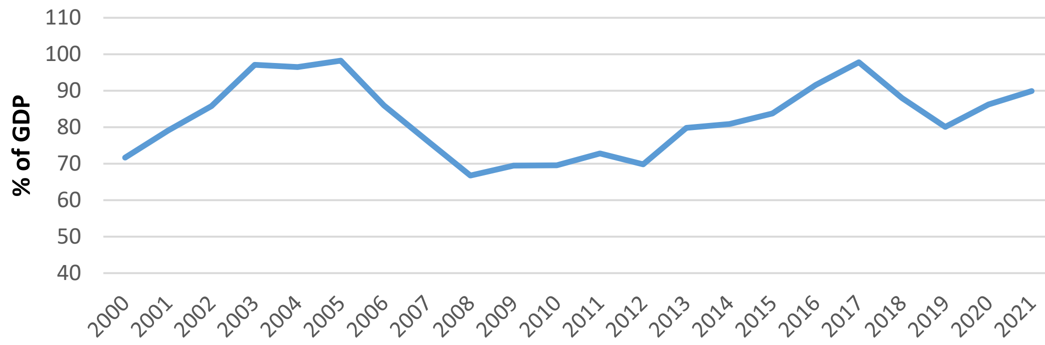
Figure 1-9: GDP per capita, current prices (PPP USD) for Egypt (excluding china)



Source: IMF World Economic Outlook Database April 2023 and Author's Calculations

Figure 1-10: Coefficient of variation in PPP GDP per capita for EMDE's

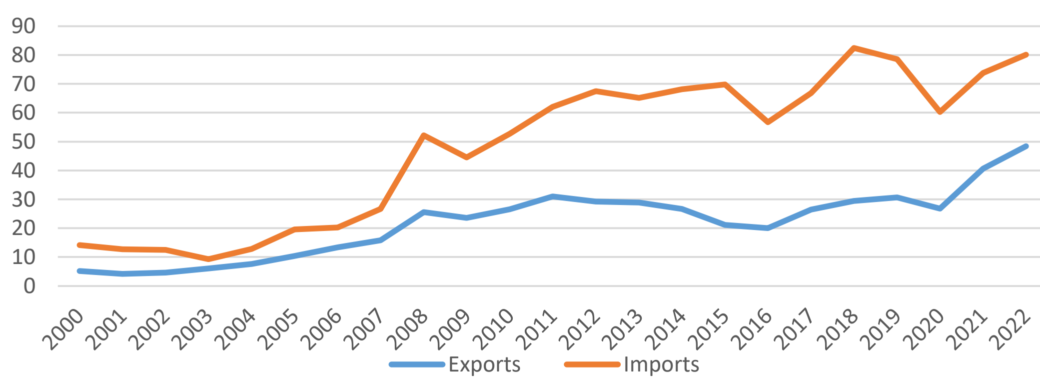
The coefficient of variation in PPP GDP per capita has seen an decreasing trend over time which implies that the variation in PPP GDP per capita across countries has been decreasing.



Source: IMF World Economic Outlook Database April 2023

Figure 1-11: General Government gross debt (% of GDP) for Egypt

The General government's gross debt as a percentage of GDP has continually risen since from 70% in 2012 with it almost touching a record high of close to hundred percent in 2018 and for the period of 2003-2005. As observed in Figure 1-11, the net borrowing for the government decreased from 7% to 5% in 2006-2007, this was also the time when the percentage of gross debt to GDP steadily decreased from 80% to about 60%. The International Monetary Fund's new $3 billion financial support package for Egypt aims to reduce government debt to less than 80% of gross domestic product (GDP) in the medium term.



Source: IMF Direction of Trade Statistics

Figure 1-12: Imports and Exports to World from Egypt in USD Billion

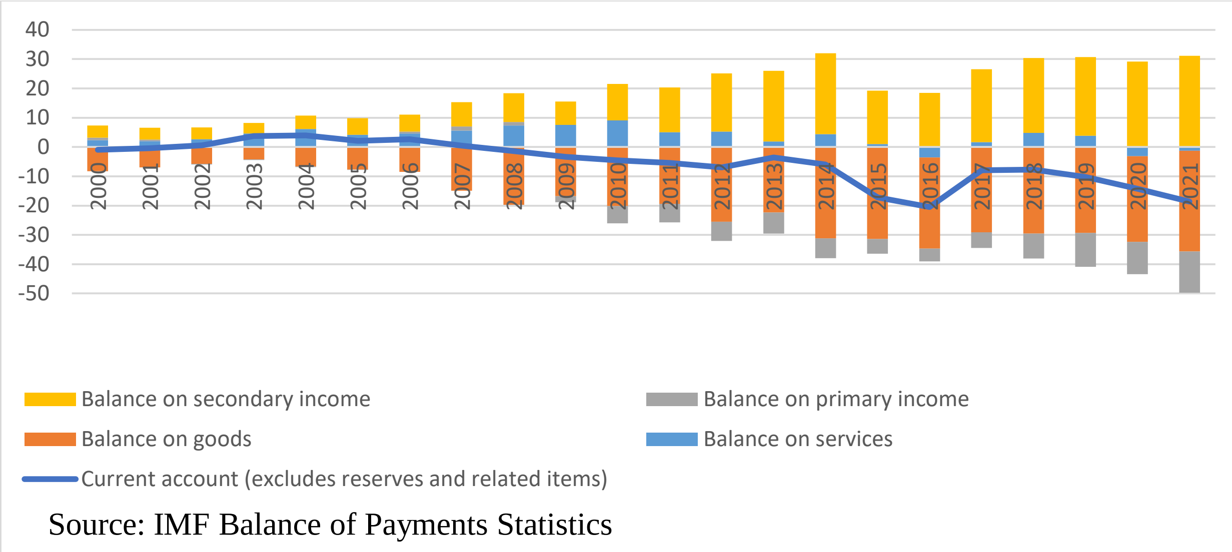


Figure 1-13: Current Account Disaggregates of Egypt (USD Billion)

Egyptian imports outweigh exports, (Figure 1-12) leading to a negative balance of trade. Even though mineral fuels, oils, and distillation products were the fundamental category of imports and exports for the country, the cumulative imports and exports were mainly non-petroleum products. As for the exports, pearls, precious stones, metals and coins, and plastics were among the principal products being sold by the country. Egypt is a top importer of wheat from Russia and Ukraine- and a supply shock further affected inflation.

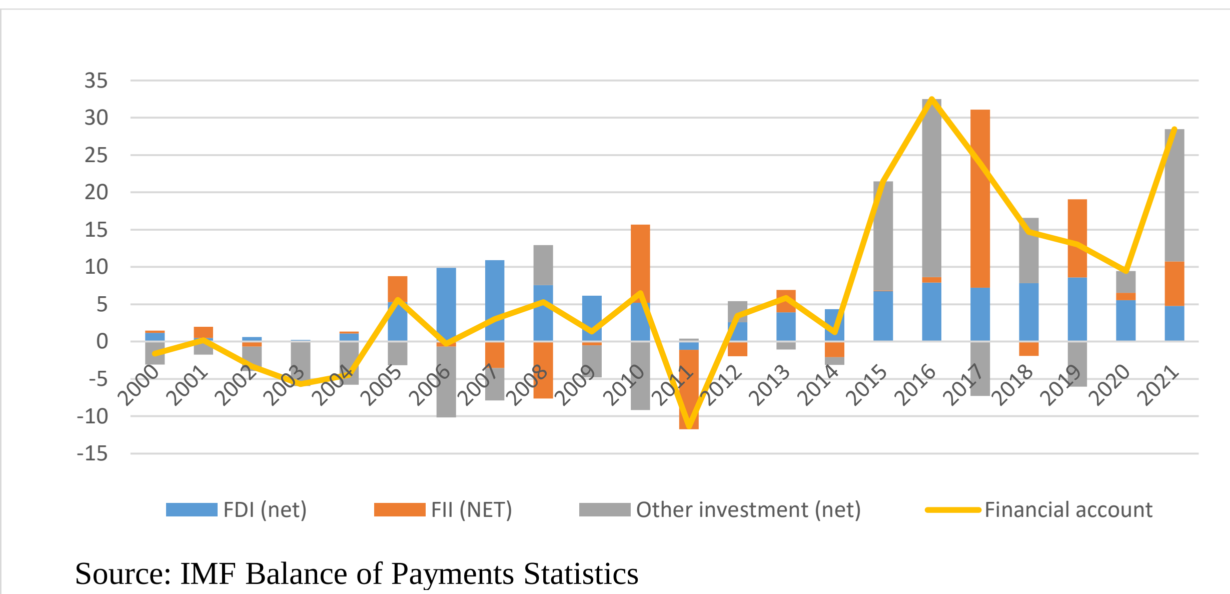
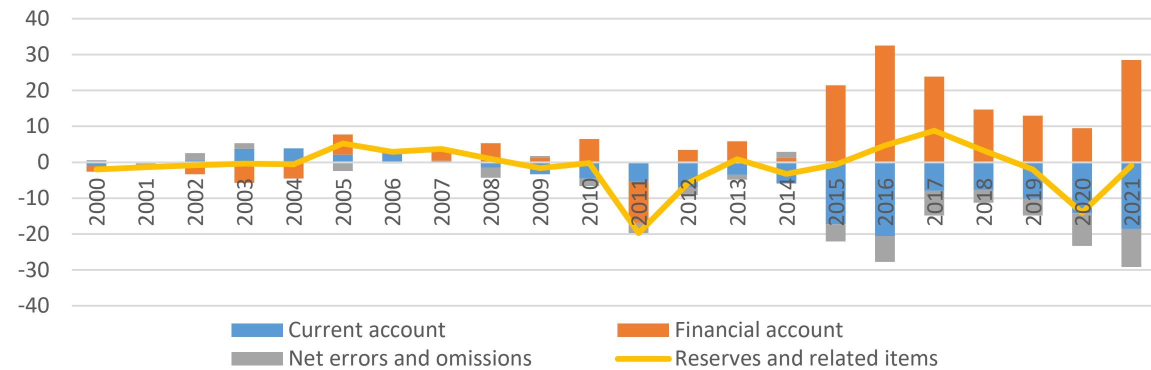


Figure 1-14: Financial Account Disaggregates of Egypt (USD Billion)

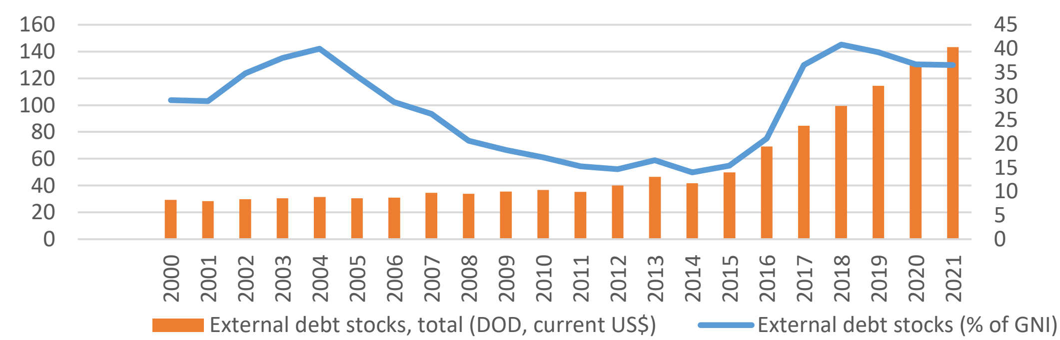
FDI- FII in the country has also been low because of the same reason-No clear picture of currency. However the scenario has been transforming after Egypt decided to float its pound in 2015 with all type of investments having a financial account credit.



Source: IMF Balance of Payments Statistics

Figure 1-15: Balance of Payments of Egypt (USD Billion)

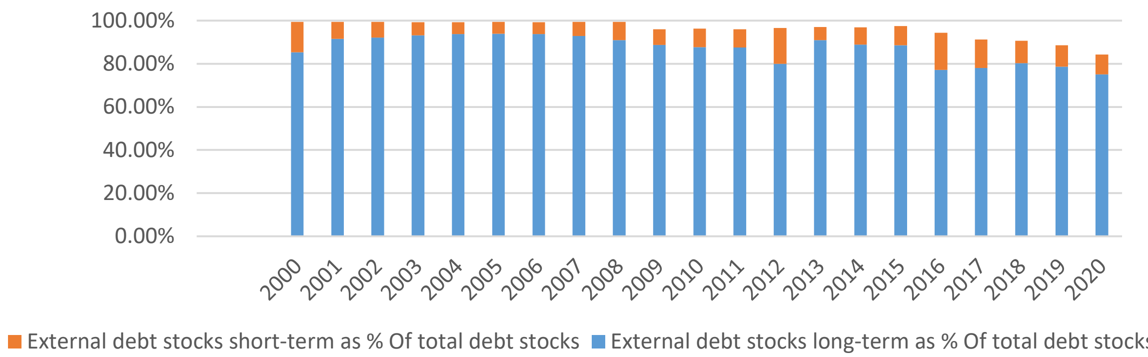
From 2016 until shortly before the Russian invasion of Ukraine, Egypt became heavily dependent on portfolio investments — mainly hot money — to shore up its financial account, offset its current account deficit, and ultimately keep its external position afloat. The outbreak of the war and the successive interest rate hikes in the United States, however, triggered a massive capital flight. In the 2021/2022 fiscal year, up to $21 billion flowed out of Egypt, according to the Central Bank (CBE) (Al-Monitor , 2023)



Source: World Bank International Debt Statistics

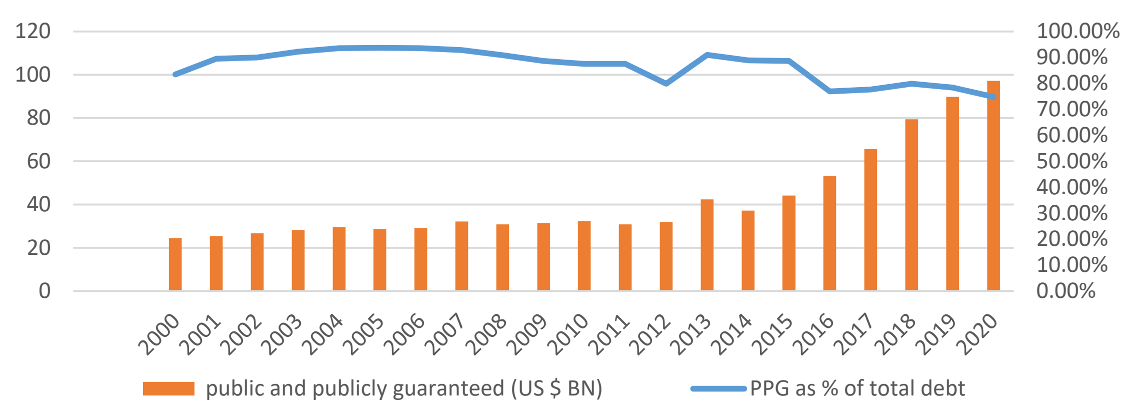
Figure 1-16: Total External Debt Stocks of Egypt

The total external debt stocks have continually been rising with external debt increasing as a percentage of GNI since 2014(15 %) to almost 40% in 2021- this was the time around which major reforms were introduced such as cutting food and energy subsidies and raising taxes.



Source: World Bank Database and Author's calculations

Figure 1-17: Maturity of Debt Classification for Egypt

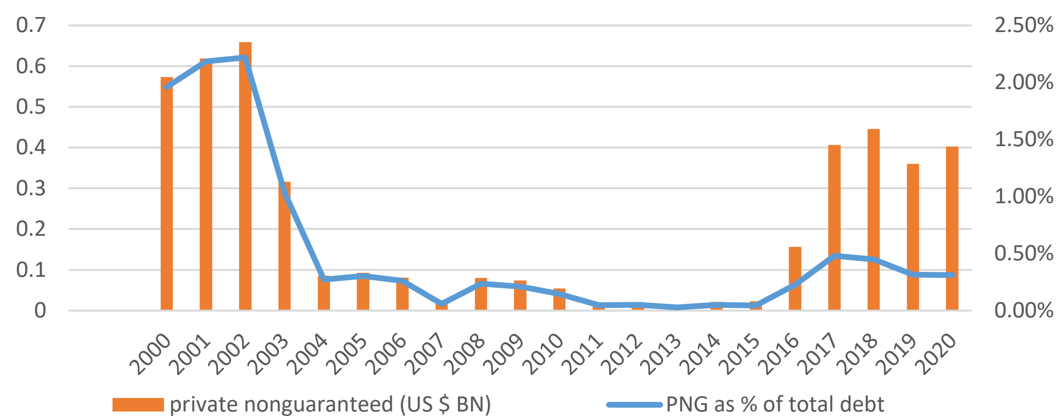


Source: World Bank Database and Author's calculations

Figure 1-18: Public and Publicly Guaranteed Debt of Egypt

Public and publicly guaranteed debt comprises the long-term external obligations of public debtors, including the national government and political subdivisions (or an agency of either) and autonomous public bodies, and the external obligations of private debtors that are guaranteed for repayment by a public entity. PPG of Egypt has continually risen from 20 Billion U.S dollars in

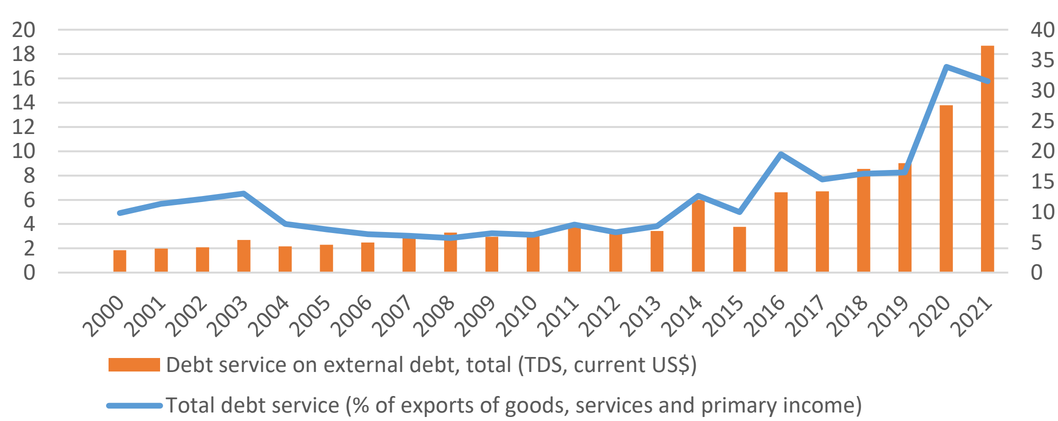
2000 to almost 100 Billion U.S dollars in 2020. However, PPG as a percentage of total debt has remained fairly constant at 80%



Source: World Bank Database and Author's calculations

Figure 1-19: Private nonguaranteed debt of Egypt

The private non-guaranteed debt is swayed with the market's perception of the economy An Ambitious effort to open and liberalize the economy initiated in mid-2004 created uncertainty around the economy's future performance due to which PNG fell drastically.. Reassured by IMF deals in 2016 and 2020, multilateral lenders, foreign governments and institutional investors jumped on board and Private debt started rising again following 2016.



Source: World Bank Database and Author's calculations

Figure 1-20: Debt Service on External Debt of Egypt

With rising debt, the debt service on external debt has also continually risen over the years from 2000-2020.

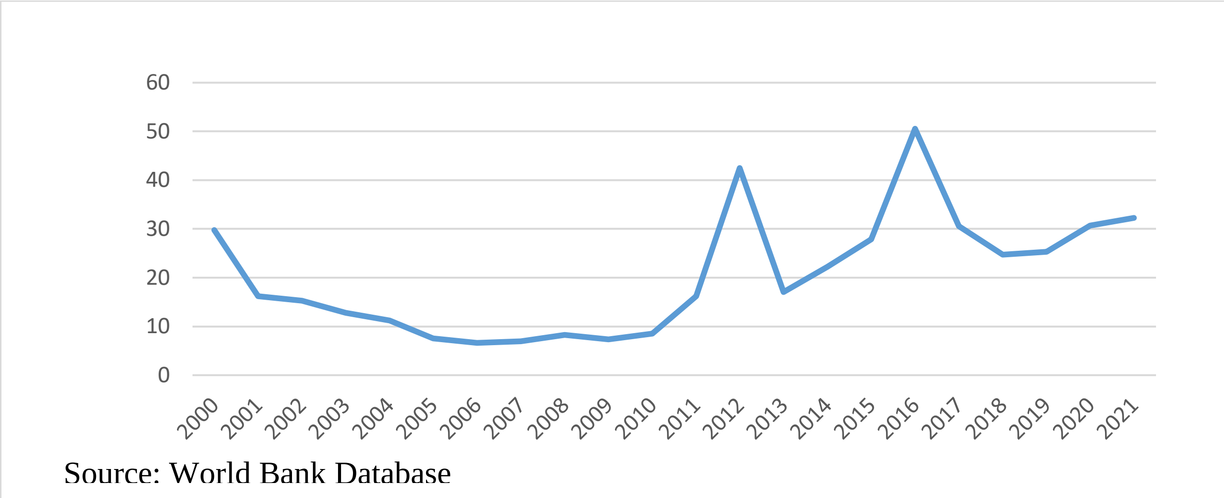


Figure 1-21:Short-term debt (% of total reserves) of Egypt

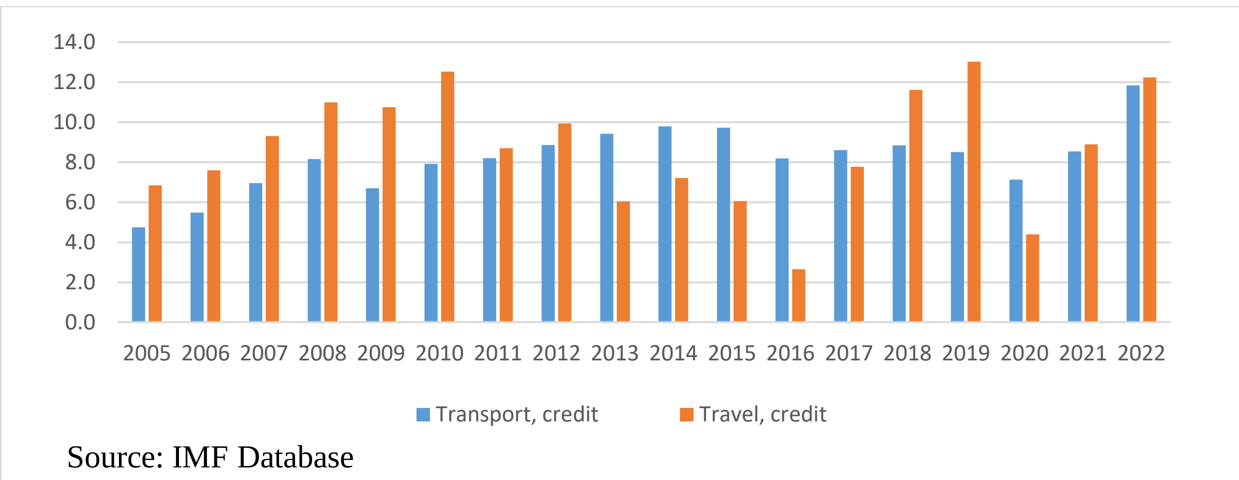
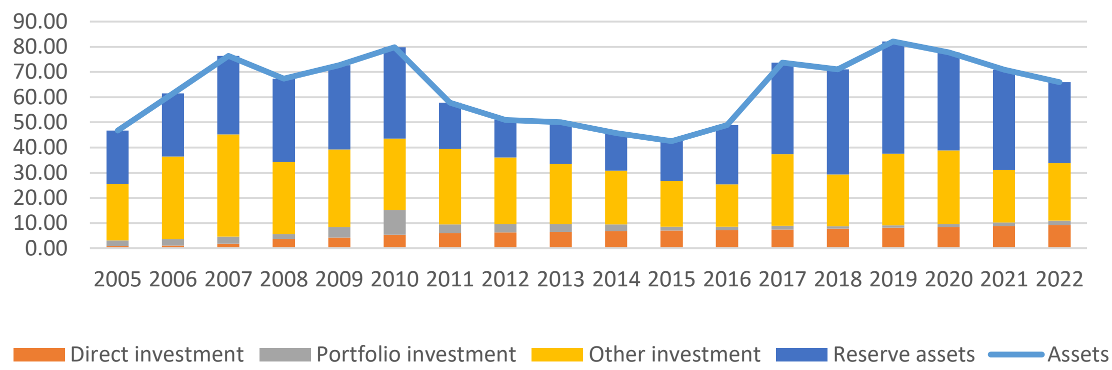


Figure 1-22: Transport and Travel revenue to Egypt (USD BN)

Leading up to the 2008 international financial crisis and the 2011 Egyptian revolution, Egypt undertook significant structural reforms to facilitate economic growth. Although these reforms had some significant success in increasing economic growth, the government failed to tackle head-on the issues of poverty, high unemployment (especially among women and youth), inequality, and corruption. Following the Egyptian revolution, political and regional developments continued to undermine Egypt's economy. With fewer tourists and less income from the Suez

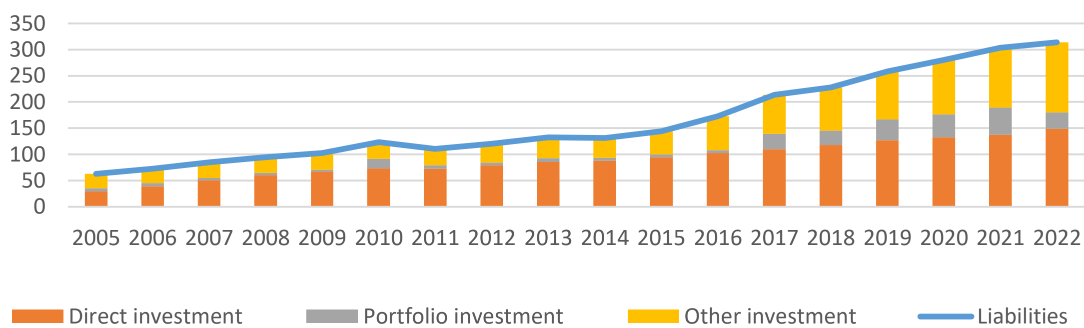
Canal (due to the stagnating global economy), economic growth slowed.(Figure 1-22).Moreover, the government increased public debt to fund its expenditures which is seen as a sharp increase in debt in 2011 and again in 2016 when it undertook a loan from IMF.



Source: IMF Balance of Payment and International Investment Position

Figure 1-23: Assets of Egypt in USD Billion

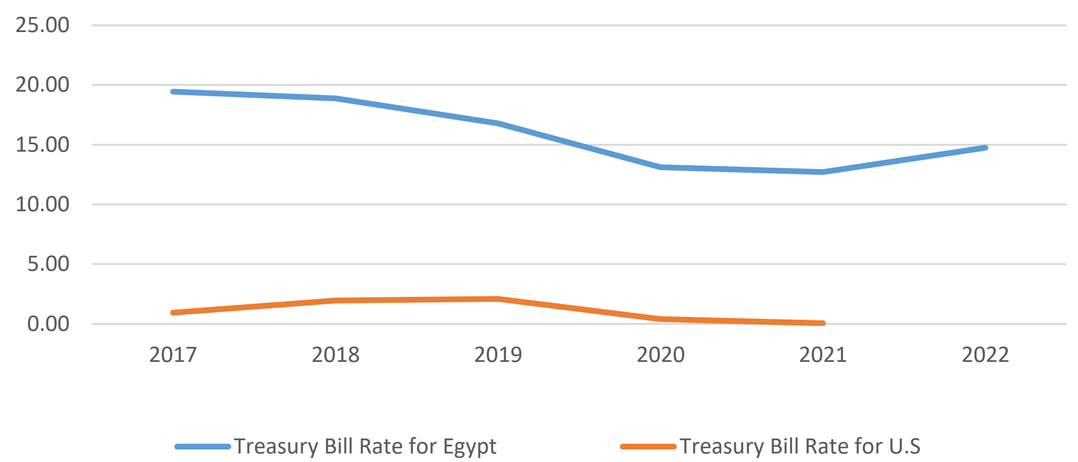
The direct investment of Egypt has remained constant over the years following 2016. The major assets of Egypt are in the form of reserve assets and other investments with portfolio investment having the minimum share. Egypt has plans to sell more stakes in the coming times, including in the Gabal el-Zeit wind farm, military-owned Wataniya Petroleum and a power plant built by Siemens. (OECD, 2020) This is in order to finance its debt obligations.



Source: IMF Balance of Payment and International Investment Position

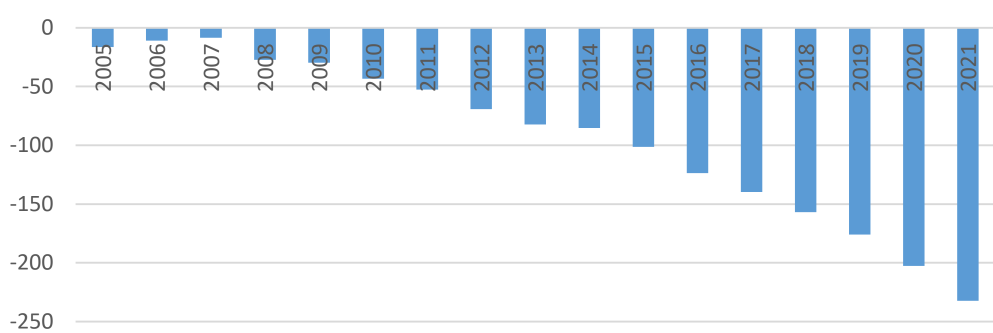
Figure 1-24: Liabilities of Egypt in USD Billion

The liabilities of Egypt reached an all-time high at almost 300 billion US dollars in 2022. During COVID-19 period, investments came due to high returns, foreign investors flocked to Egypt's treasury bills, and remittances from Egyptians abroad also went up.



Source: IMF Financial Statistics Database

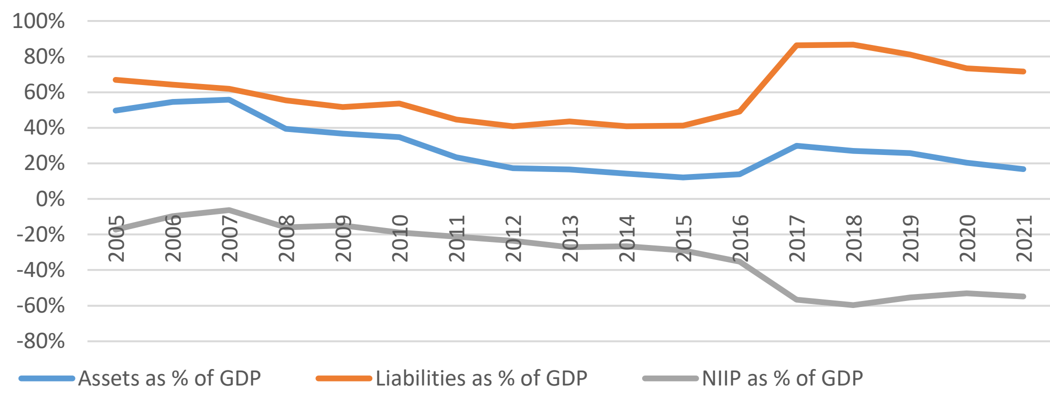
Figure 1-25: Treasury bill rates for Egypt and U.S



Source: IMF Balance of Payment and International Investment Position

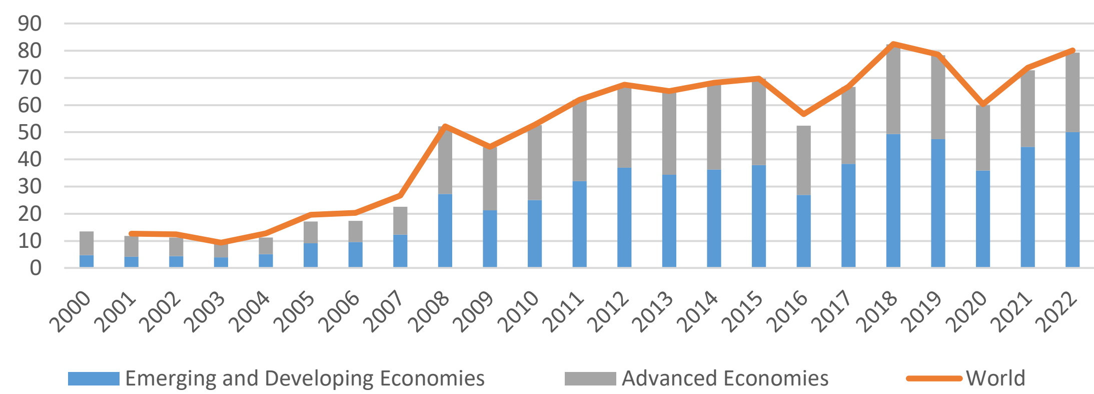
Figure 1-26: Net international investment position of Egypt (USD Billion)

The net international investment position for Egypt has been continually deteriorating. With a negative NIIP, Egypt's NIIP as a percentage of GDP has almost reached negative 80% which implies a continually declining share of Egypt's foreign assets and a rising share of other countries assets in Egypt.



Source: IMF Balance of Payment and International Investment Position

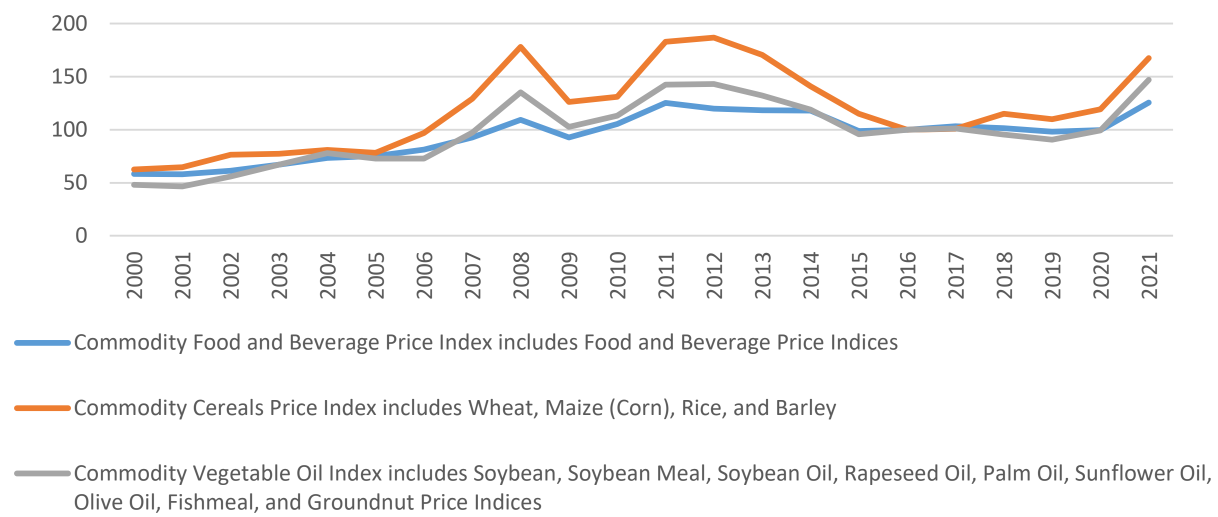
Figure 1-27: Net International Investment Position for Egypt (% of GDP)



Source: IMF Direction of Trade Statistics

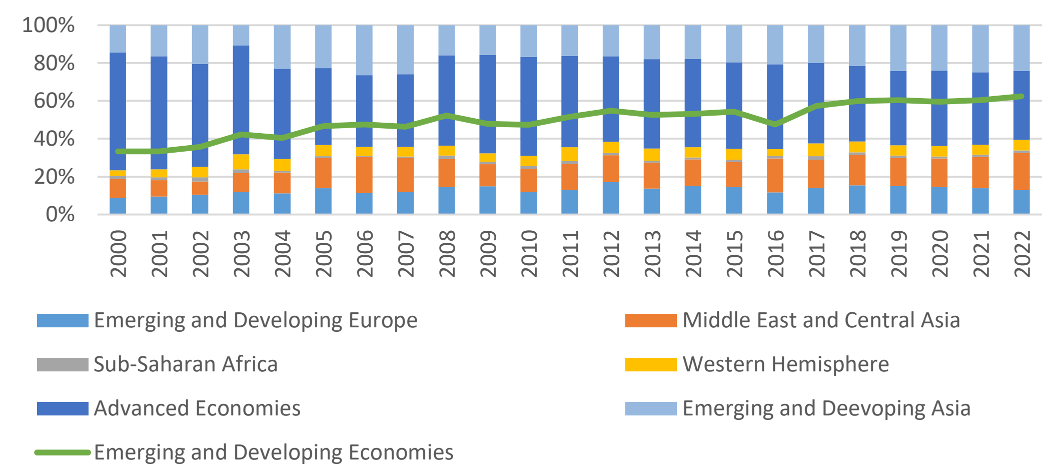
Figure 1-28: Imports of Egypt from Developing and Advanced Economies

Egypt's share of imports from emerging and developing economies has been rising from 30% in 2011 to 50% in 2022. Egypt imports mainly mineral and chemical products agricultural products, livestock and foodstuff, machinery and electrical equipment and base metals. Russia's 2022 invasion of Ukraine drove up commodity prices and thus Egypt's already sizeable import bill, showing just how heavily the country relies on purchases of fuel and cereals. (Figure 1-29) from abroad.



Source: WEO Database

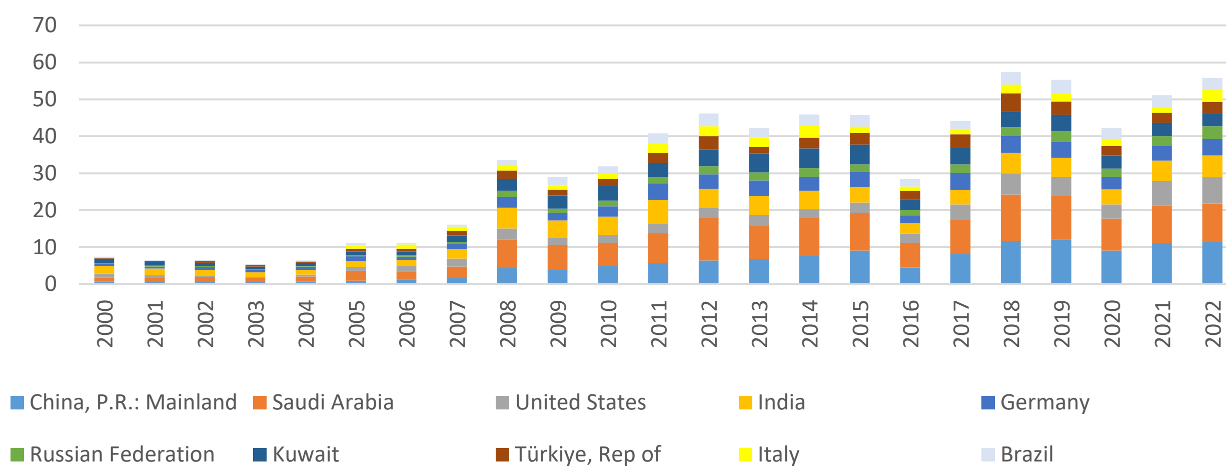
Figure 1-29: Food and fuel price Index



Source: IMF Direction of Trade Statistics

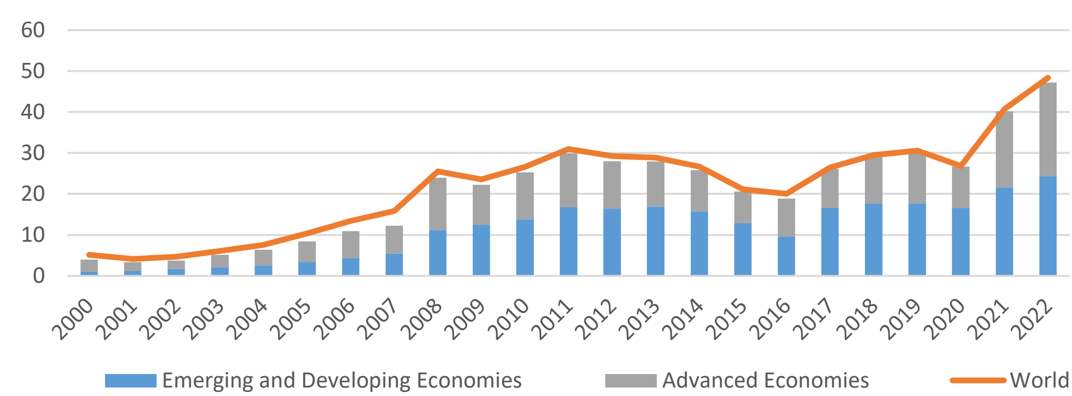
Figure 1-30: Share of imports by area Of Egypt

Figure 1-30 shows the percentage of total imports from different parts of the world. The highest share belonging to emerging and developing Asia in developing countries categories with almost 20% share throughout 2000-2020. Middle East and Central Asia are second in the list followed by emerging and developing Europe. The share of advanced economies taken cumulatively has decreased from 50% in 2008 to 30% in 2022.



Source: IMF Direction of Trade Statistics

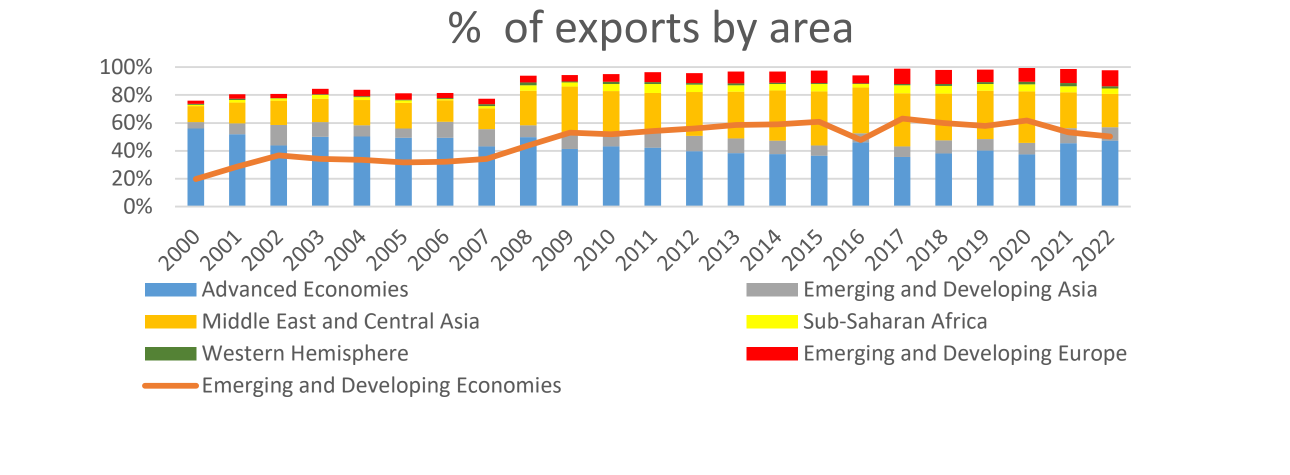
Figure 1-31: Top 10 countries-Egypt Imports (USD Billion)



Source: IMF Direction of Trade Statistics

Figure 1-32: Exports of Egypt from Developing and Advanced Economies

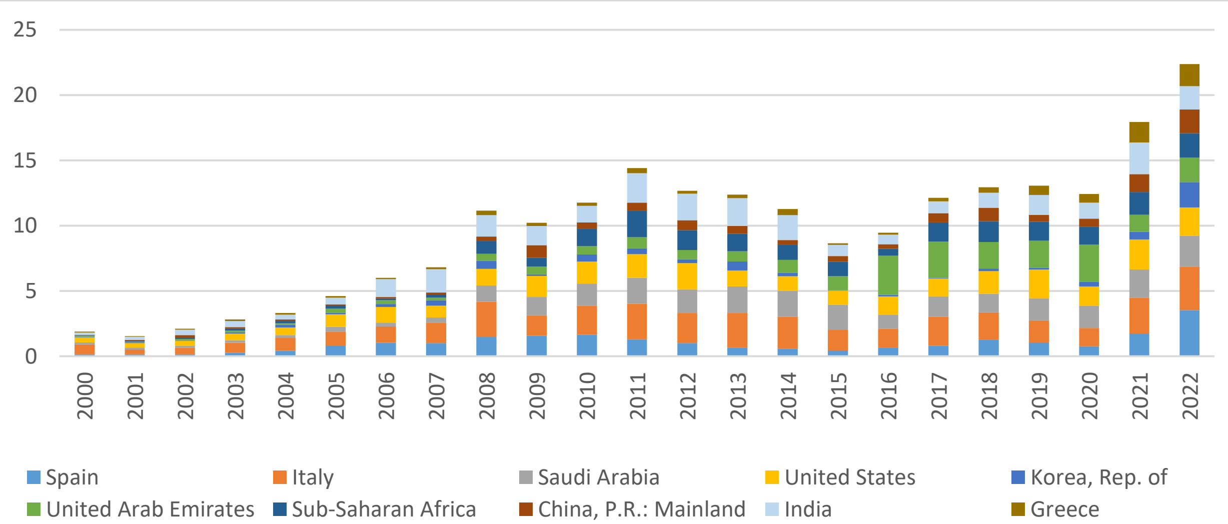
Egypt's export share to both advanced and emerging economies is almost the same in 2022, however this was biased towards emerging and developing economies in the former years. The major exports are oil and other minerals, chemical products, agricultural products, livestock and others fats and, mainly cotton.



Source: IMF Direction of Trade Statistics

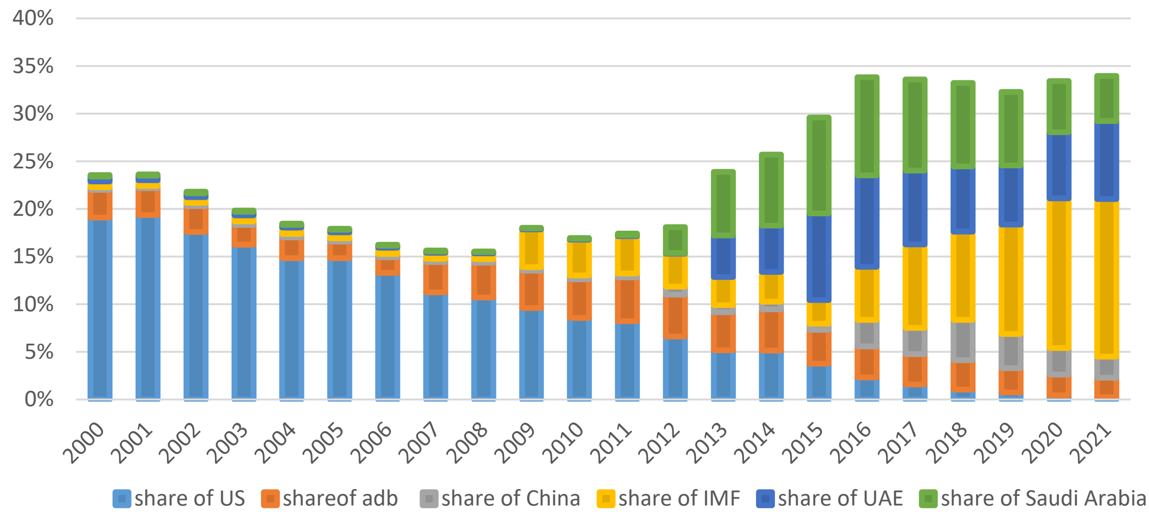
Figure 1-33:% of exports by area of Egypt

Figure 1-33 shows the percentage of total exports from different parts of the world. The highest share belonging to Middle East and Central Asia in developing countries categories with its share fluctuating between 15-20% for the entire period of 2000-2020. Sub Saharan Africa are second in the list followed by Emerging and Developing Europe. However, the major exports are to advanced economies to which Egypt exports 60% of its total exports.



Source: IMF Direction of Trade Statistics

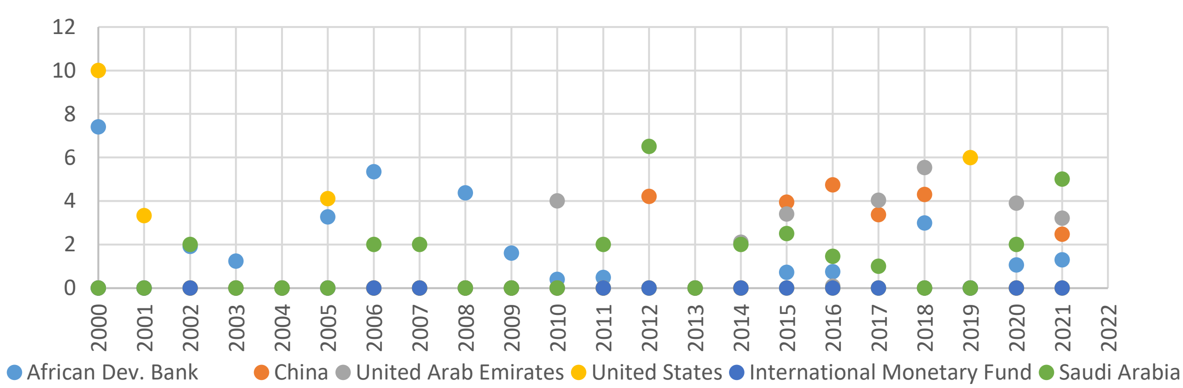
Figure 1-34: Top 10 countries to which Egypt Exports (USD Billion)



Source: World Bank International Debt Statistics and Authors Calculations

Figure 1-35: Creditor Composition External Debt from different countries for Egypt

The share of IMF has continually been increasing while the share for nearly all other multinational institutions and nations has been declining. The debt from US, African Development Bank, China, IMF, UAE and Saudi Arabia make almost 40% of Egypt's creditors.



Source: World Bank International Debt Statistics and Authors Calculations

Figure 1-36: Average interest on new external debt commitments for Egypt (in %)

The graph shows the average interest commitments of Egypt on new debt it undertakes from its major creditors. The interest commitments on debt from US has been the highest which explains the reason for its continually declining share of debt as seen in fig 1.16). UAE, China and Saudi Arabia are the other nations for which average interest commitments of Egypt are high. The share of debt from IMF has risen over 2000-2022 this can be accredited to the extraordinary situation due to which they had to resort to IMFD lending which was the only option left : moreover the rate of average interest is the low.

The way out

High global food and fuel prices have significantly impacted Egypt's external accounts, placing pressure on the pound and stoking inflation. This forced the government into a new IMF program that would focus on massive asset sales and privatizations as well as economic stabilization measures between 2023 and 2027. Although the adjustment would slow economic development, the EIU anticipates that monetary and fiscal tightening will bring inflation down toward the target range's upper bound by 2024.A plausible source of revenue for the government can be an increase in tax rates to finance its objectives. (**Error! Reference source not found.**) The government can urther try to increase revenue from tourism and transport with Suez Canal in focus. (Figure 1-22). It is the only route that connects European waters with the Arabian Sea, accounts for 12% of global trade and around 10% of the world's daily seaborne oil trade. Over 20,000 vessels pass through the canal every year, with the route playing a key role in connecting African, Asian, and European commodity markets. (African Business, 2023)Over the longer run the central bank will prioritize growth over defending the pound, which was floated in late 2022, leading to sustained depreciation but keeping the current-account deficit within manageable limits. Economic growth should exceed its long-term average in the second half of the forecast period. (Economist Intelligence Unit, 2023)

Chapter 2

GHANA

Ghana, situated along the vibrant West African coastline, is a nation that boasts a rich tapestry of culture, history, and economic potential. Located on the Gulf of Guinea, this West African country has long been celebrated for its stability and democratic governance in a region sometimes marked by instability. The country falls into the "Low-Middle-Income" income group category. Historically known as the Gold Coast due to its abundant resources, Ghana's economy has diversified over the years, with agriculture, mining, and services playing pivotal roles. Recently, Ghana has been garnering attention for its growing oil industry, making it one of Africa's rising economic stars. However, like many nations, Ghana has also faced challenges, particularly in managing its external debt and addressing income inequality. Ghana is included both umder the lending categories of "HIPC" (Heavily Indebted Poor Countries) and "IDA" (International Development Association). With a population of 32 million, the Ghanaian economy depends on agriculture and service.

Ghana has earned recognition as a remarkable achievement in sub-Saharan Africa. It holds the distinction of being the initial nation to achieve independence from colonial rule in 1957. During the 1990s, it successfully established a stable democratic system, surmounting a history of prolonged political turmoil. Ghana is a significant contributor to the global production of gold and cocoa and enjoys one of the region's highest per capita gross domestic products. Nevertheless, the economy has faced challenges, experiencing a decline in growth from 8 percent in 2012 to 2 percent in 2015. Despite its promising past, Ghana's economic landscape has unfortunately been witness to deterioration in recent years.

Several significant events contributed to the deterioration of Ghana's economy:

1. **2012 Dumsor Crisis**: In 2012, Ghana faced a persistent electricity crisis known as "Dumsor," which resulted in reduced economic production and electricity rationing. This crisis lasted until 2015 and was primarily due to factors like poor rainfall affecting hydroelectric power generation and disruptions in gas supply for thermal power plants.

2. **2013 Crisis**: The collapse in the price of gold in 2013 had a detrimental impact on Ghana's economy. This led to a loss in the value of Ghanaian exports, causing the current account to swell

to 12.3% of GDP. The fiscal deficit also worsened as government revenues from export tariffs on gold declined.

3. **2015 Crisis**: By 2015, Ghana's economy faced mounting challenges, including widening current account and budget deficits, high inflation, and a depreciating currency. Rising interest rates and a growing number of bad loans in banks further exacerbated the situation. One of the root causes was excessive government spending, particularly on the bloated civil service.

4. **2017 Onwards**: The government's ineffectiveness since 2017 played a significant role in the economic deterioration. While the government initially achieved success in reducing inflation and narrowing the budget deficit, much of this growth was driven by the oil sector. External shocks, such as the COVID-19 pandemic and the Russia-Ukraine war, also had an adverse impact on the economy. The agricultural sector, which constitutes a substantial portion of Ghana's GDP and export earnings, received inadequate investment. The failure to increase agricultural output, particularly in cocoa production, was an important obstacle in the path of economic growth and transformation. The government reinstated allowances for trainee nurses and teachers in 2017, which had previously been suspended. While this decision was influenced by political considerations, it strained the public purse, costing over $2.5 million annually. Additionally, ambitious projects like the construction of a cathedral have faced funding challenges and got stalled.

Ghana experienced steady growth from 2000 to 2008. This growth is attributed to the increase in the prices of gold and cocoa, which further increased the export revenue of the country. This also resulted in the decline in the gross debt from 2000 to 2006. However, the global economic downturn that followed the 2009 Financial Crisis had a significant impact on Ghana, causing its real GDP to contract by 5% that year. Subsequently, there were several years of growth, with the real GDP rebounding from 5% in 2009 to a robust 13% in 2012. Unfortunately, from 2012 onward, Ghana's economic growth took a downturn. This was primarily attributed to various factors, including the 2012 Dumsor Crisis, a decline in gold and cocoa prices in 2013, and government ineffectiveness leading to rising debt, high inflation, increased interest rates, and a widening current account deficit. Between 2012 and 2015, the real GDP declined by 11%. Although there was a 5% growth from 2016 to 2017, the trend reversed again from 2017 onward. The period from 2019 to 2021 witnessed another decline in GDP due to the global pandemic's impact. (Figure 2-1)

In terms of Consumer Price Index (CPI) inflation, Ghana experienced a consistent increase from 2012 onwards. Inflation surged from from 8% in 2012 to 17% in 2017. Another surge in inflation occurred during the global pandemic starting in 2020, with inflation reaching 31.8% in 2022. (Figure 2-1)

Figure 2-1

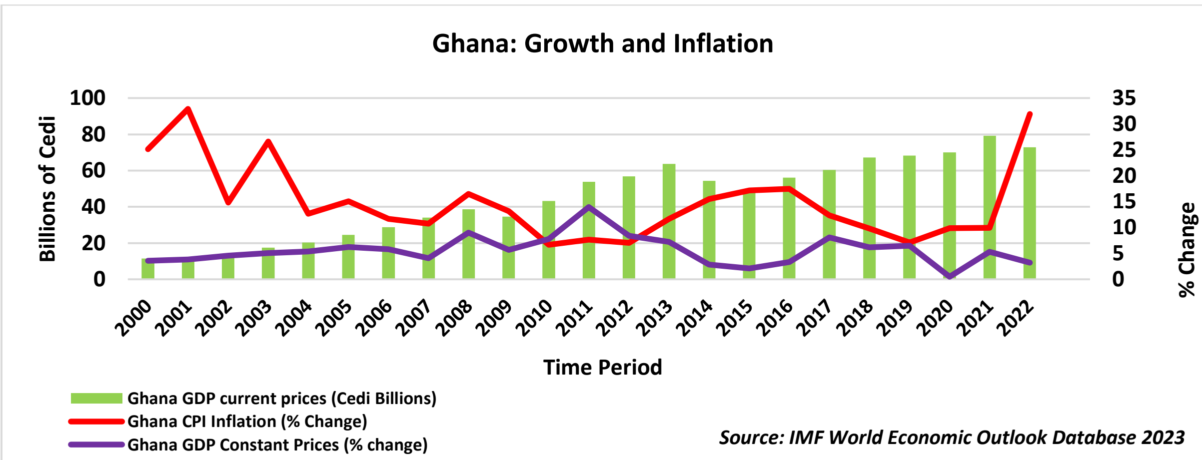
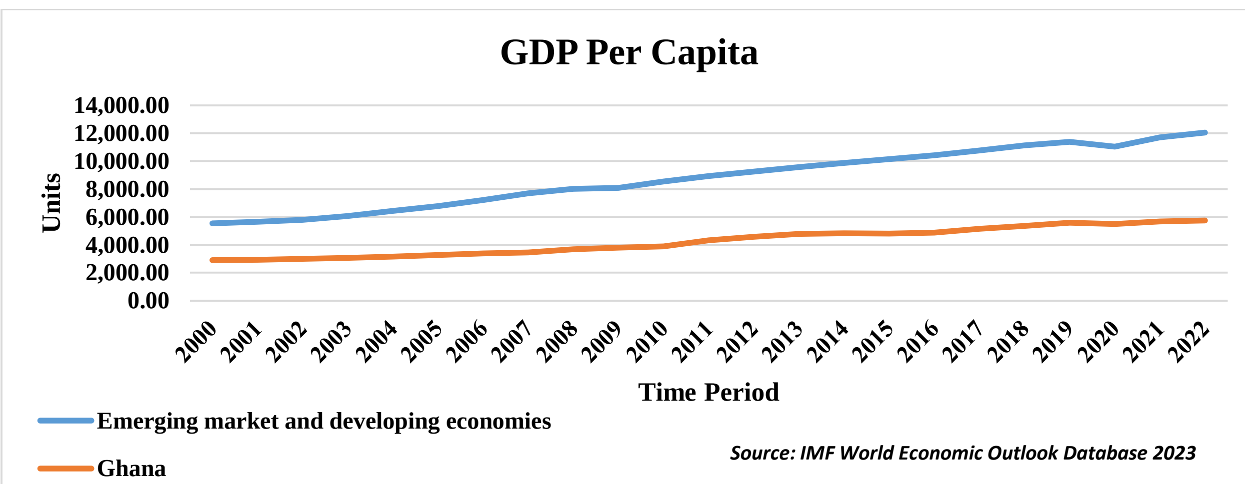


Figure 2-2: GDP at Current Prices

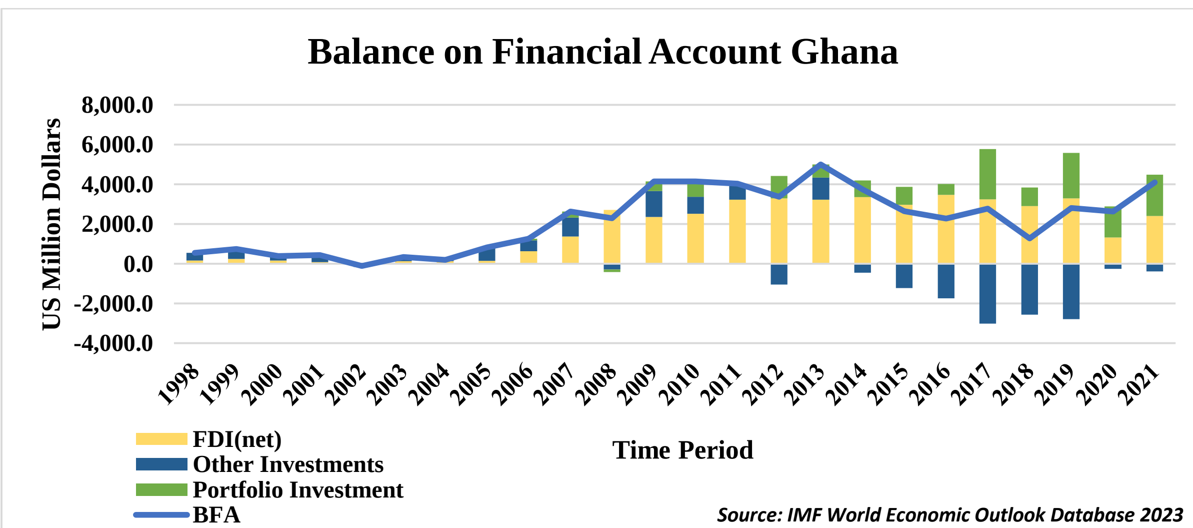


The balance on the financial account of a country refers to the net flow of assets (such as investments and loans) between that country and the rest of the world. Ghana has been receiving FDI's since 2008 but on the other hand other investments have been on a decline. According to the World Investment Report 2022, Ghana experienced an increase in FDI inflows, rising from $ 1.88 billion in 2020 to $ 2.61 billion in 2021, primarily due to projects in extractive industries

(UNCTAD , 2023). The country's FDI stock also reached USD 41 billion in 2021. However, global FDI momentum weakened in 2022 due to factors like the Ukraine war, increasing food and energy prices, financial instability, and debt pressures, as reported by UNCTAD's Investment Trends Monitor. Ghana's leading investor nations include South Africa, the Netherlands, France, Mauritius, and China. (Figure 2-3)

In 2021, significant investments occurred from Singapore, Australia, India, and China (GIPC, FDI flows). FDI flows were primarily directed towards sectors such as services, oil and gas, manufacturing, trade, construction, and agriculture (GIPC, FDI flows). Ghana actively promotes itself as a West African hub for foreign investors through initiatives like the annual Ghana Investment Summit. Additionally, the $ 16 billion COVID-19 Alleviation and Revitalization of Enterprises Support (CARES) program running from 2020 to 2024 aims to attract investment in sectors like agribusiness, fertilizers, automotive assembly, aluminium, and steel.

Figure 2-3: Ghana BFA



Ghana's economic narrative is marked by a stark contrast between a positive Balance on the Financial Account, driven by FDIs, and a persistent deficit in the broader Balance of Payments. The fluctuations in reserves, often experiencing downturns during economic turmoil, emphasize the necessity for comprehensive economic policies to address trade imbalances and external shocks, ultimately working towards achieving a more sustainable and balanced external financial position. (Figure 2-4)

In Ghana's economic landscape, a significant divergence exists between the Balance on the Financial Account and the overall Balance of Payments. The Financial Account has shown remarkable resilience and positivity, primarily attributable to the influx of Foreign Direct Investments (FDIs). These investments, originating from foreign entities seeking business opportunities within Ghana, have significantly contributed to the country's financial stability and overall growth. However, the current account of Ghana tells a contrasting story, consistently indicating a deficit. This imbalance signifies that Ghana's economic transactions with the rest of the world, encompassing trade in goods and services, income flows, and transfers, have not achieved equilibrium. Despite the positive impact of FDIs on the financial aspect, the current account deficit has, at times, contributed to the consistent overall deficit.

One key factor affecting the Balance of Payments is the inherent volatility in Ghana's foreign exchange reserves. These reserves serve as a crucial buffer to stabilize the country's external financial position. However, they have experienced notable fluctuations over the years, with significant declines occurring during periods of economic turmoil. These include the global financial crisis in 2008, sharp declines in the prices of key exports such as cocoa and gold in 2012, economic challenges in 2018, and the adverse impact of the COVID-19 pandemic in 2020. These reserve declines during economic crises underscore Ghana's vulnerability to external shocks. While FDI have provided a source of stability and positive financial inflows, other factors such as trade imbalances, fluctuations in commodity prices, and external economic conditions continue to challenge the overall balance of payments. Having a negative overall BOP implies that there is no addition to the reserves. (Figure 2-4)

The breakdown of Ghana's current account shows a persistent budget deficit, with the only growing and positive sectors being secondary income (remittances sent by citizens) and the balance on goods since 2018. The balance on goods and services declined in 2012 due to the price crash of gold and cocoa. Ghana has experienced a current account deficit since 2000, with no periods of current account balance or surplus. Notably, a significant portion of the current account balances is attributed to secondary income, emphasizing the importance of remittances in Ghana's external finances. (Figure 2-5)

Figure 2-4: Ghana BOP & BFA

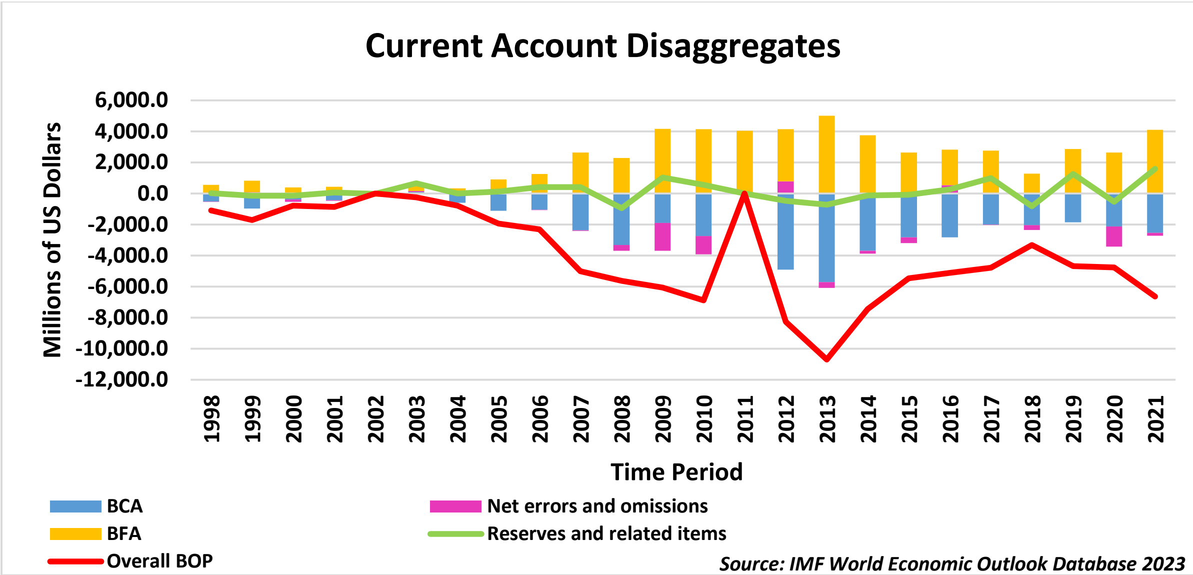
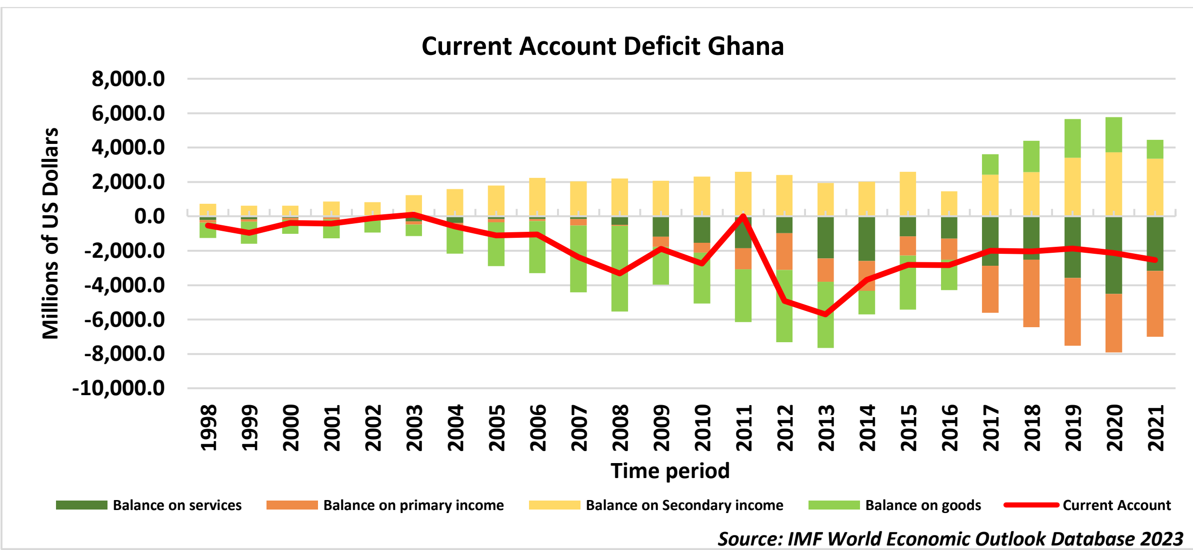
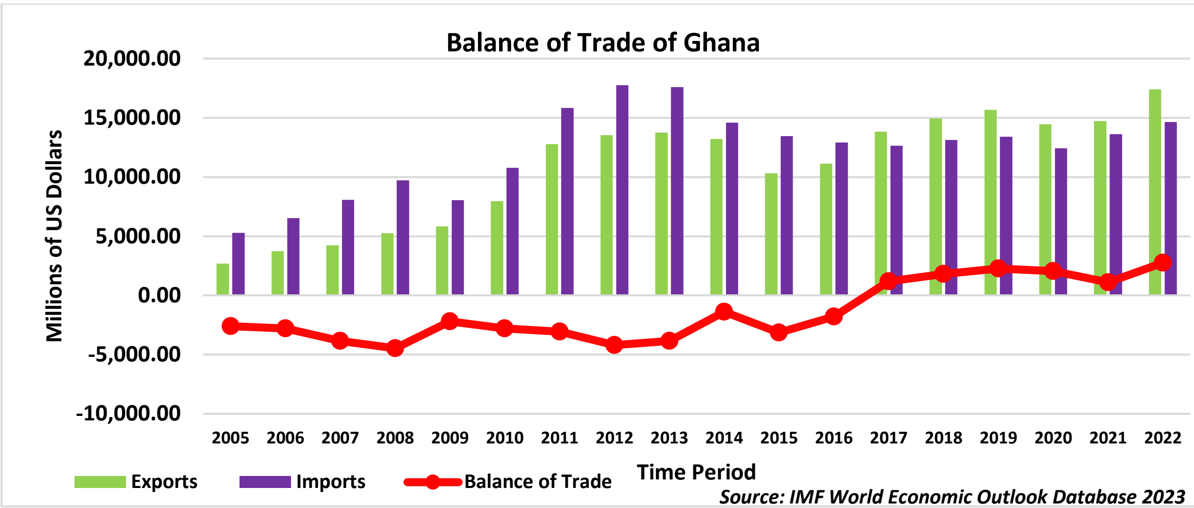


Figure 2-5: Ghana Current Account Deficit



Ghana's trade balance profile can be divided into two distinct phases. Prior to 2017, the country experienced a trade deficit, with imports surpassing exports. However, post-2017, there was a notable shift as exports began to outpace imports. This transformation can be attributed to the government's economic recovery efforts, particularly through the export of new commodities like oil and timber. Notably, in 2012, Ghana witnessed a significant decline in exports, primarily due to the sharp drop in the prices of its major export commodities, gold and cocoa. Despite being a primary commodity exporter, Ghana imports manufactured goods from around the world. Overall, the trade balance indicates a deficit until 2016, followed by a trade surplus from 2017 onward. (Figure 2-6)

Figure 2-6: Ghana BOT



Ghana's global exports have shown a steady increase, with notable drops occurring in 2012, 2016, and 2021 (Figure 2-7). These declines were attributed to falling commodity prices, electricity shortages, and the global pandemic. Fortunately, exports rebounded swiftly after each of these setbacks. Ghana primarily exports four major products: gold, cocoa beans, timber, and crude oil, and it ranks as the world's second-largest cocoa bean producer. (Figure 2-10), (*Figure 2-6*)

Ghana's imports are mainly sourced from three major global regions: Sub-Saharan Africa, Asia, and the European Union. Over time, Ghana's exports to the European Union and Asia have grown, while exports to Sub-Saharan Africa have decreased. This shift can be explained by the high demand for primary goods like gold and cocoa in Asia and Europe, coupled with increased production of these goods by other African nations, leading to reduced imports from Ghana.(Figure 2-8)

The top five countries to which Ghana exports its goods are South Africa, Switzerland, the Netherlands, India, and China. Notably, exports to South Africa have experienced significant growth, with an annualized rate of 20.2% over the last 26 years, reaching $546 million in 2021. Switzerland is the second-largest destination for Ghana's exports, driven by the mutual trade in cocoa and chocolates. Exports to Switzerland have grown at an annualized rate of 19.1%, reaching $2.44 billion in 2021. China imports crude petroleum, manganese ore, and asphalt mixtures from

Ghana, while India primarily receives gold, crude petroleum, coconuts, Brazil nuts, and cashew nuts.(Figure 2-9)

Ghana's imports can be categorized into two types: oil and gas products and non-oil products, with non-oil imports being the more significant category (Figure 2-15). The country's imports have increased annually and come from developing and advanced economies (Figure 2-13). The top countries from which Ghana imports include China, the United States, the United Kingdom, Belgium, South Africa, and India (Figure 2-14). Notable products imported from South Africa to Ghana include delivery trucks, semi-finished iron, and other iron products. Switzerland exports packaged medicaments, hand saws, and medical items to Ghana.

Figure 2-7: Exports by Ghana to the World

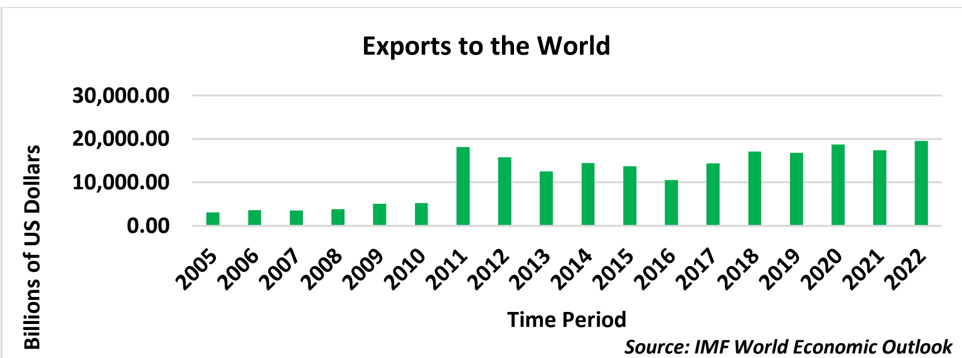
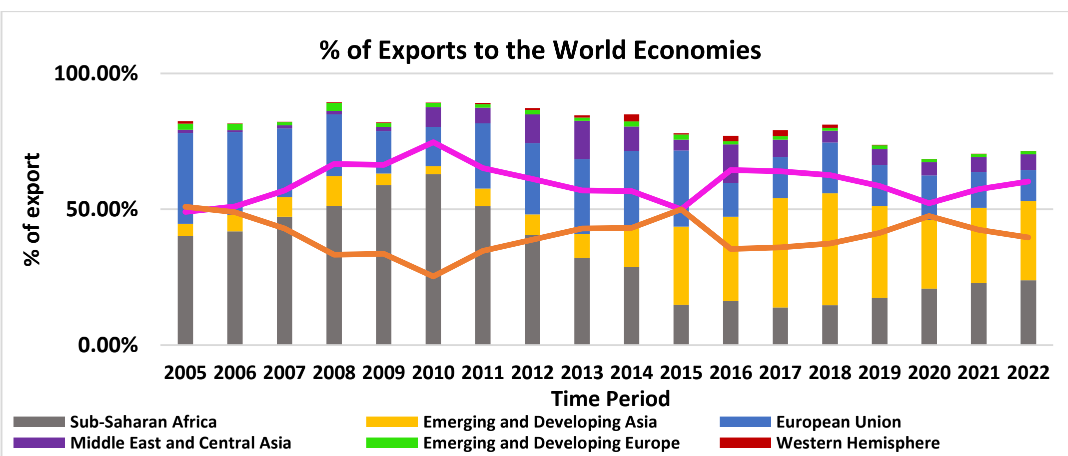


Figure 2-8: Export by Ghana to World Economies



Source: IMF World Economic Outlook Database 2023

Figure 2-9: Top 15 Countries to which Ghana Exports

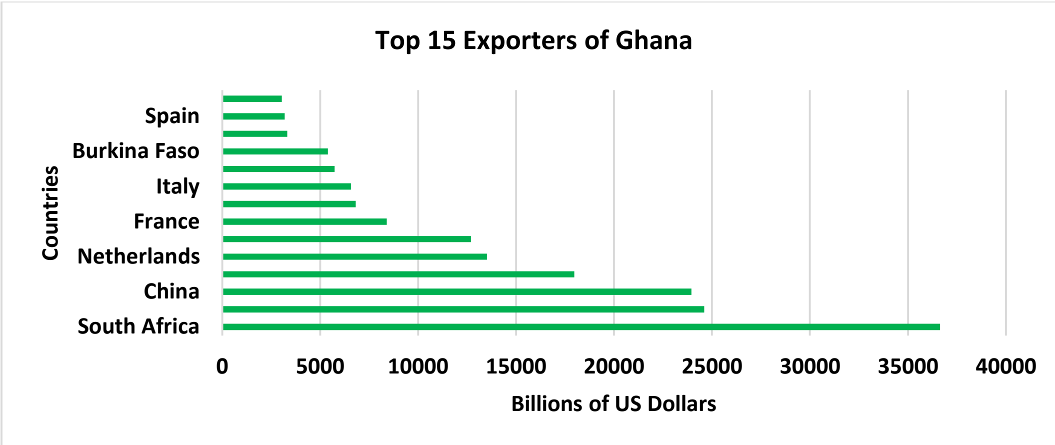


Figure 2-10: Major Export Products

Source: IMF World Economic Outlook Database 2023

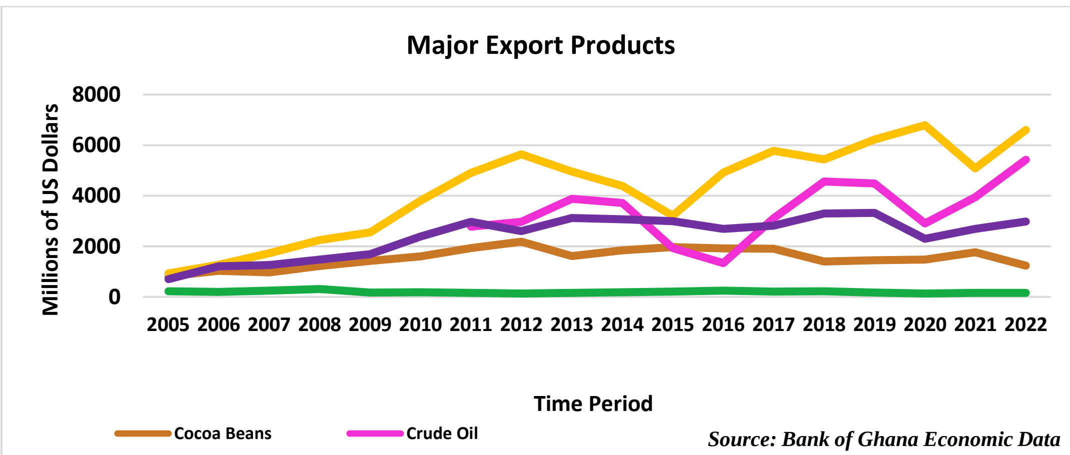


Figure 2-11: Ghana's Share in World Cocoa Production

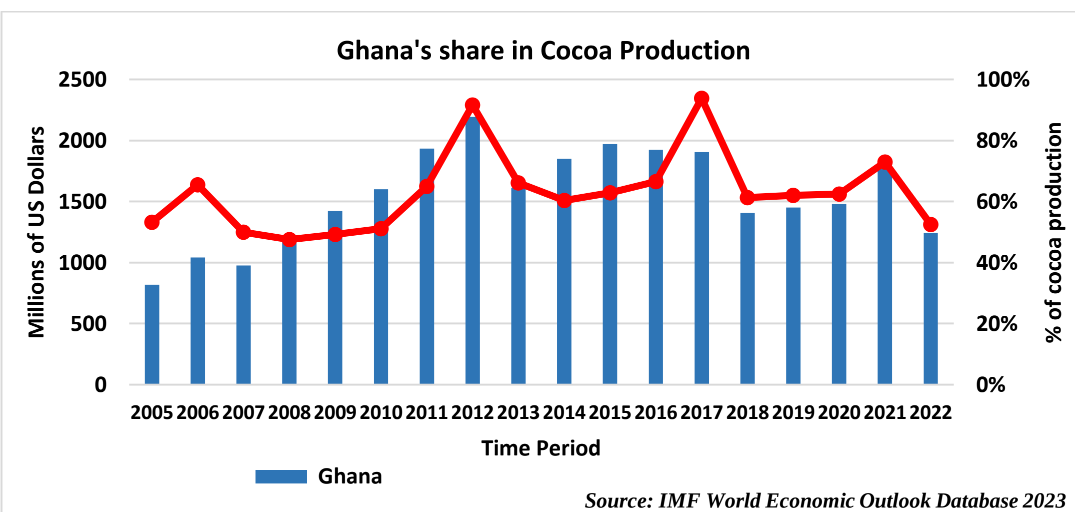


Figure 2-12: Imports to Ghana from World

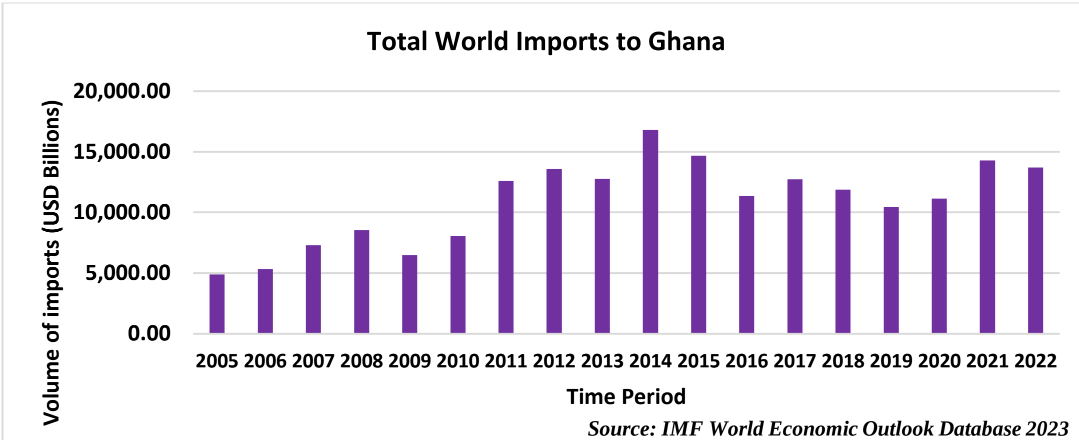


Figure 2-13: Imports to Ghana from World Economies

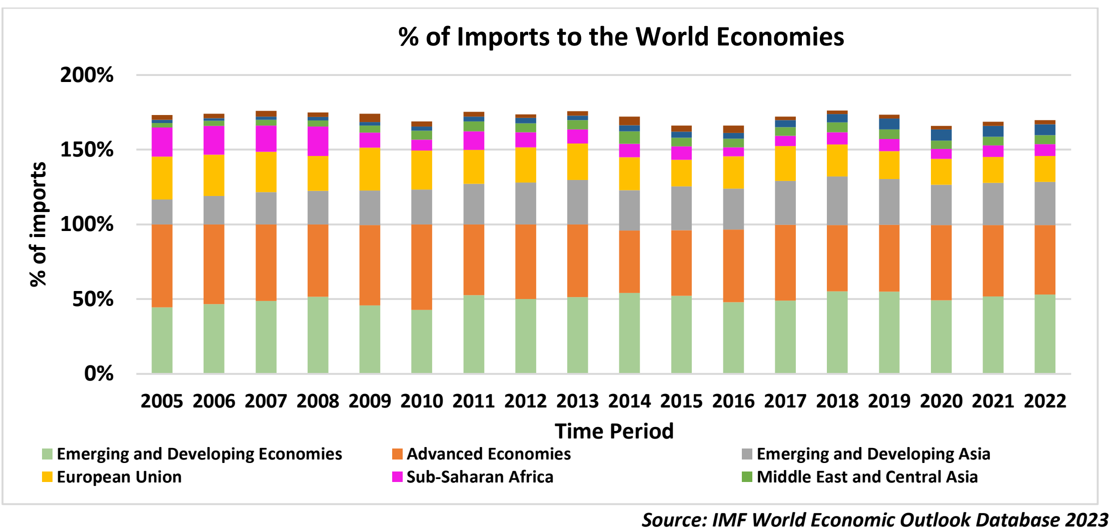


Figure 2-14: Top 15 Countries from which Ghana Imports

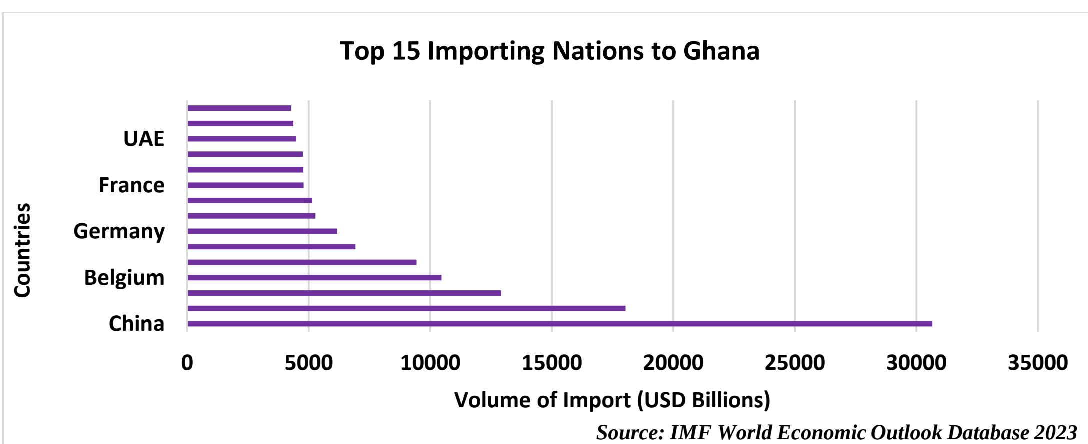
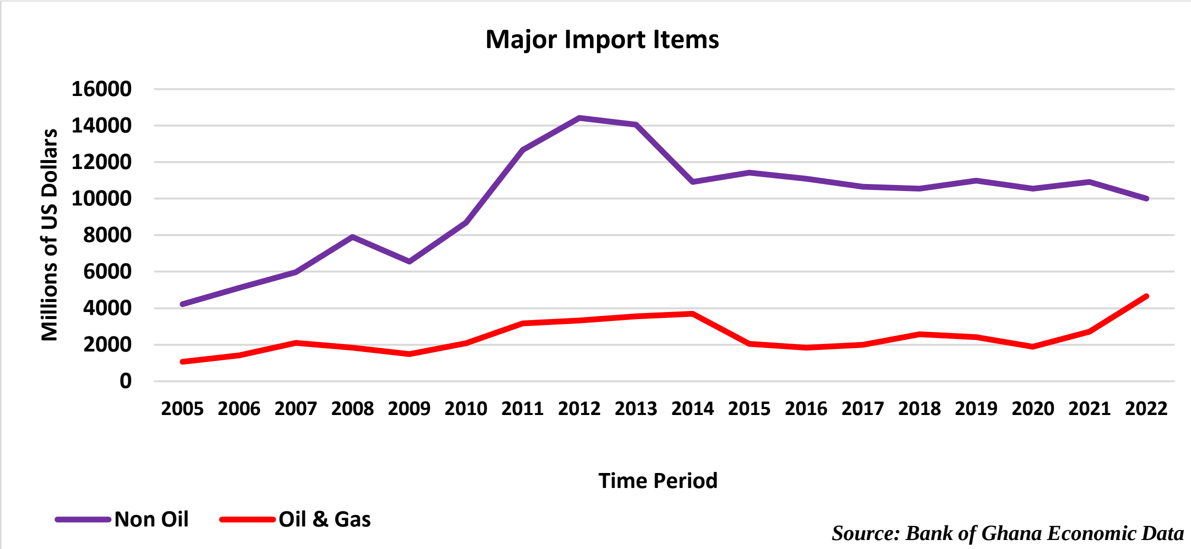


Figure 2-15: Ghana's Major Import Items



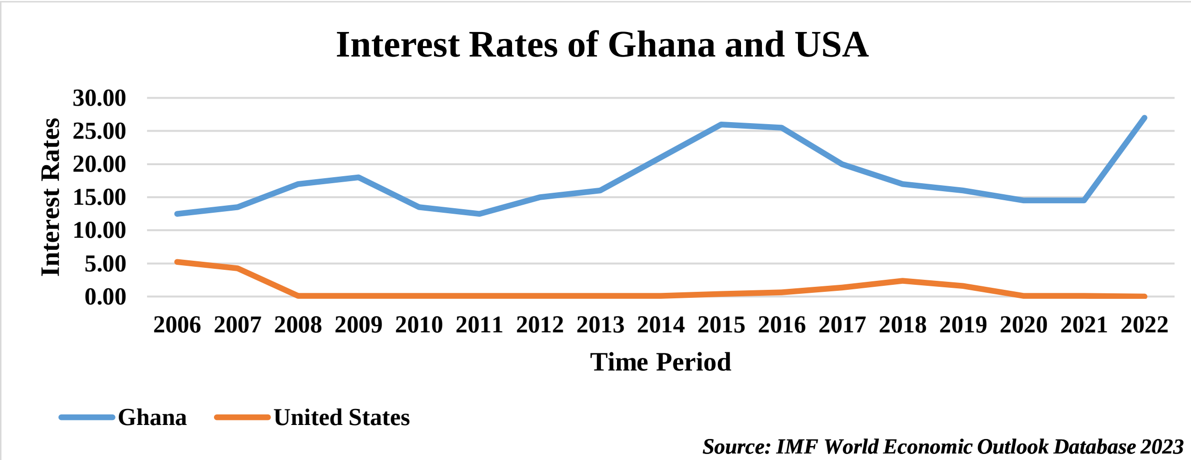
The disparity in interest rates between Ghana and the United States has exhibited a notable trend of divergence over the years, highlighting the contrasting economic landscapes of the two nations. In the United States, interest rates have generally demonstrated a higher degree of stability, in stark contrast to Ghana's fluctuating interest rate environment.(Figure 2-16)

Ghana's interest rates have been characterized by double-digit figures, signifying a degree of volatility in the country's economic conditions. This volatility reached its zenith starting from 2012, and for several years thereafter, interest rates in Ghana experienced a consistent upward trajectory. However, a significant shift occurred in 2016 when Ghana's interest rates commenced a steady decline. Unfortunately, this decline was interrupted in 2021, as interest rates surged to an alarming 27%.(Figure 2-16)

Conversely, during the same period, the United States maintained a relatively stable interest rate landscape. The U.S. interest rates exhibited a narrower range, oscillating between a low of 0.13% to a high of 1.6%. This stable interest rate environment underscores the United States' efforts to maintain economic stability and manage fluctuations effectively.

The widening gap in interest rates between Ghana and the United States underscores the divergent economic challenges and policy responses faced by these two nations. Ghana grapples with economic volatility, whereas the United States has maintained a more consistent and stable interest rate environment. This divergence in interest rates has also been resulting in capital flows to emerging market economies like Ghana in search for yield.

Figure 2-16: Interest Rates in USA and Ghana

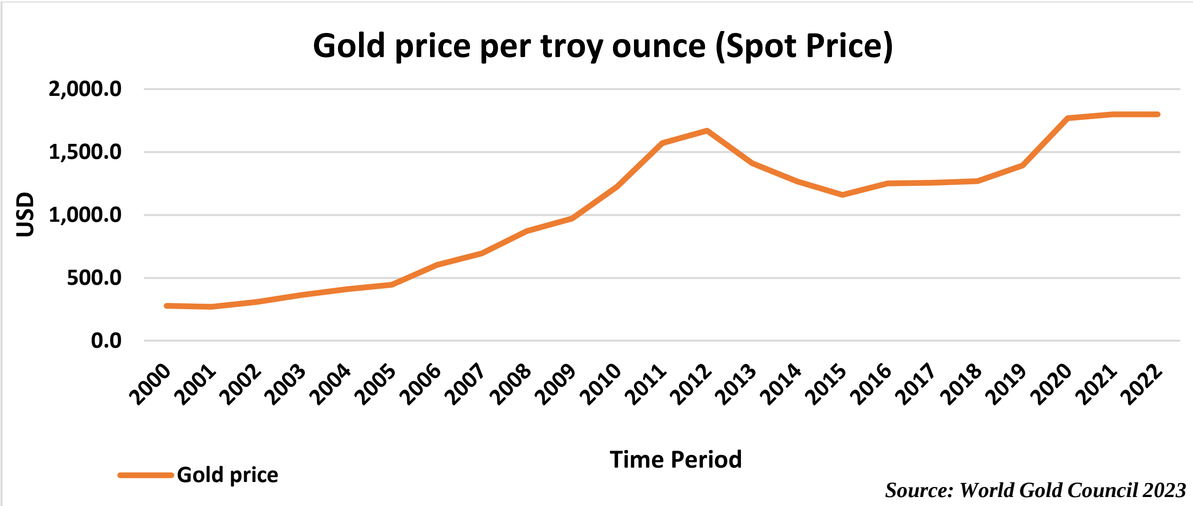


The Ghanaian economy has long been heavily dependent on the export of primary commodities, with cocoa and gold serving as key pillars of its economic foundation. These exports have historically generated significant revenue and played a pivotal role in shaping the country's economic landscape. However, a critical turning point occurred after 2012 when the global price of gold experienced a substantial crash, triggering a profound economic downturn in Ghana.(Figure 2-17)

Gold, prized for its stability and value, had been a reliable source of export revenue for Ghana for many years. Yet, in 2012, the global gold market witnessed a sharp decline in prices, sending shockwaves through the Ghanaian economy. The abrupt fall in gold prices translated directly into reduced export income, leading to economic instability and formidable challenges for the nation.

This economic downturn manifested as decreased government revenues, heightened fiscal deficits, and a challenging macroeconomic environment. Ghana grappled with rising inflation, currency depreciation, and difficulties in meeting its financial obligations. The overreliance on gold exports had rendered the economy vulnerable to the whims of global commodity price fluctuations, underscoring the urgent need for economic diversification and a more resilient economic strategy.

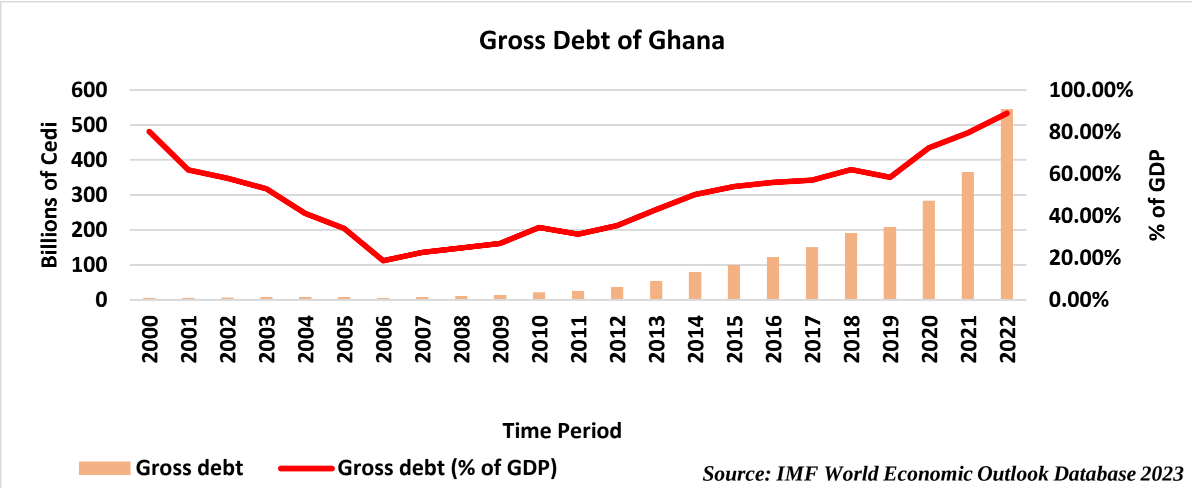
Figure 2-17:Spot Price of Gold



When we take an overview of Ghana's gross debt levels spanning from 2000 to 2022 it is seen that notably, following the Jubilee Movement in 2000, the country's debt was cancelled, leading to a decrease in gross debt. Between 2003 and 2006, Ghana experienced a significant reduction in its debt burden, primarily due to successful debt cancellation initiatives under the IMF and World Bank's Heavily Indebted Poor Countries and Multilateral Debt Relief programs. However, the trajectory of debt in Ghana shifted after the 2009 Financial Crisis, with lending increasing notably. During the period from 2013 to 2014, there was a decline in commodity prices, including a decrease in the value of the Ghanaian cedi. Consequently, Ghana's external debt and debt payments grew proportionately larger. This trend persisted as economic conditions worsened during the period from 2012 to 2017. The advent of the global pandemic in 2020 further fueled debt accumulation. As of 2022, Ghana's gross debt reached 546 billion Cedi, equivalent to 89% of its GDP, illustrating the substantial increase in debt levels in recent years. (Figure 2-18)

Ghana's total external debt has exhibited a consistent upward trend over the years, with notable spikes occurring in 2013 and 2018. These increases in external debt coincided with periods of economic instability. During this time, the ratio of external debt to Gross National Income (GNI) surged from 36% in 2018 to 48% in 2021 (Figure 2-19). The majority of this increase can be attributed to the economic challenges brought about by the pandemic and issues related to governance. Most of the debt taken by Ghana was long-term external term as compared to short-term external debt (Figure 2-20).

Figure 2-18: Gross Debt of Ghana



Ghana faced a substantial challenge in 2021 as its public and publicly guaranteed debt soared to $27,000 million, representing a significant 75.65% of its Gross National Income (GNI). This debt burden has been steadily mounting since 2010, reflecting a concerning trend of increased indebtedness. This situation underscores the importance of vigilant fiscal management and sustainable debt practices to safeguard the country's economic stability and future prosperity. (Figure 2-21)

Conversely, the situation regarding public non-guaranteed debt in Ghana presents a different picture. This category of debt has remained unchanged since 2014, implying that debt acquired prior to that year has not yet been fully serviced, and no new public non-guaranteed debt has been issued during this period. This stability in the non-guaranteed debt segment may indicate the country's efforts to manage and control its non-guaranteed debt obligations, potentially focusing on servicing existing debt rather than taking on new financial liabilities. Monitoring and addressing both guaranteed and non-guaranteed debt dynamics will be vital for Ghana's overall financial stability and fiscal management. (Figure 2-22)

Addressing this growing debt issue is paramount for Ghana's long-term financial health. Effective measures, including prudent fiscal policies and targeted economic reforms, will be crucial to manage and ultimately reduce the debt-to-GNI ratio, ensuring that the nation can navigate its economic challenges and maintain a solid foundation for sustainable growth and development.

Figure 2-19:Total External Debt Stocks for Ghana

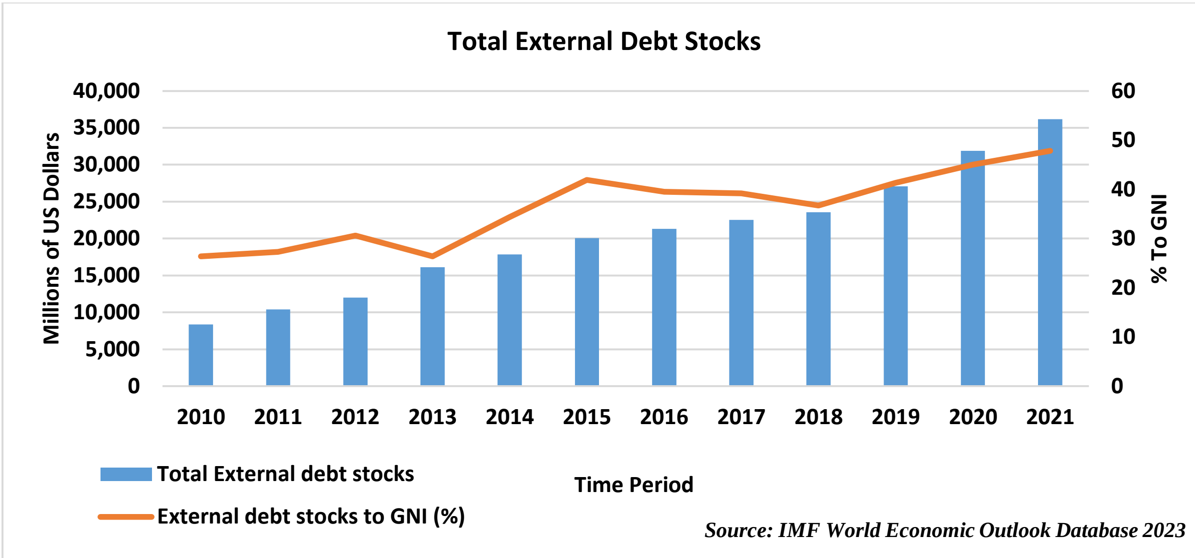


Figure 2-20: Debt Based on Maturity for Ghana

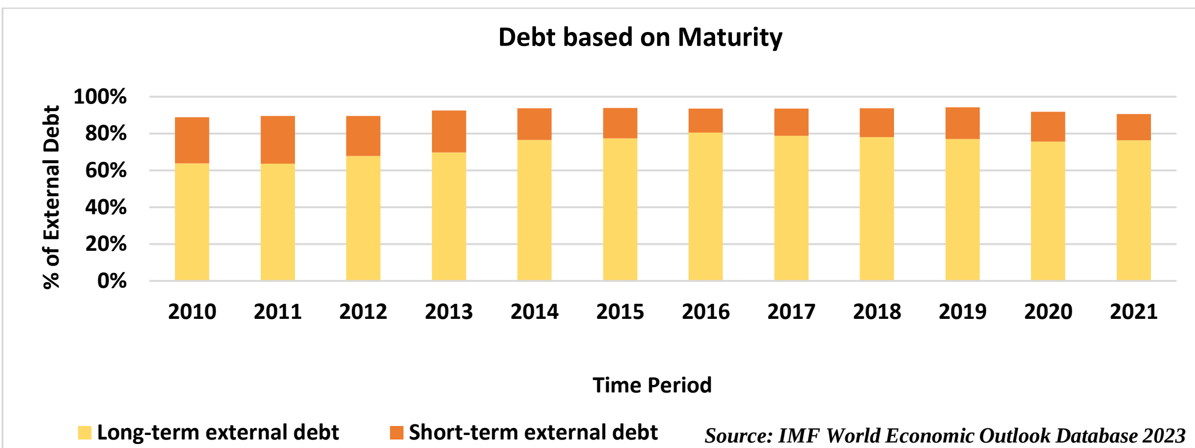
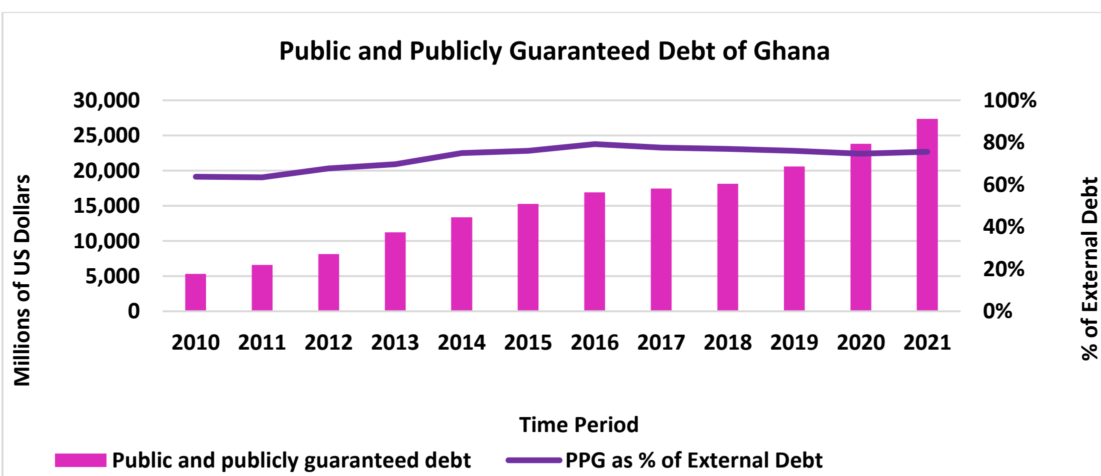
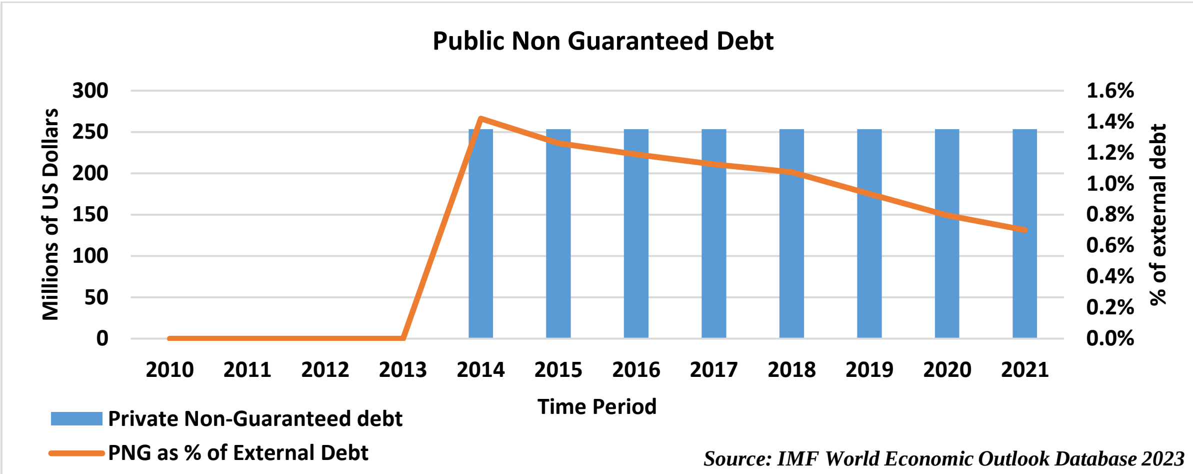


Figure 2-21: Ghana PPG



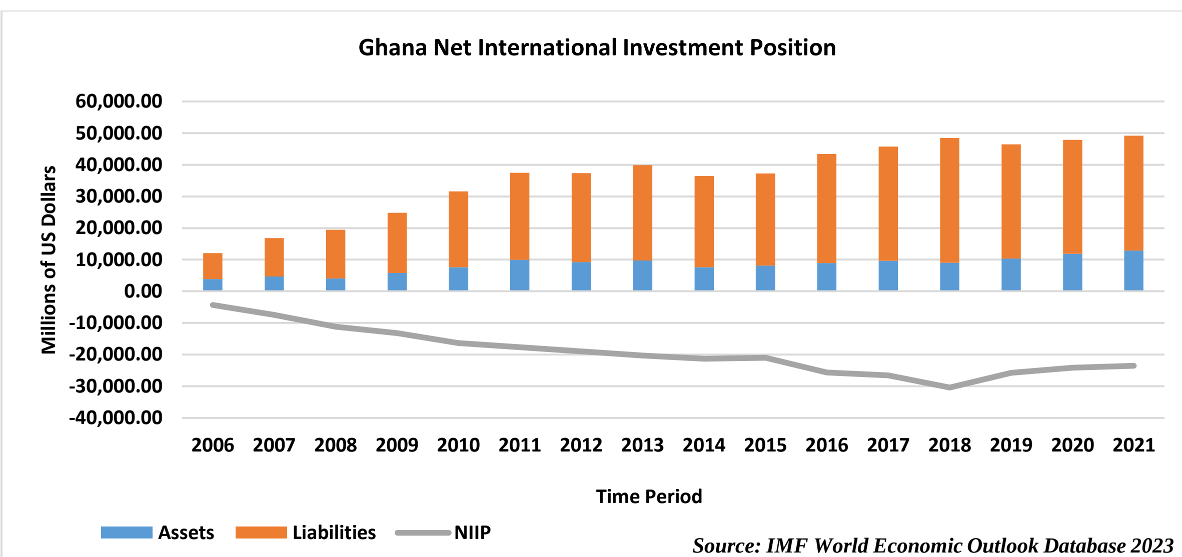
Source: IMF World Economic Outlook Database 2023

Figure 2-22: Ghana PNG



The Net International Investment Position signifies whether a country is a net creditor or net debtor to the rest of the world based on the disparity between its external financial assets and liabilities. In the case of Ghana, the NIIP has been consistently increasing in a negative trend, signifying that the nation is a debtor and has received financial aid from the rest of the world (Figure 4). This trend intensified after 2015 due to high government deficits, elevated interest rates, and ongoing financial challenges dating back to 2012. Consequently, Ghana was classified as being at high risk for debt distress in March 2015, leading to the provision of financial aid. (Figure 2-23)

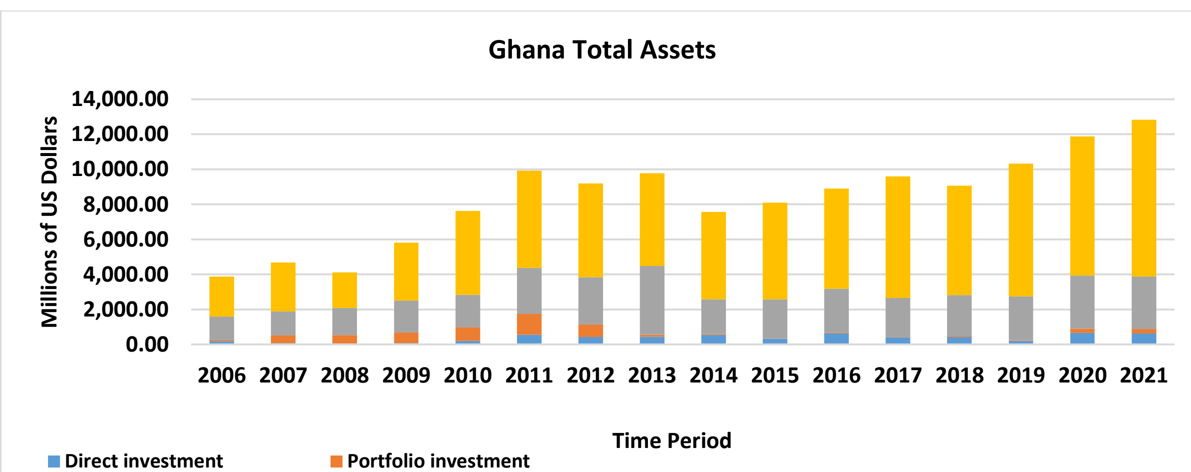
Figure 2-23: Ghana NIIP



As of 2022, Ghana's total assets amount to $8,943 million, with the highest portion represented by reserve assets held by the central bank. However, portfolio investments and direct investments by the country abroad have remained relatively low. Foreign direct investment faces several obstacles in Ghana, including costly and complex financial services, a lack of government transparency, corruption, inadequate infrastructure, a complicated property market, unreliable power, and water supply, high cross-border trade expenses, a burdensome bureaucracy, and a shortage of skilled labour. Ghana's investment code also imposes restrictions on foreign investors, barring them from participating in eight specific economic sectors, such as petty trading, taxi and car rental services, lotteries, beauty salons and barber shops management, exercise book and stationery manufacturing, retailing of finished pharmaceutical products, and the production, supply, and retailing of drinking water in sealed pouches. Furthermore, foreign investors face limited market access in sectors including telecommunications, banking, fishing, mining, petroleum, and real estate.

The proportion of assets to GDP shows that in 2021, assets accounted for approximately 80% of the GDP (Figure 2-26). In contrast, during the same year, the proportion of liabilities to GDP stood at a higher level, making up about 236% (Figure 2-27). This indicates a significant imbalance between assets and liabilities, with liabilities exceeding assets by a considerable margin, which can have important implications for a country's financial stability and fiscal health.

Figure 2-24: Ghana Total Assets



Source: IMF World Economic Outlook Database 2023

As of 2022, Ghana's total liabilities amount to $22,000 million, surpassing its current assets (Figure 2-25). This signifies that Ghana is a debtor nation. While the liabilities stemming from portfolio investments are relatively low, the direct investment liabilities have been substantial. Liabilities account for a significant proportion of GDP, with these obligations representing 30% of the country's GDP in 2021 (Figure 2-27). Furthermore, the total liabilities exceed the GDP of the country.

Figure 2-25: Ghana Total Liabilities

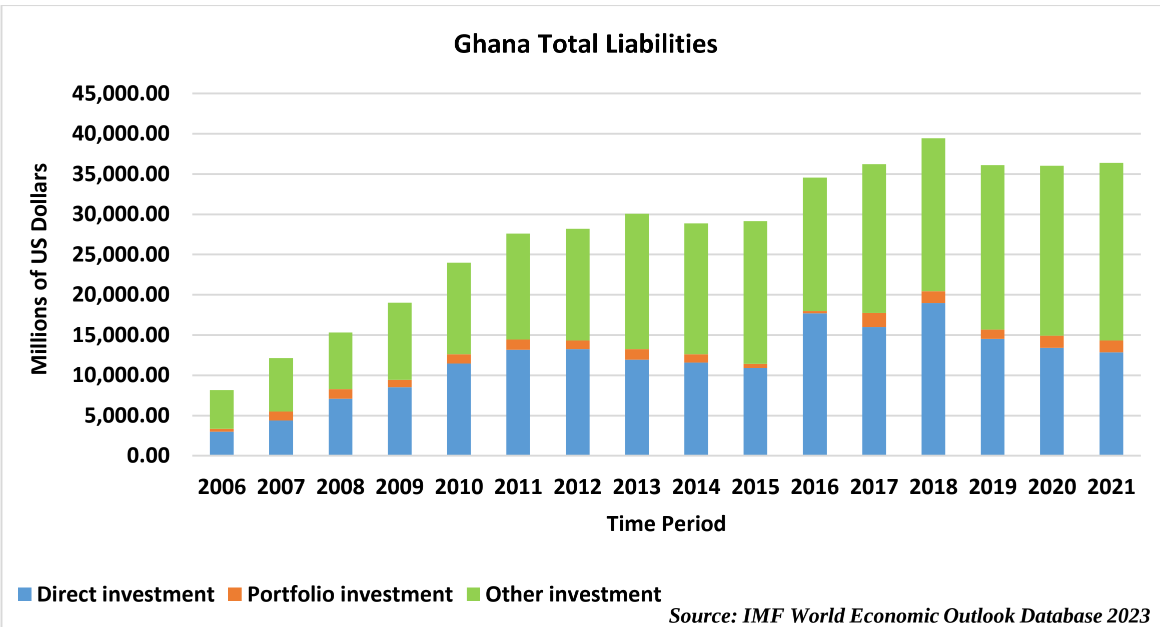


Figure 2-26: Ghana Assets as a proportion of GDP

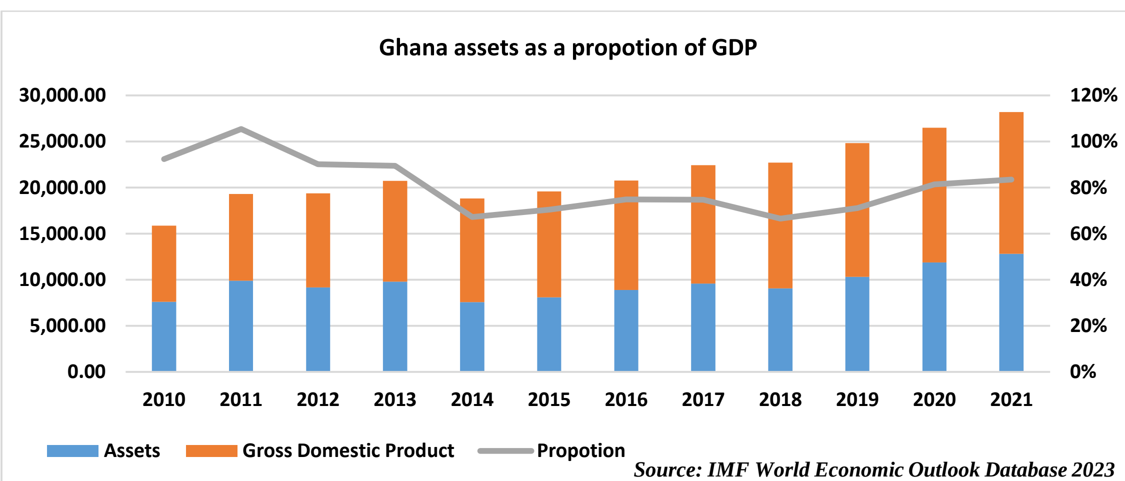
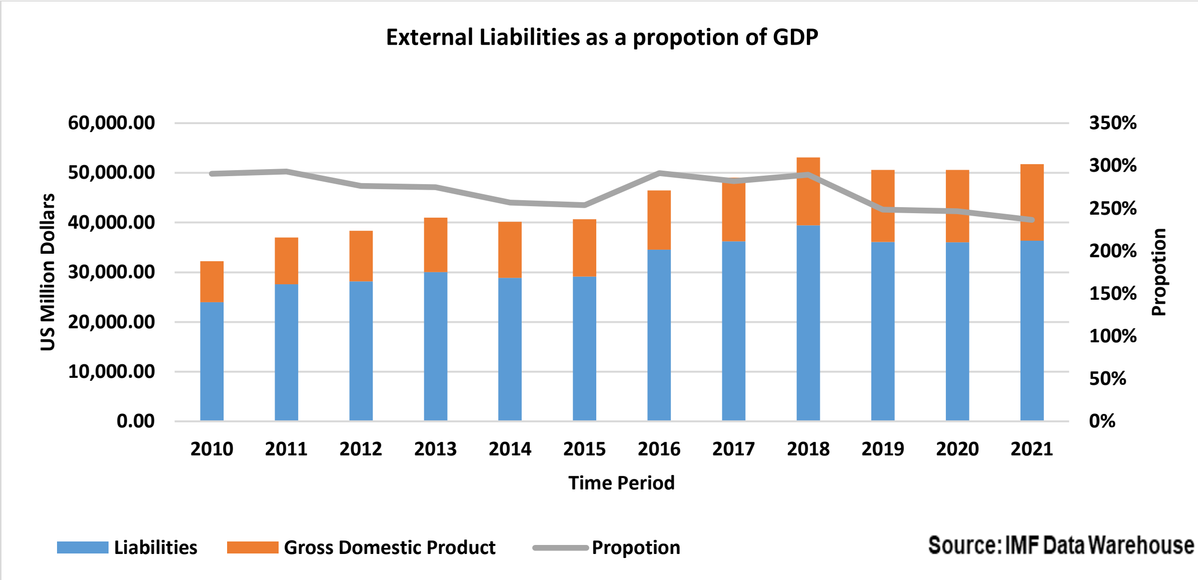


Figure 2-27: Ghana Liability as a proportion of GDP



During the 1980s and 1990s, the IMF and the World Bank extended additional loans, which in turn allowed private lenders to continue receiving their payments. Consequently, there was a shift of debt from private lenders to multilateral institutions. Unfortunately, this approach proved to be detrimental for the countries that had to repay these loans while implementing austerity measures.

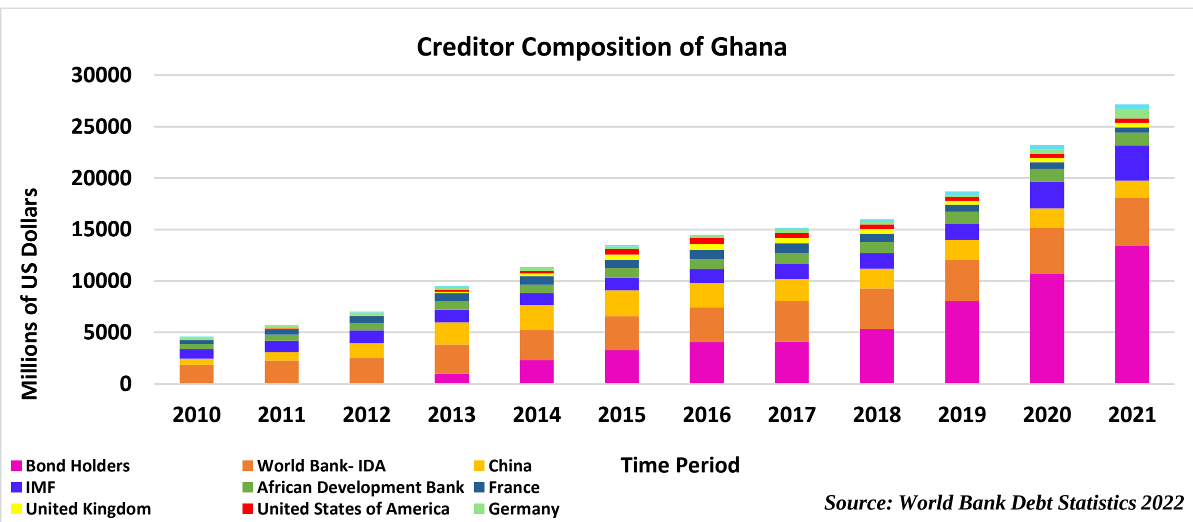
When debt cancellation initiatives (Jubilee Movement) did occur in the 2000s, it was the multilateral creditors who bore the financial burden, rather than the original lenders. Ghana experienced a significant reduction in its debt levels between 2003 and 2006 due to debt cancellation efforts under the IMF and World Bank's Heavily Indebted Poor Countries and Multilateral Debt Relief initiatives. Subsequently, Ghana's economy witnessed substantial growth in the years that followed, thanks in part to rising prices for gold and cocoa, two of the country's primary exports. This economic upturn also led to increased lending, with Ghana accumulating $18.2 billion in external loans and making $8.7 billion in debt payments between 2007 and 2015.

Between May 2007 and February 2015, the IMF and the World Bank assessed Ghana as having a moderate risk of debt distress. However, in March 2015, this classification was elevated to high risk, making Ghana eligible to access 100% of the support in the form of grants. Despite this high-risk status, the World Bank still approved $1.16 billion in loans for the country.

The composition of Ghana's creditors reveals that a significant portion of its debt is in the form of bonds.The remaining debt is held by various financial institutions, including the IMF, African Development Bank, and World Bank, as well as by creditor countries. In response to financial challenges, the government was compelled to secure new debts through bond issuances in the years 2013, 2014, and 2015. Notably, these bonds were associated with relatively high interest rates, ranging from 7.9% to 10.75%. (Figure 2-16)

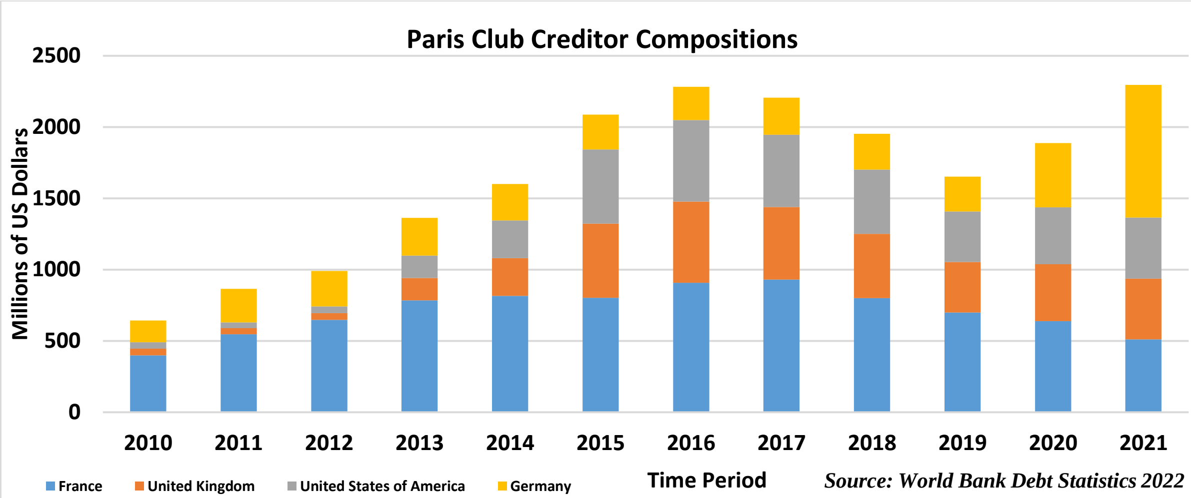
A substantial portion of Ghana's debt, totalling $13 billion, is held in the form of Eurobonds, primarily by Asset Management Companies such as BlackRock, Abrdn, and Amundi Ltd. In terms of creditor nations, China and France emerged as the leading creditors to Ghana, followed by the United States, the United Kingdom, Germany, and India. This creditor composition reflects the diverse sources from which Ghana has borrowed to meet its financial obligations and fund various development initiatives. It also underscores the importance of managing debt effectively and exploring strategies to reduce borrowing costs in order to maintain fiscal sustainability. (Figure 2-28)

Figure 2-28: Creditor Composition of Ghana



Among the Paris Club Creditors are France, US, UK and Germany. As of May 2023, according to Reuters, Ghana's official sector creditors have established a committee for debt restructuring talks. This committee is co-chaired by China and France and is associated with the Paris Club. This development signifies progress in the negotiations and sets the stage for the approval of a $3 billion International Monetary Fund (IMF) loan for Ghana. Debt restructuring talks and agreements with official creditors are critical for managing a country's debt burden and ensuring its financial stability. (Figure 2-29)

Figure 2-29: Paris Club Creditor Composition of Ghana



Recently, Ghana has taken the step of seeking debt restructuring from the G20, primarily aimed at its external debts, a significant portion of which are in the hands of private lenders. This move is imperative to facilitate access to a $3 billion IMF bailout package.

In 2020, the G20 introduced two debt treatment initiatives, with the first being the Debt Service Suspension Initiative (DSSI). Under the DSSI, debt payments were temporarily suspended, providing much-needed relief to impoverished nations, and allowing them some breathing room to address the challenges posed by the COVID-19 pandemic. The second initiative, known as the Common Framework, is another mechanism designed to address debt issues but operates differently from the DSSI. DSSI concluded in 2021 with limited success.

However, the Common Framework presented a distinct opportunity by offering a more comprehensive approach to debt relief. It aimed to achieve broader debt cancellation by involving not only bilateral lenders but also private creditors in the process. This comprehensive approach aimed to ensure that countries' debt burdens were made sustainable in a more inclusive manner. In January 2023, an official from the Paris Club disclosed to Reuters that unanimous support existed among all G20 members for restructuring Ghana's debt. Furthermore, members of the Paris Club were prepared to initiate the process of establishing a creditor committee for this purpose. (Reuters, 2023)

It is conceivable that Ghana may have a relatively advantageous position in these debt negotiations when compared to Chad. This is because, like Zambia, Ghana has also suspended its debt payments. This shared experience may provide Ghana with certain leverage and common ground in the negotiations.

Chapter 3

The United Republic of Tanzania

Established in 1964 following the amalgamation of **Tan**ganyika and **Zan**zibar, Tanzania features one of the largest cities in East Africa, Dar El Salaam which serves as both the political and business hub of the country. Before delving into an in-depth analysis of this nation’s financial landscape let’s acquaint ourselves with some essential facts to establish a connection with Tanzania.

Capital City:
Dodoma
(Since 1974)

Official Languages:
Swahili (Kiswahili) and English

President:
Samia Suluhu Hassan (Also the First female president of the country)

Currency:
Tanzanian Shilling

Time Zone:
East Africa Time

The East African country is bordered by the ***Indian Ocean and eight countries namely*** Kenya, Uganda, Rwanda, Burundi, Democratic Republic of Congo, Zambia, Malawi, and Mozambique.

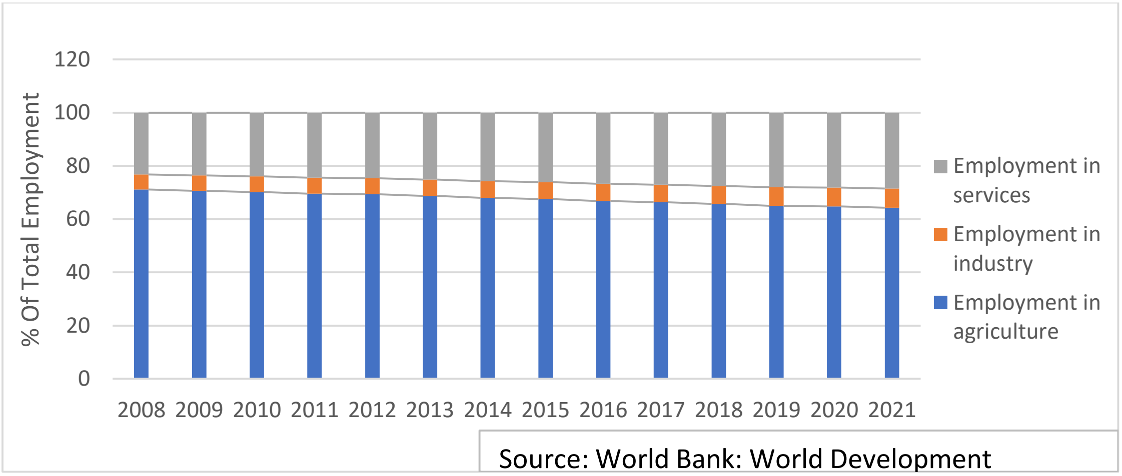


Figure 3-1: Occupational Structure of Tanzania

By virtue of its rich natural diversity, it is no shock that Tanzania is primarily an agrarian economy. With the growing share of the contribution of the tourism sector towards the GDP, followed by increased investments, we see Tanzania's employment gradually increasing in the service sector over the years as hotels and other amenities to accommodate travelers have increased over time.

In the year 2000 the Agricultural sector contributed about 48.1% of the total GDP followed by the Service and the Industrial sector accounting for 36% and 15.9% respectively However in 2012 the, service sector was in the lead contributing about 47.6% towards the GDP compared to Agricultural and Industrial sector which accounted for 26.8% and 24% of the total GDP in the country (OECD/AfDB, 2002).

Despite having a fallen contribution towards the GDP, Agricultural sector remains to be a main source for employment with 64% of the working population employed in that sector.

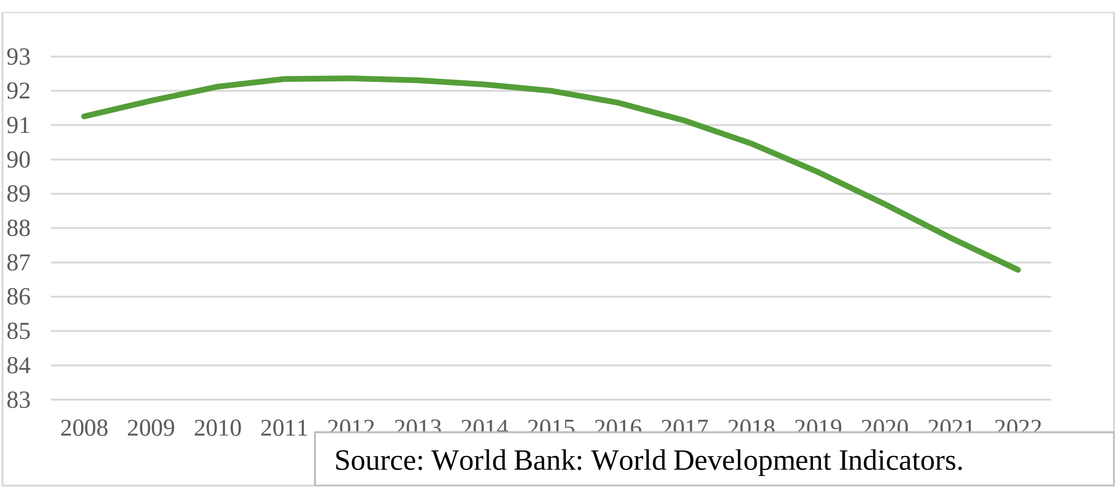


Figure 3-2: Age dependency ratio in Tanzania

As we can observe from ,Figure 3-2 Tanzania had a high dependency ratio up until year 2012. This can be attributed to the high fertility rates in the country mainly due to the lack of work opportunities leaving people to prefer larger family sizes, a logic similar to what we see in the rural areas in India. However, with increased investment towards healthcare facilities, decreasing mortality rates, along with focus on generating more job opportunities in order to decrease fertility rates and push the youthful population into the working age population, Tanzania has been trying to tap into its demographic dividend.

Figure 3-3: Annual GDP growth rate (In percent) of Tanzania

Tanzania had one of the strongest growth rates between the year 2000-2008 speaking in terms of non-oil producing countries in Sub-Saharan Africa (OECD, 2013). During the 2008 financial crisis, GDP growth rate had fallen down to 5% growth however, in 2010 the economy started to revive again showing a 1% increase the growth rate as compared to the previous year.

In 2011, Tanzania along with a few other Sub-Saharan African countries, had witnessed a severe drought which as per sources is said to be one of the worst seen in the past 60 years, causing adverse supply shocks in the country affecting more than just exports. If we look at Figure 3-4 we can observe the impact of the same on Inflation rates as scarcity of food grains led to a surge in the level of domestic prices. With a consequent increase in the global fuel prices , Inflation increased by almost double the amount in 2012 as compared to 2010. Of course, this was followed by tightening of fiscal and monetary policies by the government hence curbing the high inflation levels later on in the coming years.

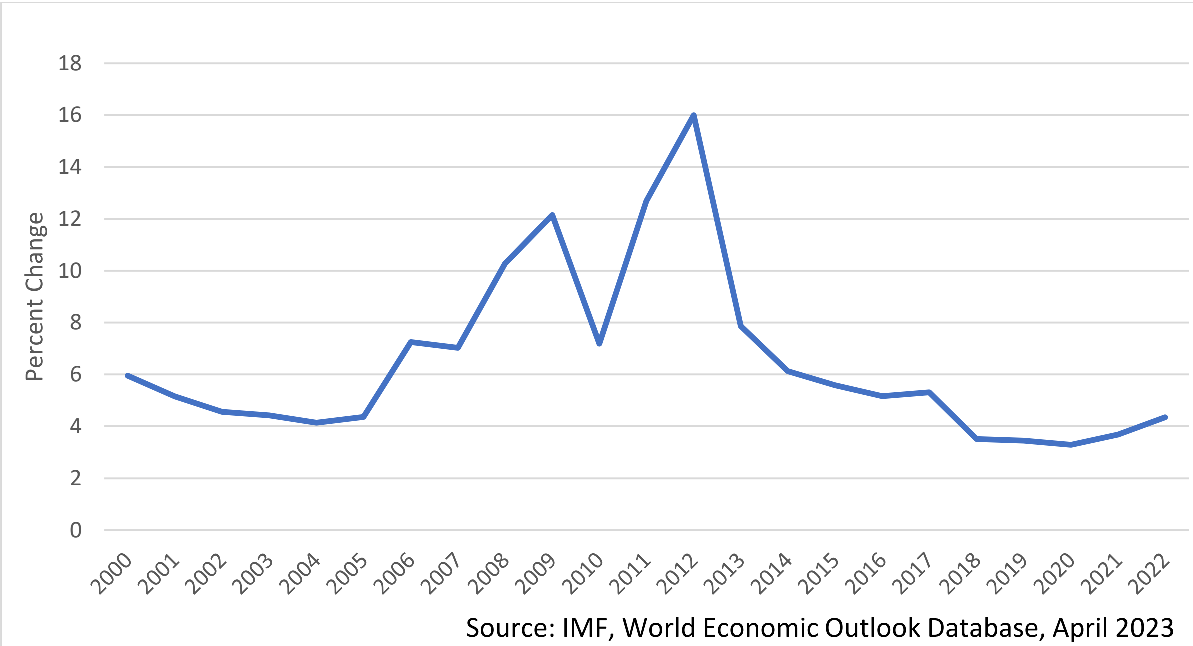


Figure 3-4: Percent change in Inflation, average consumer prices of Tanzania

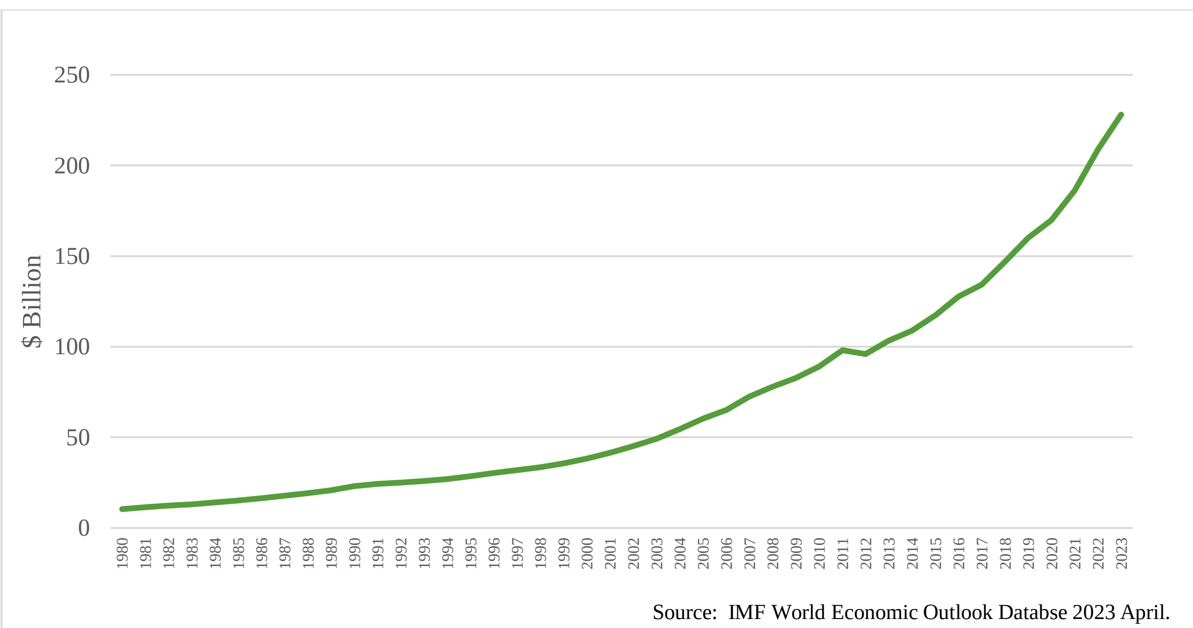


Figure 3-5: GDP of Tanzania in terms of current prices

When looking at the above figure, we mustn't let the stats fool us into thinking that Tanzania has being over seeing a continuous increase in the GDP ever since the year 1980. As studied earlier, the reason behind a continuous rise in the GDP of Tanzania in terms of current prices is because of the high inflationary levels that persisted in the country from time to time.

BOP ANALYTICS FOR TANZANIA

A country's BOP account, when seen over a span of time, can tell us a lot about its developmental policies and areas of focus. It will help us understand where the government gets its financing from and what the future of the economy holds. When thinking of investing in an economy, this account can surely help one understand which industry to invest into and the risks associated with it. Our purpose of the study is to observe and understand the developmental part of this country battling severe debt crisis, where is focuses its funds and how it moves on to becoming a lower middle income nation.

1. Balance on Current Account

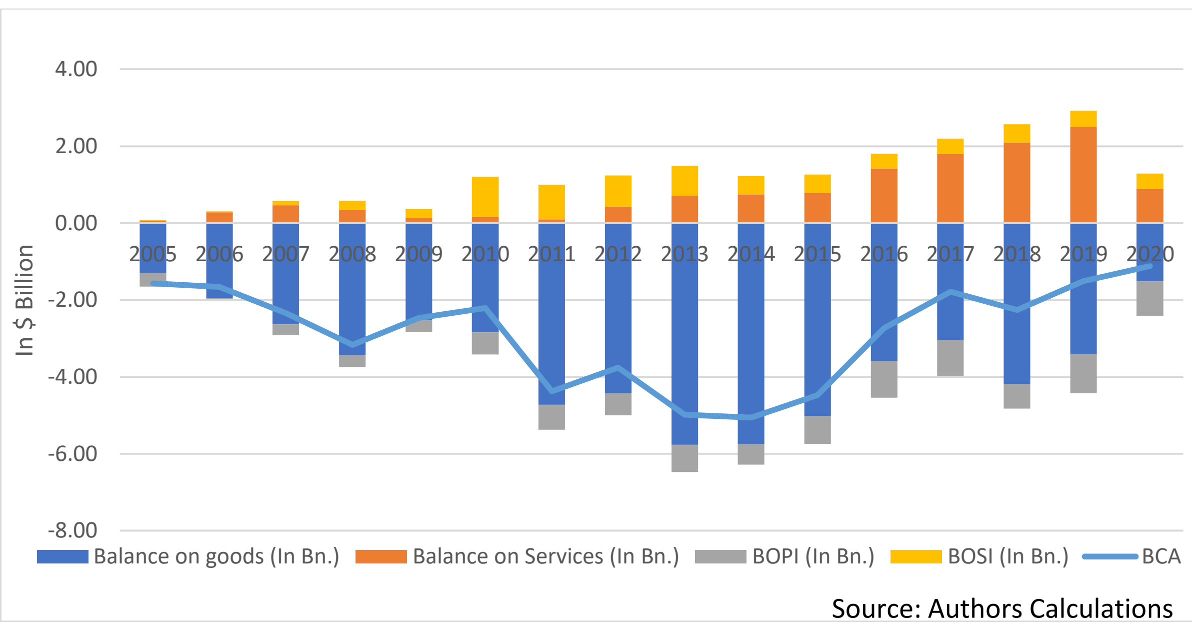


Figure 3-6: Balance on Current Account of Tanzania over the years

Looking at the above given trend in current account balances of the country, one can easily deduce that Tanzania has a huge import surplus. Having negative balances on good and from its primary income, the country relies heavily on financial aid transfers and its income from its booming service sector. Let us look at these 4 components of the account in detail to get a better idea.

NEGATIVE TRADE BALANCE ON GOODS:

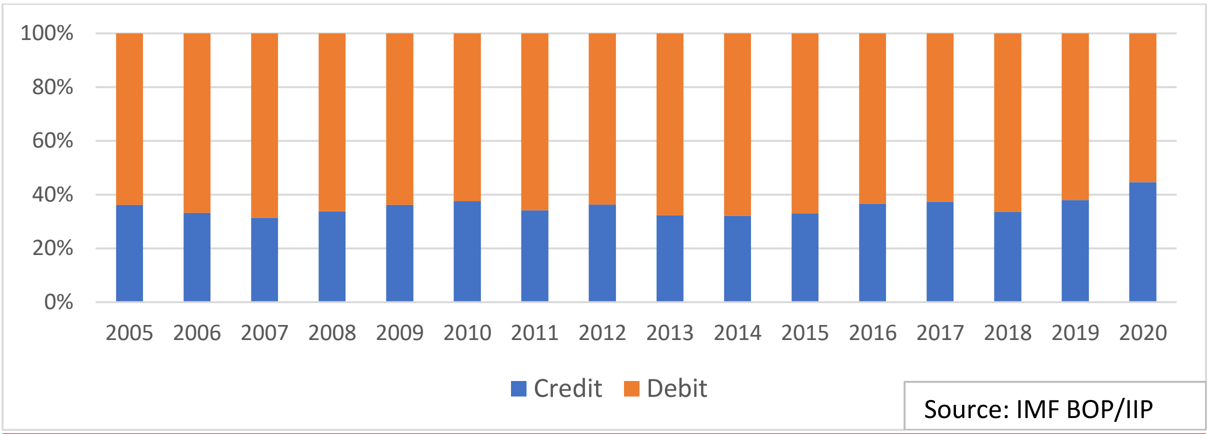


Figure 3-7: Relative Trend in Balance on Goods Account of Tanzania

We already saw in Figure 3-6 how Tanzania has a negative net balance on goods. Looking at the above chart we notice how the ratio of the goods imported to those exported is roughly 3:2 over the years.

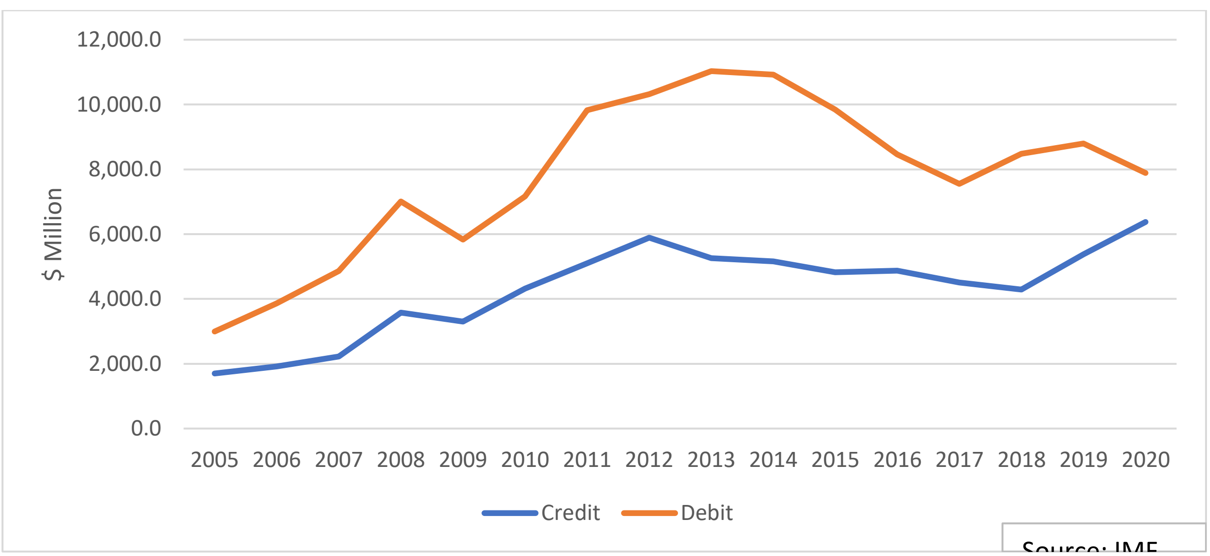


Figure 3-8: Absolute trend in Balance on Goods in Tanzania

The positive balance on services accounts for three things, namely:

1. Transport Services
2. Travel Services
3. Other Services

Let us look into all three of them individually…

Transport Services

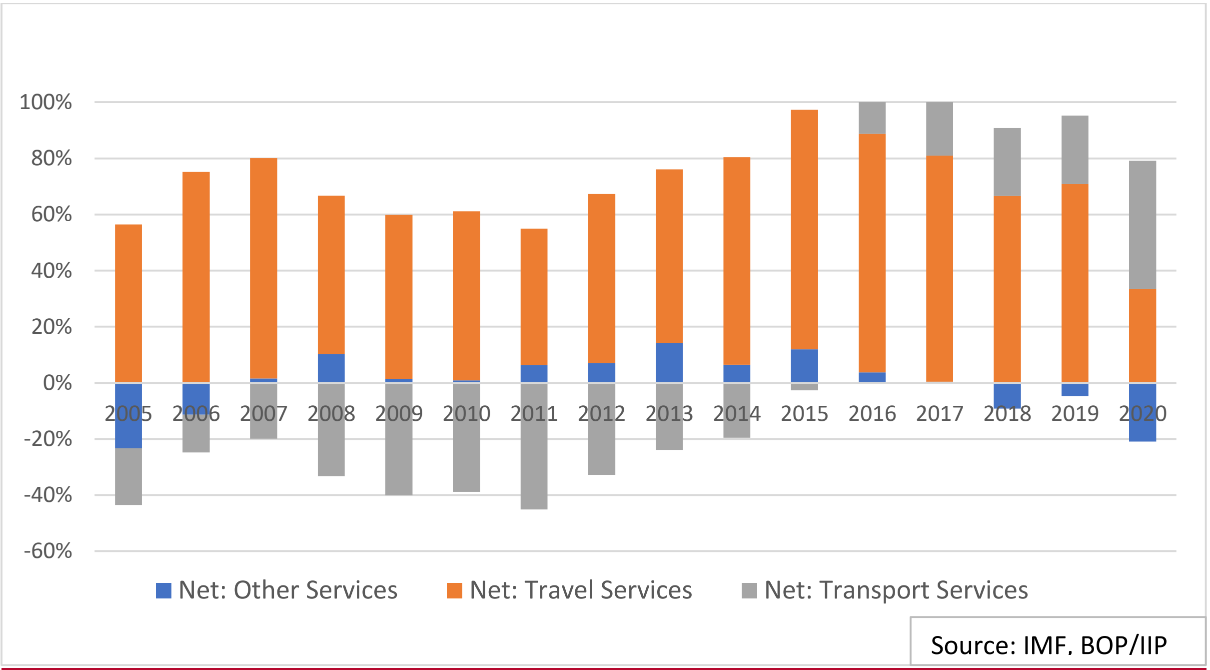


Figure 3-9: Balance on Services of Tanzania

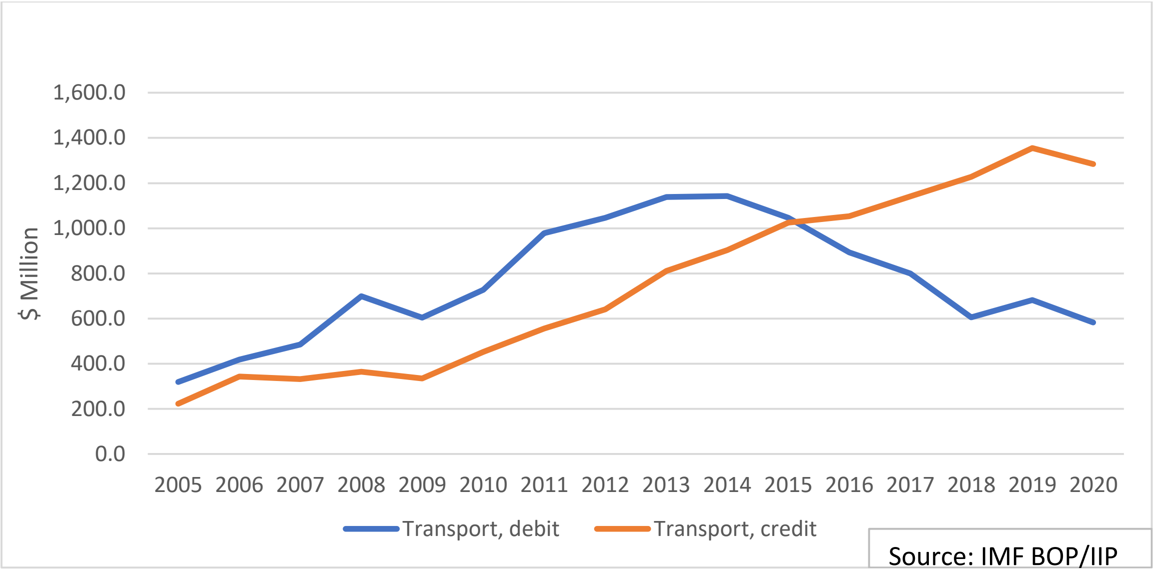


Figure 3-10: Trend in the flow of Transport services to and from Tanzania

As we can observe from the above chart, there has been a decline in the outward dependency of Tanzania for freight services as infrastructure in the country has witnessed impressive investment over the years by tapping into loans, bilateral agreements and other financing options.

Transport and Utilities infrastructure project worth US$19 billion are in the pipeline. When we speak of shipment, we refer to Air, port, railways and road. Having the Indian ocean to its side, Dar es Salaam has developed upon its quality of services however its capacity is still its low point as the city suffers from high demand but accounting to it being one of the most populated cities in East Africa, a high congestion and poor inward linkages. However, it is not the only port in Tanzania, and even so, the government is actively planning its expansion to meet space constraints *(PwC)*.

TRAVEL SERVICES

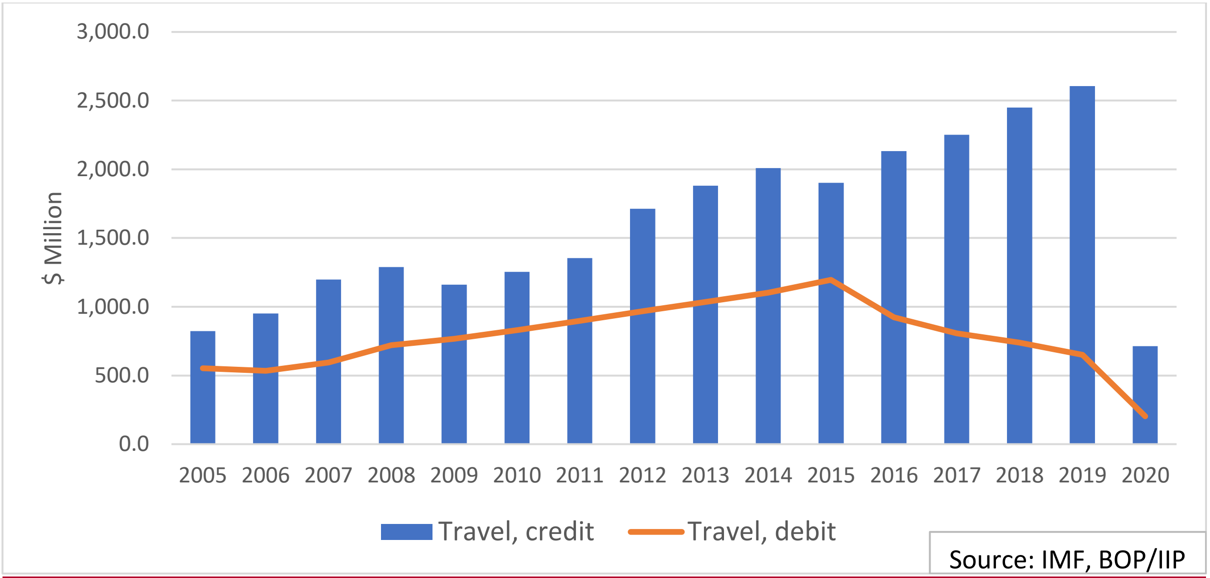


Figure 3-11: Observing the Travel service account of Tanzania

Tanzania is known for its geographical appeal. It is home to the highest point in Africa: Mt. Kilimanjaro, bordered by three of the largest lakes on the continent: Lake Victoria (second largest freshwater lake in the world) in the north, Lake Tanganyika (Worlds second deepest lake) in the west, and Lake Nyasa in the southwest. Not only this, the country also has 22 National Parks covering around 15% of the total land area.

The World Economic Forum's Travel and Tourism Competitiveness Index ranked Tanzania 1st in Africa and 12th worldwide for the quality of its nature-based tourism resources.

It is due to factors like these that makes this place an attractive tourism destination.

Tanzania has three international airports and several domestic airports. Deeming to the above-mentioned advantages, Tanzania's tourism sector has gradually grown over the years with the increased investments.

In 2020, we witness a decline only due to travel restrictions imposed due to the COVID-19 pandemic however 2022 reports show a recovery thus insuring a promising future.

OTHER SERVICES

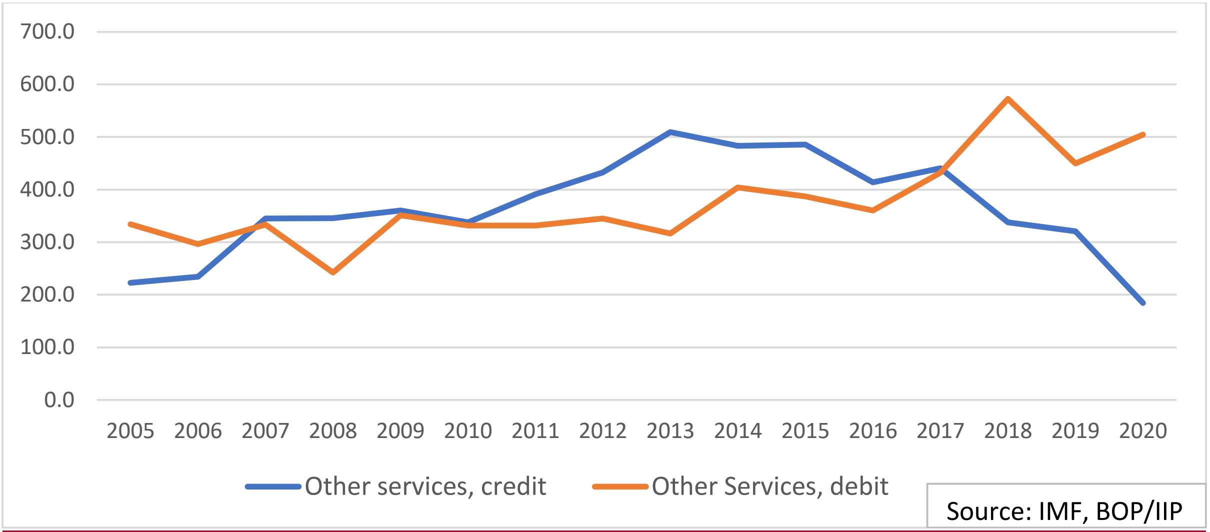


Figure 3-12: Flow of other services in Tanzania

NEGATIVE BALANCE ON PRIMARY INCOME

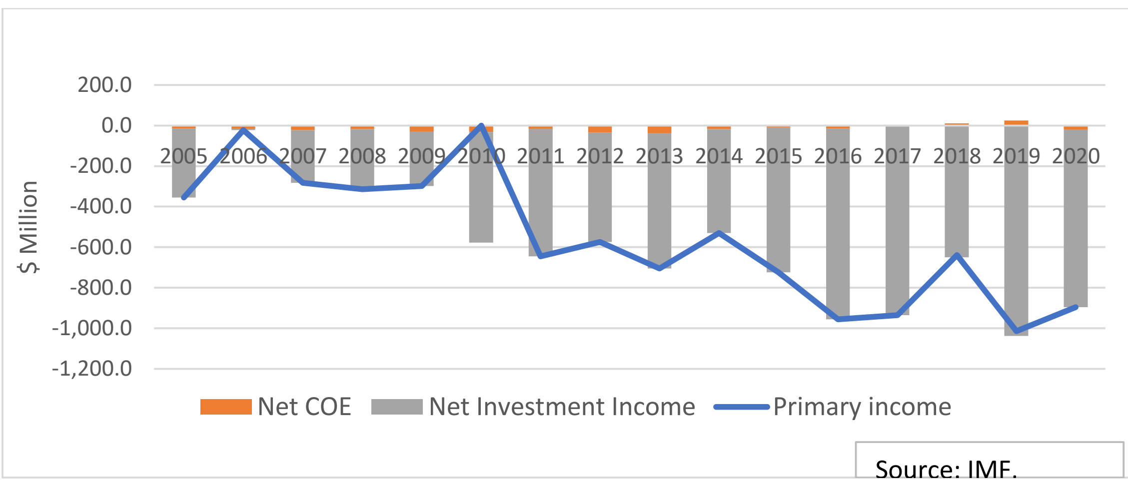


Figure 3-13: Balance on Primary Income of Tanzania

We see that there has constantly been negative net balances on the Primary account of Tanzania. Looking at the graph, initially one might believe that this is a fallback of the country and is something it needs to work upon. However to actually interpret this chart we need to ask ourselves, what exactly are the components of the Primary income account.

It is an account which consists of the following types of primary income: dividends, reinvested earnings, interest, and compensation of employees.

Since earlier times, the government has been proactively trying to come up with ways to build a better investment environment in the country and attract FDI. (Refer to Figure 3-16 for more information)

Section 4 of the Tanzania Investment Act of 1997 introduced the Tanzania Investment Centre (TIC) which is responsible for encouraging, facilitating and fostering Investment within the country. It does so by keeping in touch with Tanzania's embassies around the globe and organizing investment forums from time to time to attract the attention of potential investors.

It is due to such active efforts that one may believe that the huge debit in primary income is due to outflow of dividends and other interests on investments made.

POSITIVE BALANCE ON SECONDARY INCOME

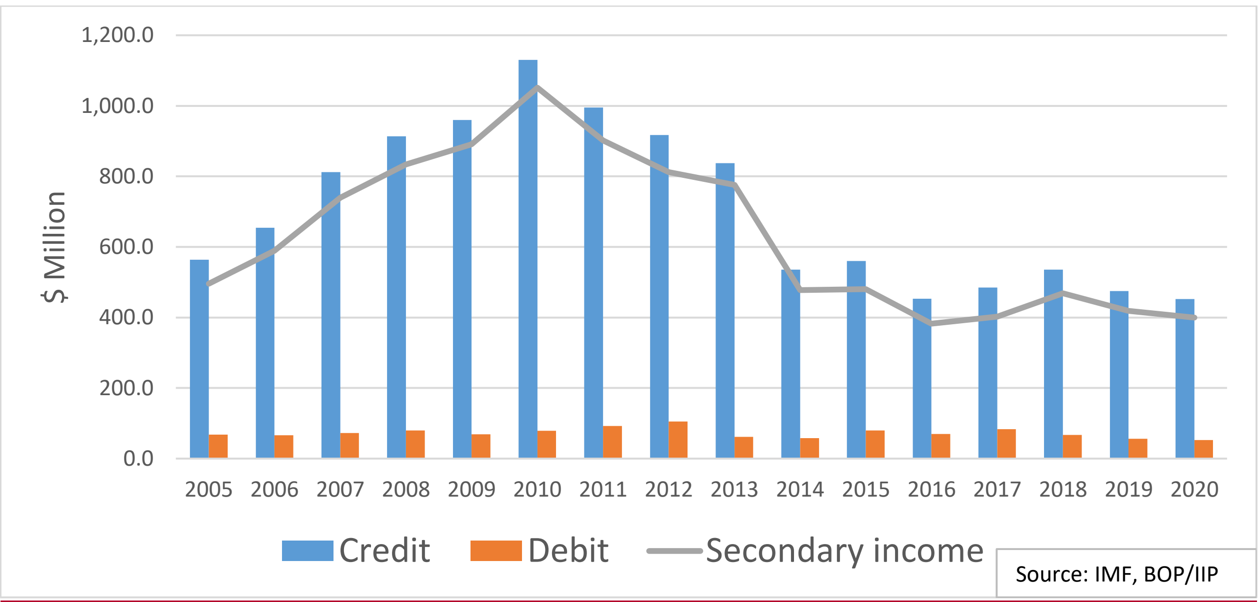


Figure 3-14: Balance on Secondary Income account of Tanzania

Secondary income account helps us to understand what kind of financial support a country is getting from outside. It does not include capital transfers i.e., those which lead to transfer of assets or reduction of liabilities but includes current transfers which only lead to a change in disposable income. As current transfers and government aid oversaw a major decline in the year 2014, the current account deficit widened even further as oil imports surged with the huge plunge in the prices in the final quarter of the year, the same can be seen from Figure 3-6.

In 1996, after long public advocation and concern towards unsustainable debt levels in certain countries, the IMF along with the World Bank launched the 'Heavily Indebted Poor Countries Initiative.' The original agenda was to basically reduce debt and bring it down to sustainable levels however in 1999 the initiative was re formulated and E-HIPC or Enhanced HIPC was launched with aim to not only provide full and complete debt relief but also to promote growth and reduce poverty in the countries. Keeping in mind the debt relief eligibility requirements for countries, Tanzania was deemed eligible for assistance under this initiative in year 1999 and in November 2001, having reached its completion point, got approved US$ 2,026 million worth of debt relief in end-1999 net present value (NPV).

	US$ million (1999NPV terms) Completion point
Total HIPC Debt Relief	**2,026**
Bilateral Creditors	1,006
Multilateral Creditors	1,020
Of which:	
African Development Bank Group	***125***
World Bank	*695*
IMF	*120*
Other	*80*

Source: African Development Bank Group report

Figure 3-15: Breakdown of Tanzania's HIPC Assistance as approved at Decision Point

In 2005, Multilateral Debt Relief Initiative (MDRI) was launched to complement the earlier HIPC initiative. Tanzania and all the other countries who were eligible for financial aid under the HIPC initiative are also eligible for aid under this scheme.

2. Balance on Financial Account

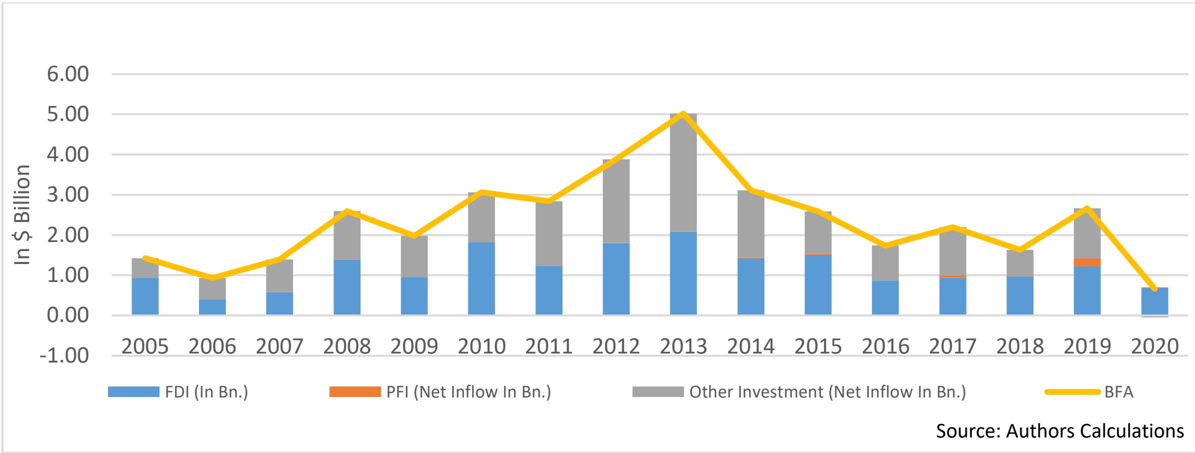


Figure 3-16: Balance on Financial Account of Tanzania over the years

Tanzania has been a member of the World Trade Organization since 1995 and is also a member of numerous regional trade agreements such as the East African Community (EAC), imports from whom are exempted from the 18% VAT which is charged on all other non-EAC imports.

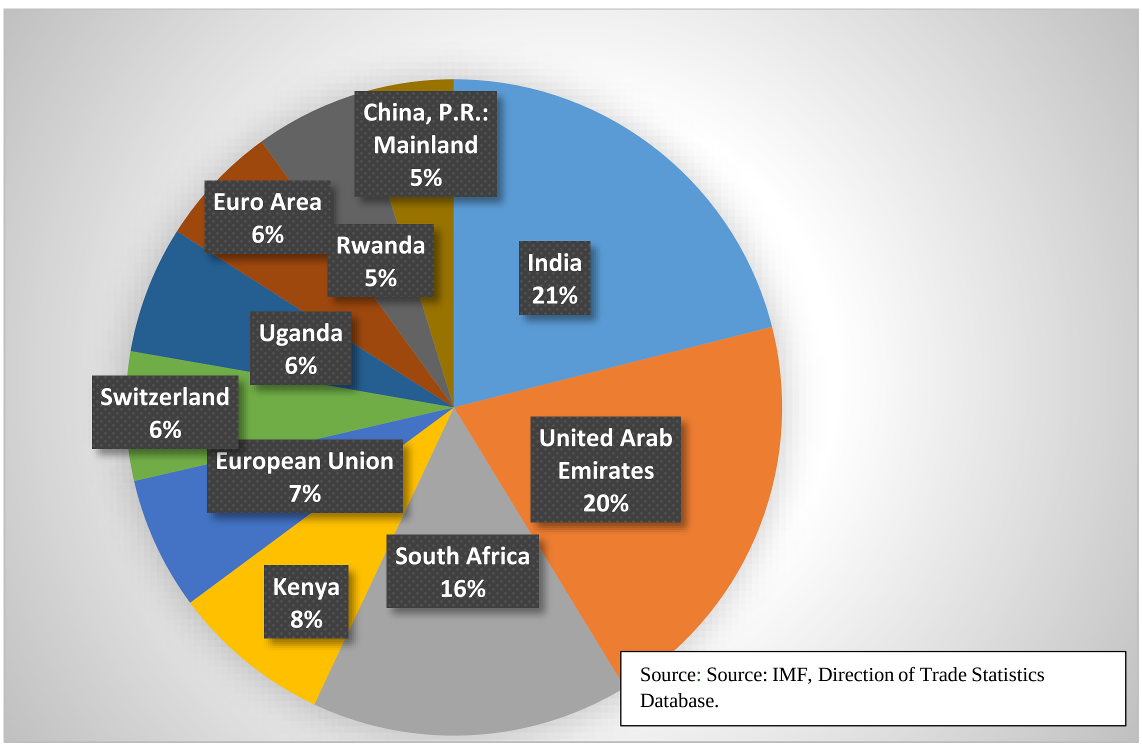


Figure 3-17: Major exporting destinations for Tanzania as of 2022

As we can see from the above pie chart, Tanzania majorly exports to India, UAE, South Africa, Kenya and the European Union. The country is a major exporter of Gold, manufactured goods, minerals, coffee and various agricultural products.

As per several online sources, in the years 2021-22 when the entire economy was suffering due to the catastrophic effects of the COVID-19 pandemic, Gold was the major exporting item accounting for approximately 3 billion U.S. dollars which is half of what was earned due to export of goods as we can see from Figure 3-8. A study by Josaphat Kweka on "Trade Policy and Transport Costs in Tanzania" tells us that because of poor road network in Tanzania, 1/3rd of the total cost is due to domestic transport costs and an even larger share, due to international transport cost hence decreasing the profitability for the producer and decreasing goods competitiveness in in global market (Kweka).

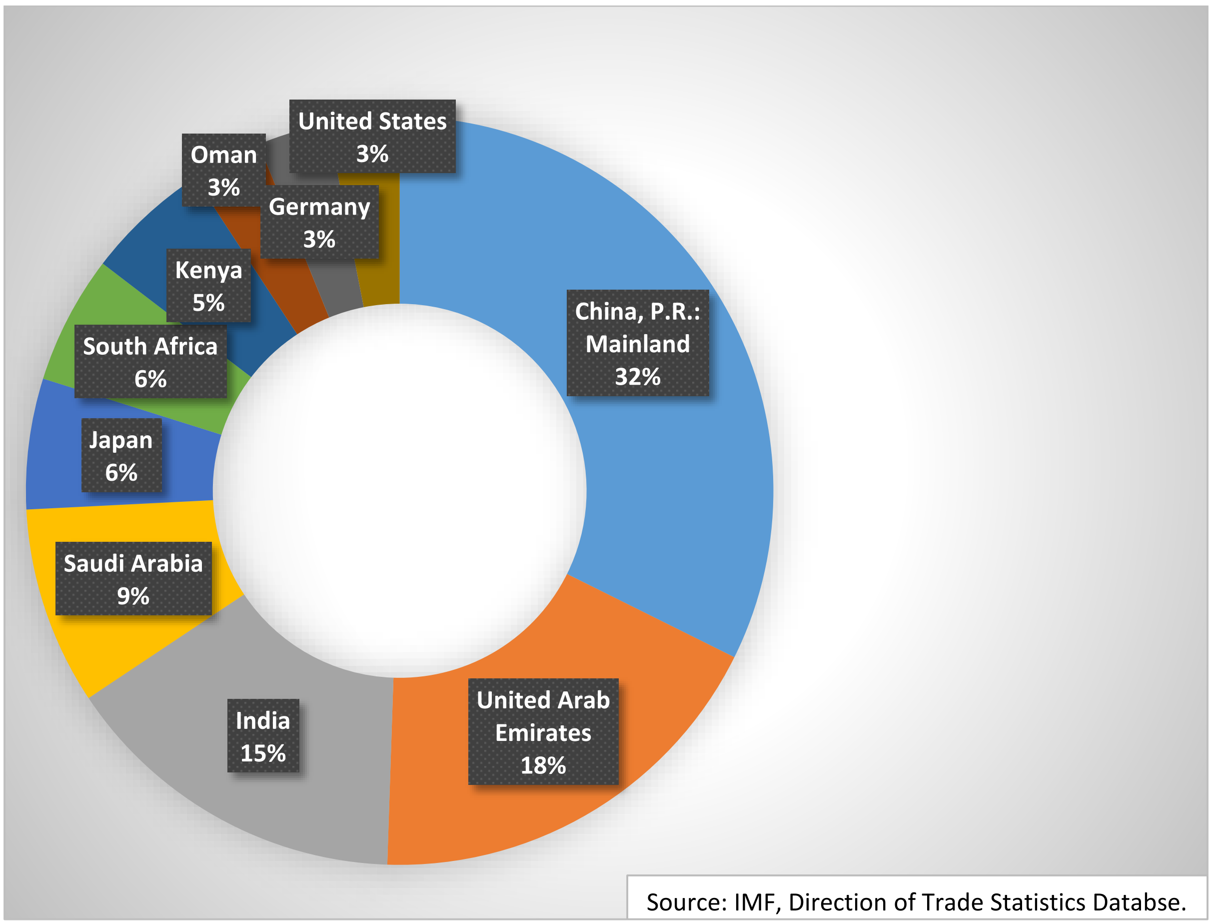


Figure 3-18: Major Importing country sources of Tanzania as of 2022

Figure 3-19: Tanzania's Bilateral trade with India

Tanzania's bilateral trade with India has always been on upmost interest to traders in both nations. Not only is India one of the top three major importing countries of Tanzania, but also one of the top exporting destination. On July 8, 2023, External Affairs Minister S. Jaishankar mentioned that the two nations have now started trade settlements in local currencies and that this new initiative will help in even further promoting commerce between the two countries. One of the main exporting items of India to Tanzania is petroleum products which explains the major surge in imports from India in 2013-14.

Chapter 4

Zambia

Zambia is a landlocked country located in Southern Africa, gained independence from British rule in 1964 and has been a relatively stable democracy.

Economy

The economy of Zambia, the second-largest copper producer in Africa after the Democratic Republic of the Congo, is highly dependent on copper prices, which generate three-quarters of export earnings. The country's growth has slowed in recent years (**Error! Reference source not ound.**), due to the fall in the price of copper, but also to the consequences of the drought on agricultural and hydroelectric production, as well as the pandemic.

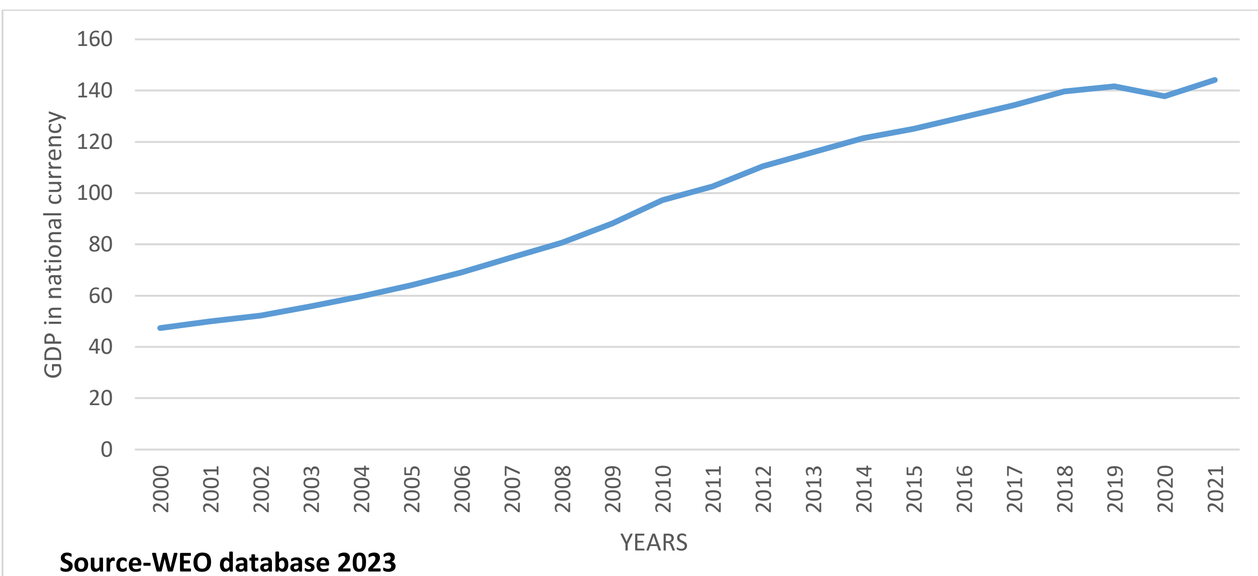


Figure 4-1:Gross domestic product at constant prices of Zambia

Sector	Contribution to GDP	Percentage of Workforce Employed
Agricultural	3.4% of GDP	49.6%
Industrial	42.5% of GDP	10.5%
Service	49.9% of GDP	39.8%

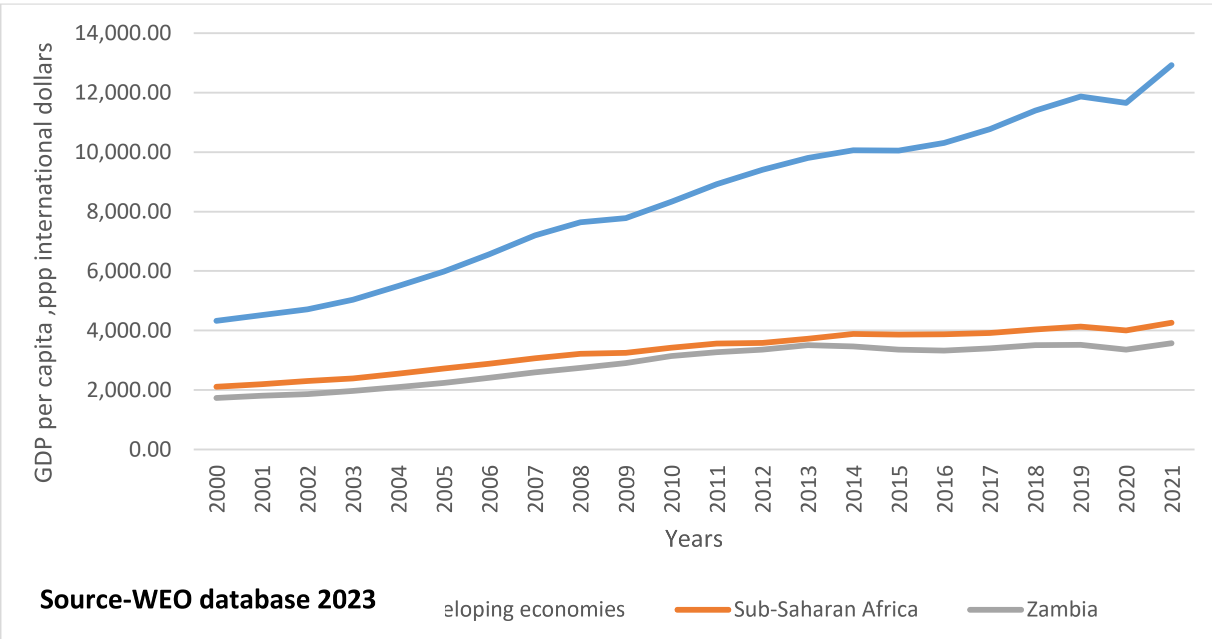


Figure 4-2:GDP per capita at current prices, purchasing power parity international dollars of Zambia

Zambia's GDP at current prices, when adjusted for Purchasing Power Parity, is closely associated with the economic trends observed in Sub-Saharan Africa. However, it remains notably below the GDP levels of Emerging Markets. This suggests that while Zambia is progressing within its regional context, it faces developmental challenges that need to be addressed to bridge the gap with the more advanced economies (**Error! Reference source not found.**).

GDP Growth

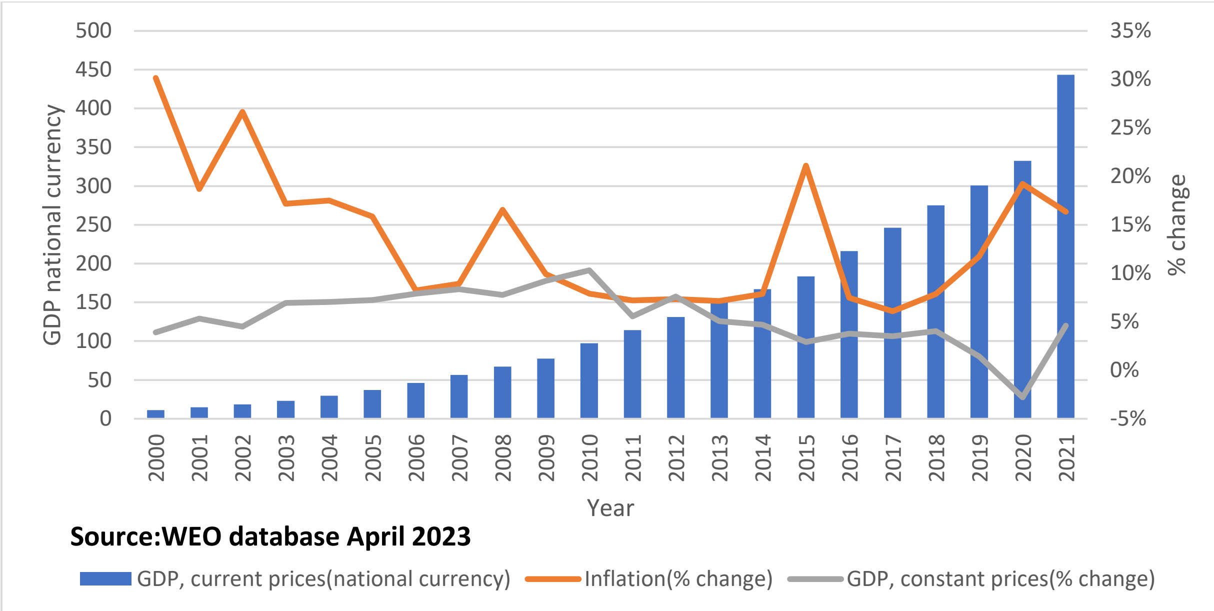


Figure 4-3:GDP at current, constant prices and inflation (%change) of Zambia

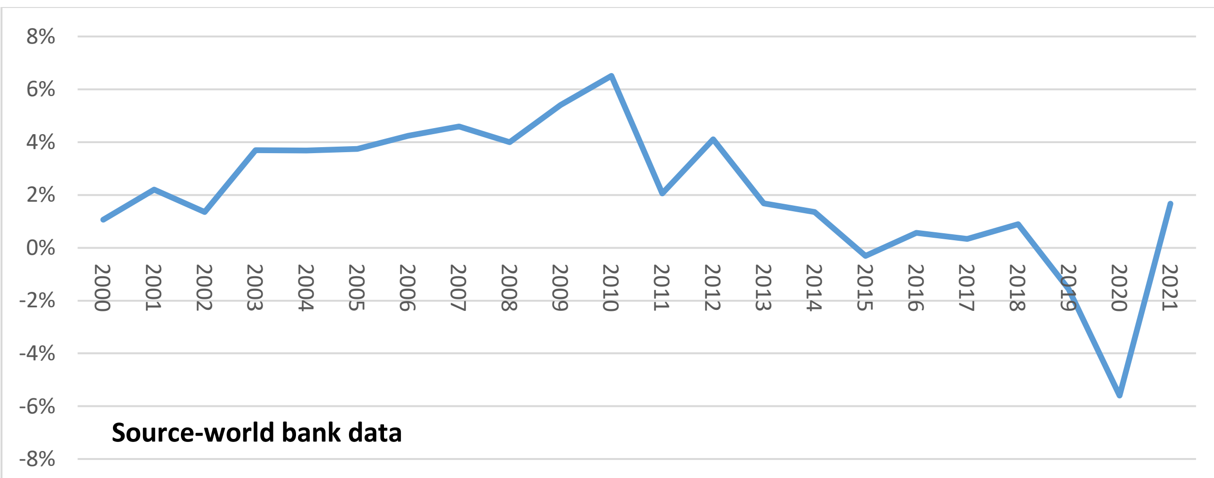


Figure 4-4:GDP per capita growth (annual %) of Zambia

Zambia's GDP at current prices has shown consistent growth, reflecting nominal economic expansion. Yet, the percentage change in GDP at constant prices closely follows the fluctuations in the inflation rate, indicating a possible interplay between inflation and real economic growth (**Error! Reference source not found.**). Moreover, it's worth noting that Zambia's real GDP emonstrated a strong recovery with a growth rate of 4.6% in 2021 and 3.0% in 2022 after experiencing a contraction of 2.8% in 2020(**Error! Reference source not found.**) Zambia is the irst African country to default on its external debt during the COVID-19 pandemic in late 2020. This recovery was primarily driven by robust performance in wholesale and retail trade, agriculture, and mining and quarrying sectors, signifying the resilience and potential of the Zambian economy.

Unemployment Rate

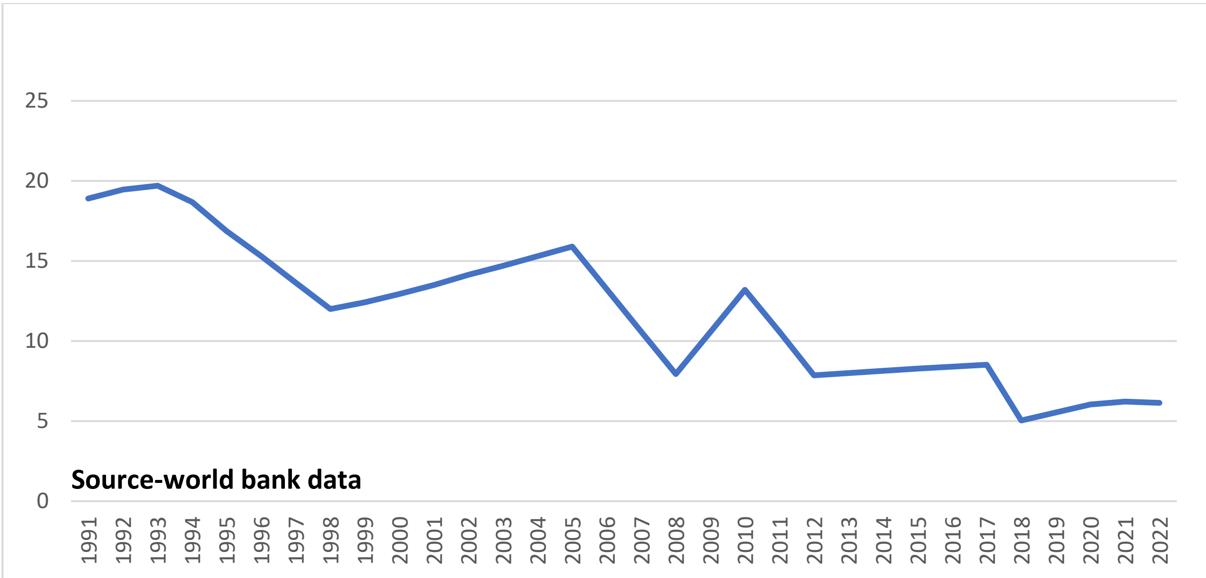


Figure 4-5:Unemployment, total (% of total labor force) of Zambia

In the early 2000s, Zambia grappled with high unemployment rates, particularly among its youth, due to economic challenges and slow growth. The mid to late 2000s (**Error! Reference ource not found.**) brought signs of improvement as government initiatives and increased foreign investment led to a gradual decline in unemployment. Throughout the early 2010s, despite overall economic growth, unemployment remained a concern with disparities in job opportunities. In the late 2010s, economic challenges, including falling copper prices (**Error! Reference source not ound.**), caused fluctuations in unemployment rates. Up to 2021, Zambia continued to face fluctuating unemployment rates, exacerbated by the COVID-19 pandemic's disruptive impact on various sectors and job losses.

Copper, oil prices fluctuations and total external debt (1970s to 2000s)

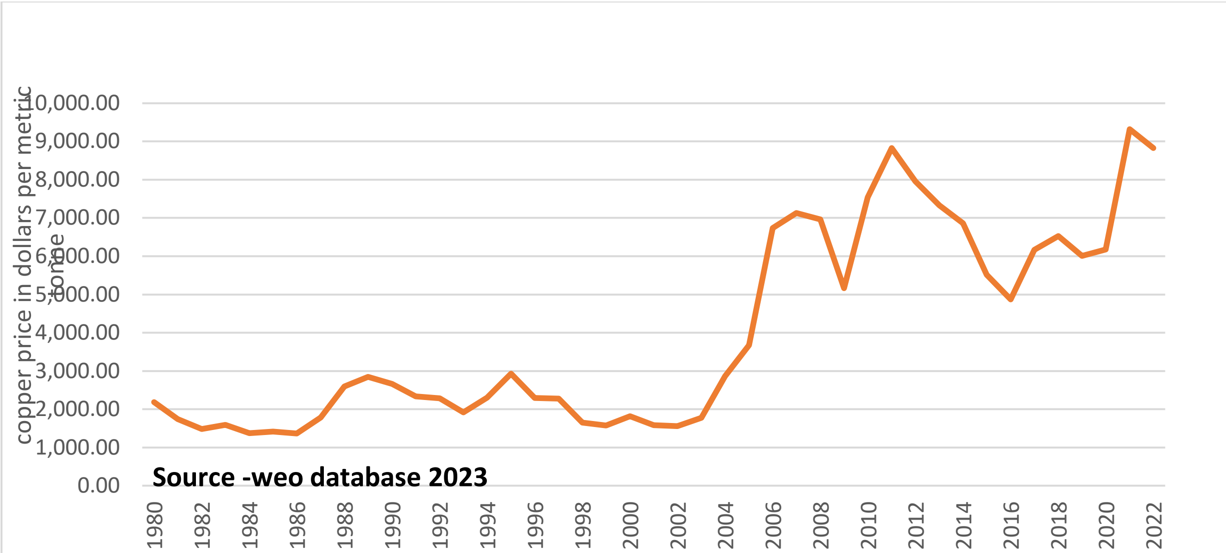


Figure 4-6:Price of copper per metric ton (1980 -2022)

In 2000 Copper prices started the year at around USD1,800/MT and experienced fluctuations throughout the year due to economic uncertainty. They ended the year at approximately USD1,500/MT. In2005 Copper prices began the year at about USD3,000/MT, driven by strong demand from emerging markets like China. Prices steadily increased and reached approximately USD4,000/MT by the end of the year. Price of copper in 2010 started around USD6,000/MT and experienced a significant surge due to increased demand from China's rapid industrialization. By the end of the year, copper prices had risen to about USD8,000/MT. Copper prices in 2015 faced challenges due to slowing growth in China and oversupply concerns. Prices started the year at around USD5,500/MT and fell to approximately USD4,500/MT by year-end. In 2020 the COVID-19 pandemic had a substantial impact on copper prices. Starting the year at about USD6,000/MT, prices initially fell due to reduced economic activity. However, stimulus measures and a rebound in manufacturing led to a recovery, with prices ending the year at approximately USD7,500/MT. Copper prices in 2023 have experienced some fluctuations. They began the year at around USD8,000/MT, reflecting strong demand for infrastructure and green energy projects. Prices have been influenced by supply disruptions and geopolitical factors (**Error! Reference ource not found.**).

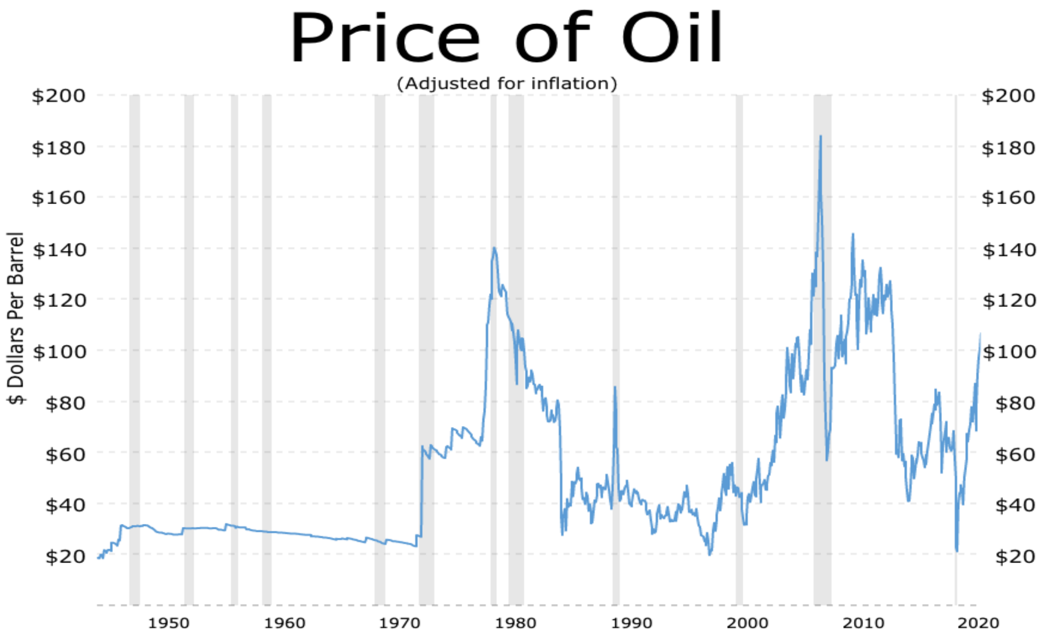


Figure 4-7:price of oil

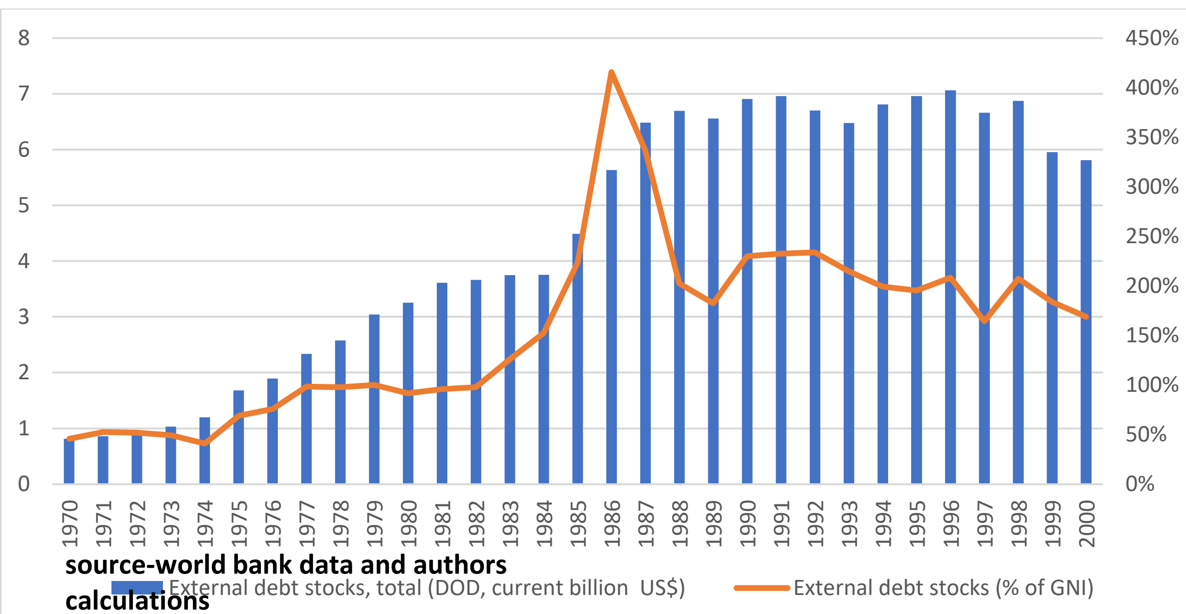


Figure 4-8:Total external debt and external debt stocks (% of GNI) 1970- 2000 of Zambia

Zambia's colonial past, characterized by indirect British rule and division among tribes, left a legacy that hindered development. Gaining independence in 1964, Zambia became heavily dependent on copper exports but faced isolation due to its support for African independence movements and opposition to white minority rule in neighboring countries.

In the 1970s, Zambia borrowed significantly to finance development projects and cope with falling copper prices (**Error! Reference source not found.**) and rising oil costs (**Error! ference source not found.**). External debt soared from USD800 million to USD3.2 billion, largely from Western banks.

A crisis emerged in the late 1970s as U.S. interest rates surged, making it nearly impossible for Zambia to repay loans (**Error! Reference source not found.**). In 1983, the IMF intervened by roviding funds to pay back western banks, effectively bailing them out. In the late 1990s, Zambia became eligible for debt relief under the HIPC initiative, designed to reduce the debt burden of qualifying nations through coordinated efforts of creditor nations and international financial institutions.

The IMF and World Bank imposed conditions in exchange for their loans, including austerity measures, trade liberalization, and privatization. These policies, combined with high debt repayments and falling copper prices, led to economic contraction. In the early 1990s, Zambia underwent economic reforms and adopted the Structural Adjustment Program (SAP) The SAP included measures such as fiscal consolidation, currency devaluation, and privatization of state-owned enterprises. Although these reforms led to some macroeconomic stabilization, they also resulted in social challenges, such as increased poverty and unemployment (**Error! Reference ource not found.**).

The removal of trade taxes on used clothes reduced government revenue and flooded Zambia with cheap imported clothing, harming local textile manufacturers. Privatization of copper mines further reduced government income and increased dependence on copper exports. (Debt Justice, 2017)

Total external debt (2000s to 2021)

By 2004, Zambia was grappling with an external debt burden of approximately USD7 billion, which precipitated two decades of austerity and declining living standards. This period inflicted severe hardships on the majority of Zambians, who confronted a myriad of challenges, from adverse economic conditions to the scourge of diseases and natural calamities. Amidst this crisis, international initiatives like the Heavily Indebted Poor Countries (HIPC) program gained prominence, offering some respite. However, the relief provided by such initiatives came with contentious conditions, including privatization and austerity measures. These policies had far-reaching repercussions, including the denial of a livable wage to teachers and the exacerbation of societal hardships. Zambia's resistance to certain mandates enforced by international financial institutions, such as the forced privatization of a bank, prolonged the attainment of debt relief even as the nation grappled with the ongoing crisis.

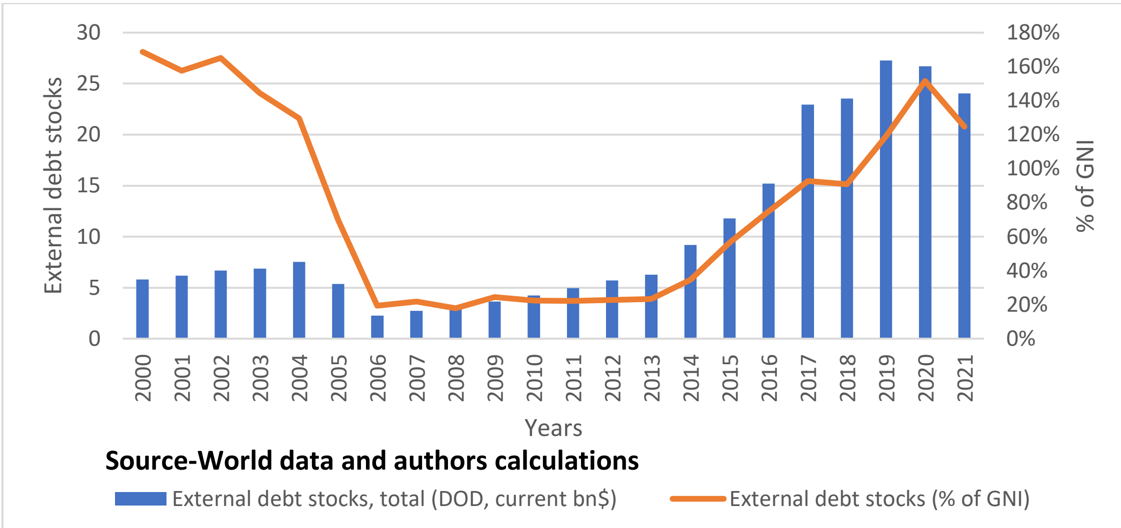


Figure 4-9:Total external debt and external debt stocks (% of GNI)2000-2021 of Zambia

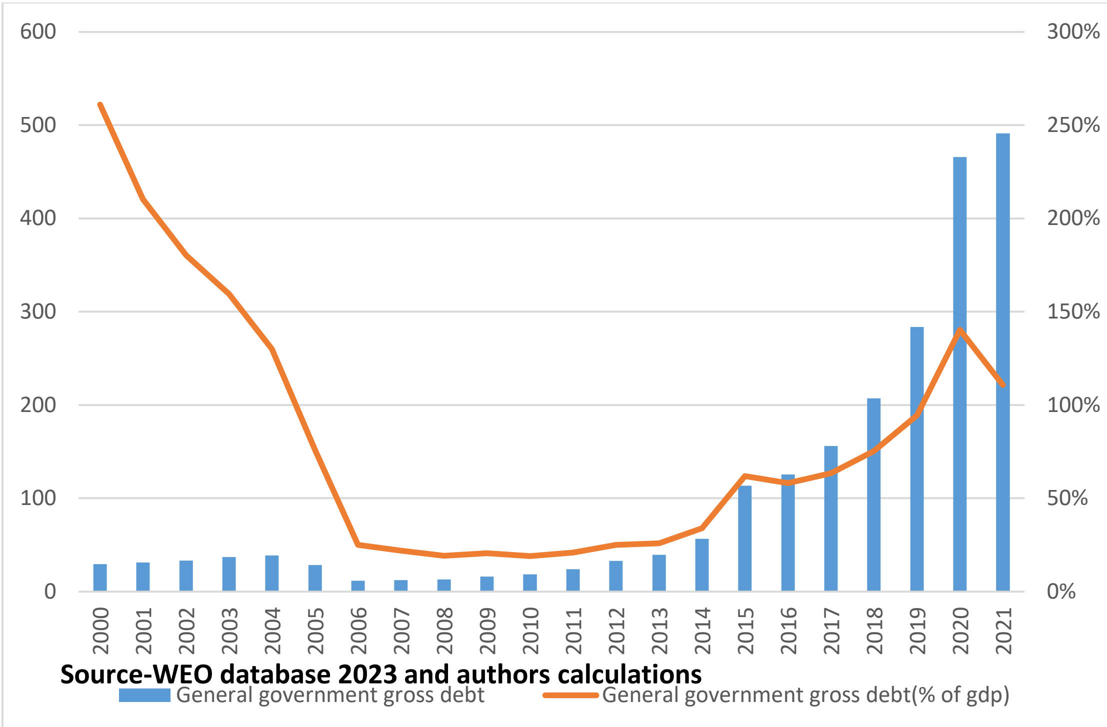


Figure 4-10:Genral government gross debt and as a % of GDP of Zambia

Zambia ultimately achieved the completion of the HIPC initiative in April 2005, leading to the cancellation of approximately USD4 billion in debt. Nevertheless, hurdles persisted, exemplified by a drought in November of the same year, which triggered food shortages impacting over a million people.

Despite these challenges, debt relief liberated substantial financial resources, which were redirected towards vital sectors such as education and healthcare. Zambia initiated programs like the provision of free anti-retroviral drugs to 100,000 citizens, the removal of user fees for primary schools nationwide, and the extension of free healthcare services to rural areas. Coupled with debt cancellation and a favorable trend in copper prices, Zambia's economy commenced a steady recovery, characterized by an average annual growth rate of 6 percent.

Starting in 2012(**Error! Reference source not found.**), Zambia initiated a new phase of ebt accumulation, guided by recommendations from international financial bodies like the IMF, World Bank, and regional institutions. This borrowing was primarily intended to fund critical infrastructure projects such as bridges, highways, and hospitals. However, a significant challenge emerged as these projects exceeded their expected timelines for generating revenue and delivering socioeconomic benefits.

The situation worsened due to two key factors. First, copper prices, a vital source of revenue for Zambia, did not meet the anticipated high levels. Second, unforeseen global events, notably the emergence of COVID-19 in 2020, compounded by an ongoing climate crisis, further strained Zambia's capacity to meet its debt repayment obligations. These factors converged to create severe challenges in managing and servicing the accumulated debt.

Zambia recently published figures showing that its total public debt stock climbed to USD32.8 billion, including interest arrears at the end of last year, of which USD18.6 billion was external.

PNG VS PPG

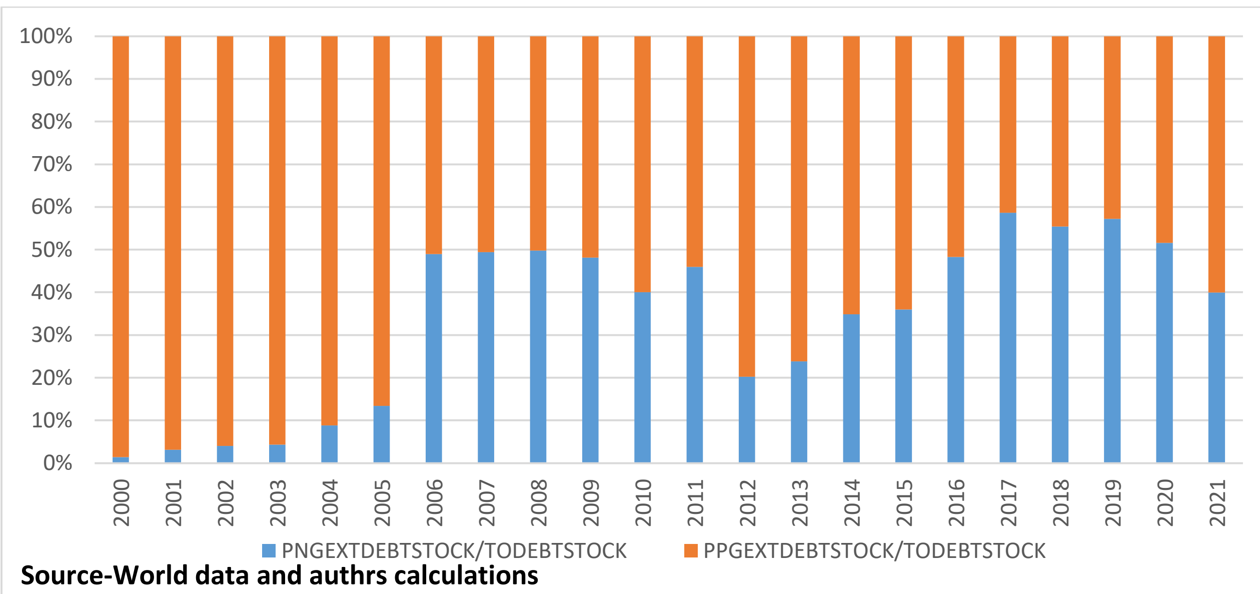
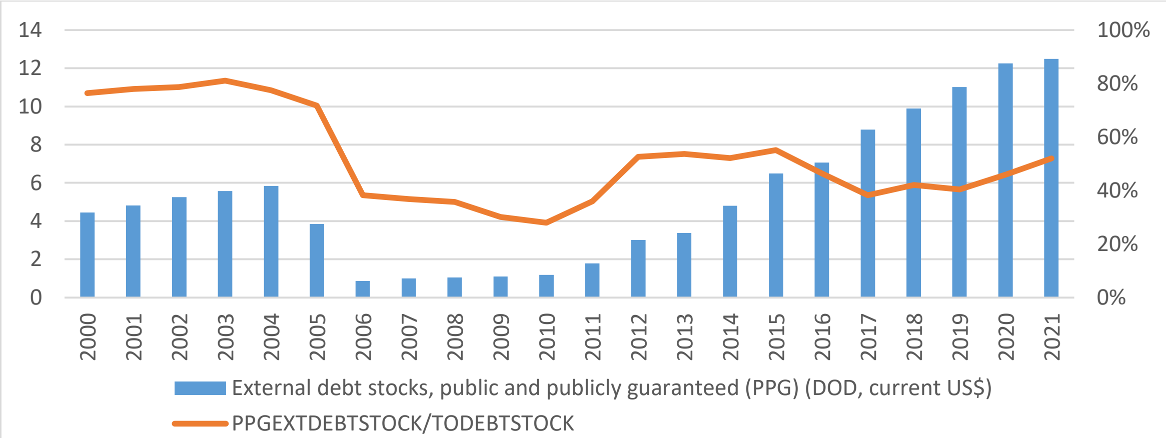


Figure 4-11:PPG and PNG as a % in total external debt of Zambia

Zambia's participation in the Heavily Indebted Poor Countries (HIPC) initiative in the late 1990s aimed to alleviate the PPG debt burden. This initiative led to substantial debt forgiveness, offering relief to the country's finances. Post-HIPC Era (Early 2000s - mid-2010s) following the HIPC initiative, Zambia enjoyed a period of relative debt stability. PPG debt remained manageable, while PNG debt started its ascent as private borrowing gained attraction (**Error! eference source not found.**). Resurgence in debt accumulation (mid-2010s): Recent years have brought fresh challenges, driven by plummeting copper prices, a primary revenue source. The government, struggling to compensate for reduced income, resorted to increased PPG borrowing. Concurrently, PNG debt continued to rise, as private entities sought financial resources. Present Zambia currently grapples with mounting concerns regarding the sustainability of its debt. Accumulated PPG and PNG debt pose serious economic challenges, impacting fiscal policies, economic stability, and social spending, with implications for the nation's future development and stability.



Source-World data and authors calculations

Figure 4-12:Public and Publicly Guaranteed Debt and it as a % of total debt of Zambia

PPG percentage in total debt stock. It is evident that the percentage of public debt in relation to the total debt is experiencing a downward trend (**Error! Reference source not found.**). One ossibility is increased private sector involvement in financing various projects. PNG percentage in total debt stock. Zambia's rising percentage of PNG debt within its total debt reflects a shift towards increased private sector borrowing for development

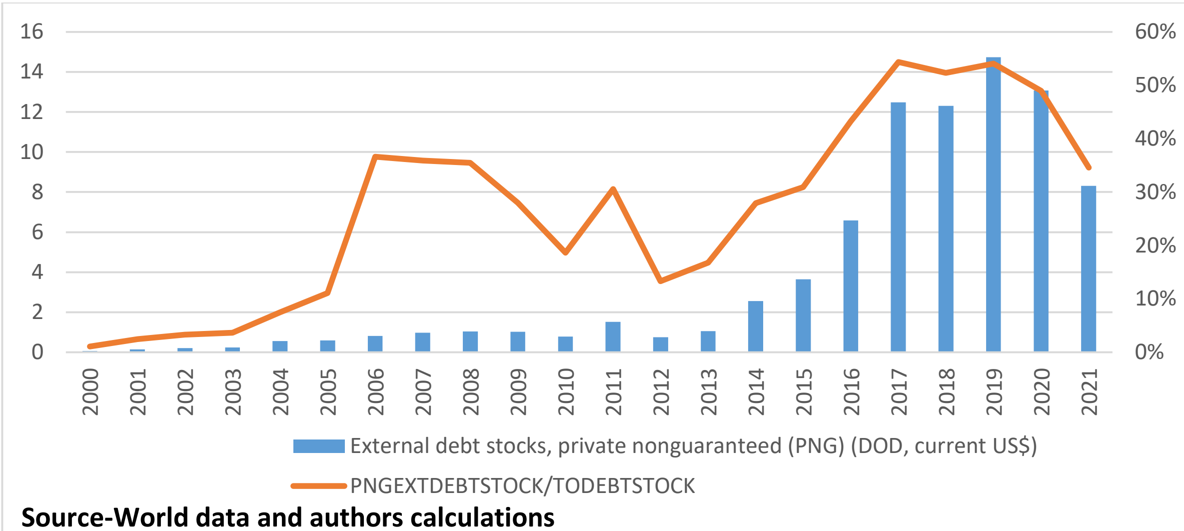


Figure 4-13:Private Non guaranteed Debt and it as a % of total debt of Zambia

PNG percentage in total debt stock. Zambia's rising percentage of PNG debt within its total debt reflects a shift towards increased private sector borrowing development (**Error! Reference ource not found.**)

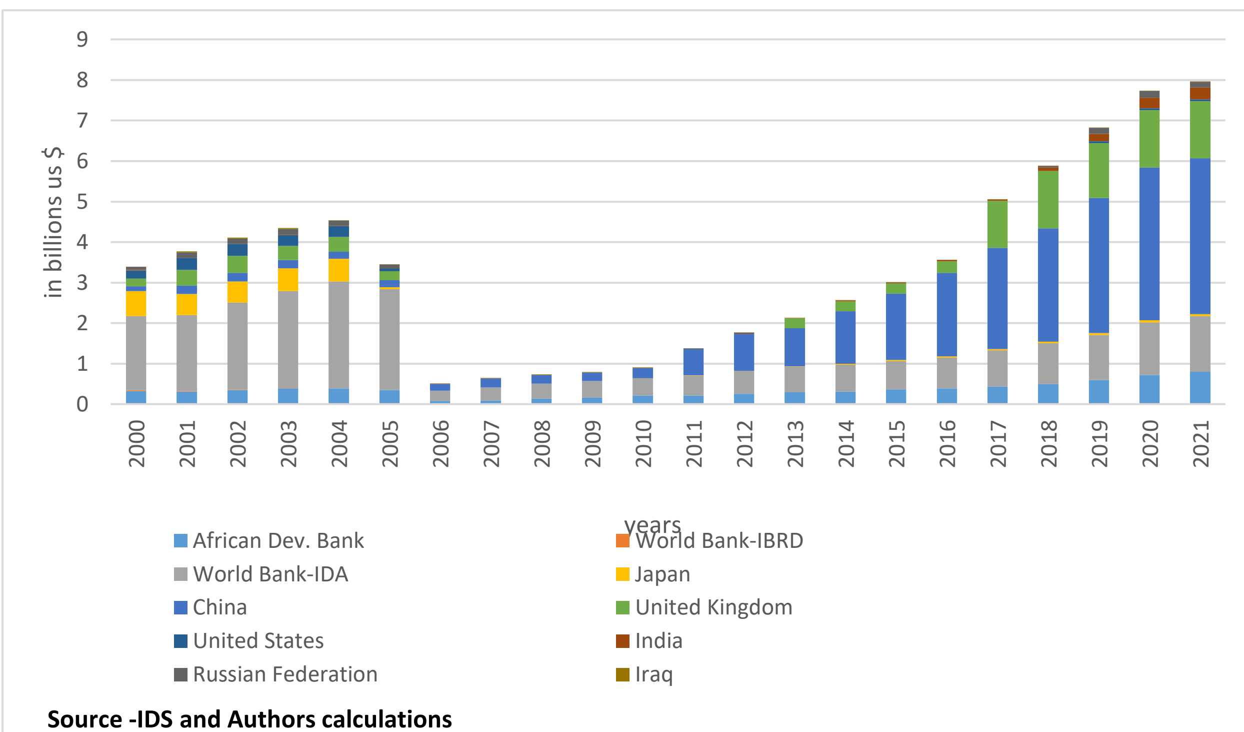


Figure 4-14:PPG debt over years of Zambia

This trend signifies an increasing reliance on Chinese financing for Zambia's development projects and infrastructure initiatives (**Error! Reference source not found.**). Zambia's significant orrowing from China for BRI-related projects has raised concerns about debt sustainability. The country has been working to renegotiate some of these loans to reduce the debt burden. Zambia borrowing from china started rising from 2011 around 655 million USD, now currently Zambia's Chinese debts stood at USD3.4 billion

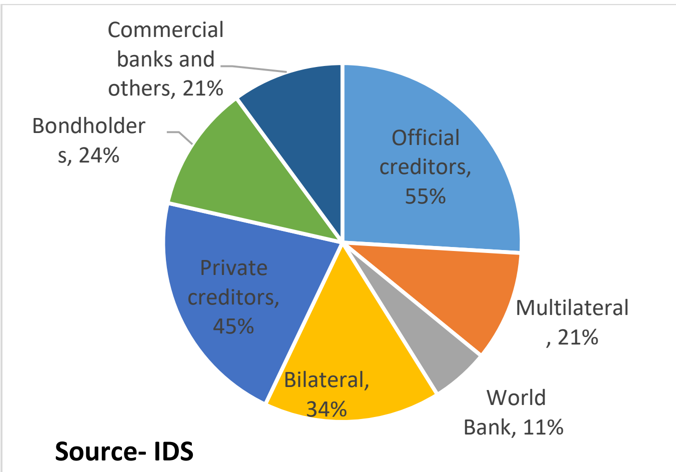


Figure 4-15:Types of creditors (% of PPG) of Zambia in 2022

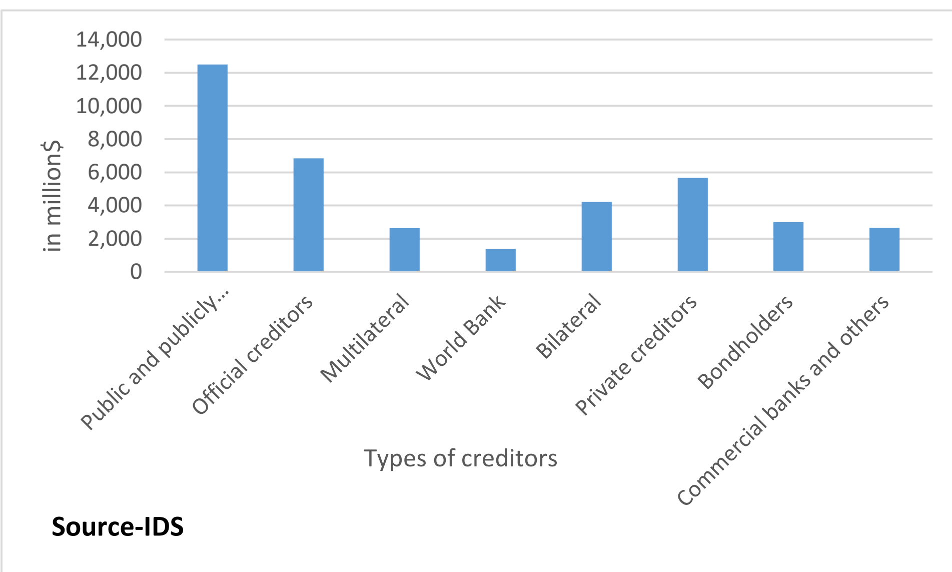


Figure 4-16:Types of Creditors of Zambia in 2022

The rise of Private lending

The rise of private lenders (**Error! Reference source not found.**), exemplified by lackRock, in the debt scenarios of impoverished nations like Zambia, stems from a significant transformation in the global financial landscape over the past decade. Traditionally, heavily indebted countries relied on loans from foreign governments, often coordinated through the Paris Club. However, a pivotal shift occurred roughly 12 to 13 years ago when these nations gained sovereign credit ratings, allowing them to access private lending markets through bond issuance, fundamentally altering the international financial paradigm.

Zambia epitomizes this shift, with a substantial 45% of its external debt payments between 2022 and 2028 owed to western private lenders. BlackRock and similar private creditors have played a significant role, refusing to suspend Zambia's debt payments in 2020 despite the G20's Debt Service Suspension Initiative. Between 2021 and 2024, an estimated 59% of Zambia's external debt payments will flow to private creditors, potentially yielding substantial profits, from 75% to an astounding 250%, if Zambia repays in full. This situation raises grave concerns, as Zambia grapples with a pandemic and economic challenges, forcing cuts in essential sectors. The dominance of private lenders complicates debt resolution efforts, posing a critical test for addressing sovereign debt crises in the Global South. Ultimately, this issue extends beyond fiscal considerations, entailing complex political and economic dynamics that profoundly affect ordinary citizens. (Singh, 2022)

Vulture funds

Vulture funds are entities that purchase distressed debt on the secondary market, typically at significantly reduced prices. This debt, often in the form of bonds or loans, is distressed due to the financial problems of the debtor, causing it to trade well below its face value. Vulture funds aggressively pursue full repayment of this debt, frequently resorting to legal action and litigation. Their notable characteristic is their willingness to buy distressed debt at a discount and then employ legal means to recover the entire face value, potentially yielding substantial profits. This practice has sparked ethical and legal concerns, particularly when applied to sovereign debt of heavily indebted poor countries (HIPCs), as it can hinder debt relief efforts and impact these nations' economic stability. One such case in 1999, a vulture fund named Donegal International acquired a USD44 million debt that Zambia owed to the government of Romania for a mere USD 3.2 million. Notably, debts owed to private creditors like Donegal were excluded from the Heavily

Indebted Poor Countries (HIPC) initiative, even if the debt originated from a public lender like the Romanian government.

Donegal aggressively pursued Zambia for the debt, eventually reaching an agreement where Zambia would pay USD16 million of the original USD44 million owed. However, when Zambia missed a payment, Donegal took legal action in a British court to demand the full USD44 million. The court, while criticizing Donegal for dishonesty, refused to enforce the full payment. Nevertheless, Zambia was compelled to pay USD17.5 million as a result of this contentious debt dispute. This case underscores the challenges and controversies associated with vulture funds and their pursuit of distressed sovereign debt.

Litigation against heavily indebted poor countries (HIPCs) by vulture funds poses significant drawbacks. It distracts from critical policy matters, undermines HIPC debt relief, and leads to uneven burden sharing among creditors. The issue may also lead to backlash from taxpayers in creditor countries and encourage opaque financial practices by HIPCs.

The Paris Club, recognizing the harm caused by vulture fund litigation against heavily indebted poor countries (HIPCs), resolved in May 2007 to avoid selling their claims on HIPCs to creditors not participating in HIPC debt relief. They encouraged others to do the same and collaborated with international institutions to address the issue. G-8 Finance Ministers also expressed concern and pledged to identify measures based on Paris Club efforts. G-7 Debt Experts invited key institutions to discuss minimizing the adverse impact of vulture funds on HIPC economic development. (Debt Justice, 2017) (African Development Bank, 2022)

Current Account

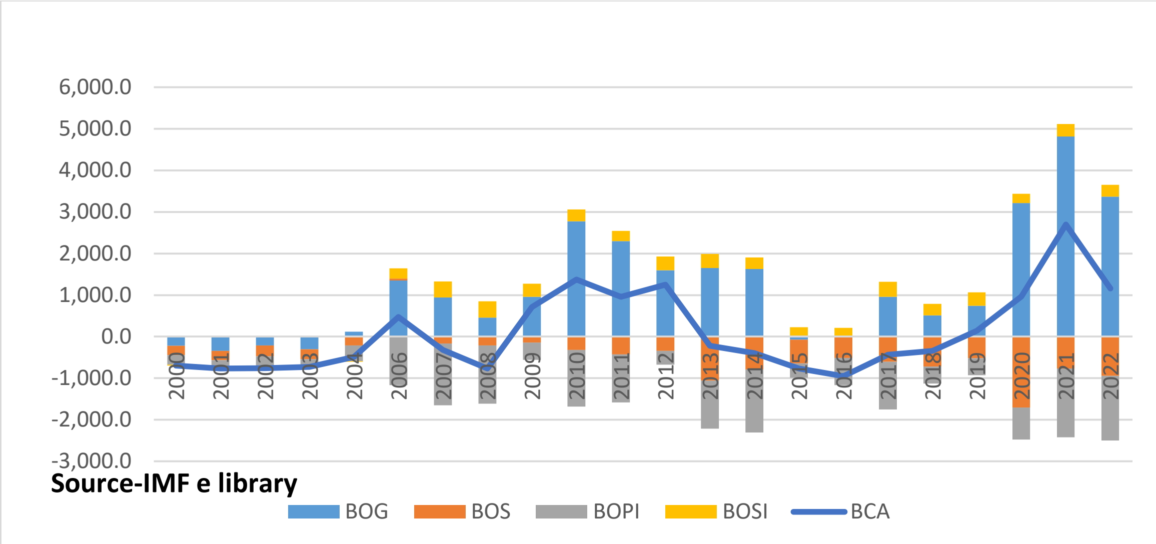


Figure 4-17:Current account balance of Zambia

Zambia's balance of current account, it's apparent that the balance of goods and the balance of secondary income are positive, indicating favorable aspects of the country's economic interactions. However, the other two elements, the balance of services and the balance of primary income, are negative, signifying areas of concern.

Balance of Goods and Balance of Secondary Income positive indicates, Zambia likely exports more goods than it imports, especially commodities like copper, which are a significant part of its economy. This surplus contributes positively to the balance of payments. The positive secondary income indicates that Zambia is likely receiving more income from remittances than it is paying out. This is a favorable aspect of the balance of payments.

Balance of Services and Balance of Primary Income negative indicates, negative balance of services suggests that Zambia may be spending more on services like tourism, transportation, or consulting fees to foreign entities than it earns from providing similar services to others. This deficit requires attention to improve the overall balance. A negative balance of primary income indicates that Zambia may be making more payments to foreign investors, such as dividends and interest on external debt, than it is receiving from its investments abroad. Addressing this deficit is crucial for a healthier balance of payments.

Balance of Goods in 2013 and 2014, the BOG was positive, suggesting that Zambia had a trade surplus in goods during these years. This indicates that the value of goods exported exceeded the value of goods imported. In 2015 and 2016, the BOG became negative, indicating a trade deficit in goods. This means that Zambia was importing more goods than it was exporting. In 2017 and 2018, the BOG turned positive again, signaling a return to a trade surplus in goods. In 2019, BOG was higher compared to previous years, which suggests a further improvement in Zambia's trade balance in goods.

Balance of Services and Balance of Services and Income both BOS and BOSI were consistently negative from 2013 to 2018. This indicates that Zambia was running deficits in the trade of services and income payments, including factors like interest and dividends on foreign investments. The negative balances in services and income payments offset the positive balance in goods trade during these years, contributing to the overall negative BCA.

Balance on Current Account from 2013 to 2018, Zambia's BCA remained in negative territory (**Error! Reference source not found.**). This suggests that during these years, Zambia as consistently importing more goods and services than it was exporting. A negative BCA typically indicates a trade deficit and a reliance on foreign capital to fund the deficit. In 2019, the BCA turned positive. This shift signifies that Zambia started exporting more goods and services than it imported during that year

In summary, the transition from a negative BCA to a positive BCA in 2019 reflects an improvement in Zambia's trade balance. The positive trend in the balance of goods trade during 2017-2019 played a significant role in this improvement, suggesting that Zambia was exporting more goods and reducing its trade deficit. However, the persistent negative balances in services and income payments (BOS and BOSI) over the years indicate ongoing challenges in these areas.

Financial Account

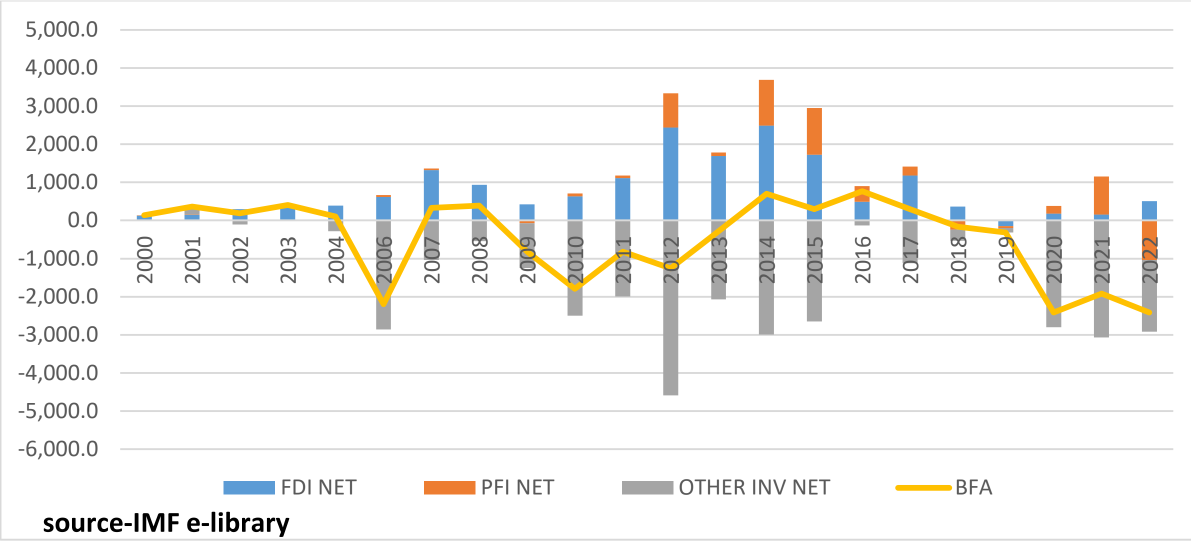


Figure 4-18:Financial account balance of Zambia

Zambia's financial account balance in terms of its components, there is a mixed picture with certain elements in the negative and others in the positive. The net financial account balance, calculated by subtracting liabilities from assets, can provide insights into the country's external financial position.

A positive FDI balance indicates that Zambia is receiving more foreign direct investment than its residents are investing abroad. This can be beneficial as it brings in capital, technology, and expertise, stimulating economic growth. A positive PFI balance suggests that Zambia is attracting investments in its financial assets, such as stocks and bonds, from foreign investors. This can be seen as a vote of confidence in the country's financial markets and economic prospects.

A negative balance in other investments implies that Zambia may have more liabilities than assets in this category. This could include things like short-term loans or trade credits. A deficit here may require careful management to avoid overreliance on external financing.

In 2021 and 2022, Zambia experienced a negative Balance of Financial Account. However, this negative balance was offset by a positive Balance of Current Account, signaling a trade surplus as it exported more than it imported.

Balance of payment

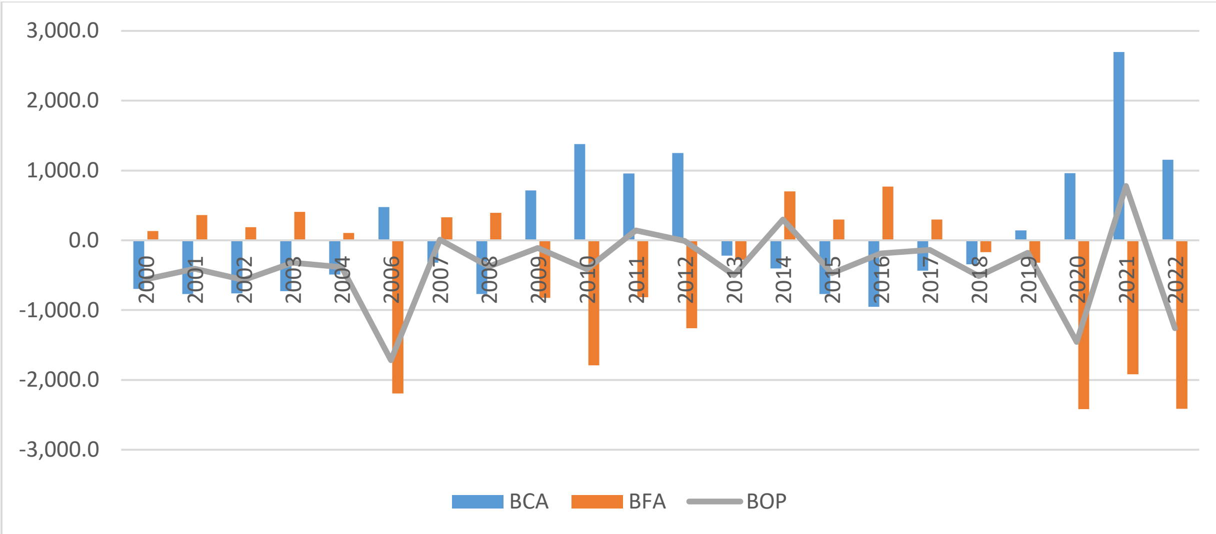


Figure 4-19:Balance of payments of Zambia

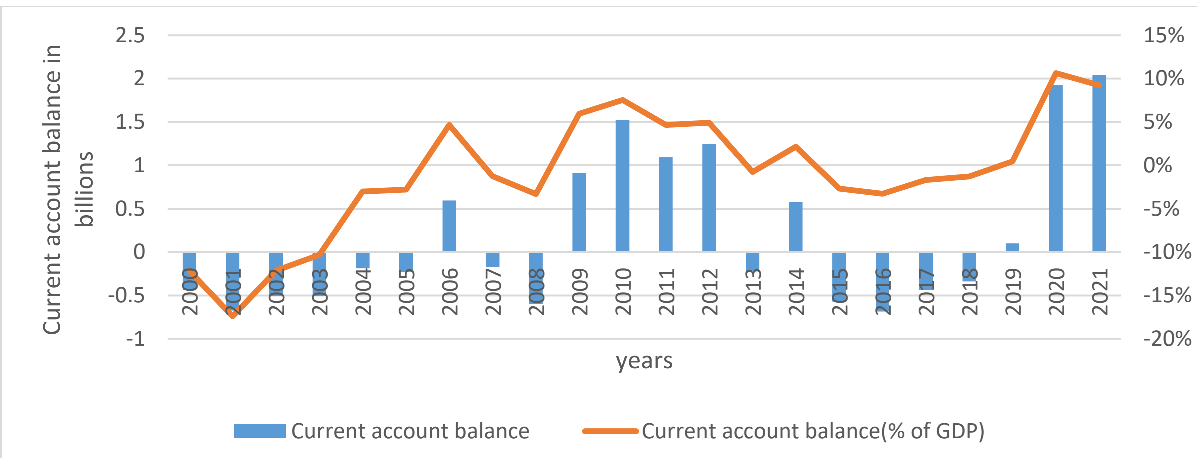


Figure 4-20:Current account balance (% of GDP) of Zambia

International Investment position

Other investment typically includes items like trade credits, loans, and currency and deposits. A higher share in this category might indicate that Zambia relies more on short-term financing and trade relationships, which can carry risks if not managed effectively. It could reflect a need for working capital or financing for infrastructure projects. A lower share of "portfolio investment" suggests that Zambia may not attract as much foreign capital through instruments like stocks and bonds. This might indicate that international investors are less inclined to invest in Zambia's financial markets.

The prevalence of "direct investment" and "other investment" in liabilities indicates that Zambia may have substantial foreign investment and debt in the form of loans, trade credits, and currency deposits. "Direct investment" often represents long-term commitments from foreign entities to establish businesses or acquire assets within Zambia.

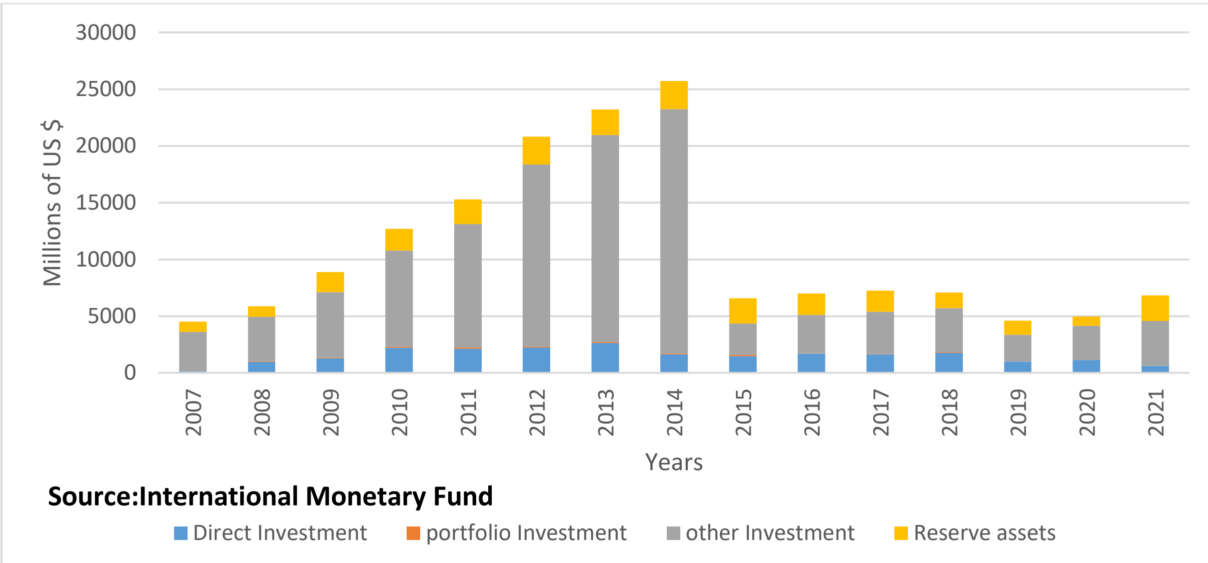


Figure 4-21:Composition of External Assets of Zambia

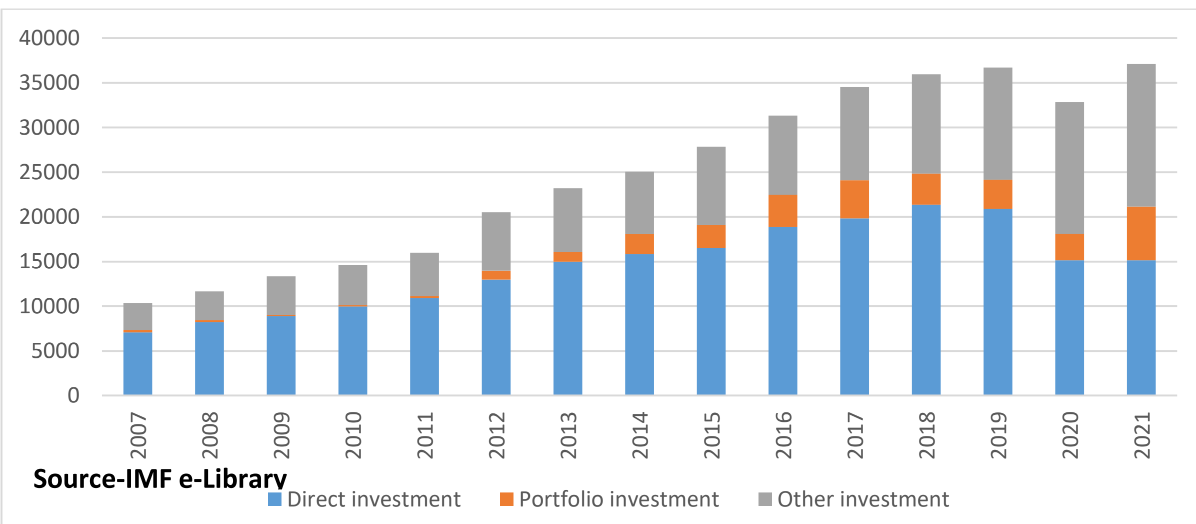


Figure 4-22:Composition of external liabilities of Zambia

Zambia's negative net investment position, driven by substantial foreign debt, poses challenges such as debt servicing strains, currency risks, and reduced investor confidence. Prudent policies are needed to manage debt, promote growth, and ensure long-term economic sustainability and development.

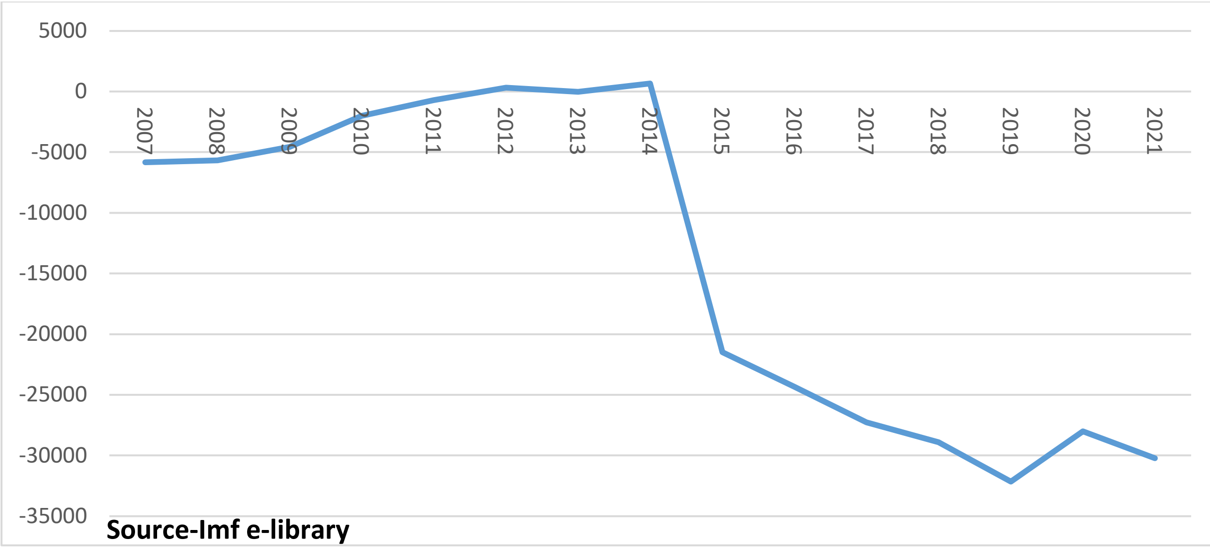


Figure 4-23:Net Investment position of Zambia

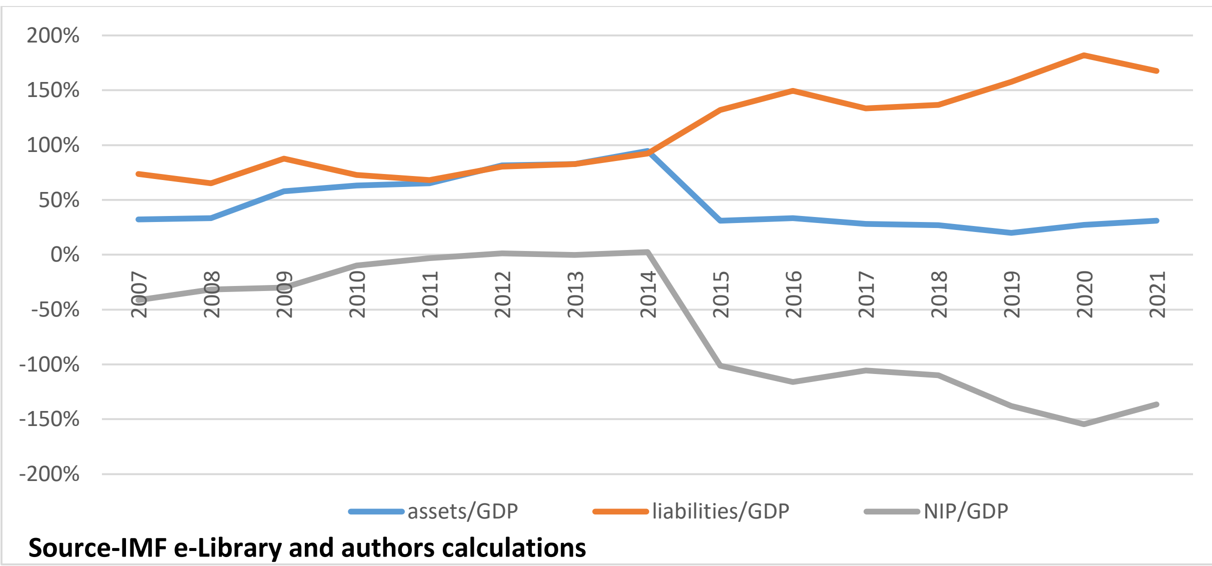


Figure 4-24:Assets, liabilities and NIP (% of GDP)

Trade

Total exports and imports in 2021 are USUSD 10,101 million and USUSD 6,435 million respectively. Exports consist of 1,953 different products, shipped to 119 countries. Imports involve 3,843 distinct products sourced from 180 countries. These statistics reflect a significant export surplus, with the value of exports exceeding that of imports (**Error! Reference source not ound.**). (World bank)

In 2021, Zambia was the number 107 economy in the world in terms of GDP, the number 86 in total exports, the number 125 in total imports, the number 160 economy in terms of GDP per capita USUSD and the number 96 most complex economy according to the Economic Complexity Index. (OEC)

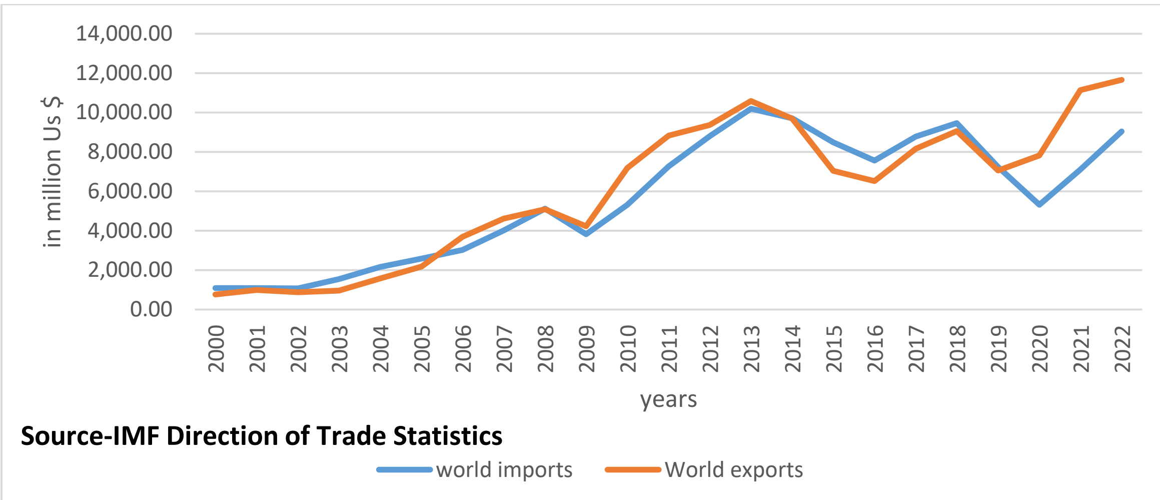


Figure 4-25:Imports and Exports to World of Zambia

Exports

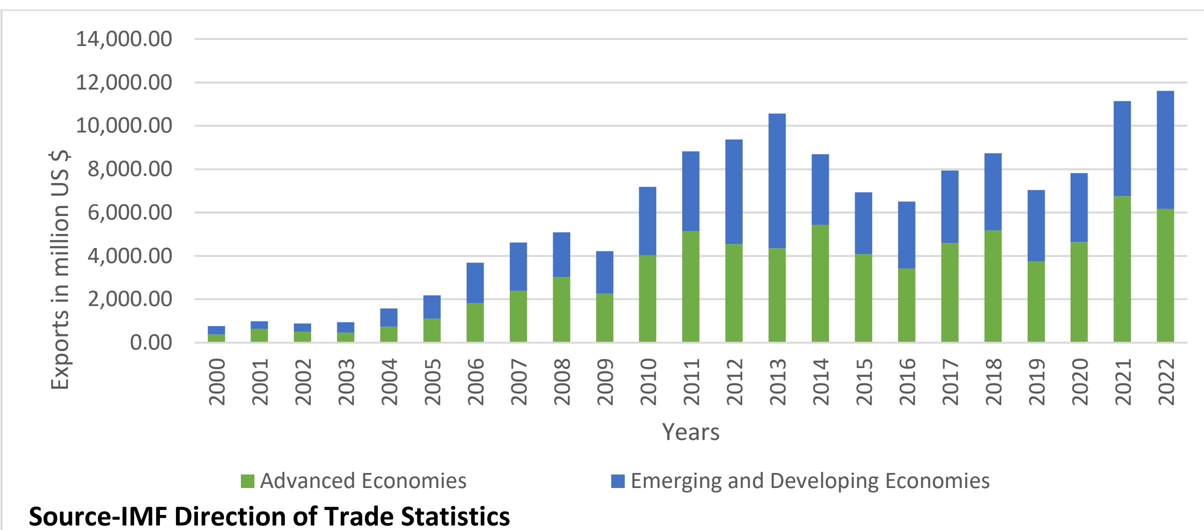


Figure 4-26:Exports to Advanced and Emerging and Developing Economies from Zambia

In 2021, Zambia emerged as the world's largest exporter of Raw Copper, with exports valued at USD6.33 billion. This significant export sector was complemented by other key exports, including Refined Copper, Gold, Precious Stones, and Electricity. Zambia's primary trading partners for these commodities included Switzerland, China, Singapore, the Democratic Republic of the Congo, and the United Arab Emirates, underscoring its role as a global player in the copper and mining industry. This export profile highlights Zambia's substantial contribution to the global raw copper market, further solidifying its position as a key player in the international commodities trade.

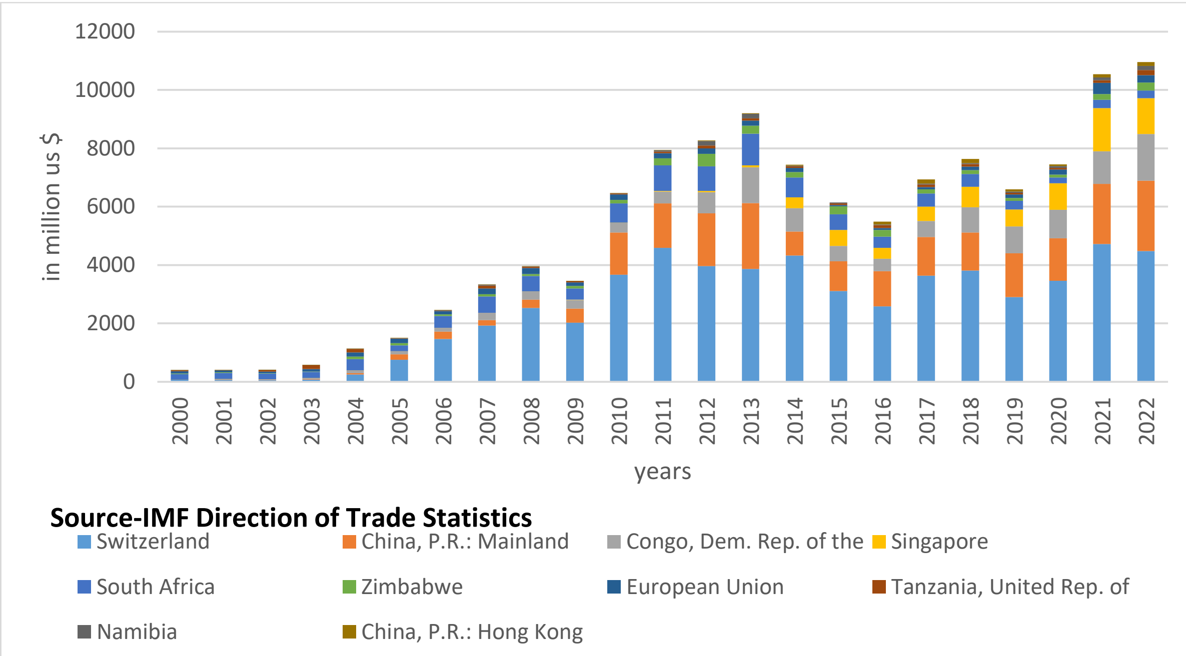


Figure 4-27:Top 10 Destinations of exports of Zambia

Zambia's economy exhibits a significant dependence on copper, as evidenced by copper's substantial share of total exports, contribution to government revenue, employment, and GDP impact. The nation is vulnerable to copper price fluctuations, with mining-related investments and infrastructure development closely tied to the sector. Despite diversification efforts, copper remains a vital component of Zambia's economic landscape (**Error! Reference source not ound.**). Zambia will aim to increase annual copper production from the 760,000 tons mined in 2022 to 3 million tons by 2030. (The africa report)

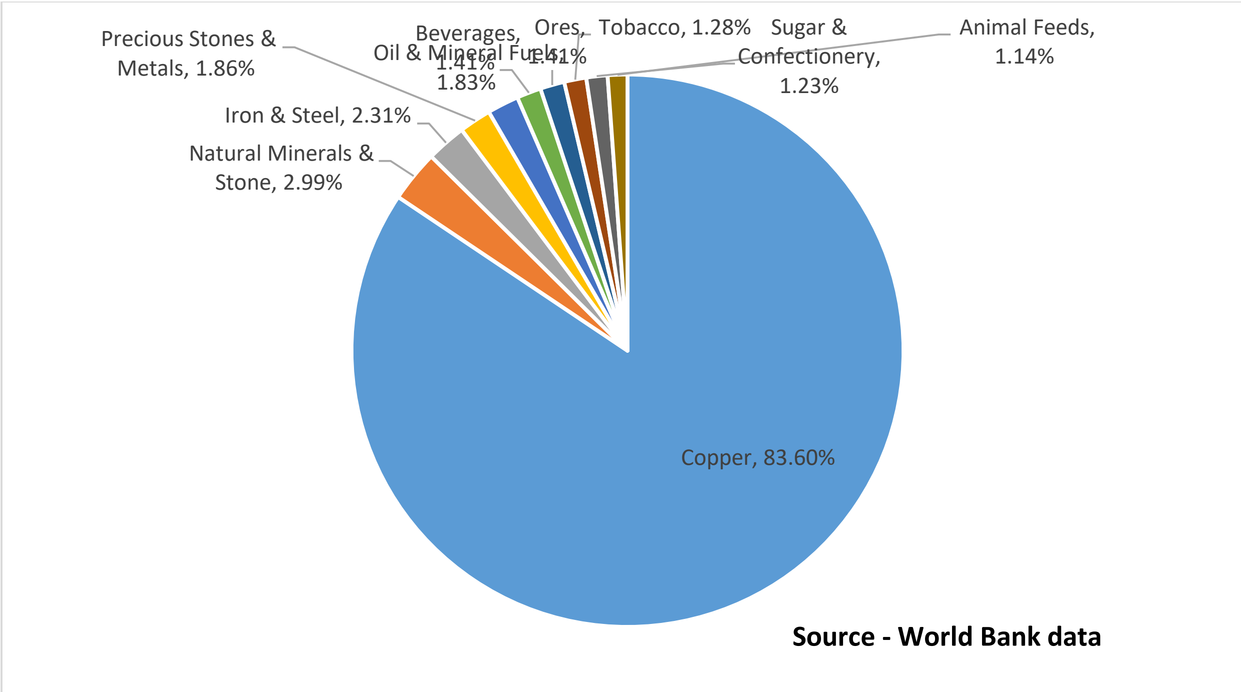


Figure 4-28:Top 10 exports of Zambia in %

Imports

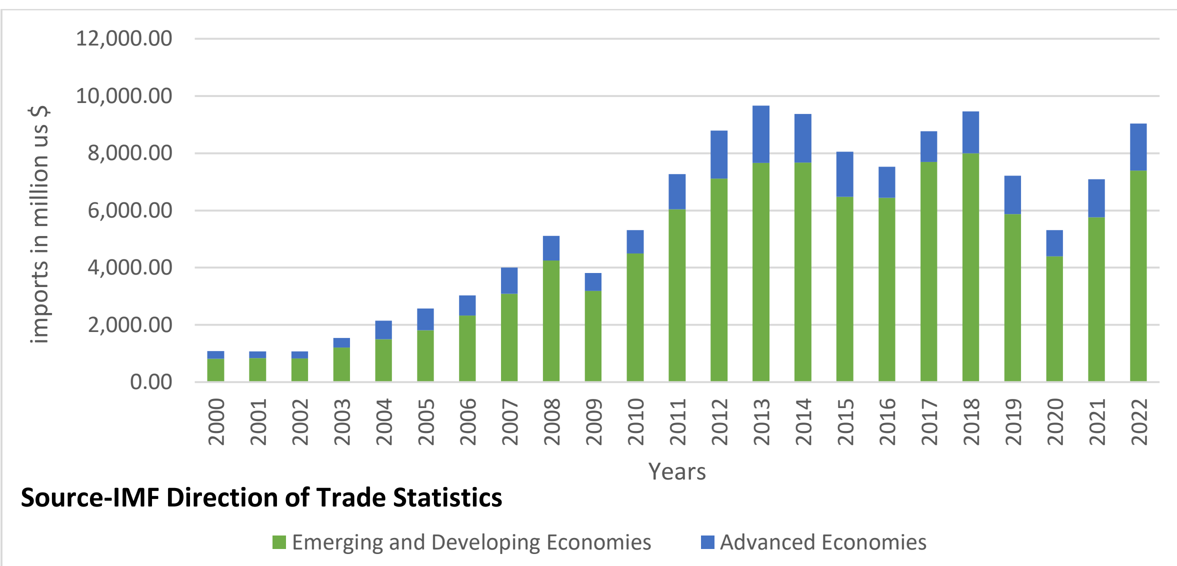


Figure 4-29:Imports from Advanced and Emerging and Developing Economies to Zambia

Zambia's import pattern reflects a greater reliance on emerging and developing economies, such as South Africa, China, and the Democratic Republic of the Congo (DRC), compared to advanced economies. This suggests that the majority of Zambia's imports originate from its regional neighbors and countries with strong manufacturing sectors, indicating a preference for cost-effective goods and a potential emphasis on regional trade relationships over imports from advanced economies (**Error! Reference source not found.**).

The top import partner for Zambia was 'South Africa'. As per Zambia trade, Zambia imports the most from South Africa these products - industrial machinery, vehicles, plastics & articles. Zambia's private sector demands these products the most from South Africa. Hence, South Africa stands at the top in importing partners of Zambia. (**Error! Reference source not found.**)

Figure 4-30:Top 10 import sources of Zambia

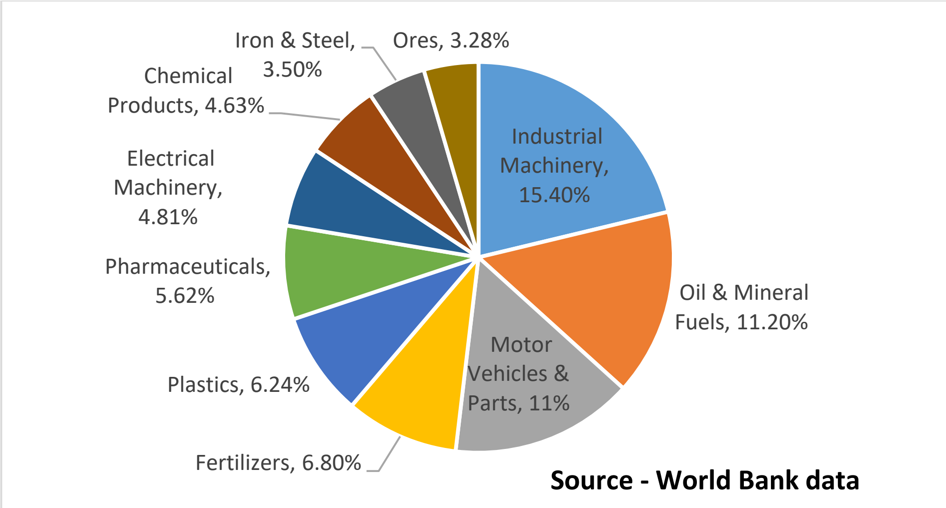


Figure 4-31:Top 10 imports of Zambia in %

The top imports are made for Industrial Machinery, while the least imports among these top imports are made for Ores (**Error! Reference source not found.**).

Zambia future

Zambia's successful debt restructuring agreement of USD6.3 billion with its foreign government creditors, notably China, marks a significant breakthrough for other debt-burdened nations facing prolonged negotiations with their creditors. China, being the largest official creditor to Zambia with USD4.1 billion owed to its Export-Import Bank. Additionally, the International Monetary Fund (IMF) granting approval for a USD1.3 billion bailout plan for Zambia provides crucial financial support, potentially stabilizing the country's precarious economic situation. Zambia's overseas bondholders have entered into non-disclosure agreements (NDA) with the government, this is a key step marking the beginning of formal talks to restructure over 3 billion USD of international bonds.

The Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative

An initiative developed collaboratively by the G20 and the Paris Club in response to the economic challenges brought about by the COVID-19 pandemic, particularly for low-income countries. The Paris Club consists of major creditor nations, while the G20 includes both members of the Paris Club and other significant bilateral creditors such as China, India, Turkey, and Saudi Arabia.

The primary aim of this framework is to address the debt issues faced by DSSI-eligible countries that are grappling with unsustainable debt levels or have substantial financing needs that extend beyond the scope of the DSSI. Under this framework, participating countries can request debt treatment on a case-by-case basis. This treatment may encompass debt restructuring, debt rescheduling, or other measures designed to create more manageable and sustainable debt conditions for these nations.

For countries burdened with unmanageable levels of public debt, the Common Framework seeks to restructure and reduce the net value of their debt to a more sustainable level. Additionally, for countries dealing with significant debt and liquidity challenges, the framework can assist in the rescheduling or reprofiling of debt by postponing its repayment obligations.

As of now, four countries—Chad, Ethiopia, Zambia, and Ghana—have formally requested debt restructuring under the Common Framework. However, it is important to note that the implementation of this framework has encountered delays and challenges. Despite its noble intentions, it has yet to fully deliver on its promise, leaving some participating nations in a protracted state of financial vulnerability.

In summary, the Common Framework for Debt Treatments beyond the DSSI represents a coordinated effort by major global creditors to address the debt-related challenges faced by low-income countries affected by the COVID-19 pandemic. While it offers the potential for debt relief and sustainability, its slow implementation and limited impact thus far highlight the complexities and difficulties involved in addressing the debt burdens of these nations. (World Bank, 2022)

Chapter 5

Introduction

Situated in the heart of the Middle East, Lebanon, once known as the “Switzerland of the East” for its vibrant financial sector and cosmopolitan culture, now stands at a crossroads marred by fiscal distress and political turmoil. As we delve deep into the persisting Lebanon’s debt crisis, we can conclude valuable insights into the dynamics that leads to the recurrent pattern in the developing world. The Lebanese experience serves as a stark reminder of how vague policy actions without a long term vision can prove disastrous for an economy and how important global initiatives regarding debt are for developing countries like Lebanon.

Lebanon’s story is a unique one. This paper embarks on a comprehensive exploration of the debt crisis affecting Lebanon, dissecting its origins, evolution, and the multifaceted challenges it presents.

From an economic perspective, Lebanon is a country with a diverse history that has oscillated between periods of economic prosperity and significant challenges. Historically known for its vibrant trade, banking sector, and tourism, Lebanon was often seen as a Middle Eastern economic hub. However, in recent years, the country has faced a series of severe economic crises that have led to significant economic hardships.

Traditionally, Lebanon's economy was characterized by a thriving banking sector, tourism industry, and a dynamic services sector. The country's location on the Mediterranean coast, coupled with its cultural richness and historical attractions, attracted tourists from around the world. Additionally, its banking sector, known for its confidentiality and stability, attracted deposits from across the region.

Lebanon also benefited from a well-educated and skilled workforce, a strong diaspora community, and a resilient entrepreneurial spirit. Remittances from Lebanese expatriates have played a significant role in balance of payments of Lebanon, also contributing to foreign exchange reserves.

However, in recent years, Lebanon has faced a series of economic challenges, It was faced with a banking collapse, currency devaluation, and hyperinflation. The country's banking sector, which was once a source of stability, faced severe challenges, with depositors losing access to their savings.

Lebanon's political system, characterized by sectarianism and power-sharing arrangements, has led to frequent political gridlock and a lack of effective governance. This instability has hindered economic reforms and effective crisis management.

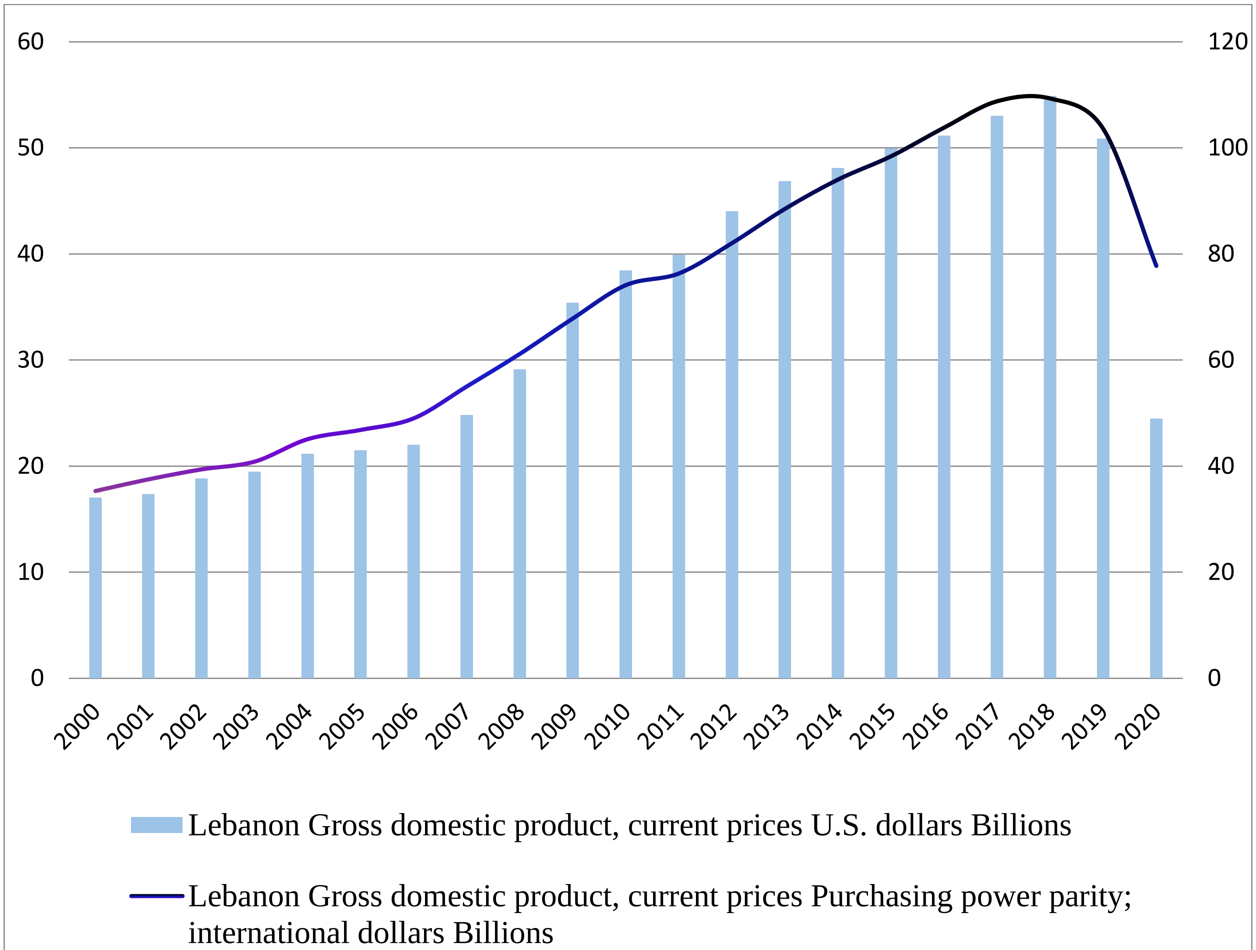
The country has been significantly affected by the Syrian civil war, hosting a large number of Syrian refugees, which has strained resources and infrastructure.

Rampant corruption and mismanagement have eroded public trust and hindered economic development.

Protests and social unrest have become more common as people demand political and economic reforms. Most importantly, the COVID-19 Pandemic exacerbated Lebanon's economic challenges, including a decrease in tourism and disruptions to global supply chains.

Despite these challenges, Lebanon possesses several assets, including a resilient and educated population, a strategic location, and a strong entrepreneurial spirit. The country's economic recovery will depend on effective governance, structural reforms, and international support. Lebanon's economic future remains uncertain, but efforts to address its challenges are ongoing as it seeks to rebuild and stabilize its economy.

Growth, Government Finances and Balance of Payments



Source: World Economic Outlook, IMF

Figure 5-1: GDP current prices and GDP PPP U.S.D. billions- Lebanon

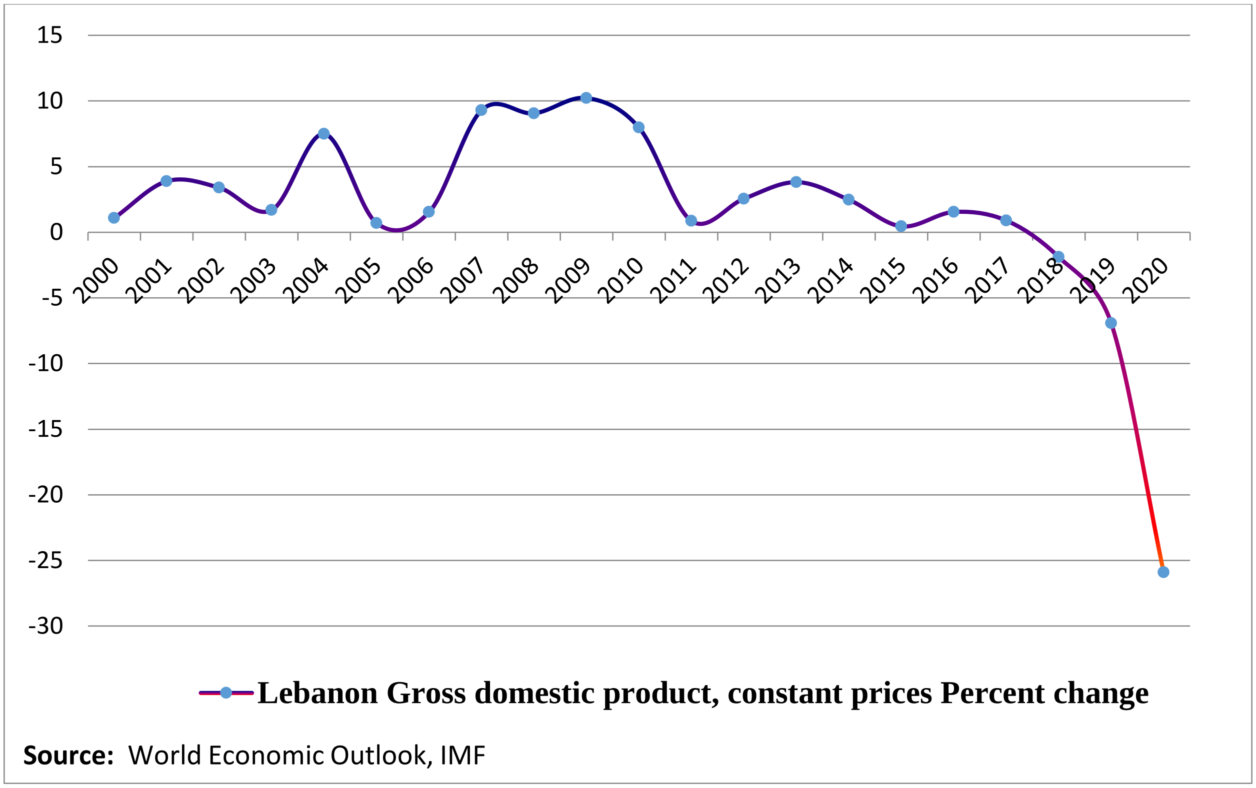


Figure 5-2: GDP constant prices, percent change- Lebanon

The figure illustrates the trajectory of Lebanon's nominal GDP in the early 21st century, offering valuable insights into the country's economic performance. During the initial five years of the century, from 2000 to 2005, nominal GDP experienced a modest increase, growing from approximately $17 billion to just over $22 billion (Figure 5-1). This relatively sluggish growth can be largely attributed to the prevailing social and political turmoil within the nation during this period.

The subsequent half-decade, from 2005 to 2010, witnessed a remarkable transformation in Lebanon's economic landscape. During this period, the country achieved a noteworthy economic expansion, with its GDP nearly doubling. This robust growth was a testament to Lebanon's resilience and its ability to rebound from earlier challenges.

However, a significant setback occurred in 2011, when Lebanon faced a substantial economic downturn. This downturn was primarily linked to the adverse effects of the Syrian civil war, which resulted in a massive influx of Syrian refugees into Lebanon. The influx of refugees had profound political and economic repercussions, straining resources and infrastructure.

Despite these challenges, the Lebanese banking sector emerged as a pivotal player in the subsequent years, contributing significantly to the nation's economic stability and growth. This resurgence began in 2018, following a significant drop in the country's GDP. By 2020, Lebanon's economy faced a dire contraction of over 25% (Figure 5-2), a magnitude of decline that had not even been experienced during the prolonged periods of civil wars and political turmoil in the nation's history.

These economic trends underscore Lebanon's ability to navigate through a complex web of challenges, although it also highlights the nation's vulnerability to regional conflicts and the importance of diversifying its economic base for sustainable growth and stability.

Furthermore, in 2020, there was a substantial and noteworthy disparity between Lebanon's Nominal GDP and GDP (PPP). This stark difference can be primarily attributed to the fact that the country's exchange rates were severely imbalanced. At that time, the Lebanese pound was significantly overvalued due to its fixed peg to the US dollar at an exchange rate of 1,500 Lebanese pounds to one US dollar. However, market rates deviated significantly from this peg, reflecting a situation where the official exchange rate no longer aligned with real-world economic conditions.

To provide some context, it's important to note that Lebanon had maintained this peg to the US dollar for many years, and this exchange rate system had contributed to both stability and instability in the country's economy. The fixed peg helped manage inflation and maintain confidence in the local currency but also created vulnerabilities, particularly when economic and political challenges arose.

The economy has contracted by about 40 percent, the Lebanese pound has lost 98 percent of its value, inflation has been at triple-digits, and the central bank has lost two thirds of its foreign exchange (FX) reserves (IMF, 2023).

In 2020, the disparity between the official exchange rate and market rates reached a critical point, reflecting the challenges Lebanon was facing. This discrepancy had significant implications not only for GDP calculations but also for the broader economic landscape, contributing to inflation, foreign exchange shortages, and financial instability. These issues exacerbated the economic crisis that Lebanon experienced during that period and highlighted the urgent need for comprehensive economic reforms.

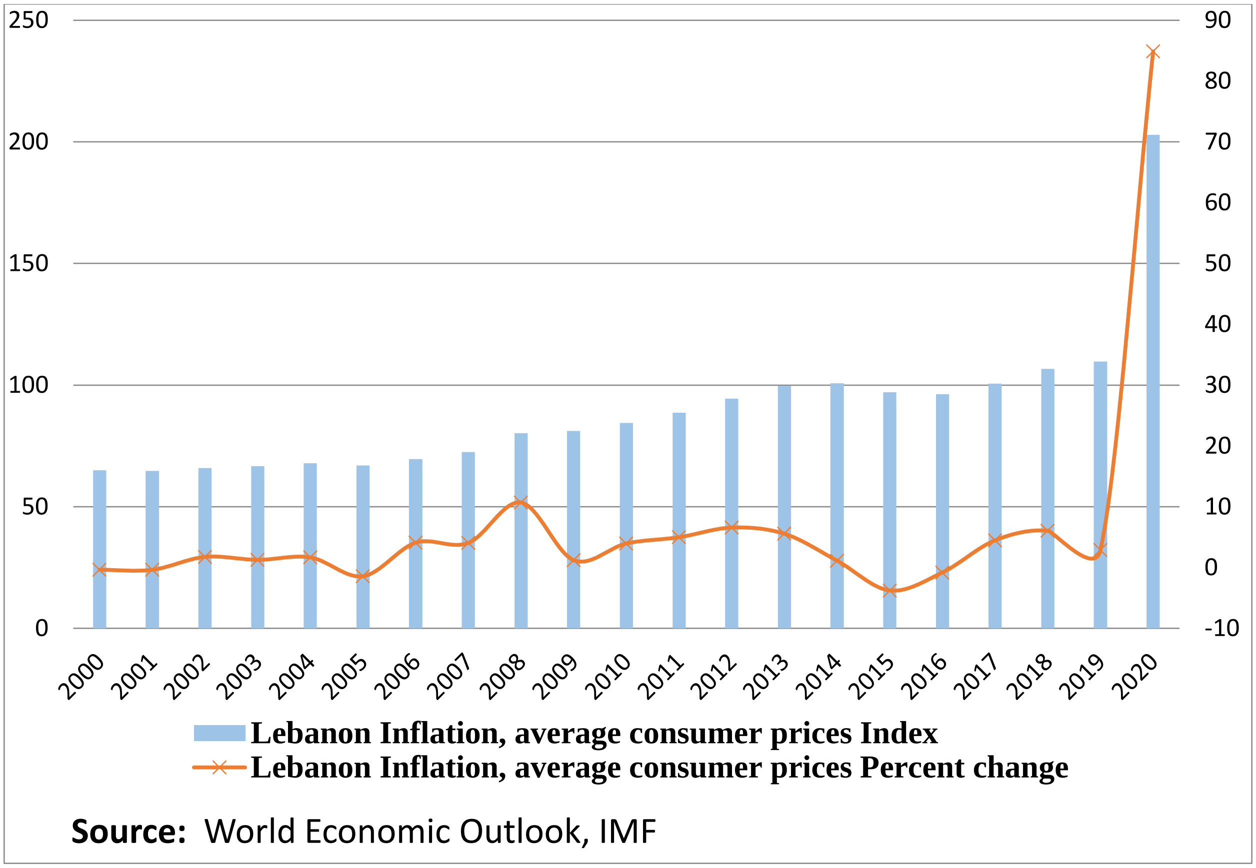


Figure 5-3: Lebanon Inflation, average CPI and Lebanon Inflation, average CPI percent change

Over the last two decades, Lebanon generally experienced moderate inflation, with the exception of 2008 when a global economic shock led to double-digit inflation rates. However, the economic landscape has taken a concerning turn, as illustrated in the accompanying graph. In just one year following 2019, inflation has surged by over 80%, implying a significant and alarming economic challenge confronting the nation (Figure 5-3). This sharp increase in inflation demands a closer examination of the underlying issues impacting Lebanon's economy. Inflation in Lebanon hit an annual rate of about 124 per cent in January as the country's worst economic and financial crises in decades continued amid a political deadlock that has blocked the formation of a new government and the enactment of reforms required to unlock billions of dollars in aid. (Derhally, 2023)

The recent surge in inflation can be attributed to various factors like currency devaluation, political instability and higher levels of public debt. Here the case of currency devaluation cannot be directly considered as the country has a fixed exchange rate system however it is because the currency’s official peg doesn’t indicate the real value that the currency holds in the market. The Lebanese pound has sunk to a historic low against the US dollar on the country’s parallel market. The Lebanese pound, officially pegged at 15,000 to the dollar, was trading at 100,000. (ALJAZEERA, 2023)

The elevated inflation levels have led to a diminishing purchasing power among citizens, casted a shadow of uncertainty over businesses and investors, and posed formidable challenges to Lebanon's overall economic stability.

Exchange Rate Turmoil: Navigating Devaluation, Parallel Markets, and New Monetary Policies

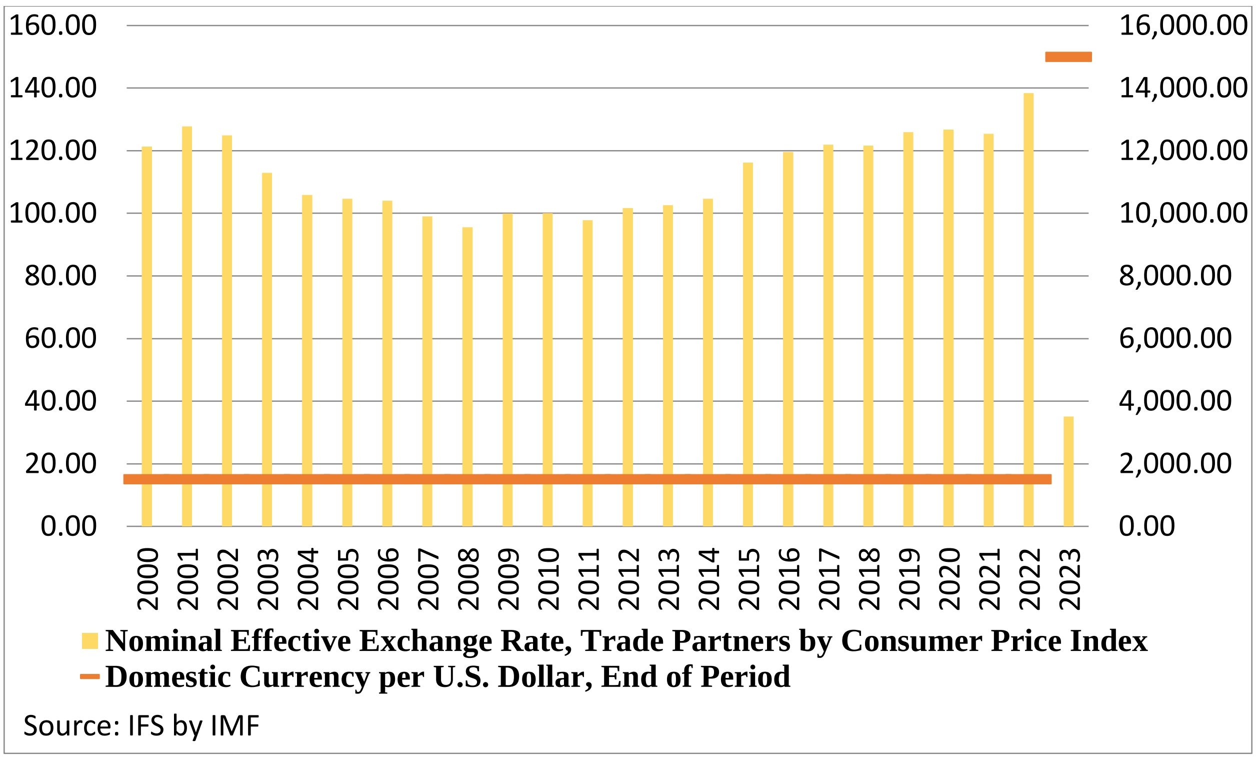


Figure 5-4: Nominal Effective exchange rate and domestic currency per U.S. dollar- Lebanon

As depicted in the graph, the nation's nominal exchange rate had remained fixed at 1507.5 Lebanese pounds per US dollar for an extended period (Figure 5-4). However, a noteworthy transition occurred in February 2023, when this rate was officially adjusted to 15000 Lebanese pounds per US dollar. While this adjustment may seem substantial, it pales in comparison to the devaluation witnessed in the parallel currency market.

There's a lot more to uncover:-

As both the government and central bank's debt mounted in 2019, depositors began to lose confidence, the diaspora whose remittances were the main source of foreign earnings began to hold back deposits, and the system started to unwind as Lebanese took to the streets to protest the country's impending economic collapse. In October 2019, the central bank allowed withdrawals at a rate arbitrarily set at 3,900 pounds to the dollar, even as the market rate soared beyond that, reaching 15,000 pounds to the dollar at one stage. Later on, a new rate of 6,240 pounds to a US dollar emerged when the central bank proposed issuing money at that rate to 800,000 recipients of a World Bank emergency aid loan of $246 million. (Vohra, 2021) On 1 February 2023, the Central Bank reset the currency peg at LL 15,000 per US dollar however the market rate is still around 1,oo,ooo L pound per US dollar.

Apart from all this confusion, a new monetary policy instrument was implemented. An exchange platform was set up in May 2021, 18 months into Lebanon's economic meltdown. It was widely recognised as a way for the central bank, known as Sayrafa, to stabilize the Lebanese pound, which nevertheless continued to decline. (Gebeilly, 2023)

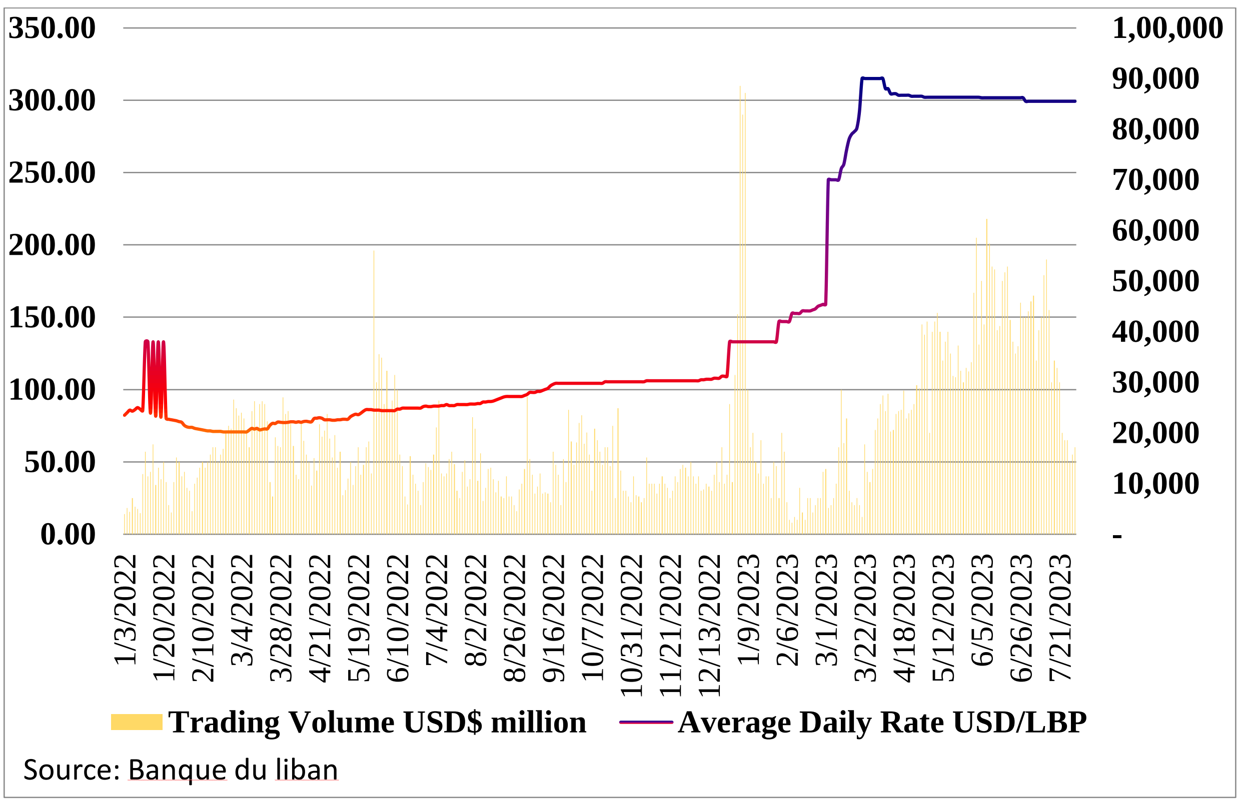


Figure 5-5: Sayrafa rates and trading volume of Lebanese pound

The Sayrafa platform was introduced in 2021 to try to limit the power of black market exchanges. The platform now prices the dollar at more than four times the official government exchange rate. Unifying the country's several exchange rates is one of several steps demanded by the International Monetary Fund for Lebanon to sanction a $3 billion bailout package. (The National, 2023)

Government Finances

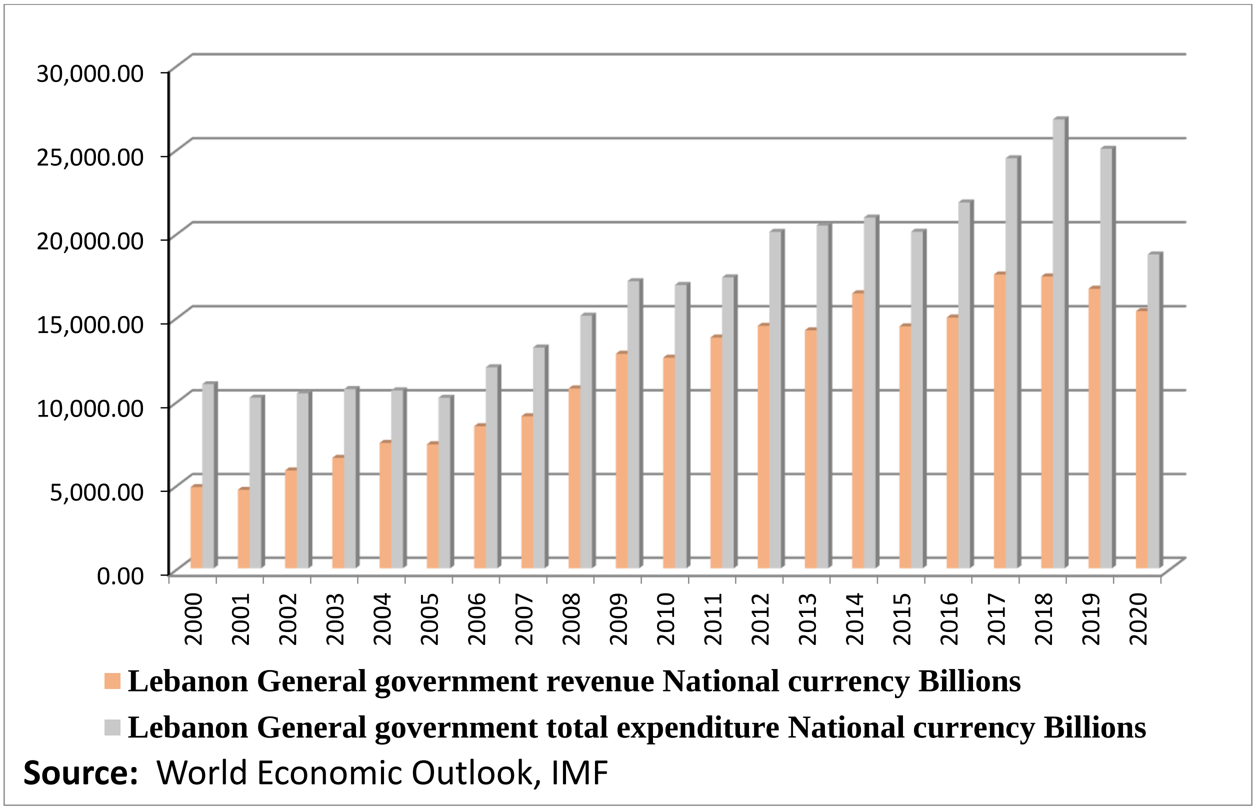


Figure 5-6: Labanon general government revenue and total expenditure in national currency billions

While government revenue witnessed an impressive surge, increasing over threefold from lira 4,848.81 billion in 2000 to lira 17,401.6 billion in 2018, it is noteworthy that government expenditure also experienced a substantial growth of more than 2.5 times over the same period. However, for a more insightful perspective, it's crucial to analyze these figures in relation to the country's Gross Domestic Product (GDP) (Figure 5-6).

When we assess government revenue and expenditure as a percentage of GDP, a distinct trend emerges. In 2000, government expenditure accounted for a significant 42.85% of the GDP, gradually declining to 32.33% by 2018, with the lowest point recorded in 2015 at 26.7% (Figure 5-7). This reduction in the expenditure-to-GDP ratio reflects efforts to control government spending.

Conversely, government revenue as a percentage of GDP exhibited relative stability during this period. This divergence between the trajectories of government revenue and expenditure as a percentage of GDP highlights the evolving fiscal dynamics within the country.

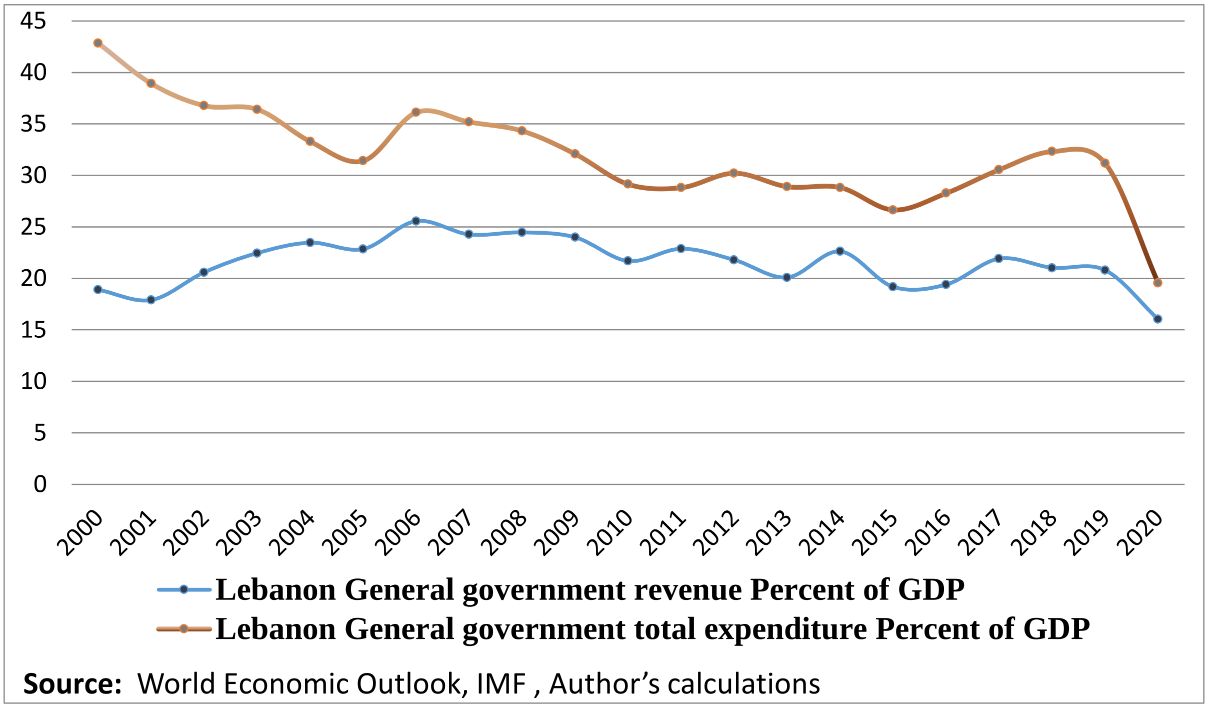


Figure 5-7: Lebanon general government revenue and total expenditure as percent of GDP

In recent years, particularly after 2019, there has been a noticeable decline in government revenue, albeit not of significant magnitude. However, the more pronounced shift has been in government expenditure, which has decreased from lira 26,753 billion to lira 18,711 billion in just a span of two years, reaching levels reminiscent of those seen a decade ago. This rapid reduction in government spending has had far-reaching implications for the economy.

Firstly, it has resulted in an overall decrease in demand within the economy, potentially exerting a drag on economic growth. The curtailed public investments in critical areas such as infrastructure, education, and healthcare have raised concerns about diminished productivity and the erosion of long-term economic potential.

Furthermore, these budgetary constraints have led to cuts in public sector employees' wages, compounded by the depreciation of the lira in the market. This combination of reduced income and diminished public services has given rise to various protests in response to these economic challenges.

Also, The fiscal deficit is estimated to have widened to 5 percent of GDP in 2022, due to collapsing revenues. (IMF, 2023)

Reiterating, the government's substantial fiscal deficit has played a pivotal role in shaping the economic landscape during this timeframe, necessitating a closer examination of the government's net lending and borrowing activities.

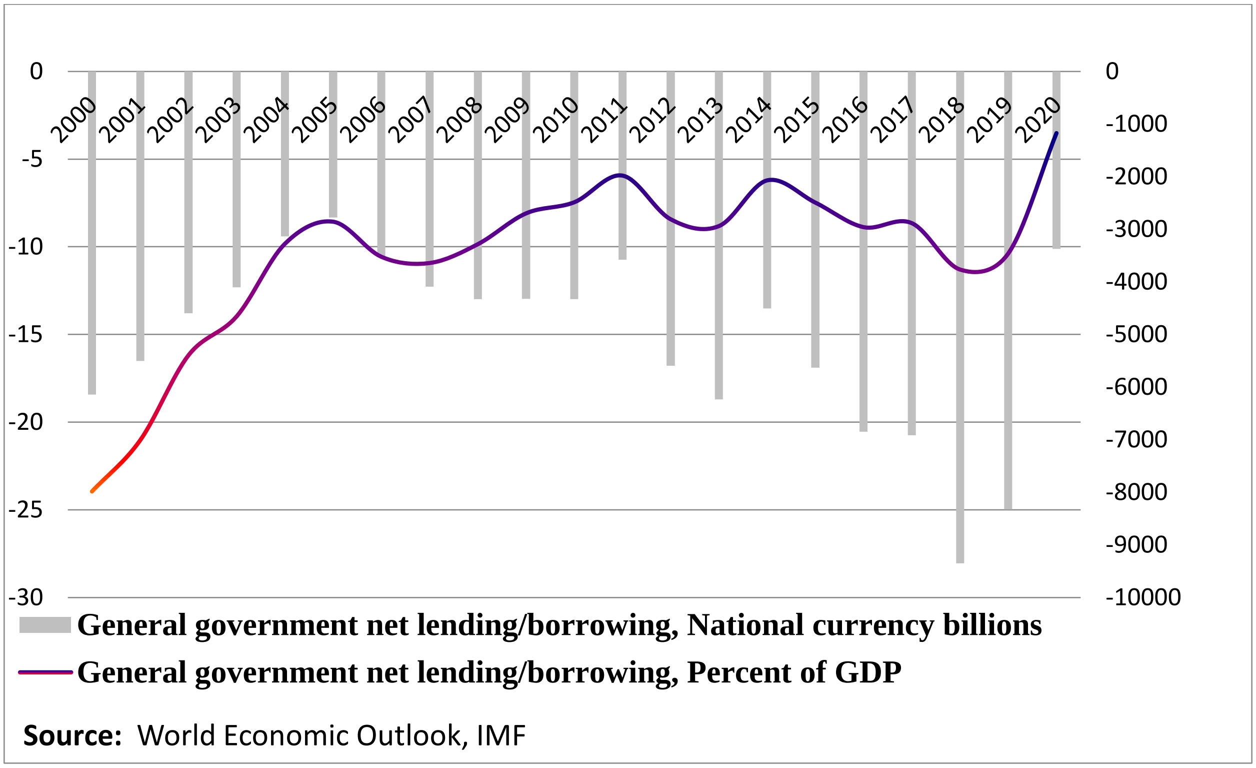


Figure 5-8: General government net lending/borrowing in national currency billions and percent of GDP of Lebanon

As shown in the figure, Government's net lending was negative in last two decades that means government borrowed significantly with the highest net borrowing in 2018 (Figure 5-8). But if we look at the net borrowings as a percentage of GDP, it has reduced from about 24% of GDP to around 3.5% of the GDP. It may look a very optimistic figure, but in real we need to take into the account the contraction of GDP that happened after 2018 as well (Figure 5-1).

External sector

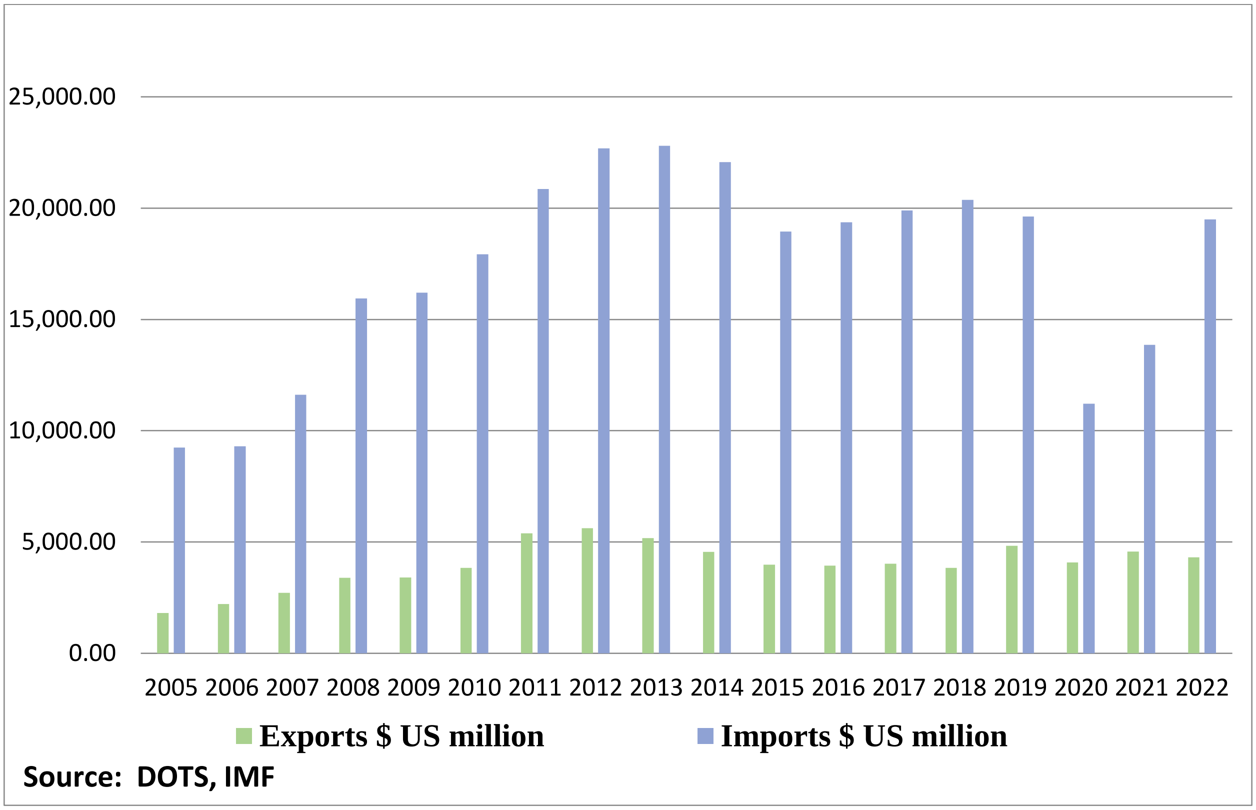


Figure 5-9: Exports and Imports U.S.D. millions- Lebanon

It is evident from the figure that the country's exports doesn't show a consistent increasing trend since last two decades and imports remained significantly higher than the exports that means the country is very dependent on imports (Figure 5-9). Further if we delve deeper into the composition of exports, country majorly exports Gold, Diamonds and jewellery of other precious metals which indicates that the manufacturing sector doesn't play a very major role in the economy which can also be regarded as one of the major reasons of a very minimal rise in exports over 20 years. (WITS, World Bank, 2021)

Even though imports declined significantly from US$ 19,619 million in 2019 to US$ 11,207 million 2020 following the pre-pandemic economic meltdown and then the impact of pandemic, exports didn't decline as much. But again with a slight decline in exports from 2021 to 2022, imports increased to the level of 2019. Thus, Balance on goods increased significantly.

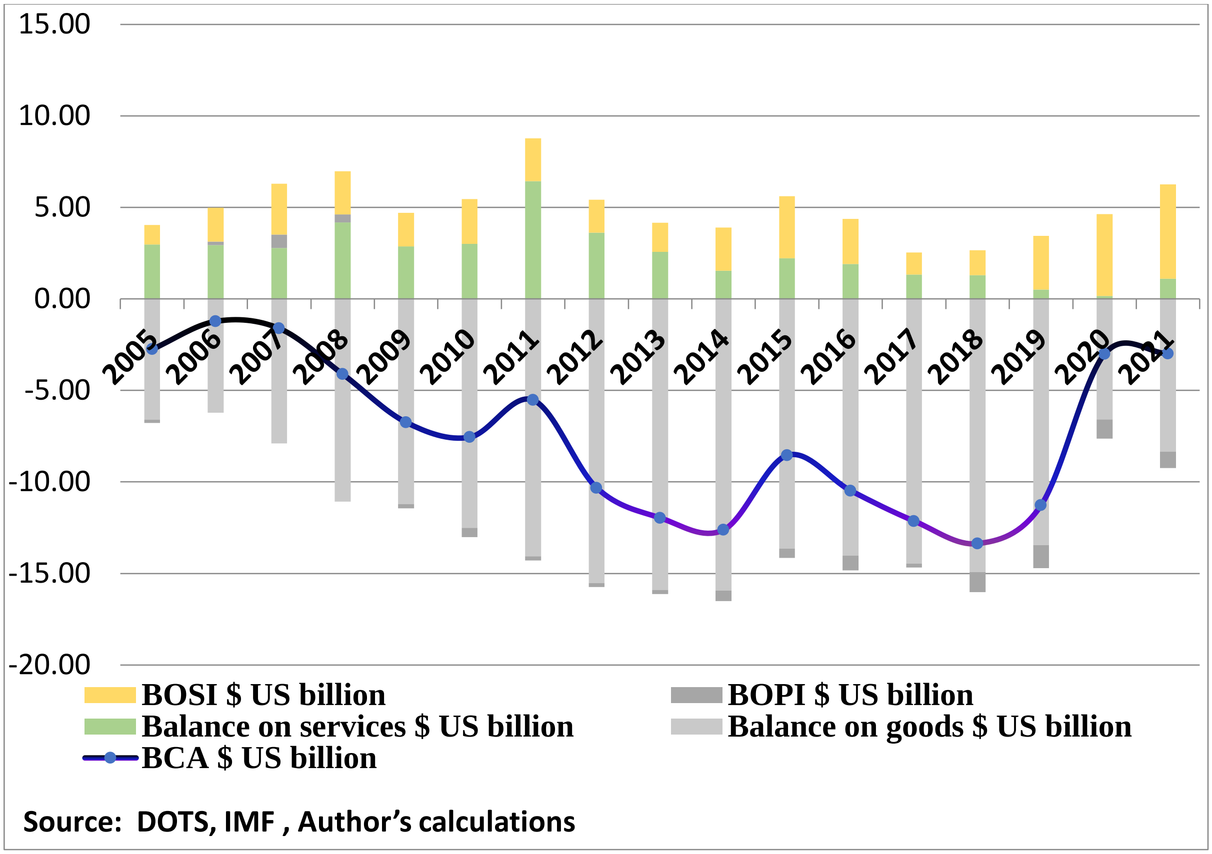
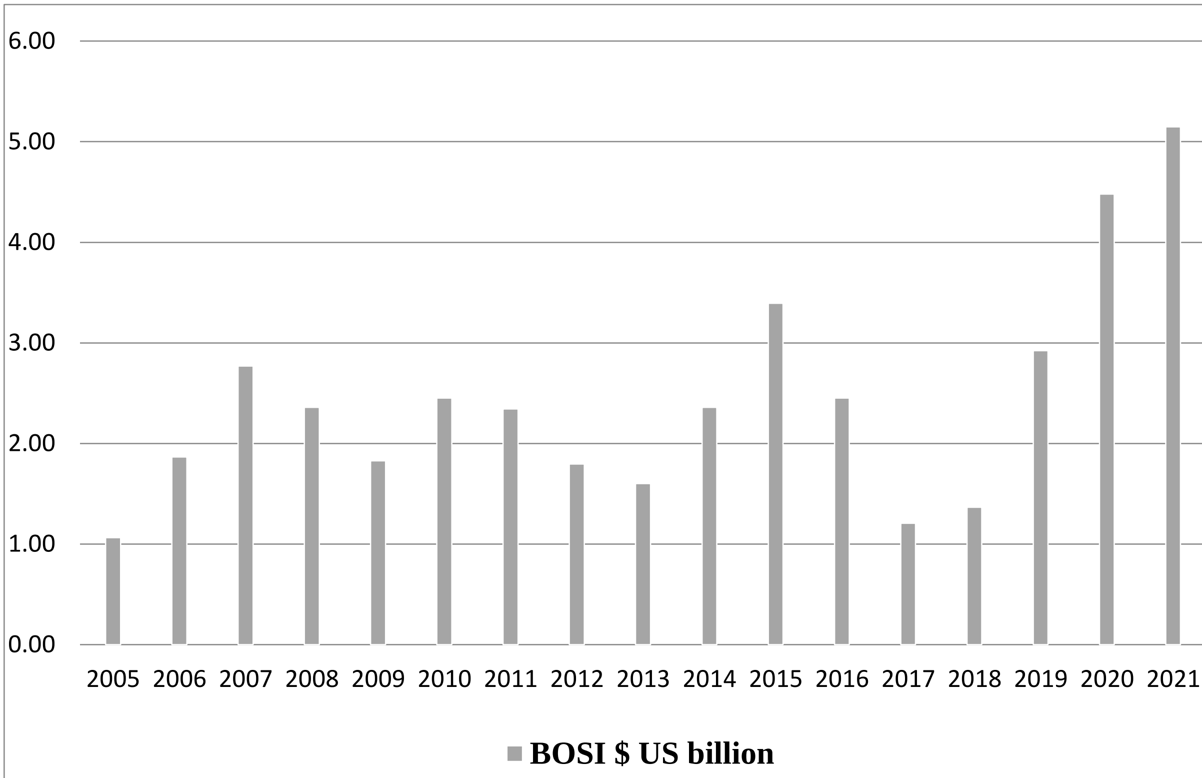


Figure 5-10: BOSI, BOPI, Balance on services, Balance on goods and BCA in U.S.D. billion- Lebanon

The balance on current account (BCA) has consistently shown a negative trend over the years under examination. When we juxtapose the Balance on Current Account (BCA) with the GDP at current prices (Figure 5-1), it becomes evident that the BCA constitutes a substantial percentage of the GDP i.e 24% in 2018. Now, let's delve into the constituents of the BCA.

The Balance on Secondary Income has consistently maintained a positive trajectory over the entire time frame, primarily due to the substantial influx of remittances received from the country's citizens working abroad.



Source: BOPS, IMF , Author's calculations

Figure 5-11: Balance on Secondary Income U.S.D. billion- Lebanon

While the Balance on Secondary Income (BOSI) exhibited fluctuations over the years, it witnessed a significant surge after the country was struck by a crisis, soaring from a mere US$ 1.37 billion in 2018 to an unprecedented high of US$ 5.15 billion in 2021 (Figure 5-11). Consequently, even though the Balance on Services, which had maintained a positive status in previous years, nearly approached zero, and the Balance on Goods continued to dominate the Balance on Current Account (BCA) with a substantial negative value, while the Balance on Primary Income remained a minor and negative component, BOSI played a pivotal role in stabilizing the country's BCA and overall Balance of Payments (BOP).

This situation, however, underscores several long-term implications, including a growing trend of citizens relocating abroad in response to crises and uncertainties. Furthermore, it highlights the imperative for the country to enhance its manufacturing capabilities to boost exports and align them more closely with imports.

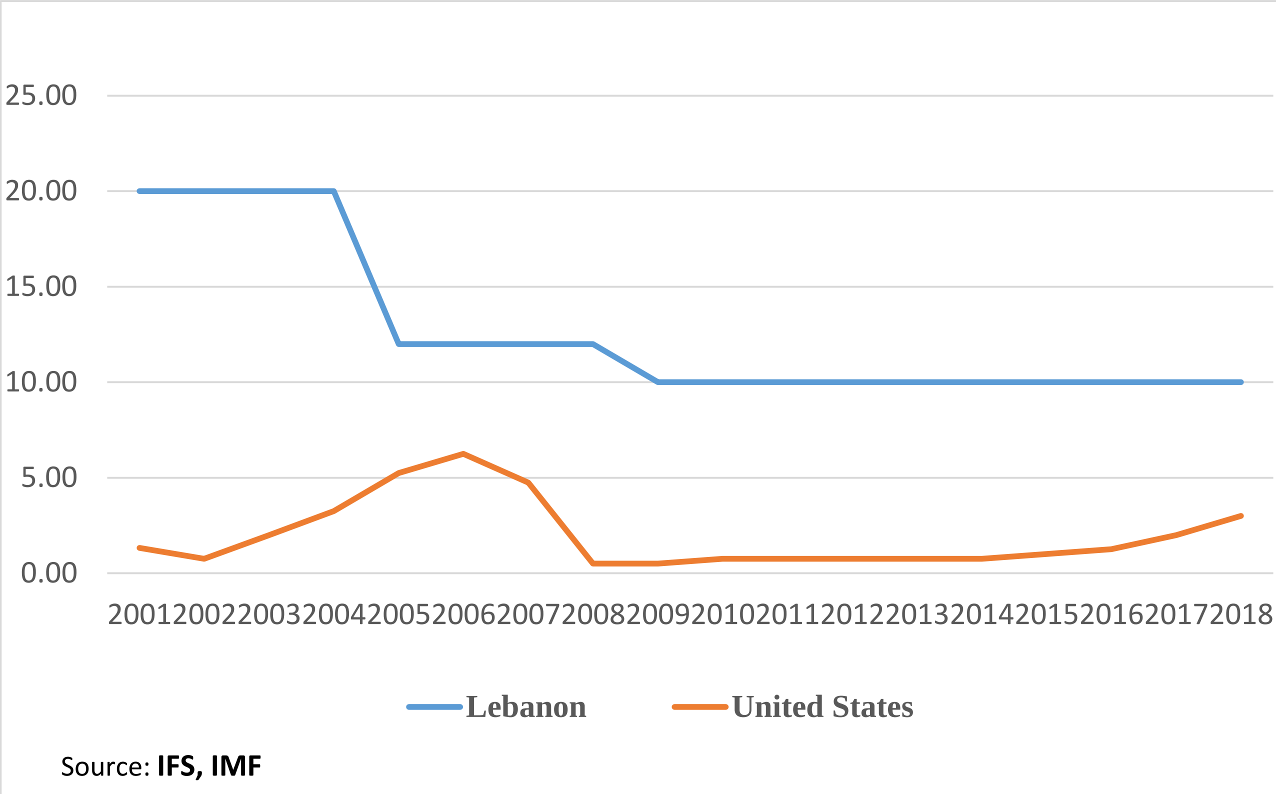


Figure 5-12: Interest rate, discount,per annum- Lebanon and United States

Over the specified time period, Lebanon consistently maintained higher interest rates compared to a benchmark nation like the United States (Figure 5-12). This discrepancy led to significant capital inflows into Lebanon for several years. However, the situation took a dramatic turn with the onset of the crisis in 2018-19, resulting in capital outflows and a subsequent depletion of the country's foreign exchange reserves. Notably, the apparent increase in foreign exchange reserves as a percentage of GDP, rising from 75% in 2019 to 102% in 2020, can be primarily attributed to the sharp contraction of Lebanon's GDP during those same years (Figure 5-13).

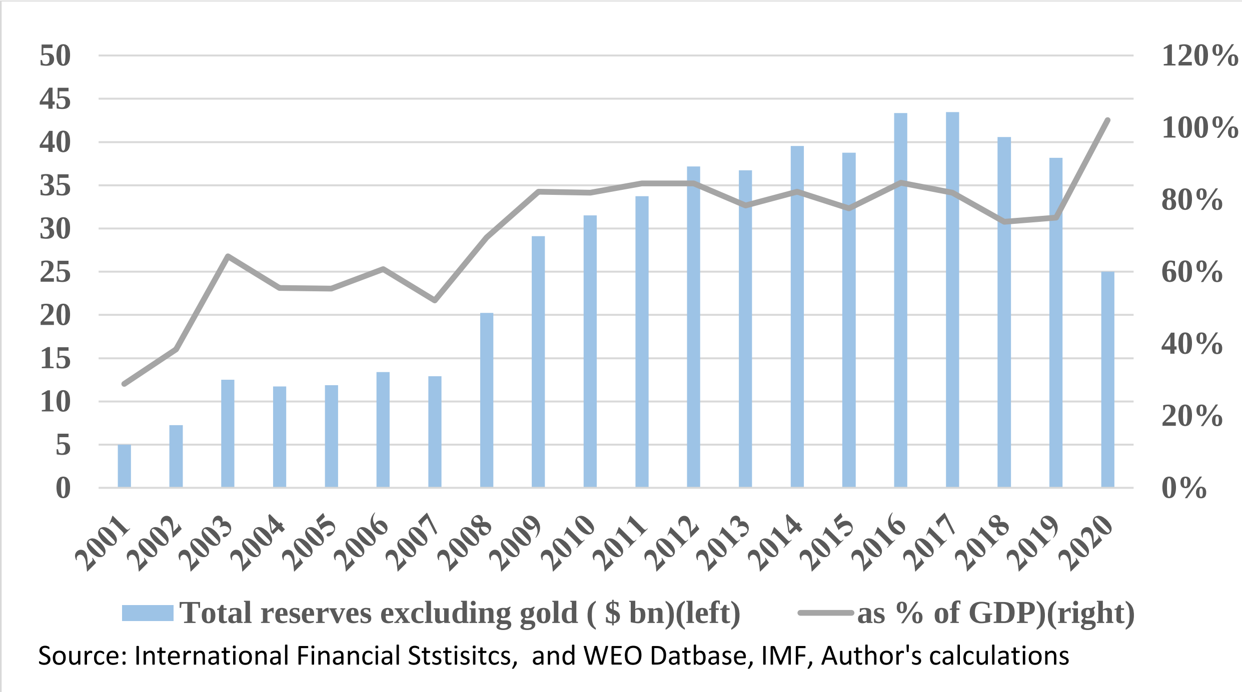


Figure 5-13: Foreign Exchange Reserves of Lebanon (U.S.D. billion)

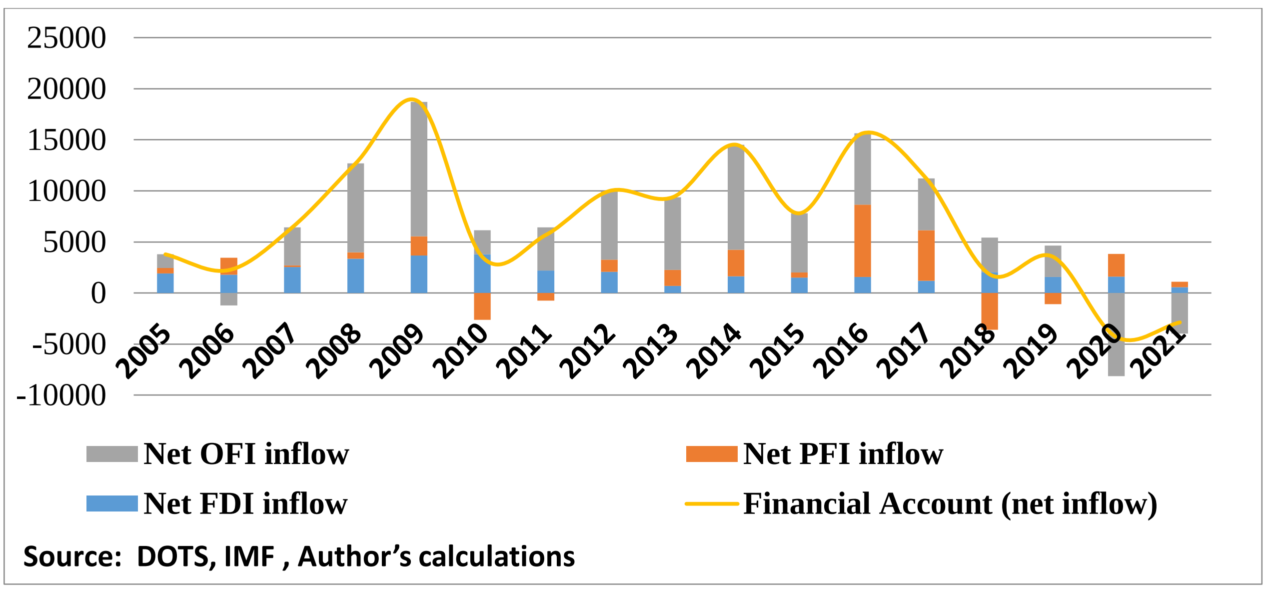


Figure 5-14: Financial Account of Lebanon (U.S.D. million)

Balance on Financial Account, a pivotal component for any economy, has consistently displayed positive net inflows throughout the observed timeframe. This positive trend can be attributed to difference in interest rates from rest of the world. But first time in 15 years it turned negative in 2020 and remained negative for the following year as well.

Portfolio Foreign Investment (PFI) initially maintained positive net inflows until 2009, transitioning to negative values for a two-year period, before reverting to positive territory. It experienced a negative phase in 2018 and 2019 but returned to a positive status post-2019.

Turning our attention to other investments, this category has sustained notably positive trends since 2006, experiencing a substantial turnaround and shifting into negative territory in 2020 and 2021 (Figure 5-14).

Talking about trade

Before we delve into the country's debt situation, it is essential to conduct a thorough examination of the composition of the country's exports and imports. This will provide us with valuable insights into the country's economic standing.

Exports

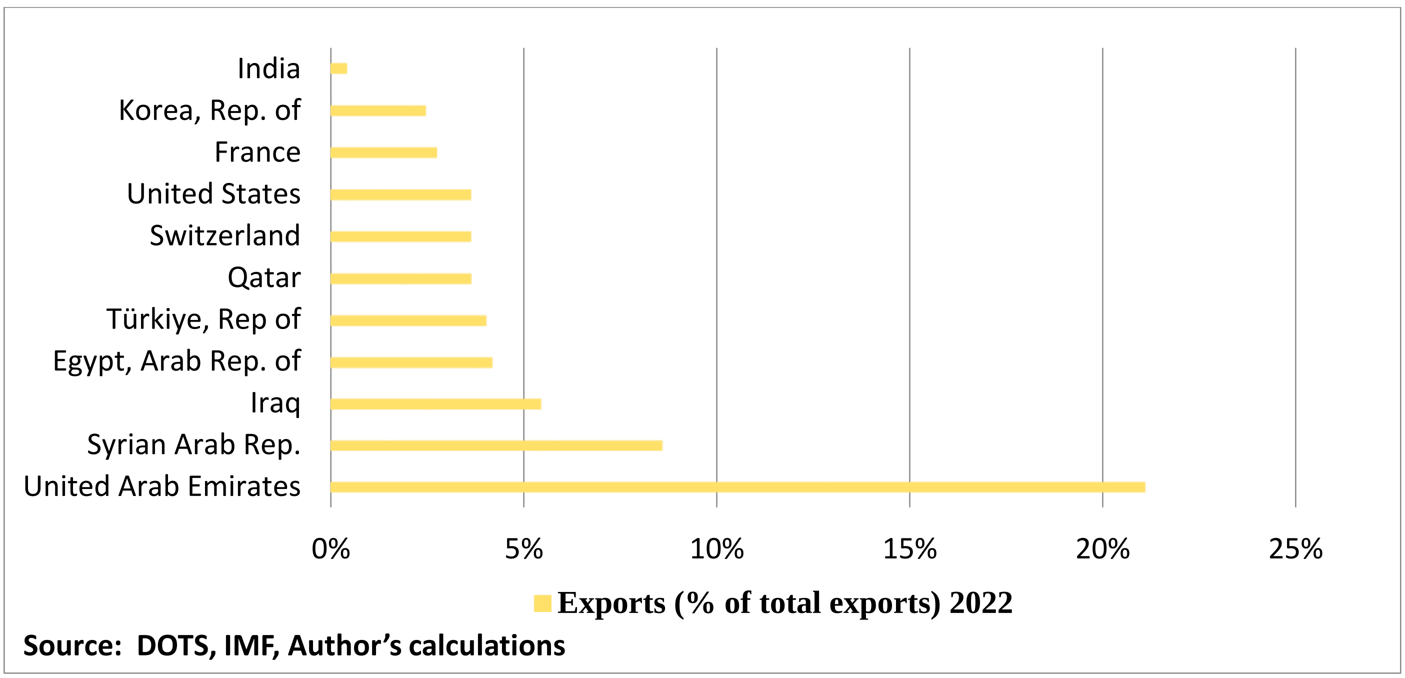


Figure 5-15: Exports from Lebanon (% of total exports) 2022

The above figure presents the top 10 destinations for Lebanon's exports, revealing a notable trend. Lebanon predominantly exports to neighboring countries such as the United Arab Emirates, the Syrian Arab Republic, Iraq, Egypt, Turkey, and Qatar. While Lebanon does engage in exports to a few other nations, including Switzerland, the United States, France, South Korea, and India, these countries do not emerge as significant trading partners for Lebanon (Figure 5-15). This is primarily due to the relatively modest absolute value of exports to these countries, despite their prominent positions as major players in international trade.

It's worth noting that despite Lebanon's location in the Middle East, a region renowned for its abundant petroleum reserves, the country does not hold a significant role as a major oil-producing nation. Political gridlock has kept the country from making the most of its reserves. (F., 2017)

The primary export commodities for the country include gold, diamonds, jewellery made from other precious metals, automobiles, and waste & scrap (cast iron. (WITS, World Bank, 2021)

This underscores that Lebanon lacks a well-established manufacturing sector and does not possess an efficient oil extraction and export industry, which are vital aspects for reducing the country's significant foreign debt burden. We will delve into this issue further in upcoming sections.

Imports

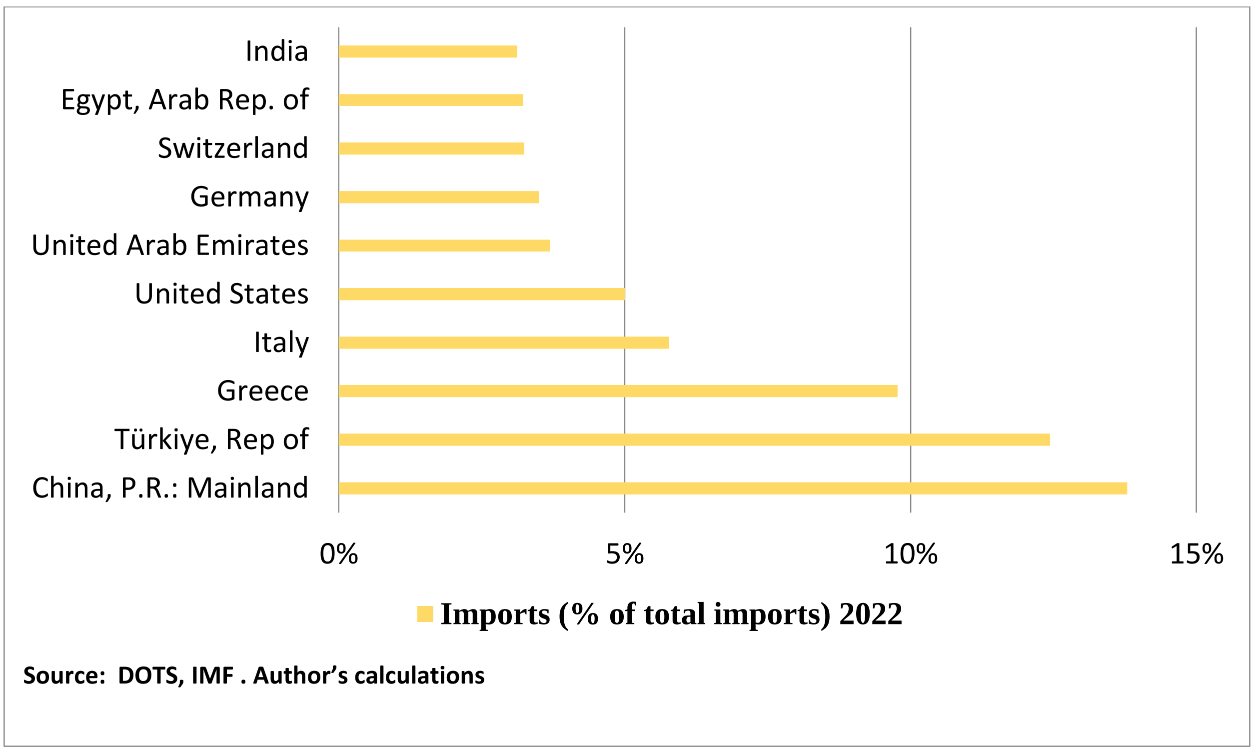


Figure 5-16: Imports to Lebanon (% of total imports) 2022

When examining Lebanon's imports, it becomes evident that China ranks as the primary source, with Turkey and Greece following closely. Additionally, Lebanon maintains substantial import relationships with countries such as Italy, the United States, the United Arab Emirates, Germany, Switzerland, Egypt, and India (Figure 5-16).

A large share of the imports is on account of Petroleum Oils, Medicaments and Gold unwrought. (WITS, World Bank, 2021)

This underscores the critical importance of Lebanon's exploration and investment in its petroleum reserves. Doing so not only has the potential to bolster its overall exports but also to reduce its import dependency, ultimately contributing to the establishment of a stable Current Account balance.

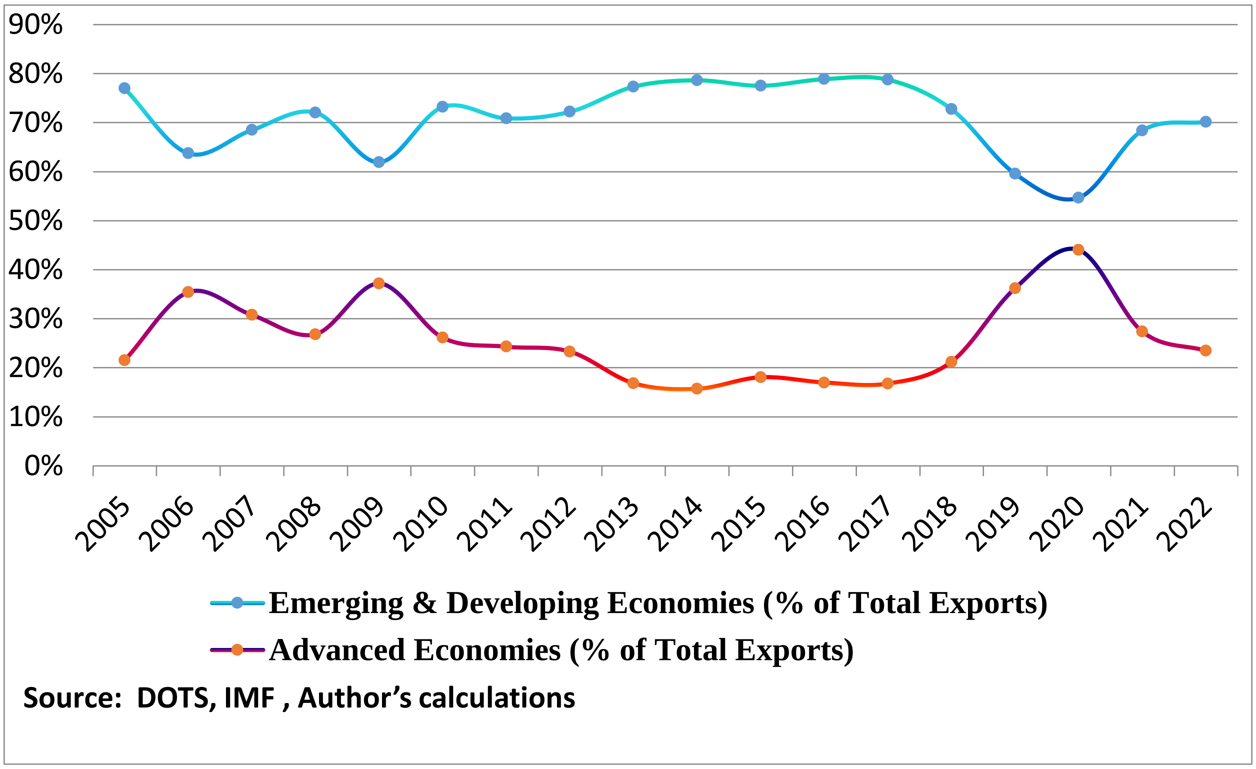


Figure 5-17: Exports from Lebanon to E&D economies and Advanced economies (% of total exports)

The primary export destinations of Lebanon have historically leaned toward emerging and developing economies (Figure 5-17). Nevertheless, the onset of the crisis in 2018 triggered a noticeable shift, characterized by declining exports to these economies and a concurrent rise in exports to advanced economies. By 2020, this transformation became so pronounced that export percentages were nearly balanced. However, the outbreak of the pandemic subsequently realigned the trend to its pre-2020 pattern.

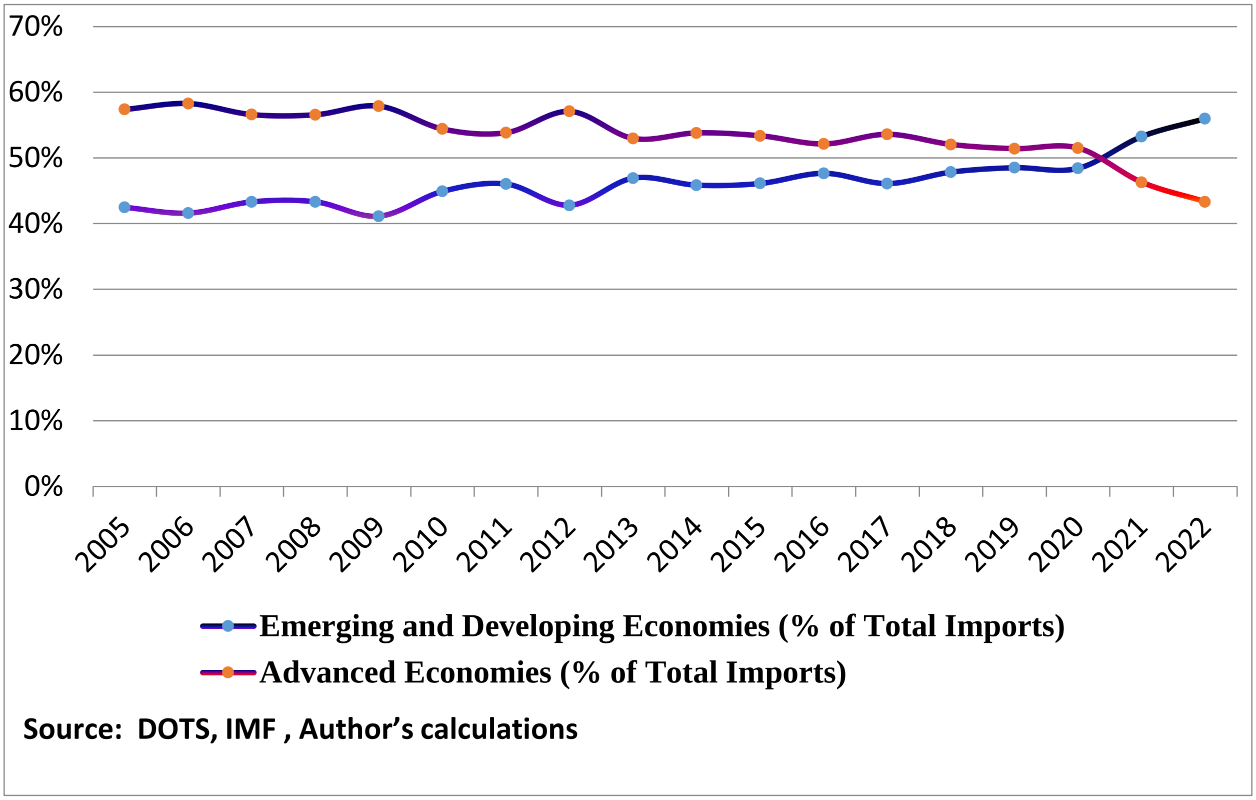


Figure 5-18: Imports to Lebanon from E&D economies and Advanced economies (% of total imports)

At the same time if we see the trend of imports in a similar fashion, 2020 was actually a turning point here. As earlier throughout the time frame, Imports from advanced economies were always more than from emerging and developing economies, but since 2020, imports from emerging and developing economies are increasing and imports from advanced economies are all time low (Figure 5-18). This indicates towards emerging global order in international trade post pandemic where the significance of emerging and the developing world has increased.

Debt situation of the country

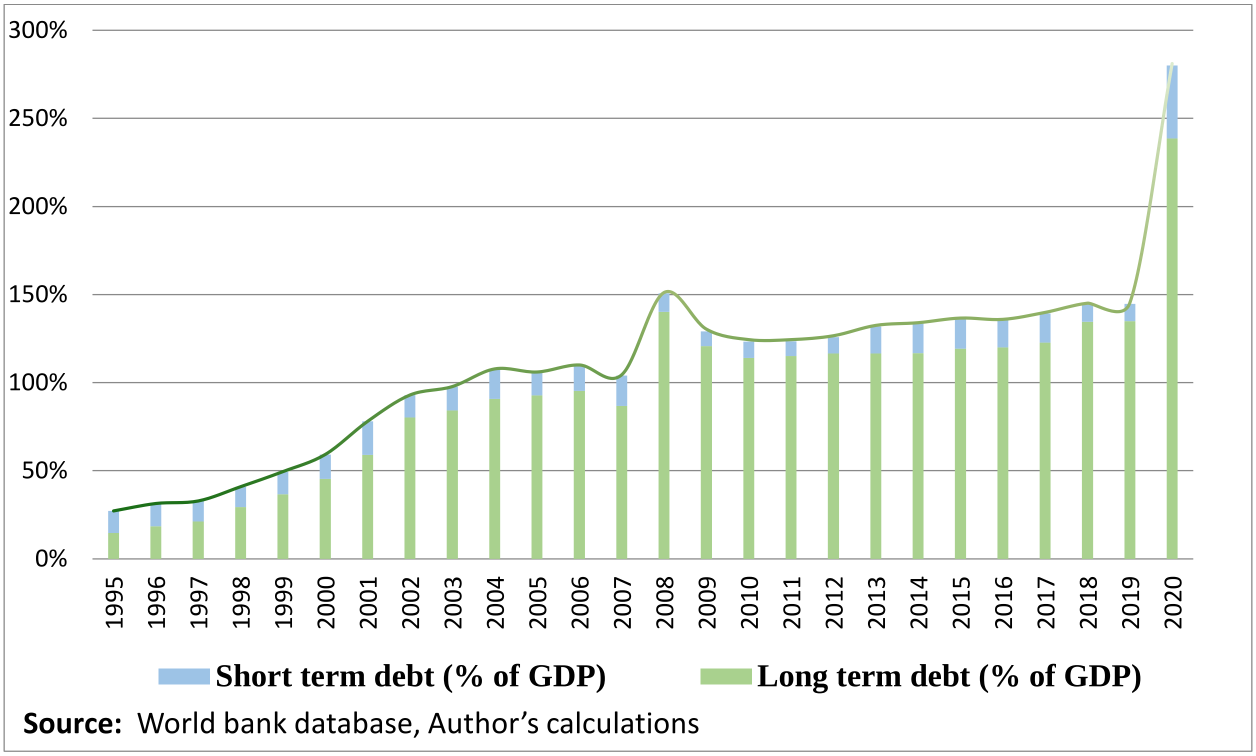


Figure 5-19: Short term and long term debt (% of GDP) of Lebanon

The data illustrates the country's trajectory of accumulating foreign debt over time. Beginning in 1995, when it constituted a mere 27% of the GDP, this debt steadily surged, reaching 108% in 2004. There were slight downturns in 2005 and 2007, followed by a significant spike in 2008. Subsequently, although there were occasional declines, the trend started a minimal but persistent upward climb from 2011 to 2019, with foreign debt already accounting for approximately 145% of the GDP by then. However, the most striking development occurred in 2020 when the total debt nearly doubled in just one year, soaring to a staggering 281% of the GDP (Figure 5-19).

Another noteworthy observation pertains to the composition of this debt. In 1995, the ratio of short-term debt to long-term debt in relation to the total debt as a percentage of GDP stood at 4:5. However, since that time, the proportion of short-term debt within the total debt has witnessed a dramatic decrease, registering at a mere 2:27 in 2019.

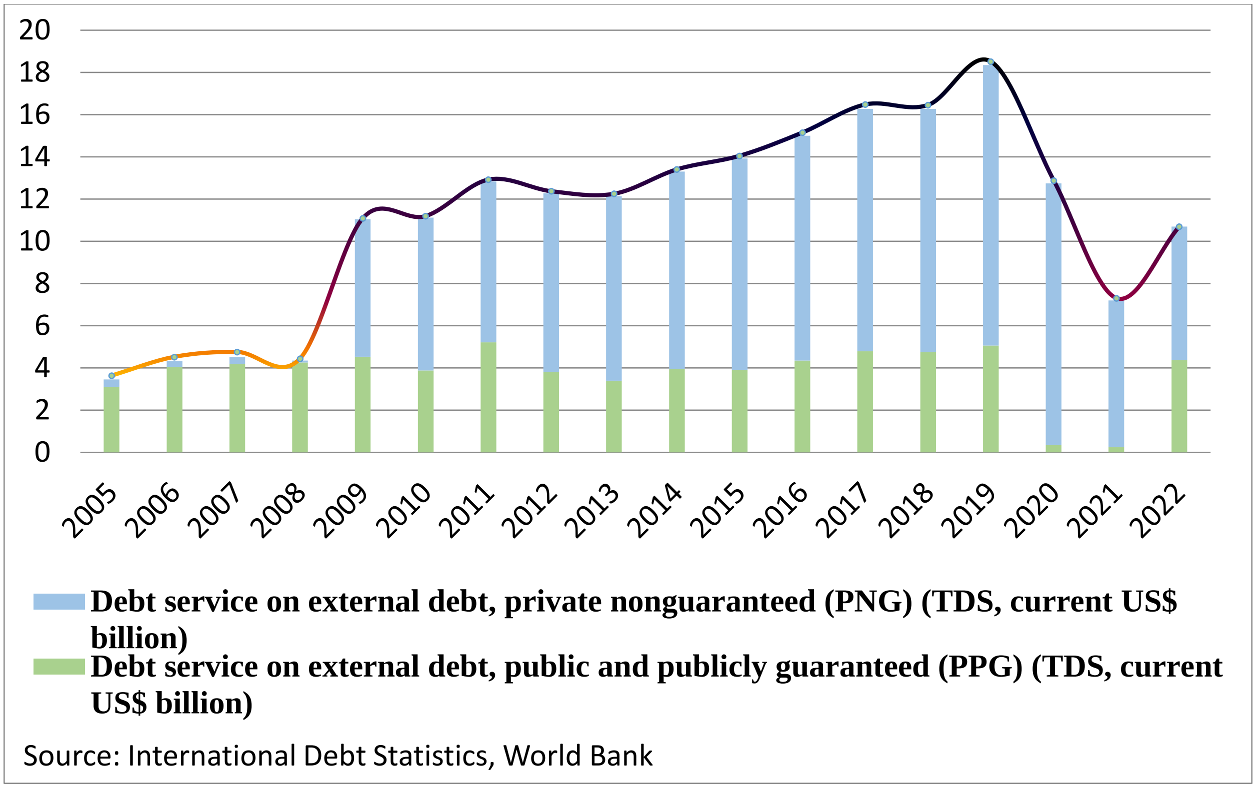
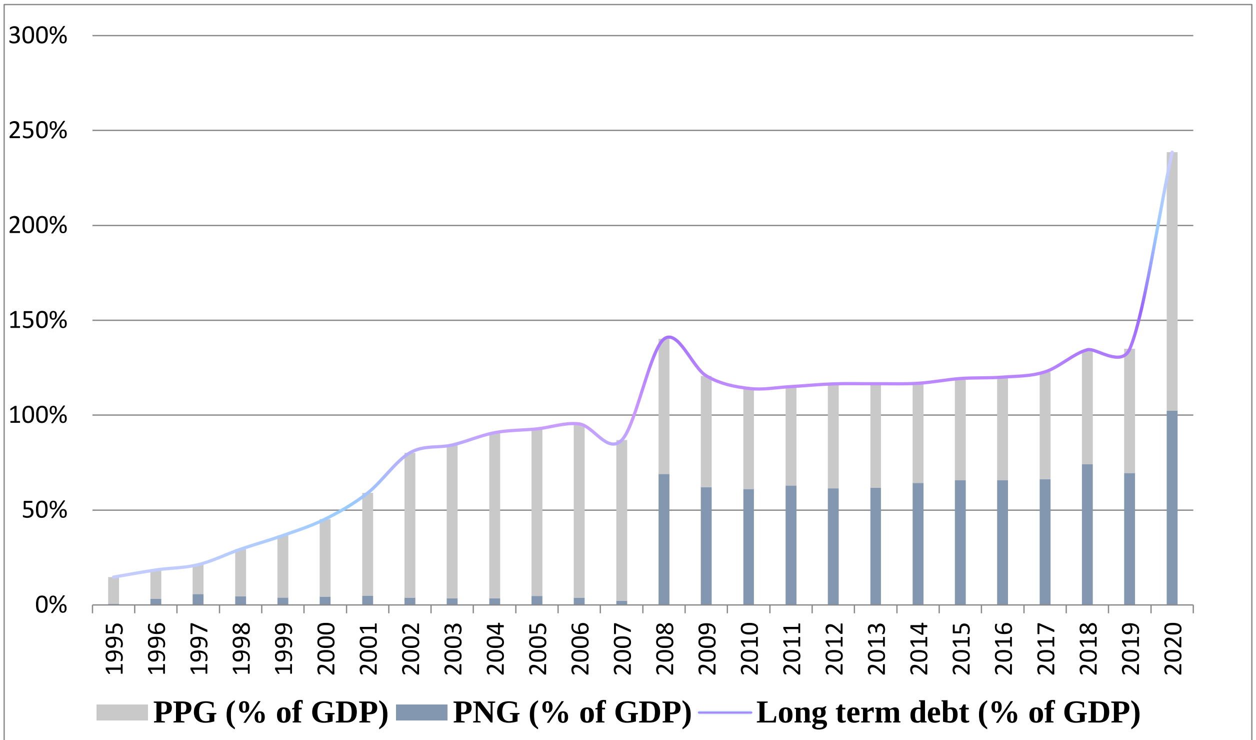


Figure 5-20: Debt service on external debt- PNG & PPG (U.S.D. billion)

As depicted in this chart, PNG debt service on external debt has experienced a remarkable escalation since 2008. However, a particularly notable trend emerges in the period following 2019. In 2019, the debt service on external debt for public and publicly guaranteed (PPG) entities reached an astonishing figure of approximately US$ 5 billion (Figure 5-20). Subsequently, this metric *dropped to almost zero and then rebounded in 2022.*



Source: World bank database, Author's calculations

Figure 5-21: Long term debt- PPG & PNG (as % of GDP) of Lebanon

The figure also underscores a noticeable trend in the realm of debt composition (Figure 5-21). Private non-guaranteed debt experienced a substantial surge in 2008 and has since consistently constituted a significant portion of the overall debt profile. Notably, by 2020, both public and publicly guaranteed (PPG) debt and Private Non Guaranteed (PNG) debt emerged as substantial *components, making up a considerable percentage of the total debt.*

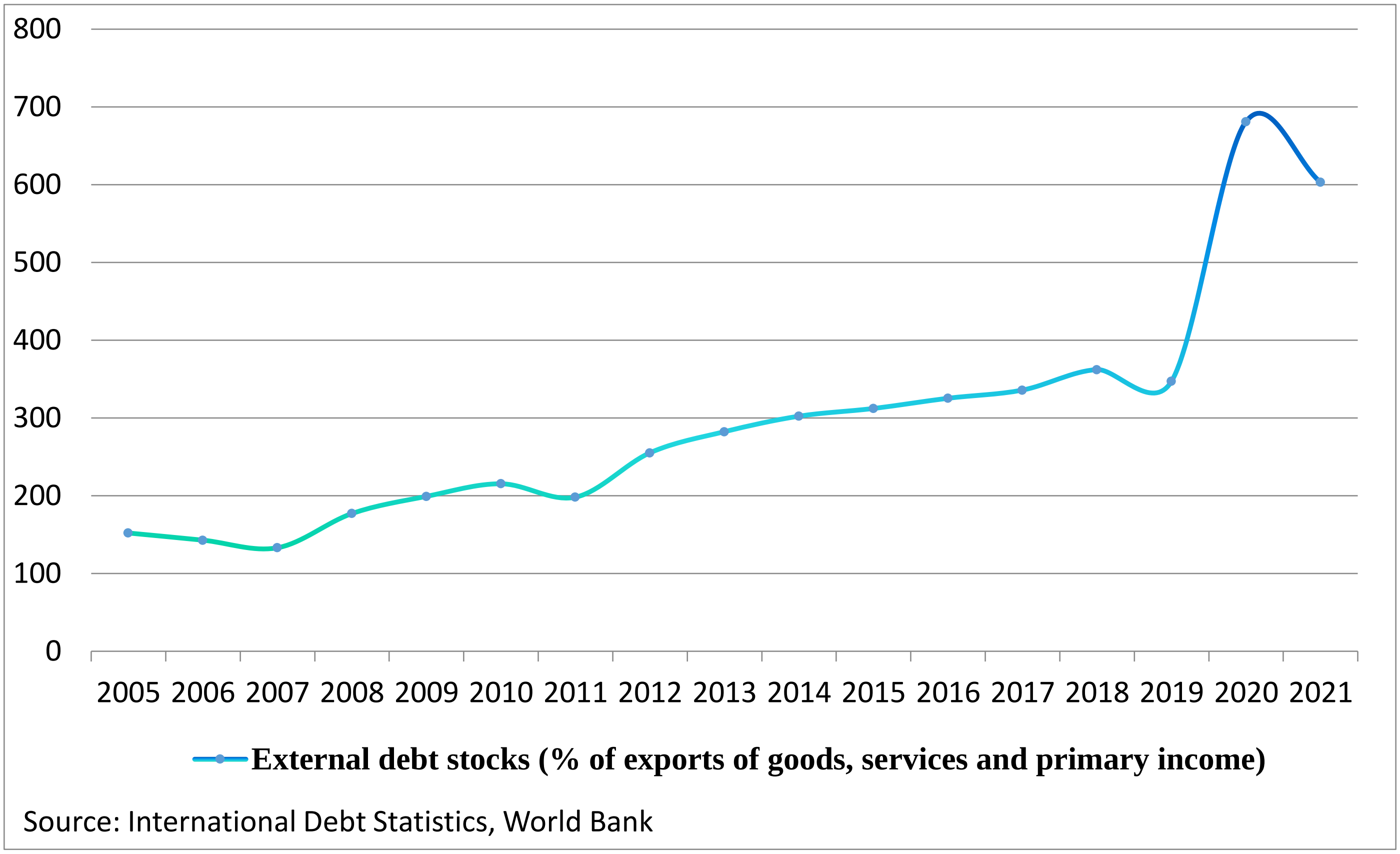


Figure 5-22: External debt stocks (% of exports of goods, services and primary income) of Lebanon

Examining the ratio of external debt stocks to the combined value of goods, services, and primary income exports reveals an important trend. This ratio stood at a noteworthy level, even in 2005, amounting to 152%. Although there were slight dips in 2006-07, 2011, and 2019, the trend primarily exhibited significant growth, culminating in approximately 362% in 2018 (Figure 5-22). The most substantial leap occurred from 2019 to 2020, primarily attributed to disruptions in international trade stemming from the COVID-19 pandemic, resulting in an astonishing figure of

681% in 2020.

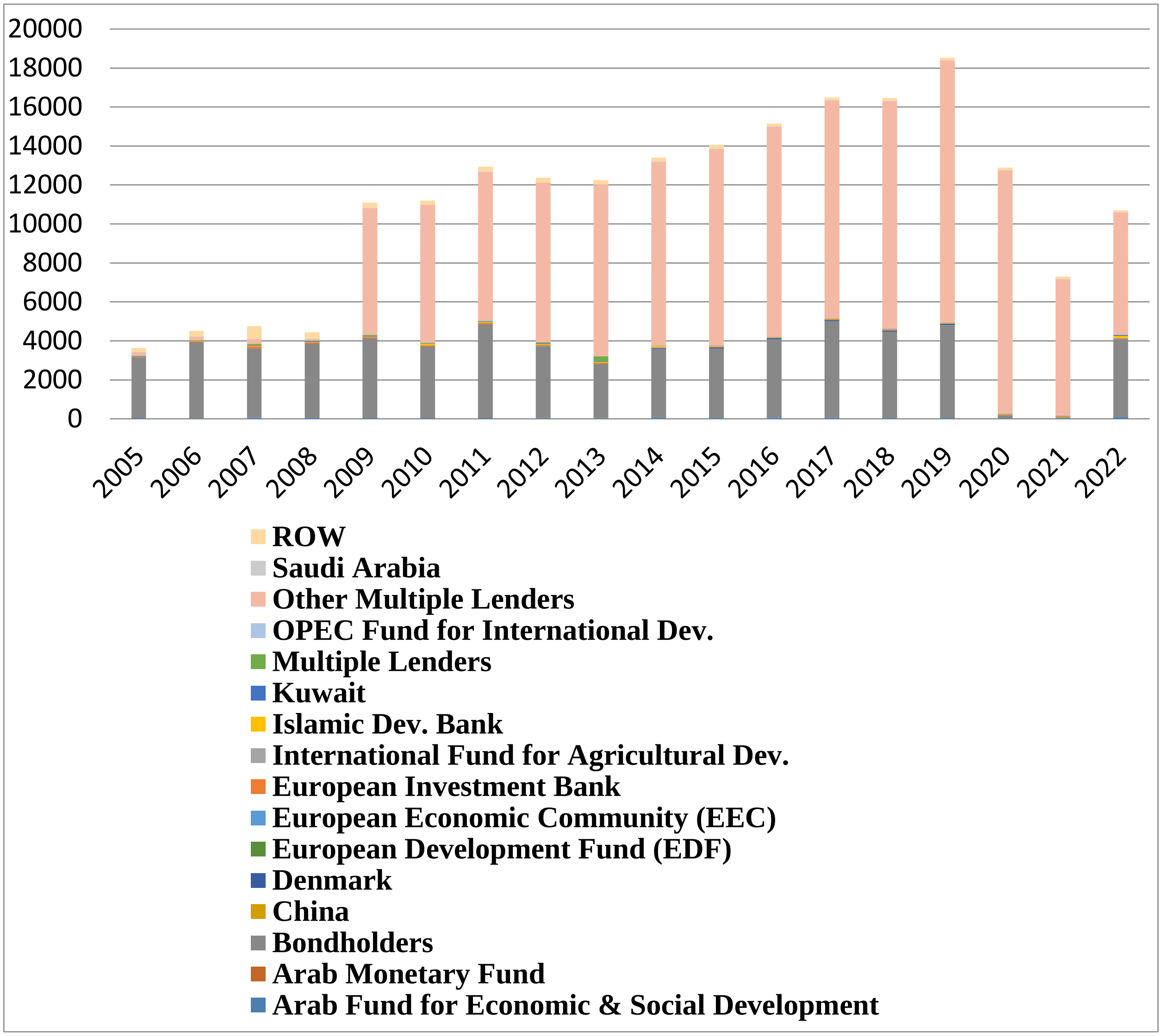


Figure 5-23: Debt service on external debt, total (TDS, current US$ million) of Lebanon

This data reveals a distinctive pattern in comparison to other countries with similar circumstances. Paris Club members have played a minimal role in shaping the country's overall debt dynamics. Prior to 2008, bondholders constituted a substantial portion of the nation's overall debt service (Figure 5-23). However, since that time, various other lenders have assumed a significant role and continue to do so.

As a result, when considering debt restructuring measures, they typically pertain mainly to the debt owed to other countries. Therefore, in unique cases such as Lebanon's, these conventional debt restructuring approaches may not yield the desired outcomes.

Chapter 6

Pakistan

Abstract

This paper discusses the ongoing debt crisis in Pakistan. Key contributing factors to this crisis include depleting foreign exchange reserves, elevated levels of inflation and unemployment, growing debt-related distress, a declining value of the Pakistani Rupee, escalating external debt, a lack of financial discipline, reduced foreign investment, and a balance of payments (BOP) crisis. Despite austerity measures, appeals for loan rollover to debt restructuring, and negotiations with the IMF for Extended Fund Facility, Pakistan's political instability still remains a major deterrent to prudent utilization of funds. The burden of unsustainable external debt severely compromises the economic prosperity and progress of any developing country. Pakistan's external debt has increased because of misuse of loans, and frequent changes in the government have caused further debt burden.

Introduction

Pakistan is undergoing an economic breakdown; the country has experienced serious debt problems which have led to worsening in macroeconomic indicators like economic growth and investment which ultimately led to high incidence of poverty. The country is walking a financial, economic, and political tight rope (Javed, 2023). The devastating floods in 2022, impact of the COVID-19 pandemic, security issues, and adverse external shocks continue to pose major economic challenges to Pakistan.

Pakistan's economy was no exception to the disastrous disruptions brought about by the COVID-19 pandemic. The global health emergency affected all nations; however, Pakistan's economy did not have the capacity to absorb the massive disruptions caused by the pandemic. Pakistan has had a history of increasing reliance on West-led global financial institutions. During the global pandemic these financial institutions did not have adequate resources to bail out countries like Pakistan, thus leading to further deterioration of economic circumstances.

Pakistan's already crippling economy, is also facing the brunt of climate change. In 2022 rain submerged large parts of the country, affecting roughly 33 million people. Roughly 70% of the onion harvest, along with rice and corn, had been destroyed. Food prices are already under pressure because of the post-pandemic supply chain disruption and the war in Ukraine, which is a major global supplier of key crops. High levels of inflation, in terms of average consumer prices has been recorded between 2007 and 2009. Since January 2022, the price of a kilo of chicken has doubled, onions are up by an eye-watering six times and eggs and wheat by over half. Price increases in everyday essentials directly impact low-income households the most, whose biggest share of everyday expenses is on food and transport. Poor households are helplessly witnessing a massive decline in their spending power, with bleak prospects of any recovery (Javed, 2023).

Pakistan made significant progress towards reducing poverty between 2001 and 2018 when the expansion of off-farm economic opportunities and increased inflow of remittances allowed over 47 million Pakistanis to rise out of poverty. However, this rapid poverty reduction has not fully translated into improved socio-economic conditions, as human capital outcomes have remained poor and stagnant, with high levels of stunting at 38 percent and learning poverty at 75 percent (World Bank: Overview of Pakistan).

According to World Bank, Growth in Pakistan—which is still reeling from the impacts of the 2022 catastrophic floods and facing supply chain disruptions, deteriorating investor confidence, and higher borrowing and input costs—is projected to drop to 0.4 percent in 2023.

Stable trend in GDP was observed in 2000s primarily driven by agricultural and manufacturing sectors. The GDP of Pakistan was 4641.31 billion Pakistani Rupee in 2000 and increased to 7884.63 billion Pakistani Rupee in 2005. Inflation remained moderate at 4% in 2003 due to stable food prices. Inflation picked up in 2005 due to rising global commodity prices and energy cost. It reached double digit levels at 12% in 2008 and 20% in 2009. Pakistan GDP growth rate for 2021 was 6.49%, a 7.76% increase from 2020 (Figure 6-0-1).

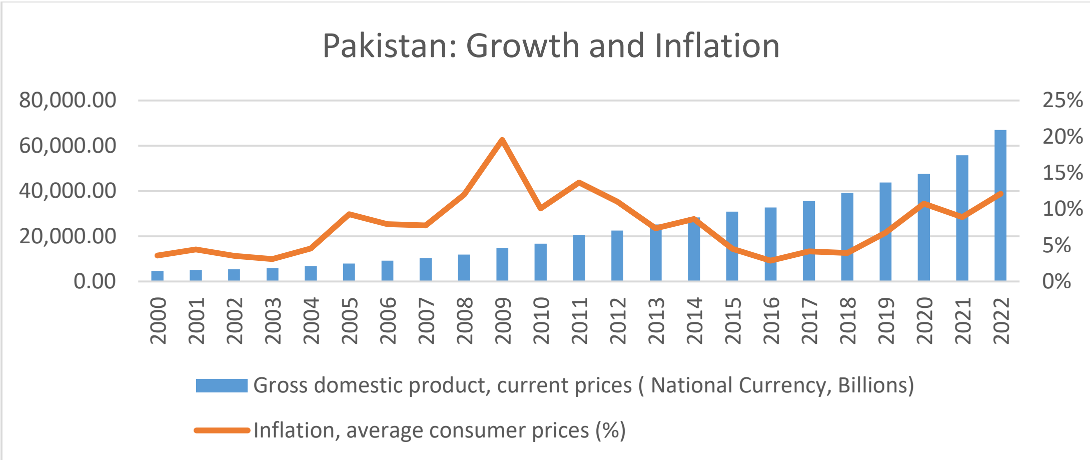


Figure 6-0-1: GDP and Inflation in Pakistan

In Pakistan, both the public debt and the budget deficit are increasing compared with the GDP. The country has been facing economic mismanagement over the last few decades. Reducing public debt is a major challenge for macroeconomic stability and sustainable economic growth. To put this into context, the total public debt to revenue amounted to 667.4% of the GDP in 2020 from 479.2% in 2011 (Pakistan Ministry of Finance 2020). Therefore, it is pertinent to examine the sustainability of public debt (Wajid & Junaid, 2023).

Debt Situation of Pakistan

The economy of Pakistan is officially reported as having a debt-to-GDP ratio of 78.0%, indicating Pakistan's debt level at USD 271 Billion. The continuous fall in Pakistani Rupee against US dollar has contributed to its external debt crisis. Low ranking by international rating agencies and grey listing of Pakistani Action Task Force (FATF) have deterred foreign investors. The vicious cycle of seeking fresh loans and repaying old ones has led Pakistan to a troublesome 'debt trap'.

Historical Overview of Pakistan Debt

In 1970's Pakistan started investing heavily in development projects and ever since then it has seen a significant rise in debt levels. In 1990 the poor economic management and political instability in Pakistan forced the government to increase its borrowings. This was accompanied by consistent budget and balance of payments deficits, which in turn narrowed the range of fiscal options available to economic policymakers. Since a large portion of government revenues was used to service debts, little room was left to undertake development activities in the public sector.

(Nawaz, 2015) Additionally global factors such as rising oil prices and increasing dollar prices further weakened the economic position of Pakistan. In 1998 Nuclear Testing imposed international sanctions on the country that led to massive decline in foreign investment, further increasing external debt of the country. Total External debt stocks of Pakistan increased from USD 20.66 Billion in 1990 to USD 34.19 Billion in 1999 and further to USD 42.31 Billion by 2007. In 2019, Pakistan's debt touched record levels at USD 107.88 Billion and has been increasing since then. (Figure 6-0-2)

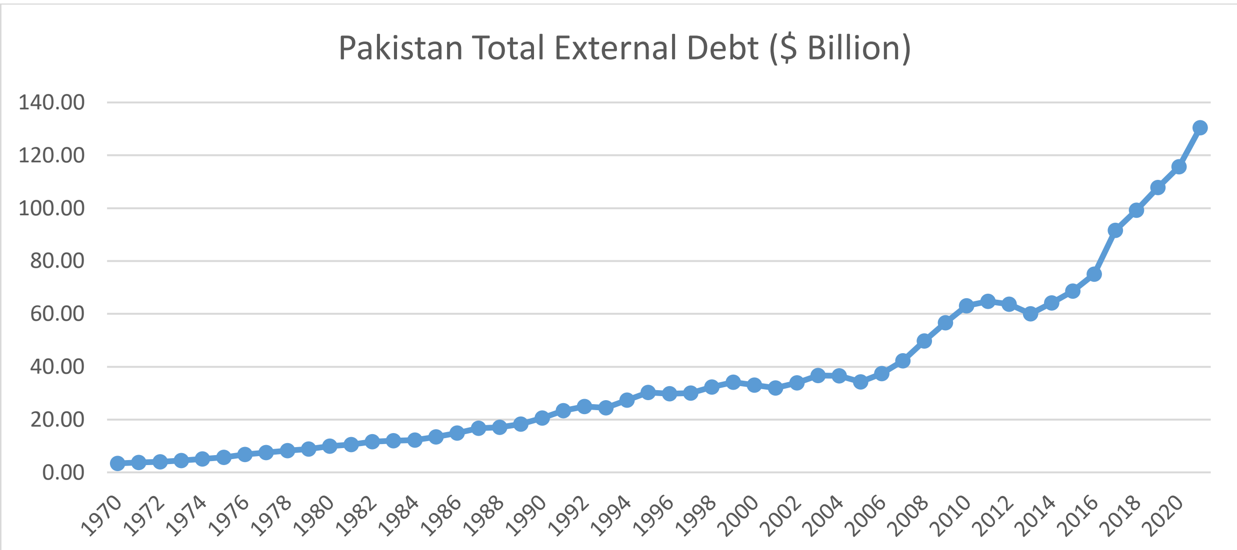


Figure 6-0-2: Total External Debt of Pakistan

Pakistan Unsustainable Debt

Pakistan's crippling economy is sitting on a large pile of debt taken from international organisations and countries like China and Saudi Arabia. Adding to the political conflict between changing governments and surging terrorism, the country is facing a risk of default due to massive debt obligations. Pakistan's association with the major all-weather allies- Saudi Arabia and China date back decades ago. Pakistan and Saudi Arabia have had a very close relationship, particularly based on religious affinity. Both countries are members of Organisation of Islamic Cooperation (OIC). Huge volumes of aid for promoting religious activities and supporting humanitarian causes have always flown from Saudi Arabia to Pakistan. (Yi, 2019). China has developmental and trading interests in Pakistan. The two also signed bilateral trade agreements aimed at speeding up industrialisation in Pakistan.

Pakistan external debt for 2021 was $130 Billion, a 12.74% increase from 2020 and external debt for 2019 was USD 107 Billion, an 8.73% increase from 2018. During the pandemic years in 2019, external debt stocks were 34% of GNI and in 2020 increased to 38% of GNI. In 2022 Pakistan's Total External Debt stood at USD 126.3 Billion i.e., a massive 33% of its GNI (Figure 6-0-3). Pakistan's debt-GDP ratio has been increasing since 2007-2008 at skyrocketing from 2015 onwards. The debt-GDP ratio presently stands at 78 percent. As such, periods of relatively high growth rates in Pakistan have been associated with better fiscal management and lower debt-GDP ratios (IMF, 2023).

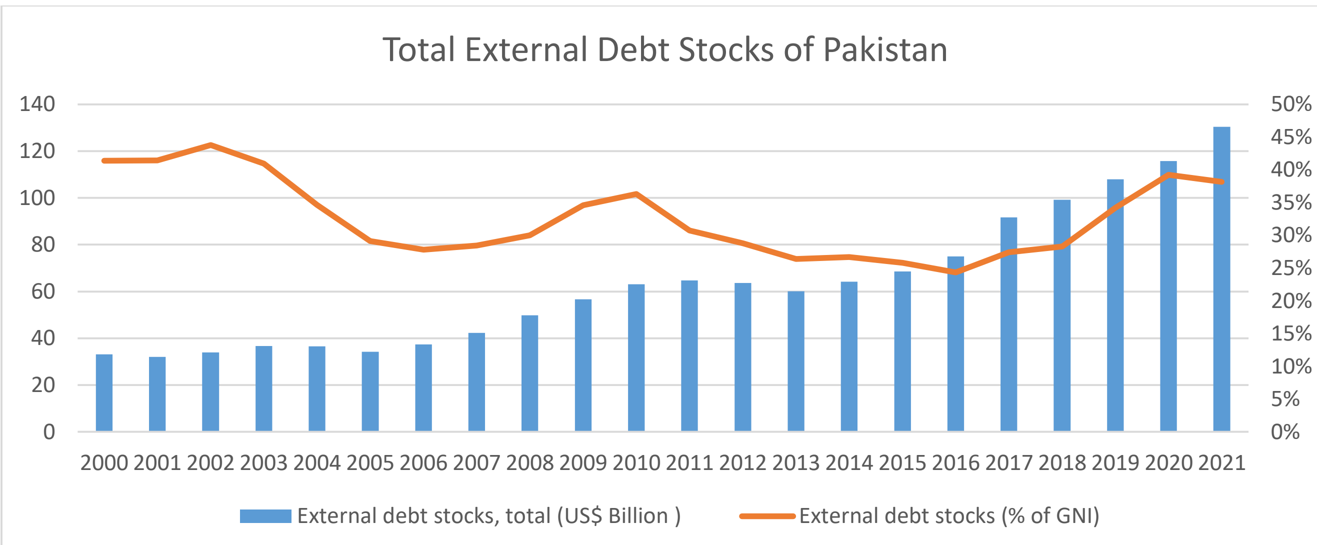


Figure 6-0-3: External Debt Stocks and External Debt Stocks as Percentage of GNI

Pakistan's debt can be dissected into four broad categories: multilateral debt, Paris Club debt, private and commercial loans, and Chinese debt.

Multilateral Creditors- Financial institutions such as Asian Development Bank, World Bank and the International Monetary Fund constitute 90 percent of the total multilateral debt, while the rest is owed to Islamic Development Bank and the Asian Infrastructure Investment Bank. The terms of most loans are largely concessional with a repayment timeline spanning 18 to 30 years.

Paris Club- Pakistan owes USD 8.5 billion to the Paris Club, a group of 22 major-creditor countries. This debt is scheduled to be repaid over 40 years with less than 1% interest rate, and is mostly owed to Japan, Germany, France and the United States.

Private Debt and Commercial loans- Private bonds, such as Eurobonds and global Sukuk bonds. Much of Pakistan's commercial loan stock is owed to Chinese financial institutions. Most commercial loans have to be repaid to the lenders between one to three years with high interest rates. Chinese commercial loans, are pegged against the Shanghai Interbank Offered Rate (SHIBOR).

Chinese Bilateral Debt- Pakistan holds around USD 27 billion of Chinese debt. This includes bilateral debt and debt provided by the Chinese government to Pakistani public sector enterprises, and Chinese commercial loans of around USD 7 billion.

By analysis of overall debt indicators, even though total external debt of Pakistan has increased over the years, Multilateral debt as a percentage of total external debt has decreased. Multilateral debt was highest in 2007, 47% of total external debt, decreasing to 42% in 2009 and further decreasing to 27% in 2021 (Figure 6-0-4). This suggests a shift in structural composition of external debt over the years with a decreasing reliance on multilateral institutions.

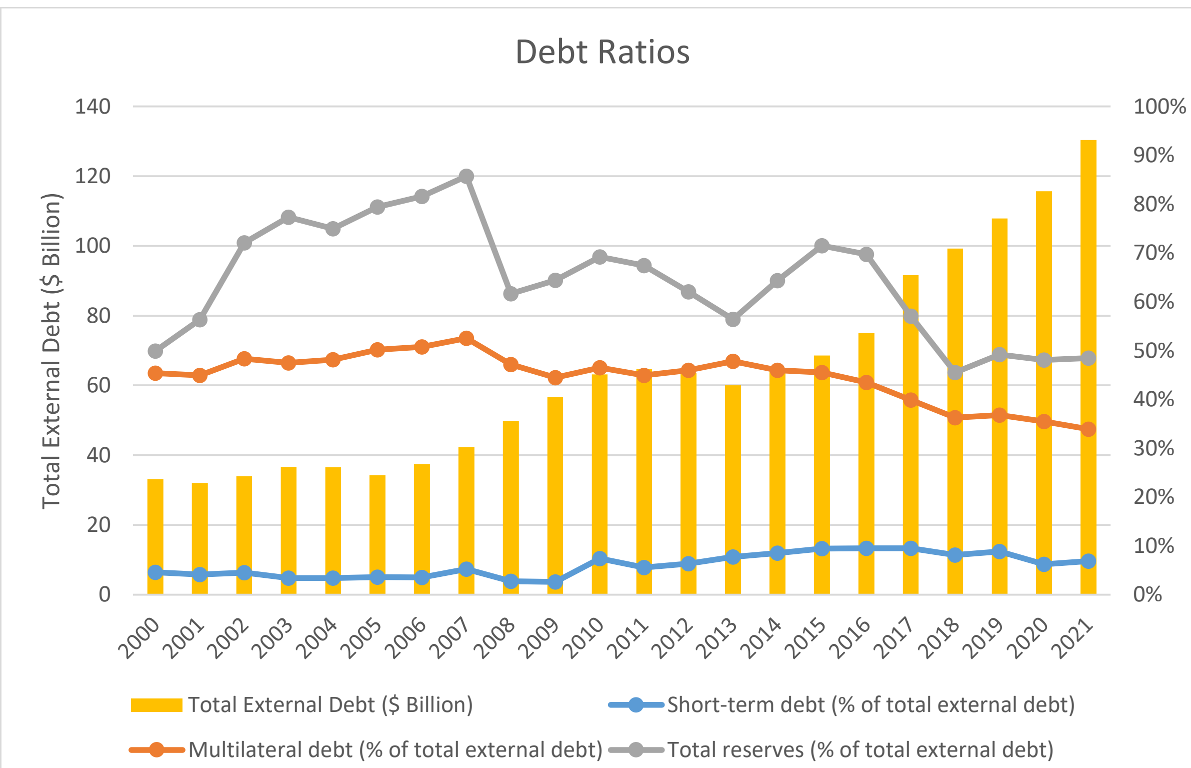


Figure 6-0-4: Debt Ratios of Pakistan

Long Term and Short-Term Debt

Pakistan’s large external debt comes with considerable repayment pressure. From April 2023 to June 2026, Pakistan needs to repay USD 77.5 billion in external debt. The major repayments in the next three years are to Chinese financial institutions, private creditors and Saudi Arabia. Long term debt as percentage of external debt stocks has generally been high in Pakistan. Since 2010, (Figure 6-0-5) short term debt as percentage of total external debt has been increasing, adding pressure to the already existing debt obligations. In 2010 short term debt accounted for almost 7% of the total external debt, it further increased to 10% of total external debt in 2017.

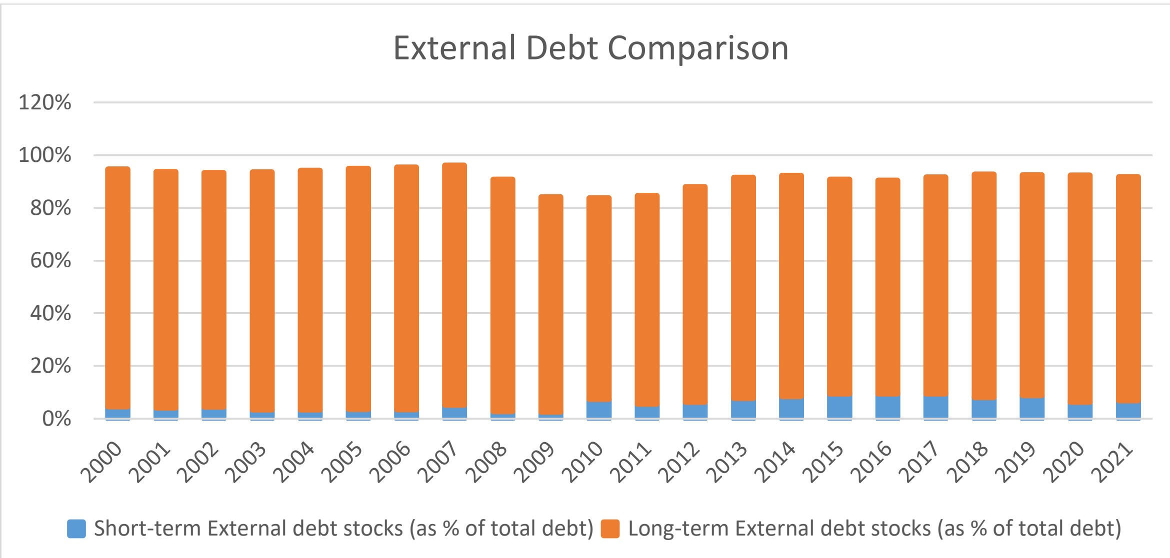


Figure 6-0-5: External Debt Comparison for Pakistan

Pakistan has historically relied heavily on long-term external borrowing to finance its development projects and infrastructure needs. Long-term external debt has consistently accounted for a substantial portion of the country's total external debt, as of 2022, long term debt was 85% of total external debt stocks. (Figure 6-0-5)

Pakistan's DSR has been on an upward trend in recent years. This increase is primarily due to the accumulation of external debt and rising debt servicing costs. Pakistan has borrowed extensively to finance its budget deficits and infrastructure projects. One such failed infrastructural project that added to the debt burden of Pakistan was the construction of the China Pakistan Economic Corridor (CPEC) under the umbrella of the Belt and Road (BRI) initiative.

BRI- Failed Promise

In 2015, it was envisaged that the China-Pakistan Economic Corridor (CPEC) would be a revolutionary project that could make the country a leading power in South Asia. The $46 billion China-Pakistan Economic Corridor (CPEC), the Belt and Road Initiative's (BRI) flagship project was its most ambitious undertaking in any single country. However, what started as a well-meaning endeavour to mitigate the turbulent foreign relations between the two nations became perhaps one of the most significant reasons for Pakistan's ongoing crisis.

In the past, before CPEC, Pakistan had seen China-driven infrastructural projects but the BRI was seen as a beacon of hope for the country's feeble public infrastructure sector. The ambitious investment of USD 46 billion, rapidly ballooned to USD 62 billion and started a new pathway for Pakistan's chronically weak power and transportation industries that have a reputation for being saddled with deficits, largely caused by ill-advised subsidies from the government.

Pakistan's power shortages—a result of high energy tariffs charged by Independent Power Producers (IPPs), the neglect of power plants, crumbling transmission lines, nothing of which was helped by decades of the government's populist agendas, have had a massive economic fallout. For over three decades, the people had been plagued with incessant electricity outages that would last 10 hours a day in the big cities, and about 22 hours a day in rural regions.

In 2018, in Pakistan, familiar structural problems kicked in, with the public debt soaring up to Rs. 30 trillion (from Rs. 6.8 trillion a mere ten years before). As the forex depletion and yawning trade deficit became very pronounced, debt sustainability became an important issue, with some accusing CPEC directly responsible for the Debt Burden as if Pakistan was a fit case of Debt Diplomacy of China (Chellaney, 2017).

This is true that for the first time in Pakistan, the debt servicing requirement was more than the federal government's share of the anticipated revenues in the 2019-20 budget and all other expenditure of the government - be it Public Sector Development Expenditure or Subsidies or Government Administration expenditure - had to be financed by the fresh debt. (Hurley, J. et al 2019)

Most CPEC funds, however, have gone to building new coal-fired power plants to help Pakistan overcome its crippling power shortages. Other prominent projects included a USD 7 billion upgrade to the railway from Peshawar to Karachi, two hydroelectric power plants in the disputed Kashmir region, a metro system in Lahore, the establishment of multiple special economic zones (SEZs), and Huawei fibre-optic cables running from China to Pakistan.

Pakistan’s participation in the CPEC has led to unrealistic projects that rely heavily on foreign loans. This has contributed to the country’s growing economic difficulties since it continues to rely on external borrowings without addressing the current economic issues. Pakistan needs to scrutinise the inflow of Chinese funds more closely before committing to further repayment obligations that may prove difficult to fulfil.

Managing the composition of external debt, including the balance between long-term and short-term debt, is essential for Pakistan's financial stability, as it affects debt servicing obligations and liquidity management. The gradually increasing debt service ratio indicate potential negative implications for the country’s financial stability.

In 2003 Pakistan had high a debt service ratio of 26%, indicating that Pakistan was using a substantial portion of its export earnings or government revenue to service its debt obligations in 2003. This ratio includes both principal and interest payments on external debt. A high percentage indicates a significant debt burden. From 2004-2009 the ratio has generally remained stable between 9%-12%. In 2017-18 during the construction of the CPEC total debt service increased to 38% which prompted to macro-economic instability experienced by Pakistan in the same year. In 2020 the debt service obligations continued to be high at 34%, deterring foreign investment, further increasing debt obligations of the government and reducing credit worthiness in the international financial markets (Figure 6-0-6).

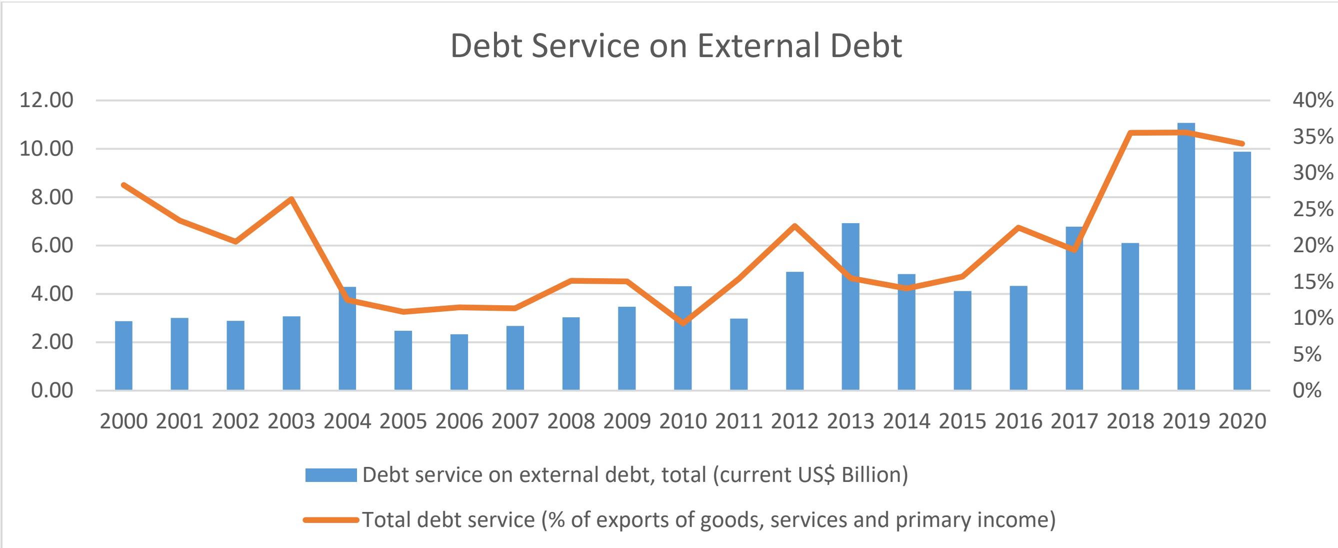


Figure 6-0-6: Debt Service on External Debt for Pakistan

Public and Publicly Guaranteed Debt (PPG)

High levels of PPG debt can result in a substantial debt service burden, as the government is obligated to make interest and principal payments on the debt. Figure 3-5; Starting from early 2000s there is a noticeable acceleration in PPG due to increased borrowings especially from international financial institutions during this period. Public and Publicly Guaranteed Debt doubled from USD 27.28 Billion in 2000 to USD 42.88 Billion in 2010. In 2017, PPG crossed the USD 50 Billion mark and accounted or 73% of the total external debt. In 2021 PPG stands at USD 94.6 Billion due to a combination of factors such as impact of COVID-19 pandemic and ongoing infrastructural projects that have increased Pakistan's public debt (Figure 6-0-7).

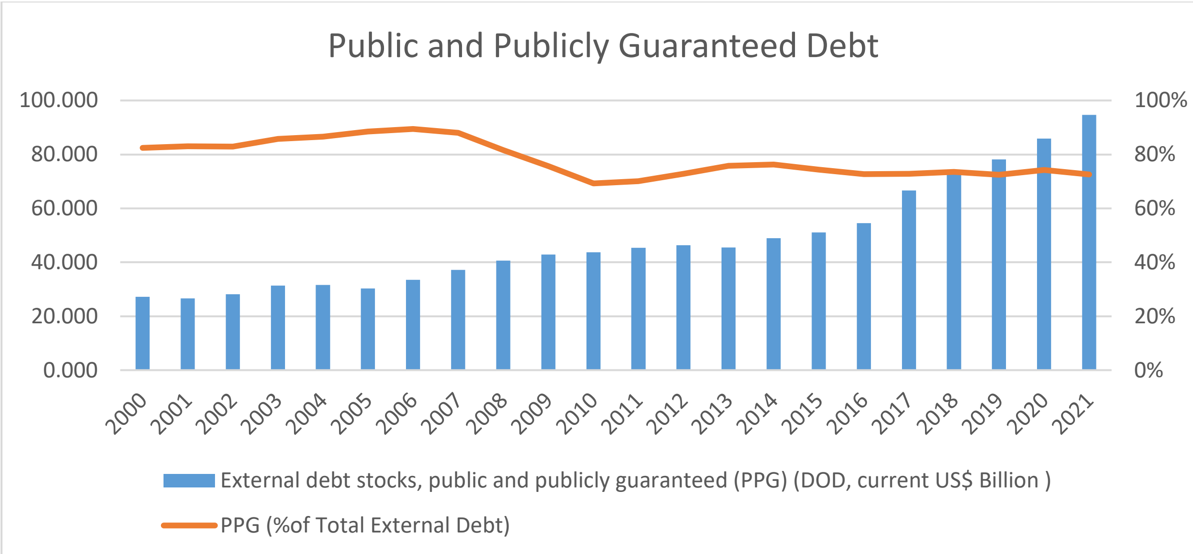


Figure 6-0-7: Public and Publicly Guaranteed Debt

Private Non-Guaranteed Debt (PNG)

Private Non-Guaranteed Debt plays a crucial role in financing private sector activities in Pakistan. In 2000, PNG stood at USD 2.56 Billion and was 7.73% of total external debt. The percentage continued to decrease and became almost 2% of external debt in 2006 indicated government largely resorted to Public and Publicly guaranteed debt in this year. However, in 2008 there was massive increase in PNG at USD 3.18 Billion 6.93% of total external debt. Significant economic challenges including political instability and external shocks caused PNG fluctuations till 2010. Since 2017 there has been a growing trend in PNG reaching USD 15 Billion in 2021 almost 12% of total external debt (Figure 6-0-8).

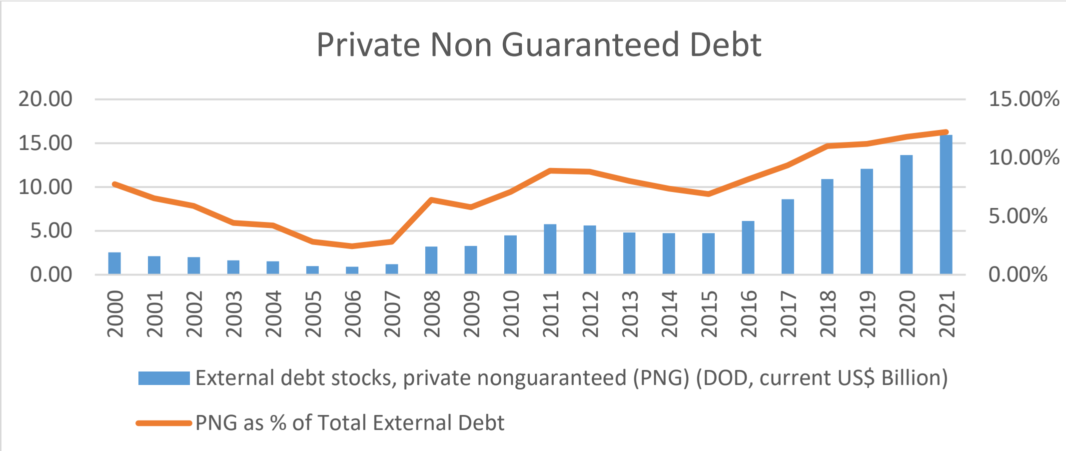


Figure 6-0-8: Private Non-Guaranteed Debt of Pakistan

Composition of Creditors to Pakistan

In 2001 Pakistan owed China a miniscule USD 0.09 Billion in debt compared to USD 27.3 Billion In 2021. The proportion of debt owed to China has increased significantly from 2013 indicating deepening of financial ties between the two countries. The increased debt is largely a result of the CPEC projects and loans provided to restore the energy crisis in Pakistan.

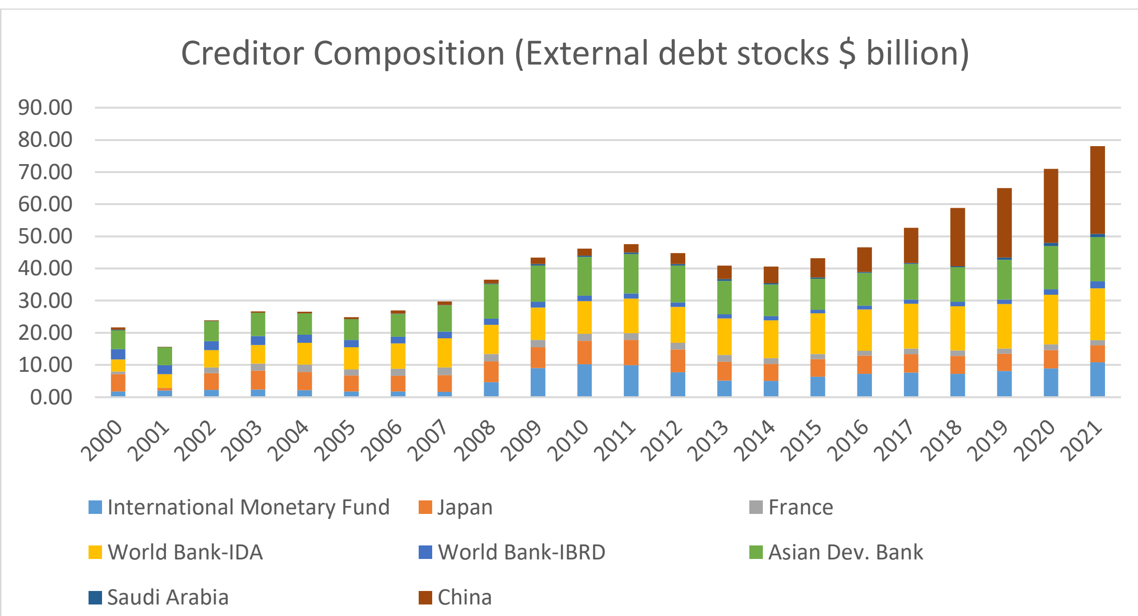


Figure 6-0-9: Composition of Creditors to Pakistan 2000-2021

IMF has also emerged as a prominent creditor to often rescue Pakistan from its debt distress, Pakistan's tumultuous relationship with the International Monetary Fund (IMF) can be described as a series of unfortunate mistakes that have had increasingly damaging consequences (Figure 6-0-9).

Over the span of 60 years, Pakistan has approached the IMF a staggering 22 times, earning it a dubious distinction. (Bhowmick, 2023). Since 2009 Pakistan has entered into multiple IMF financial assistance programs over the years. These programs typically involve providing loans or credit lines to Pakistan to help stabilize its economy and address balance of payments issues.

Balance of Payment (BOP) Situation

Pakistan has had a history of chronic negative current account balances. The negative balance indicates that the country is spending more on imports, income payments, and transfers than it is earning from exports and income receipts. This is gradually depleting its already fragile foreign exchange reserves.

In 2001 the current account balance moved in surplus despite a worsening of the balance of trade in goods. The main reason for the improvement in the figure is a transfer of money by overseas Pakistani worker's remittances. Pakistan's current account balance is highly dependent on the volume of workers remittances. A large and persistent amount of workers remittances always supports huge payments. From 2000-2003, Pakistan experienced consistent surpluses in its Current Account during these years, indicating a healthy balance of trade. In 2004, the Current Account balance turned negative, indicating that Pakistan started importing more goods and services than it was exporting, and the deficit increased significantly to an alarming low USD15654.5 million in 2009 presenting a substantial imbalance in Pakistan's external trade. The deficit continues to grow, USD 12,129 million in 2022, compared to USD 650.9 million in 2020. (Figure 6-0-10).

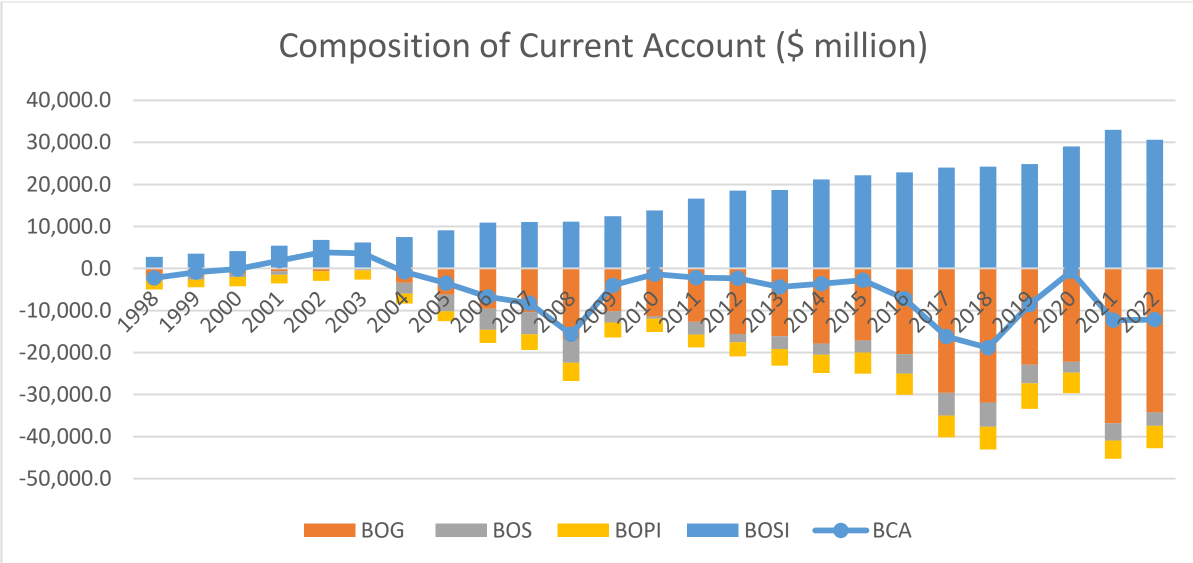


Figure 6-0-10: Composition of Current Account of Pakistan

In the past, remittances have cushioned the financing pressures related to Pakistan's trade deficit. According to BOP data from the International Monetary Fund (IMF), in the 1980s, remittances financed, on average, 32.4% of imports, dropping to 12.9% in the 1990s. Between 2000 and 2017, the share recovered to an average 17.8% and peaked at 31.3%. With high oil prices in 2005–2008 and 2010–2014, remittances became more concentrated from Middle Eastern oil-exporting countries. However, since the oil price drop in 2014, remittances have no longer compensated for the growing trade deficit (Rosbach & Aleksanyan, 2019).

Financial Account

In 2003, The government took various measures to improve the country's security situation and restore investor confidence. During this period, the government introduced a number of economic reforms aimed at creating a more conducive environment for FDI. The government also initiated a series of privatisation programs, providing attractive investment opportunities for both local and foreign investors. (Nguyen, 2022).

Pakistan experienced a surge in FDI inflows approximately between 2004 to 2007, primarily due to a combination of favourable domestic and external factors. In 2007-2008, the global financial crisis, coupled with Pakistan's own energy crisis, political instability, and weak infrastructure, continued to hinder investment inflows and economic growth in the country. Additionally, Pakistan experienced a significant surge in PFI inflows in 2014, which might be related to improved investor sentiment or specific investment opportunities (Figure 6-0-11).

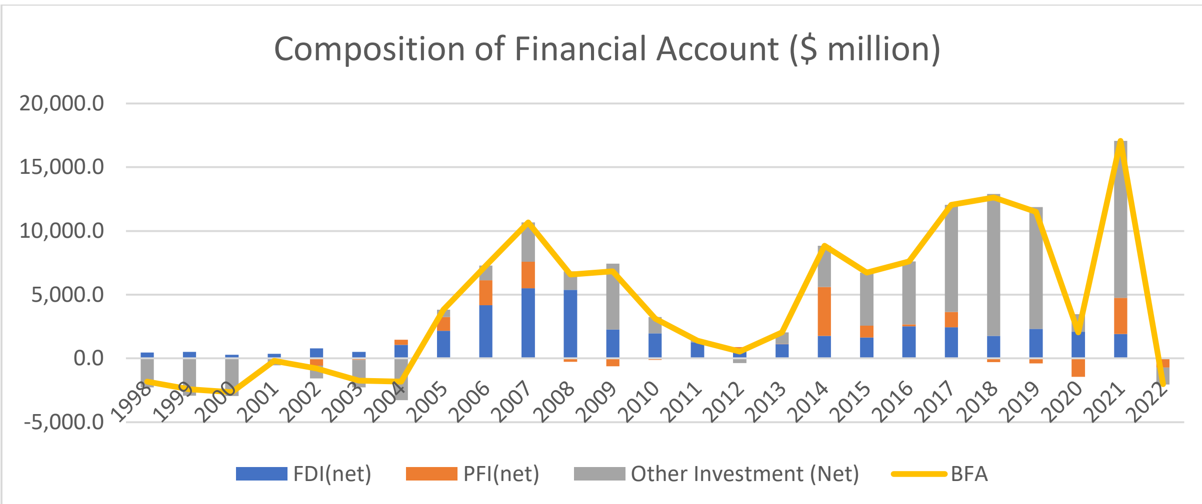


Figure 6-0-11: Composition of Financial Account of Pakistan

Pakistan's Export Trends

Pakistan's exports steadily increased till 2007 at USD 17.79 Billion. Exports plummeted in 2009 to USD 17.52 million a 15.3% change from 2008. Pakistan's export performance has been weak for decades. Since 2010, export growth has been largely stagnant, with a growing average trade deficit. The World Bank has also given Pakistan one of the lowest rankings in the world for the share of exports in GDP, at only 8.2% in 2017 (Figure 60-12).

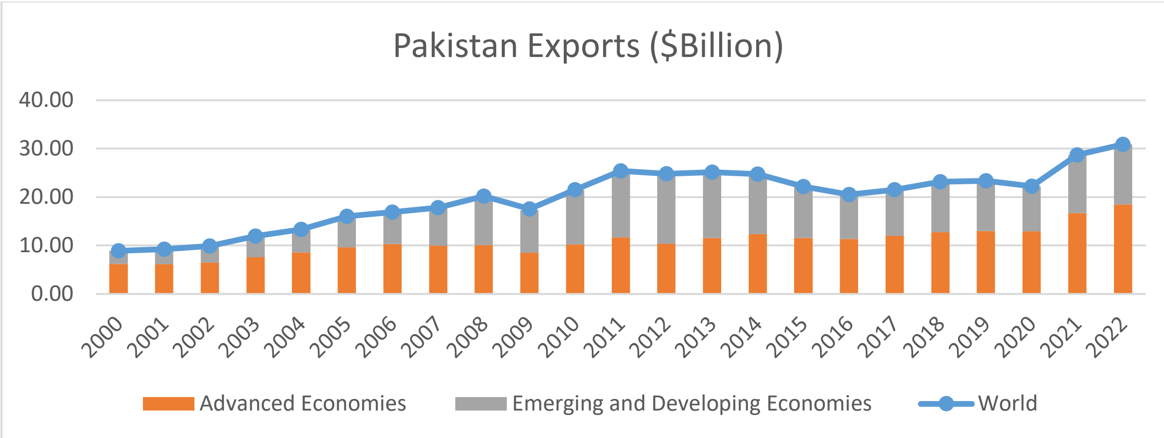


Figure 60-12: Exports of Pakistan

Pakistan's dominant export category is textiles, which accounts for 58% of all its exports in 2017. Between 2012 and 2017, Pakistan's export industries were affected by an overvalued exchange rate, which reduced its price competitiveness. In addition, exporters experienced high costs as a result of energy prices and insufficient energy supplies.

During the pandemic exports dropped to USD 22.24 Billion in 2020 and have increased to USD 30.87 Billion in 2022. Pakistan's proportion of exports to advanced economies remained heigh till 2011, from 2012-2015 the proportion of exports to Emerging and Developing economies increased significantly. Nevertheless, majority of exports continue to be directed towards advanced economies.

Coupled with diversifying its export basket to include industrial products apart from textile and rice, and taking measures to increase trade openness—a sphere where the country has consistently underperformed in comparison to its Asian counterparts, the Philippines and Vietnam, could boost both growth and forex reserves in the country. Most importantly, Pakistan should diversify and expand its foreign investment partnerships beyond China, the United States, Saudi Arabia, the United Kingdom, and the United Arab Emirates, and engage in diplomatic efforts that could open new avenues for foreign investments. (Bhowmick & Ghosh, Debt Infinitum: Pakistan's Macroeconomic Catastrophe, 2023).

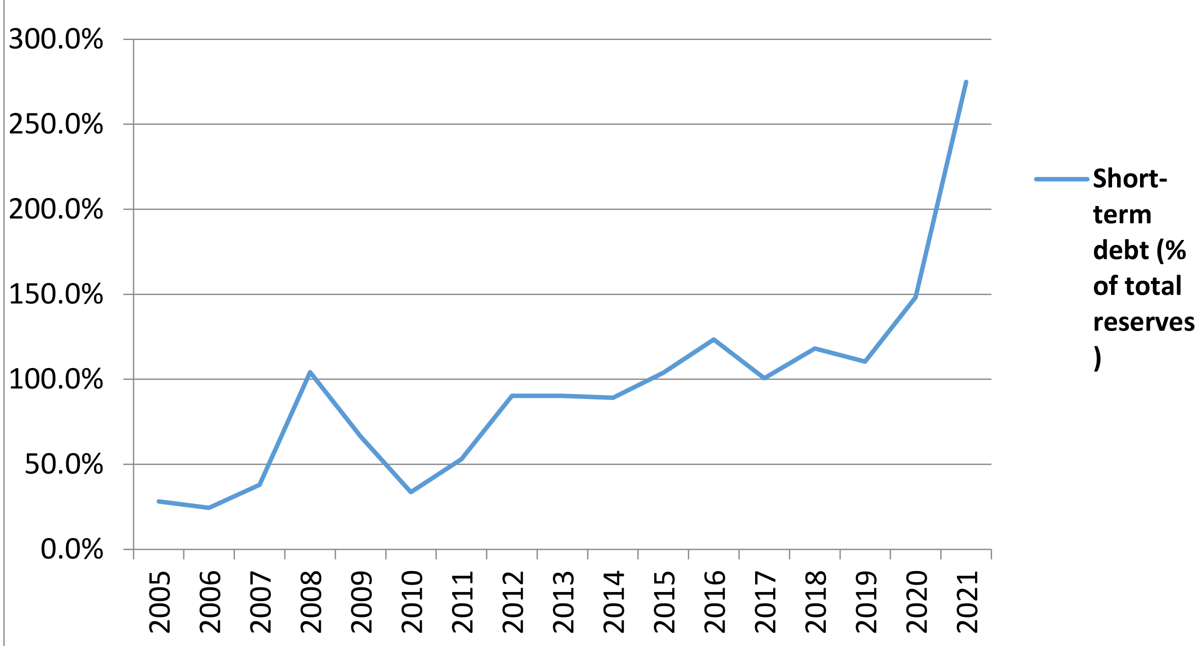
Chapter 7

Introduction to Sri Lanka

Sri Lanka, formerly known as Ceylon, is an island nation located in Indian Ocean separated from Peninsular India by Palk Strait. It gained independence after 150 years of British rule in 1948.Colombo is the executive and judicial capital of Sri Lanka while Sri Jayewardenepura is the legislative capital. A representative, democratic system of government has existed in Sri Lanka since the termination of British rule in 1948. Elections are regularly held, and citizens over 18 years of age may vote. As provided for by the constitution of 1978, the government is headed by an executive president elected directly by popular vote from a national electorate. The president selects a cabinet of ministers and other non-cabinet ministers from the parliament. The president is also the commander in chief of the armed forces—army, navy, and air force. Three ethnic groups—Sinhalese, Tamil, and Muslim—make up more than 99 percent of the country's population, with the Sinhalese alone accounting for nearly three-fourths of the people. The Tamil segment comprises two groups—Sri Lankan Tamils (long-settled descendants from southeastern India) and Indian Tamils (recent immigrants from southeastern India, most of whom were migrant workers brought to Sri Lanka under British rule). Slightly more than one-eighth of the total population belongs to the former group. Muslims, who trace their origin back to Arab traders of the 8th century, account for about 7.5 percent of the population. Burghers (a community of mixed European descent), Parsis (immigrants from western India), and Veddas (regarded as the aboriginal inhabitants of the country) total less than 1 percent of the population. (Arasaratnam & Peiris, 2023)

Debt Crisis in Sri Lanka

In April 2022, Sri Lanka announced that it was temporarily defaulting on its total external debt worth $51 billion to prevent a hard default. It said that the debt service suspension will be in force till there is restructuring and bailout by the International Monetary Fund. Short term debt as a percentage of reserves had been more than 100% since 2015 to 2021(Figure 7-1) , thus due to lack of foreign exchange reserves to finance essential imports such as food, fuel and medicine this debt service suspension was done .The finance ministry said that creditors, including foreign governments, were free to capitalize any interest payments due to them or opt for payback in Sri Lankan rupees.



Source : World Bank Database

Figure 7-1:Short-term debt (% of total reserves) of Sri Lanka

The total external debt of Sri Lanka increased from $11 billion in 2005 to $57 billion in 2021.The debt stocks as a percentage of gross national income peaked to 71.5% in 2020. (Figure 7-2). Of the total external debt in 2021, 68.6% was Public and Publicly Guaranteed debt (Figure 7-3) that is debt owed by the Sri Lankan government due to direct borrowing or guaranteeing of debt owed by state owned enterprises to rest of the world, while 15.7% was Private Non-Guaranteed debt (Figure 7-4) that is debt owed by individuals and corporates in Sri Lanka to rest of the world. The debt service on external debt that is money needed to payback interest and principal amounts on any outstanding debt peaked to 39.3% of export of goods and services and primary income in 2020. (Figure 7-5)

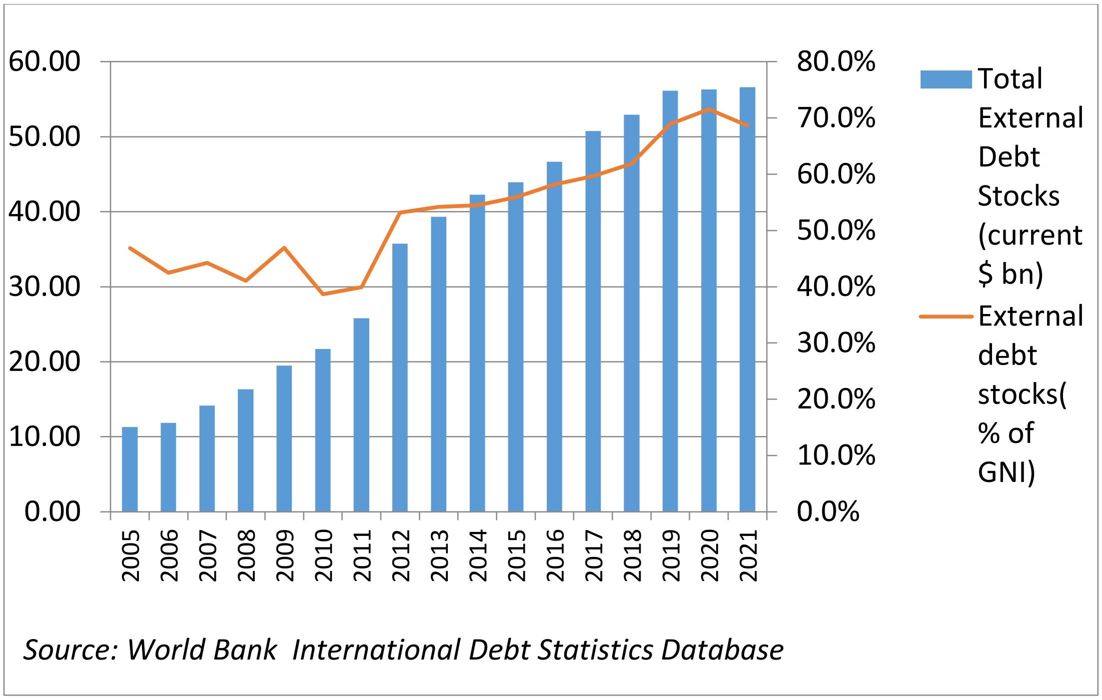


Figure 7-2:Total External Debt Stocks of Sri Lanka

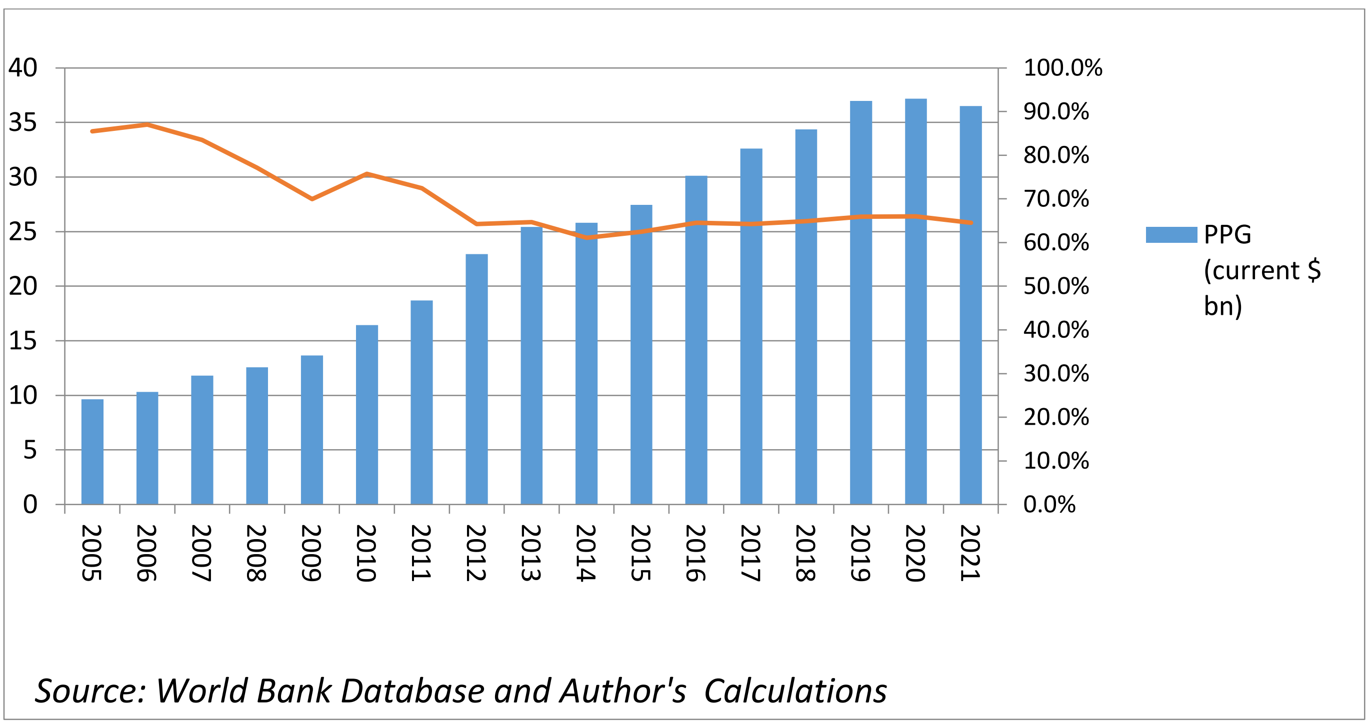


Figure 7-3:Public and Publicly Guaranteed Debt of Sri Lanka

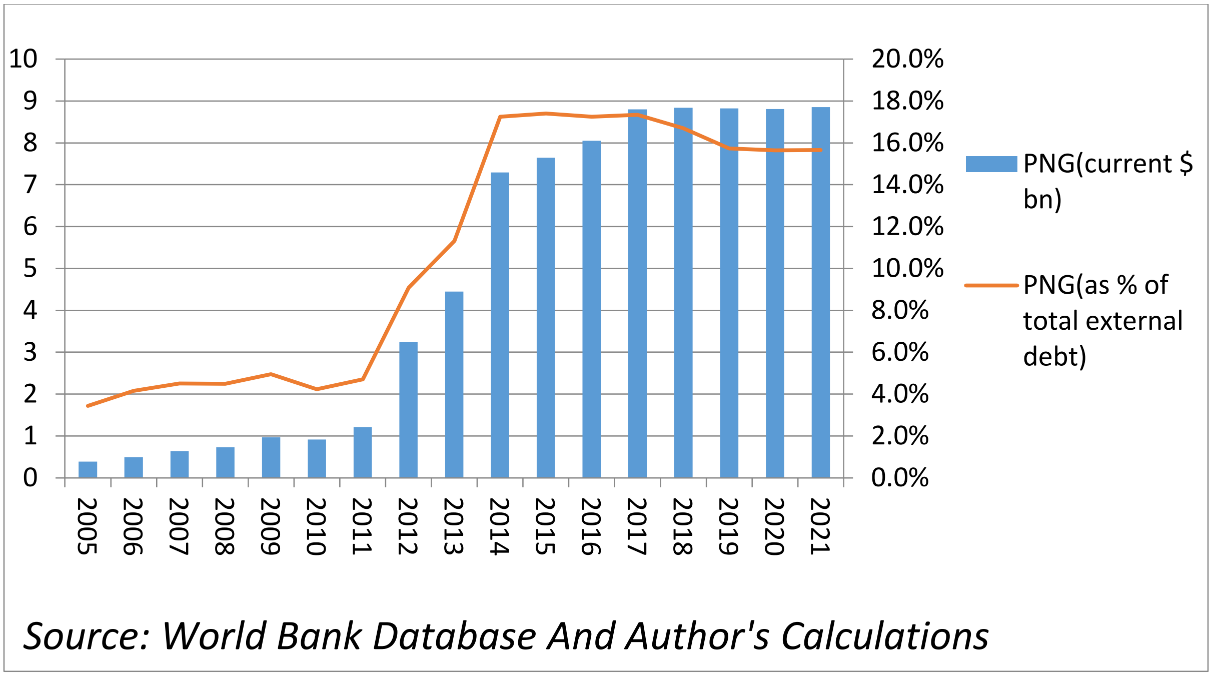


Figure 7-4:Private Non-Guaranteed Debt of Sri Lanka

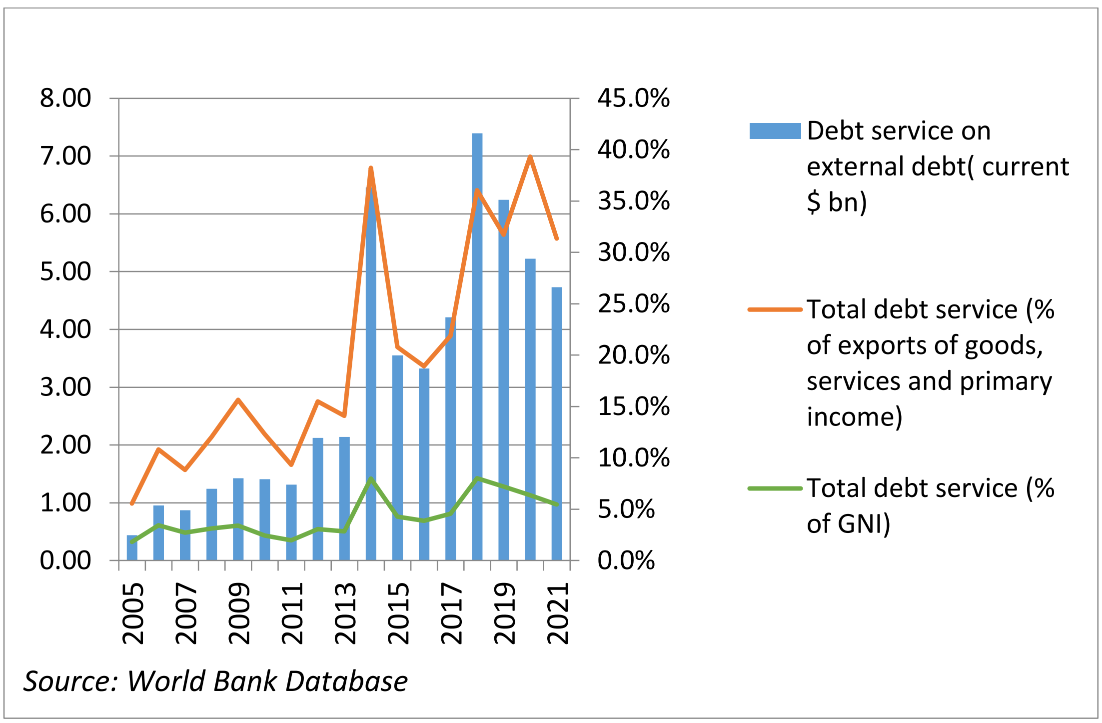
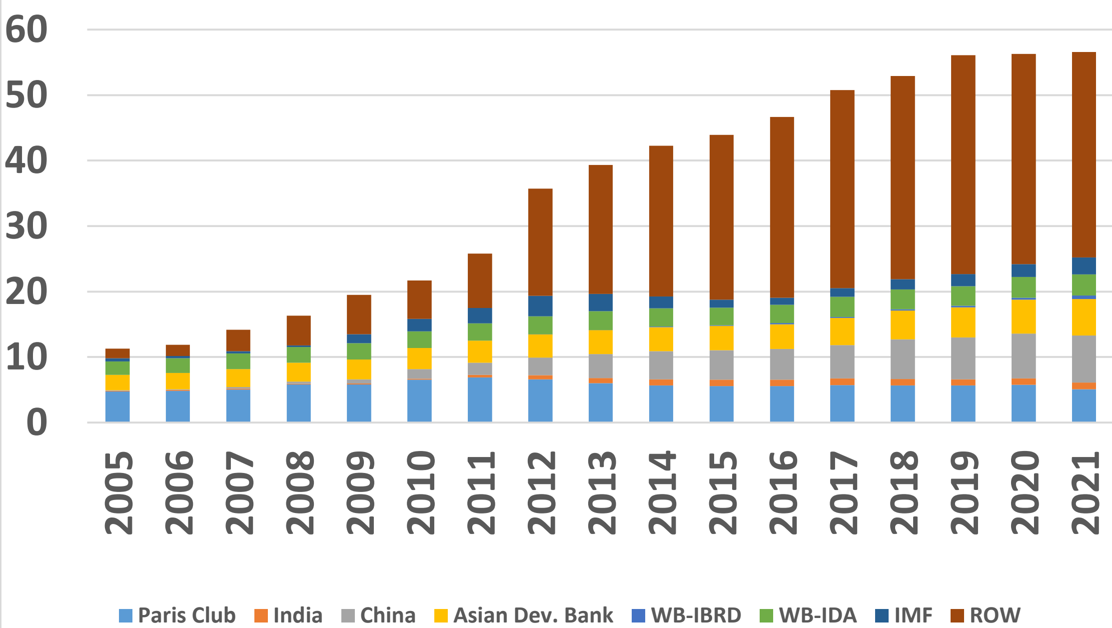


Figure 7-5: Debt Service on External Debt of Sri Lanka

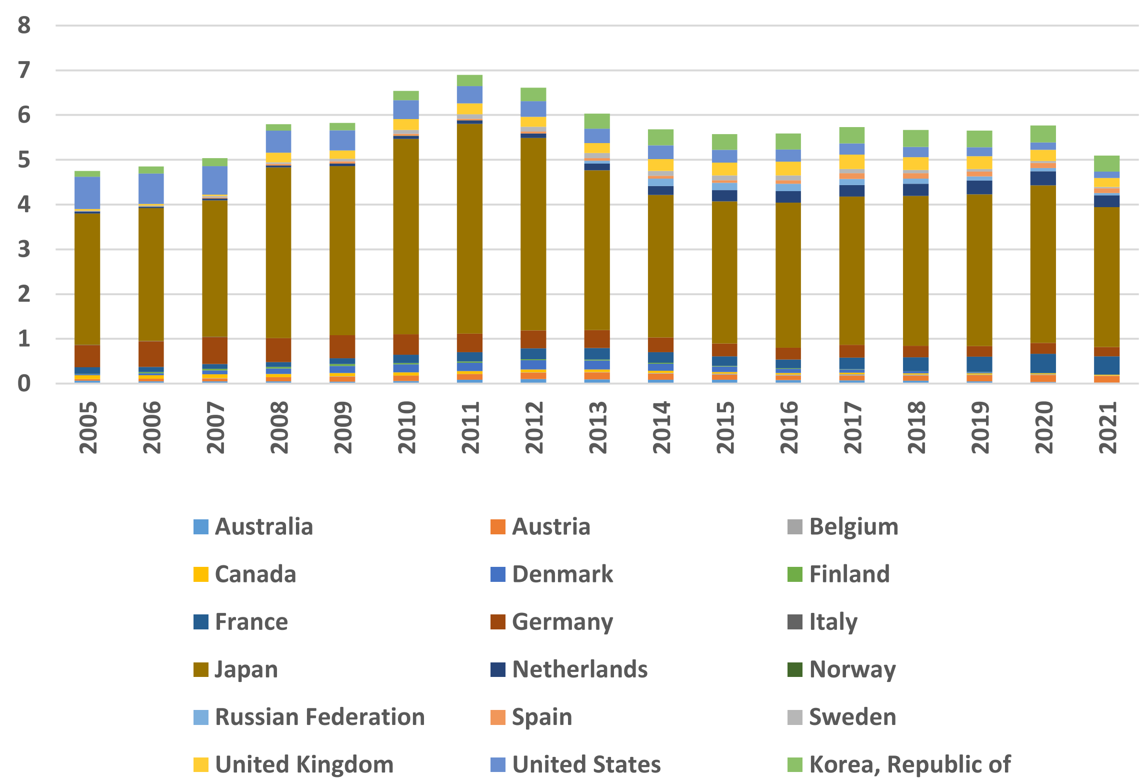
China's lending to Sri Lanka has gradually increased over the years to $7.21 billion in 2021 out of total external debt of Sri Lanka of approximately $ 57 billion in the same year making China the largest bilateral creditor for Sri Lanka accounting for approximately 12 percent of total external debt owed by Sri Lanka. Other important creditors include India, Paris Club countries (particularly Japan), Asian Development Bank, International Monetary Fund and World Bank-IDA(Figure 7-6).



Source: World Bank International Debt Statistics and Author's Calculations

Figure 7-6:Creditor Composition for Sri Lanka (Total external Debt $ bn)

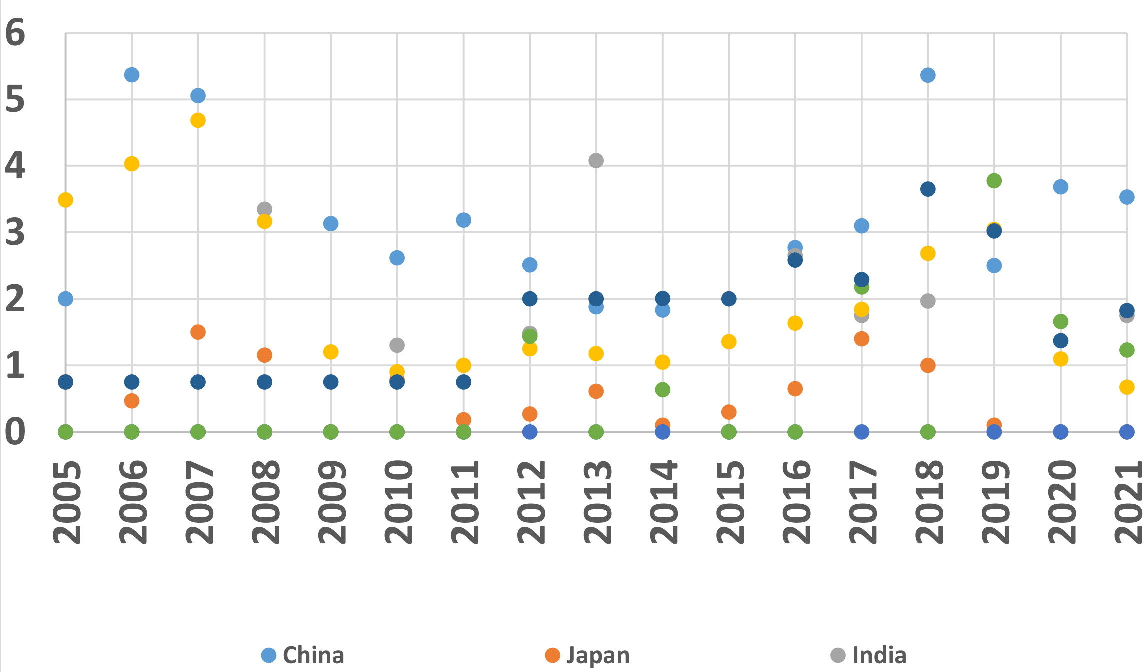
The major bilateral creditors after China are Japan and Indian as Japan lent approximately $3 billion and India approximately $ 1 billion in 2021.Out of total credit given by Paris Club countries Japan has lent more than 50% from 2005-2021.(Figure 7-7).The reason for borrowing from Japan can be its comparatively low interest rates.(Figure 7-8)



Source: World Bank International Debt Statistics

Figure 7-7:Paris Club Creditors Composition for Sri Lanka

The average interest rates of China for most years from 2005 to 2021 have been above 3 percent. (Figure 7-8). As China is a major creditor of Sri Lanka, Sri Lanka must be facing the burden of these high interest rates.



Source: World Bank International Debt Statistics

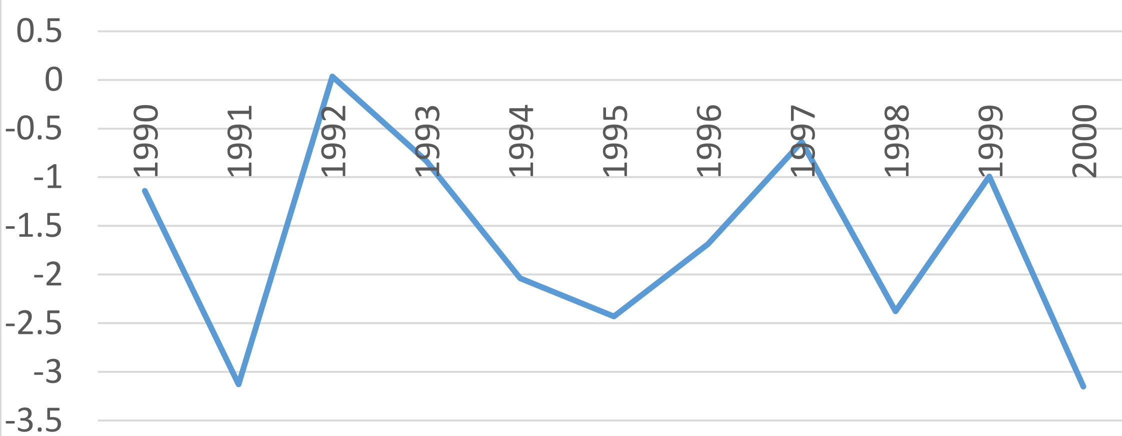
Figure 7-8:Average interest rates on New Debt Commitments(%)

The external debt stocks as % of Gross National Income increase from 58% in 2016 to 72% in 2020.(Figure 7-2). Also, the total debt service as a share of the exports of goods, services and primary income increased from 19% in 2016 to 39% in 2020.(Figure 7-5) Short term debt as a proportion of reserves was more than 100 % since 2015 and peaked to 275% in 2021.(Figure 7-1).All indicating a debt crisis.

Twin Deficit Problem

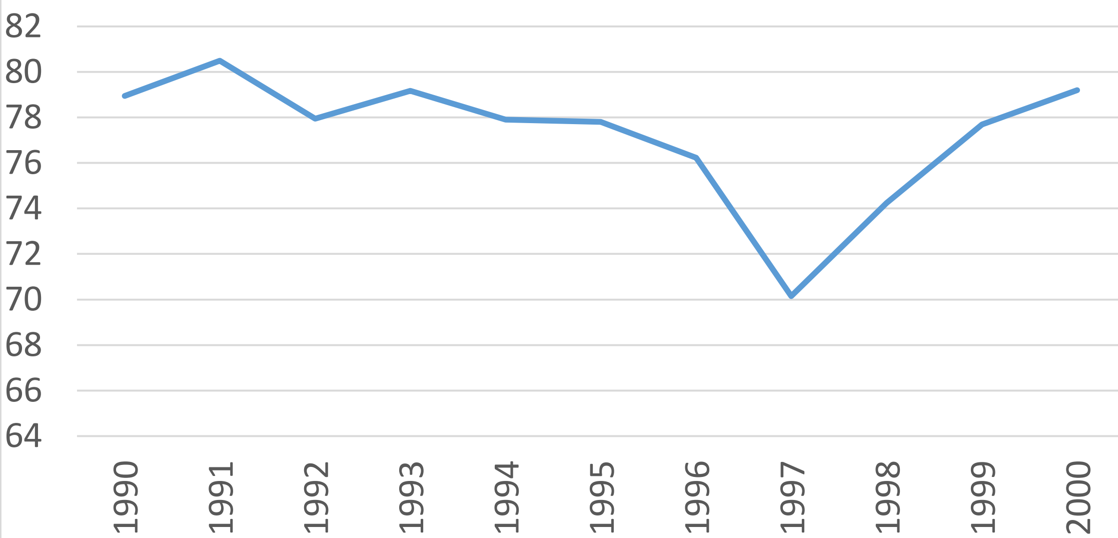
Immediately after independence it derived nearly all of its foreign earnings from export of three plantation crops; tea, rubber and coconut. During first three decades after independence Sri Lankan Government had two objectives; creating equity through social welfare and substitution of imports. The social welfare programme reduced mortality rates and increased life expectancy and literacy rates. However, subsidies on food, price controls on consumer goods and provision of free education and healthcare reduced capital accumulation thereby retarding economic growth. This further increased unemployment and reduced incomes. Moreover, industry was starved of imported inputs. In late 1970s the government liberalised the economy promoting export-oriented activities. In 1980s, Sri Lanka exported manufactured goods (mainly textiles and garments) and services. The armed conflict from 1983-2009 reduced foreign investment in Sri Lanka. (Arasaratnam & Peiris, 2023)

Sri Lanka has been characterized by twin deficit (fiscal and current Account). The fiscal deficit can be attributed to large public sector, populist public spending programs and poor performance of State-Owned Enterprises. General Government primary net lending and borrowing is Total Receipts of Government excluding Borrowings- Total Expenditure excluding interest payments on government debt. Sri Lanka had a primary deficit in all years from 1990 to 2000 except 1992 when primary net lending/borrowing was zero. (Figure 7-9). The Gross Government Debt or Fiscal Deficit (that is Total receipts of government excluding borrowings – Total expenditure) of Sri Lanka was more than 70% of GDP in all years from 1990 to 2000. (Figure 7-10)



Source: IMF WEO Database April 2023

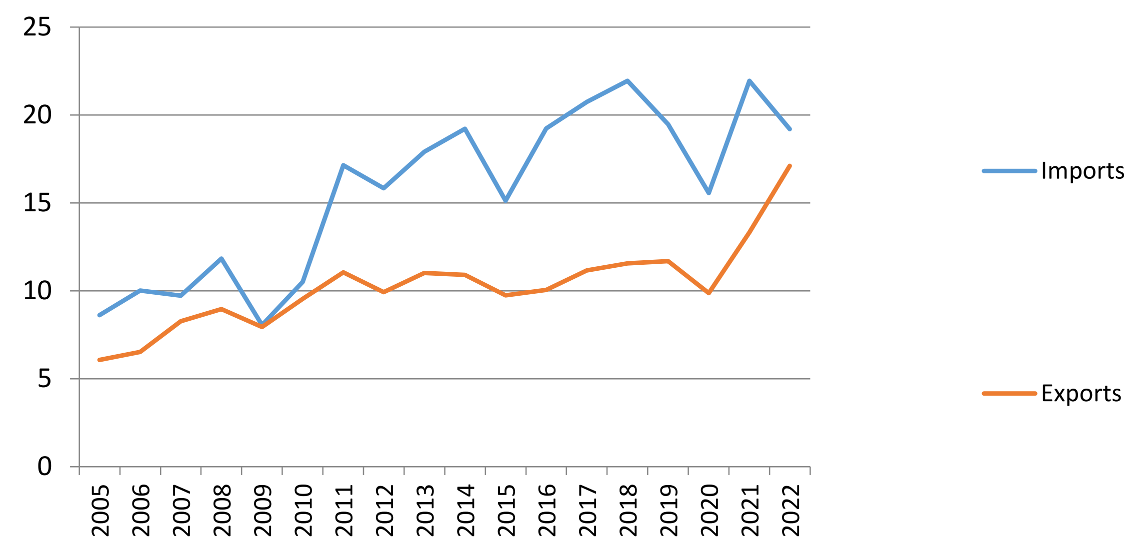
Figure 7-9:GG primary net lending/borrowing (% of GDP) of Sri Lanka



Source: IMF WEO Database April 2023

Figure 7-10:GG gross debt (% of GDP) of Sri Lanka

As far as trade is concerned, Sri Lanka was exporting primary products in 1960s and 70s while it was importing fuel, consumer goods and investment goods leading to a deficit. Even after 1970s reforms as export of manufactured goods and services began, as GDP grew imports also increased. The value of imports exceeded exports in all years from 2005 to 2022.(Figure 7-11)



Source: IMF Direction of Trade Statistics

Figure 7-11:Imports and Exports to World by Sri Lanka($ bn)

More than half of Sri Lanka's imports are from emerging and developing economies (Figure 7-12) whereas more than half of Sri Lanka's exports are to advanced economies. (Figure 7-13)

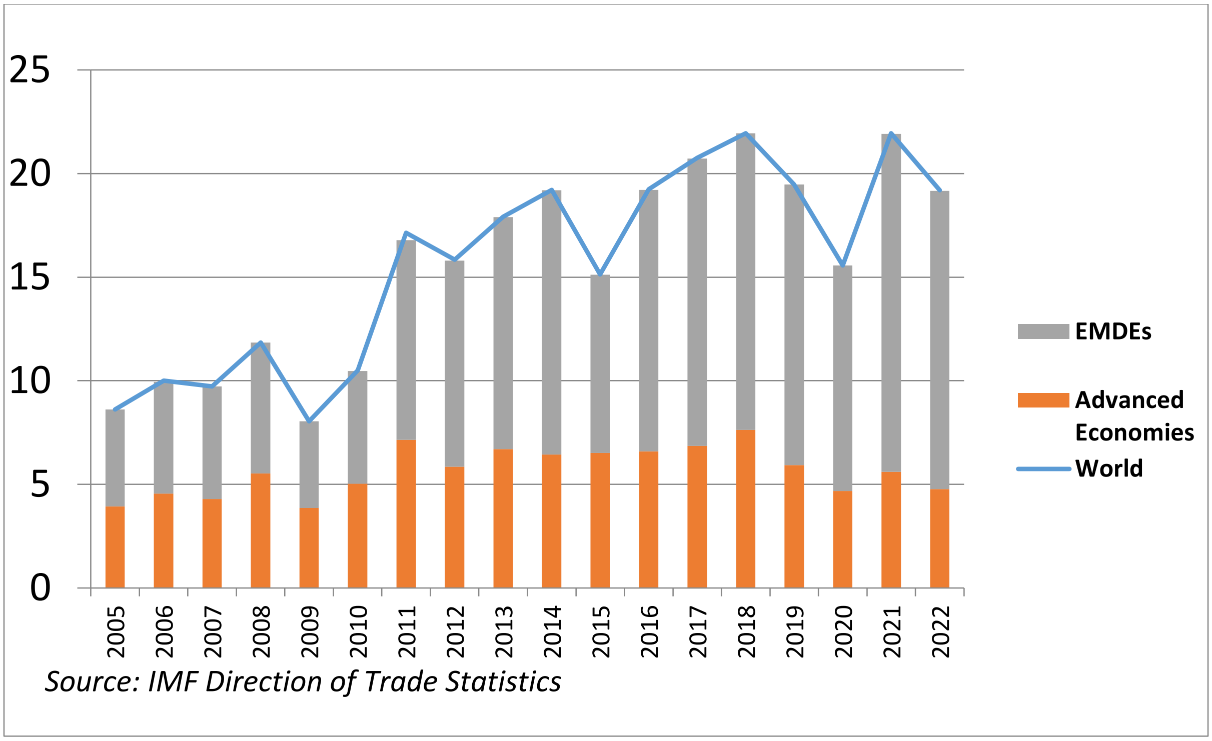


Figure 7-12:Imports to Sri Lanka($ bn)

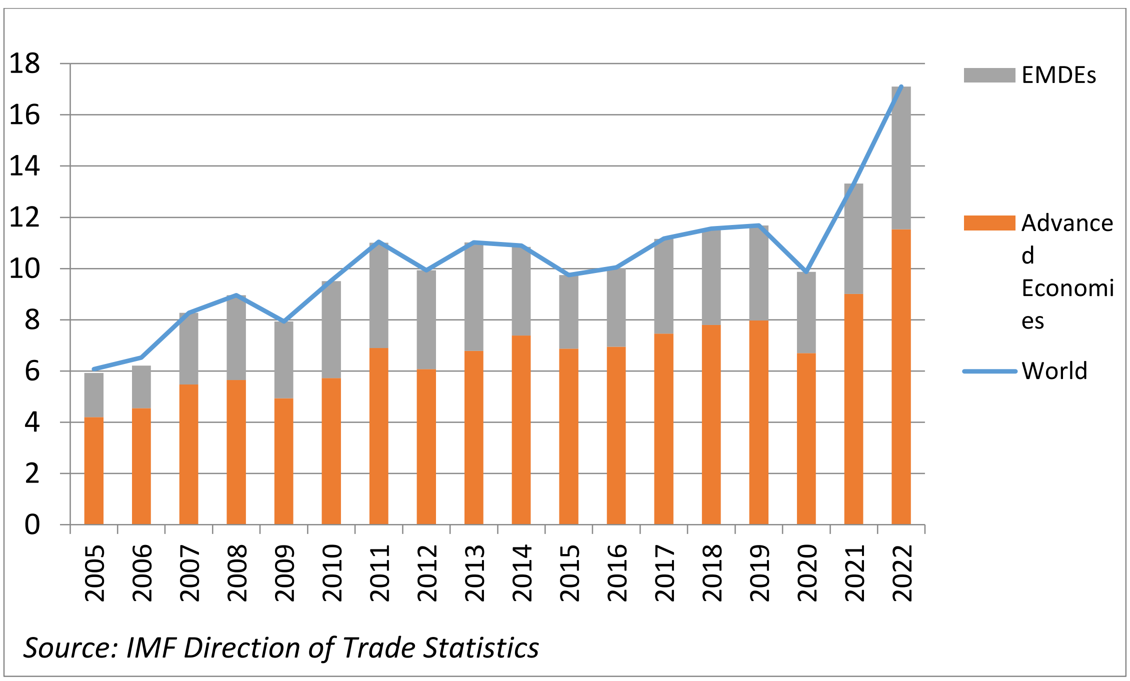


Figure 7-13:Exports By Sri Lanka($ bn)

Among Emerging and Developing Economies Sri Lanka imports maximum from Emerging and Developing Asia (Figure 7-14) and Exports maximum also to Emerging and Developing Asia. (Figure 7-15)

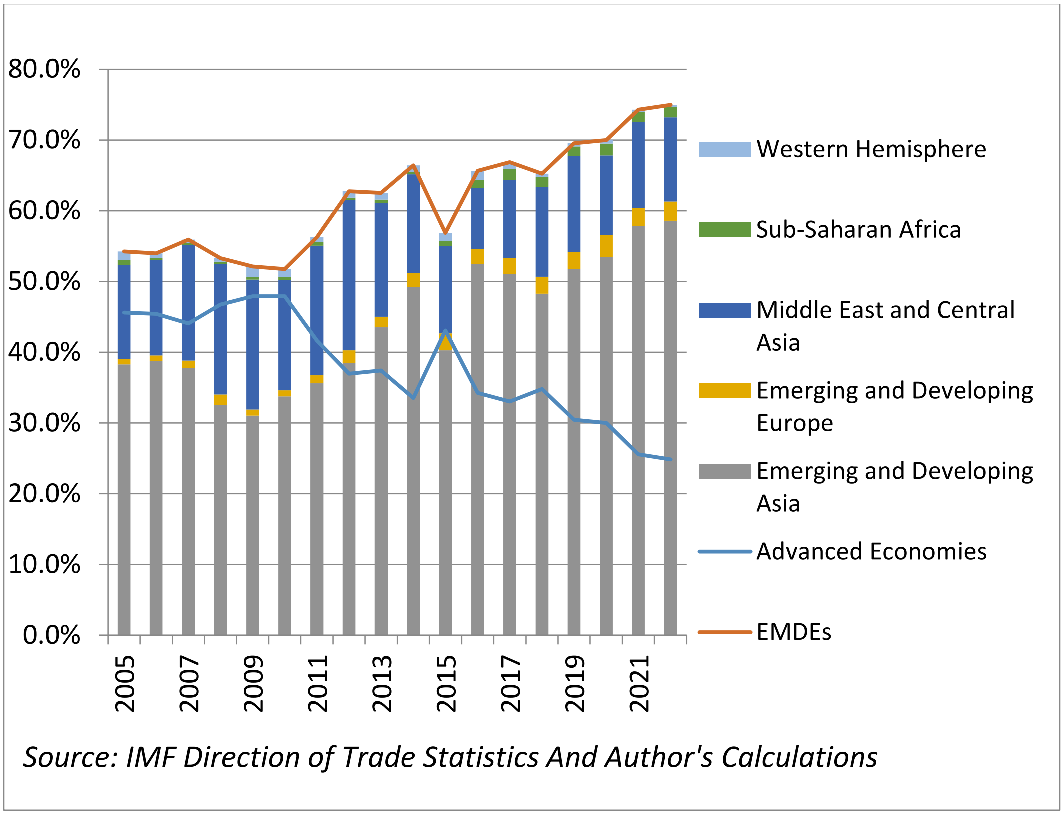


Figure 7-14:The share of Imports of Sri Lanka : 2005 to 2022

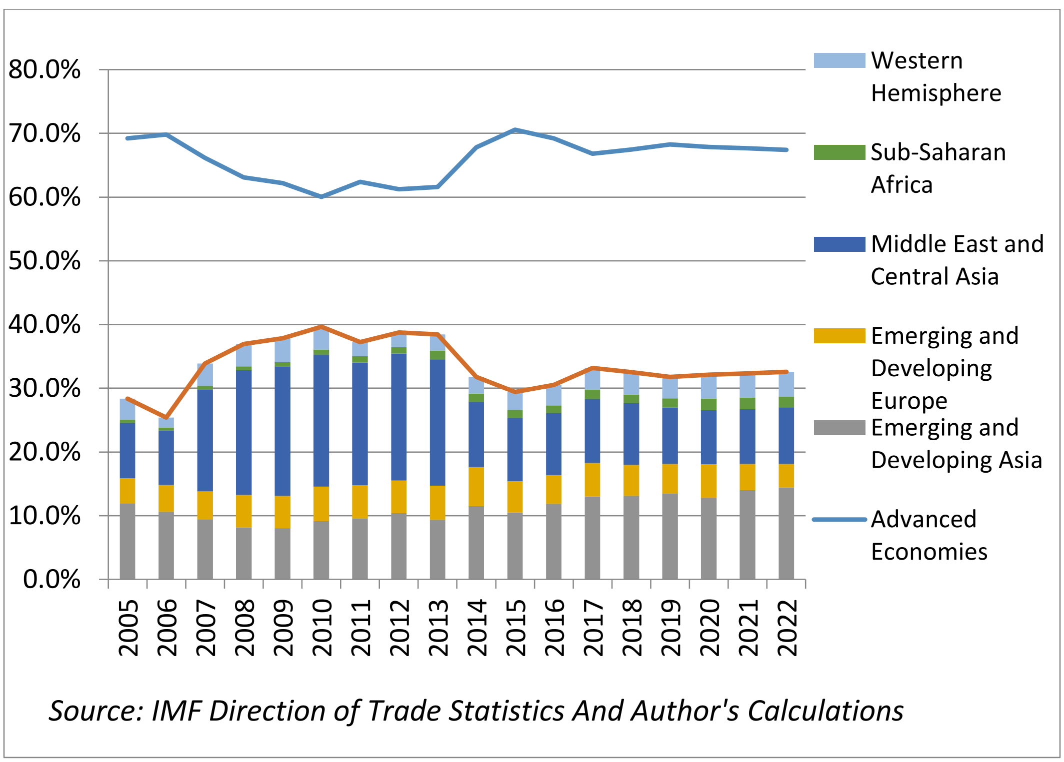
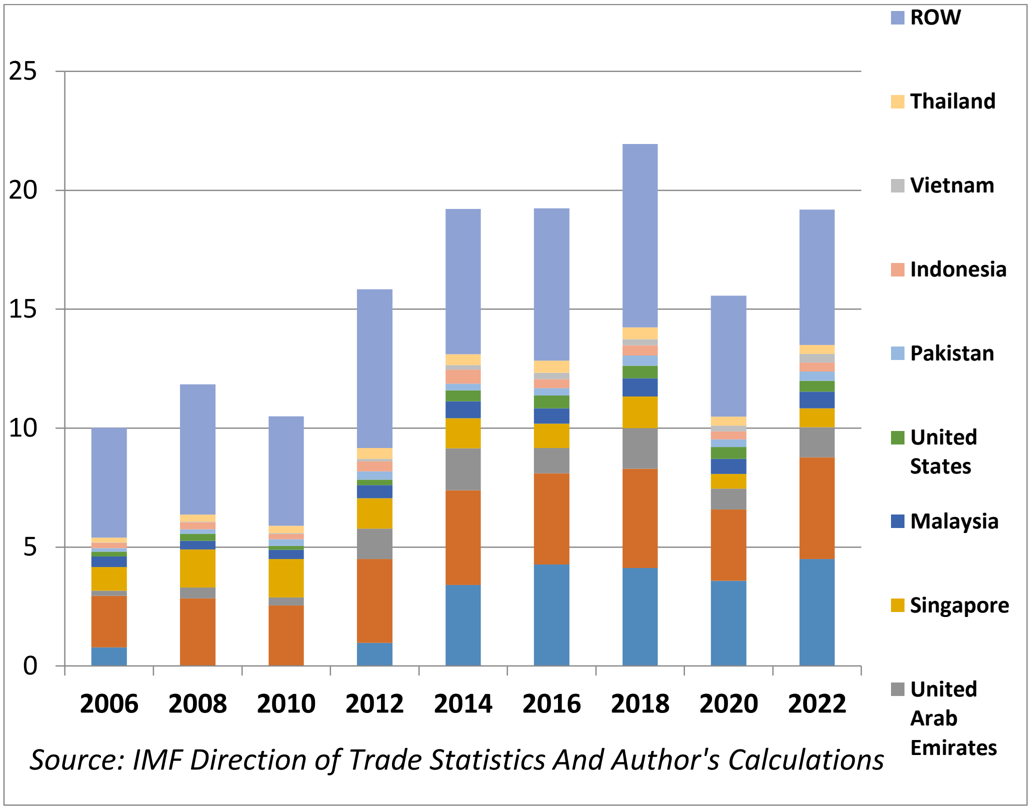


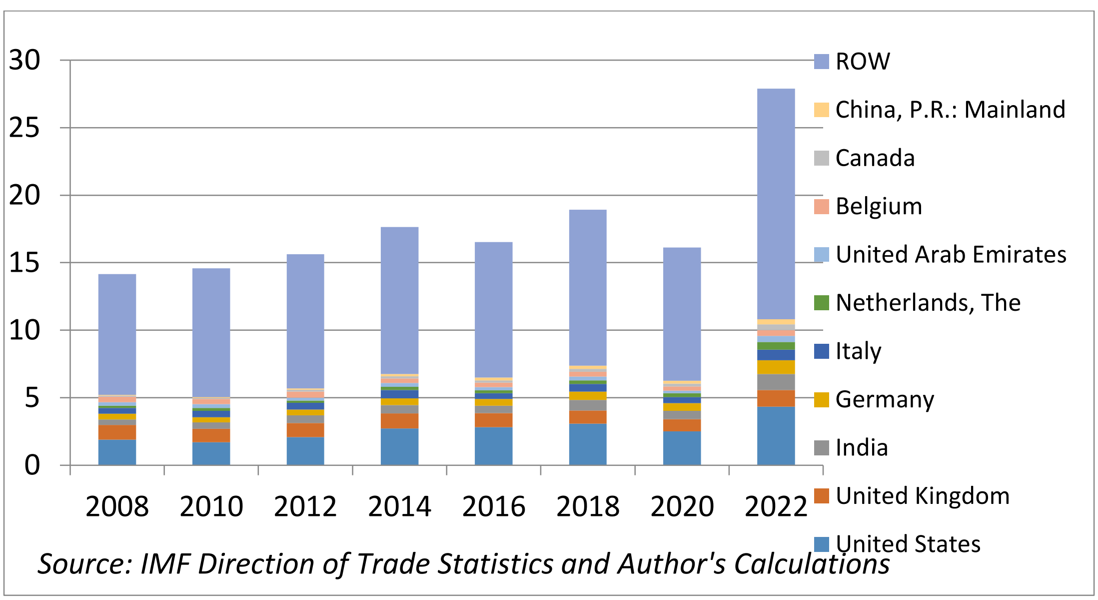
Figure 7-15: Share of exports of Sri Lanka:2005-2022

Sri Lanka imports maximum from China followed by India and then United Arab Emirates (Figure 7-16). Sri Lanka exports maximum to USA followed by United Kingdom and then India.(Figure 7-17)



Source: IMF Direction of Trade Statistics And Author's Calculations

Figure 7-16:Top 10 exporters to Sri Lanka



Source: IMF Direction of Trade Statistics and Author's Calculations

Figure 7-17:Top 10 importers from Sri Lanka

Remittances and tourism have been an important source of foreign exchange for Sri Lanka. There was deficit in all disaggregates of current account from 1990 to 2000 except Balance on Secondary Income which largely consists of remittances. (Figure 7-18)

The Balance of Payments of Sri Lanka was in surplus from 1990-2000 except in the years 1996,1999 and 2000.The surplus can be attributed to solely financial account because current account was in deficit throughout. Financial Account Surplus indicates that there was greater capital inflow into Sri Lanka as compared to capital outflow which means in Sri Lanka owes greater liabilities to foreign countries than it has assets abroad. However, given the continuous deficit on current account a surplus on the financial account was the only way of preventing the foreign exchange reserves from depleting thereby preventing a Balance of Payment crisis. But, in 1999 and 2000 the current account deficit was so huge that even the financial account surplus could not prevent the reserves from depleting. (Figure 7-19)

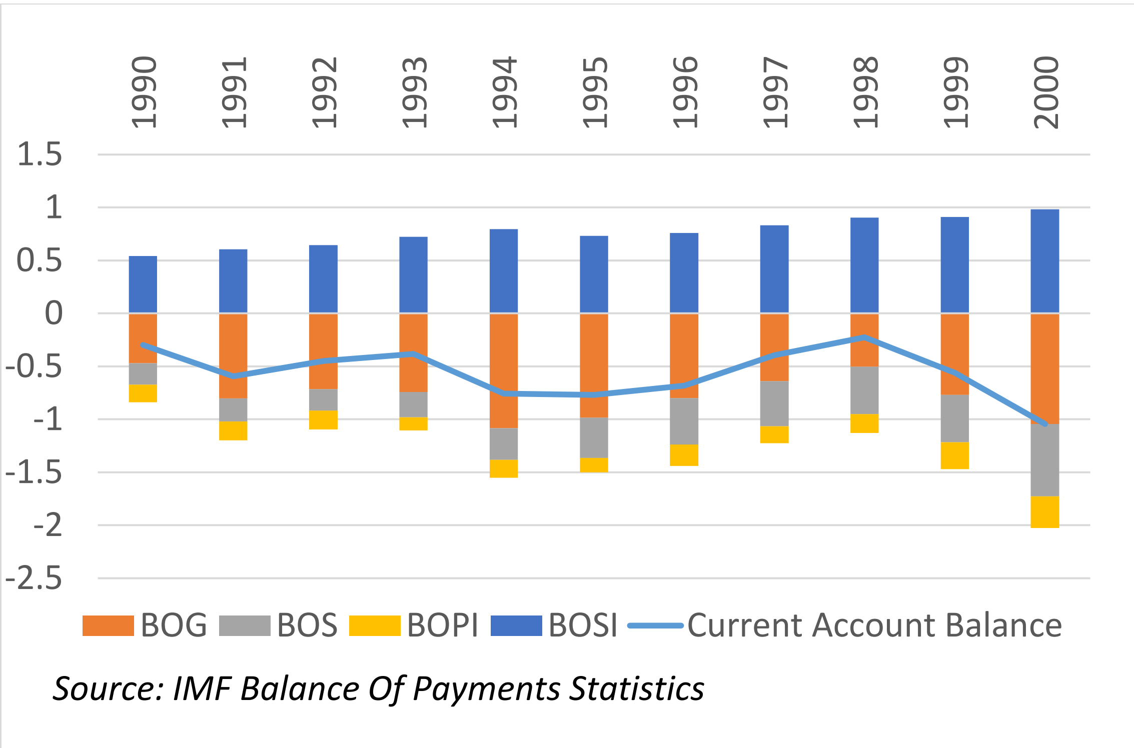


Figure 7-18:Current Account Disaggregates: Sri Lanka 1990-2000 (US $ bn)

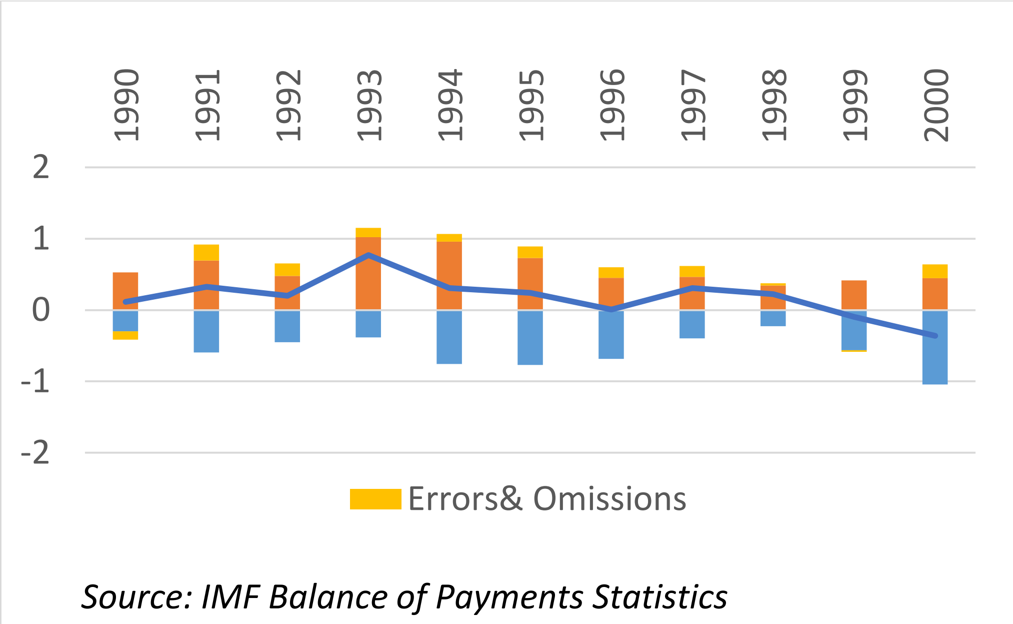


Figure 7-19:BOP of Sri Lanka :1990-2000 (US $ bn)

In 2015 the annual growth % of GDP declined from 6.4% in 2014 to 4.2%. (Figure 7-20) There was strong growth in services (particularly tourism), continued growth in agriculture. However, the negative growth in construction and weaker growth in manufacturing were indicative of a slowdown in public and private investment, as well as the negative effects of slowing world trade. (International Monetary Fund, 2016).The weakness of trade in 2015 was due to a number of factors, including an economic slowdown in China, a severe recession in Brazil, falling prices for oil and other commodities, and exchange rate volatility. (World Trade Organisation, 2016)

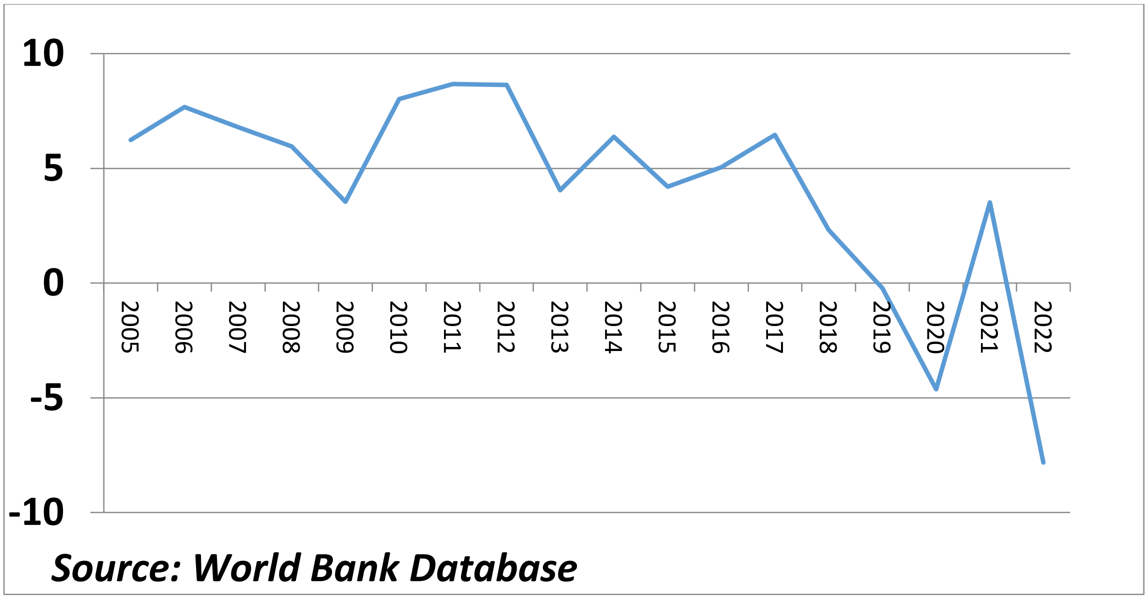


Figure 7-20: GDP(annual growth %) of Sri Lanka

The government fiscal deficit expanded to 6.9 percent of GDP in 2015. While revenue increased from 11.2% to 12.6% of GDP, this mostly reflected one-time measures and tax collections from a temporary surge in vehicle imports. Expenditures rose from 17.2% to 19.3 % of GDP on account of a post-election wage hike, a higher interest bill, additional spending on goods and services and an increase in Samurdhi transfers. Public debt increased from 70 percent in 2014 to 76 percent in 2015 (Figure 7-21)—partly reflecting debt financing of the fiscal deficit, but also the impact of rupee depreciation on the stock of foreign-currency denominated debt. (International Monetary Fund, 2016)

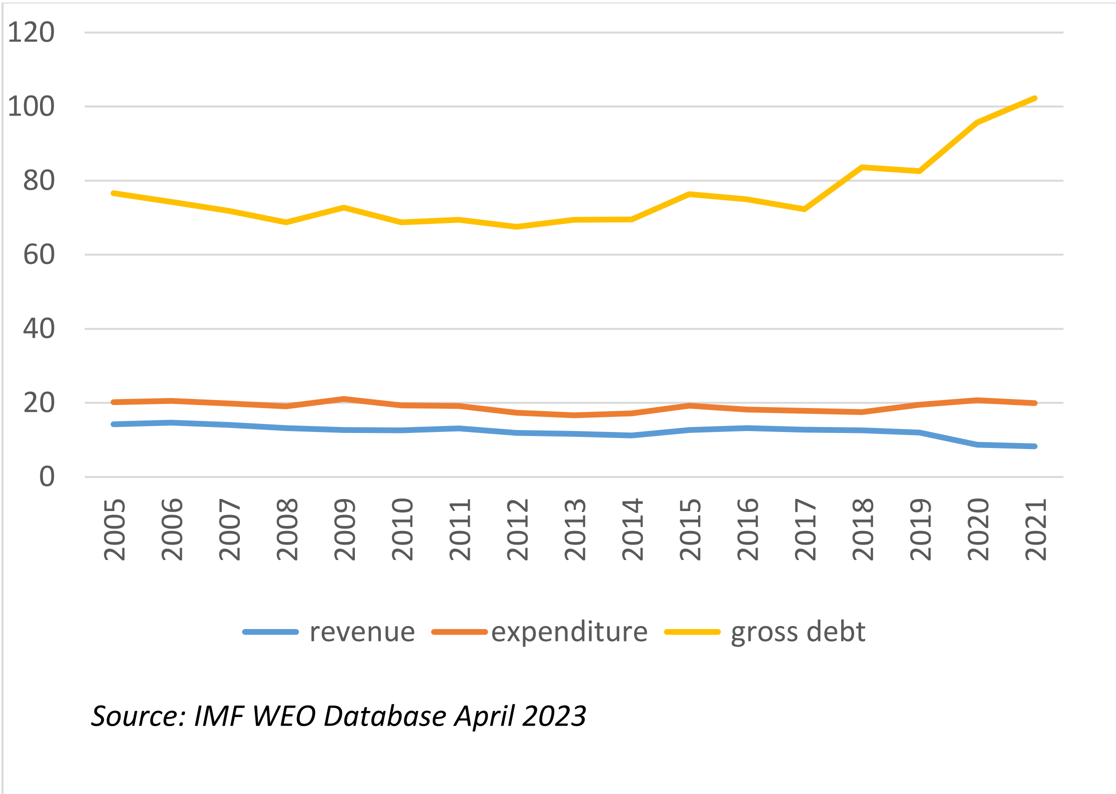


Figure 7-21:Government Finances of Sri Lanka (as % of GDP)

The current account deficit in 2015 was similar to 2014. (Figure 7-22) A strong pickup in non-energy imports (notably vehicles), negative export growth, and flat growth in remittances more than offset a lower oil bill and robust growth in tourism receipts. (International Monetary Fund, 2016)

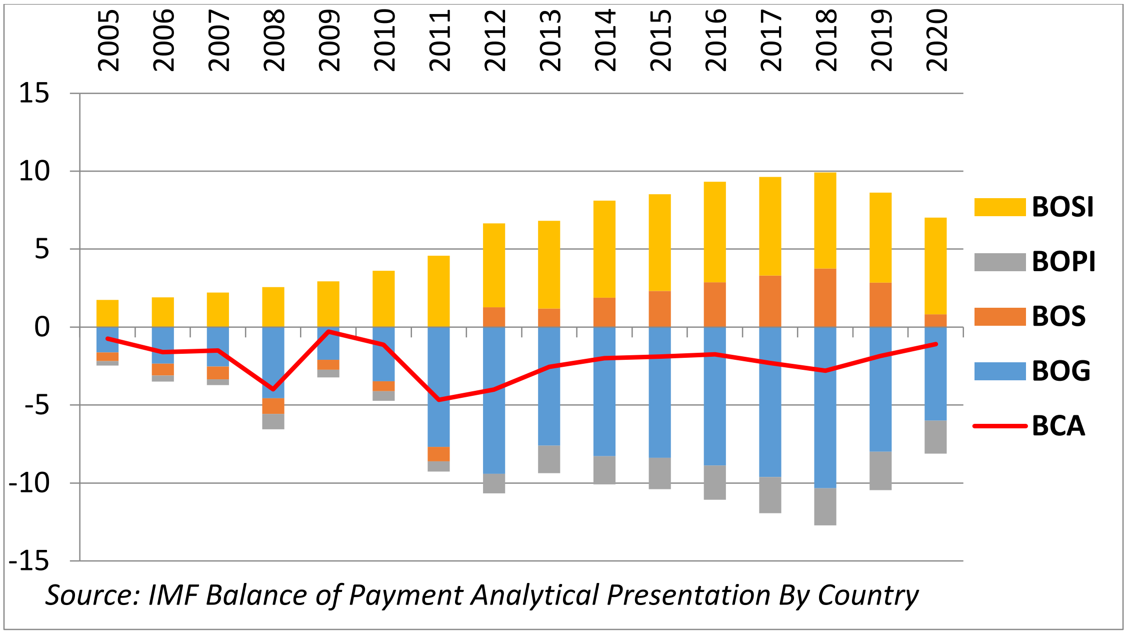


Figure 7-22:Balance on Current Account of Sri Lanka ($ bn)

In 2015, the capital and financial account position has weakened as compared to 2014 due to foreign exit from government securities, lower FDI inflows, and slow implementation of externally financed public and private projects. Investor sentiment has worsened, reflecting global market volatility and concern over domestic policies. (International Monetary Fund, 2016) .On October 2015, the Federal Reserve postponed its intention to conduct tapering on its monetary policy. The expectation that the Fed would wind down asset purchases in summer 2013 triggered financial market turmoil in the fragile five economies of Brazil, India, Indonesia, South Africa, and Turkey. These countries experienced large capital outflows and a sharp rise in the credit default swap spread. Several factors characterized the vulnerabilities in these countries, such as significant current account deficit problems, political uncertainty, and large shares of foreign holdings in the local bond and stock markets. The concerns of the fragile five created short-term financial stress for other Asia and the Pacific economies as well. In addition, global investment funds become more selective, with investment decisions conditional on the economic fundamentals of each Asian economy. Expectations of a series of interest rate hikes after the Fed meeting also resulted in exchange rate volatility. The low growth in advanced economies also translated into lower external demand, which had been a major growth engine for the majority of the Asian economies. (Punzi & Chantapacdepong, 2016). The spillovers were magnified by domestic imbalances, as evidenced by higher volatility around the two elections (January and August 2015), and the official budget passed in November 2015. (International Monetary Fund, 2016).The portfolio foreign investment declined from $2 billion in 2014 to $ 700 million in 2015.Foreign Direct Investment also declined from $830 million in 2014 to $ 630 million in 2015.(Figure 7-23)

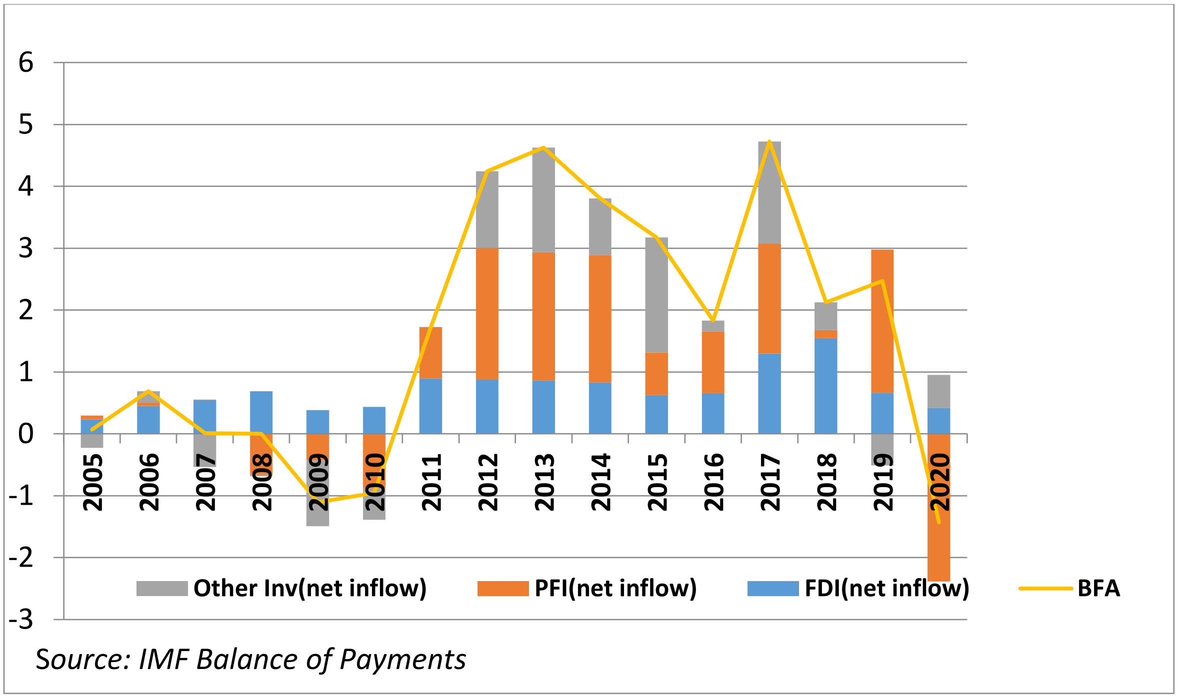


Figure 7-23: Balance on Financial Account of Sri Lanka($bn)

The balance on financial account declined from $3.8 billion in 2014 to $ 1.8 billion in 2016. (Figure 7-25).The Sri Lankan Re depreciated from 136 per dollar in 2015 to 146 per dollar in 2016.(Figure 7-24)The rupee was held relatively steady during the first eight months of 2015—depreciating by only about 2 percent as the CBSL provided about $1.9 billion to the foreign exchange market. Following the August elections, the CBSL shifted policy to cease giving a daily reference rate, exit from daily intervention and allow the market a greater role in determining the value of the rupee—with the rupee depreciating by some 4 ½ percent in that month despite net intervention of an additional $517 million. Intervention resumed after a short period, with central bank net sales of another $856 million in the remaining months of 2015, and the rupee depreciating slowly by another 2 percent. (International Monetary Fund, 2016). Thus, we can see a decline in reserve assets from $ 8.2 billion in 2014 to $7.3 billion in 2015 to $ 6 bn in 2016.(Figure 7-26) but liabilities only grew from $52.8 billion in 2014 to $ 54.8 billion in 2016.(Figure 7-27).The Sri Lankan Re depreciated from 104 per $ in 2005 to 199 per dollar in in 2021 further making it difficult for Sri Lanka to repay its debt.(Figure 7-24)

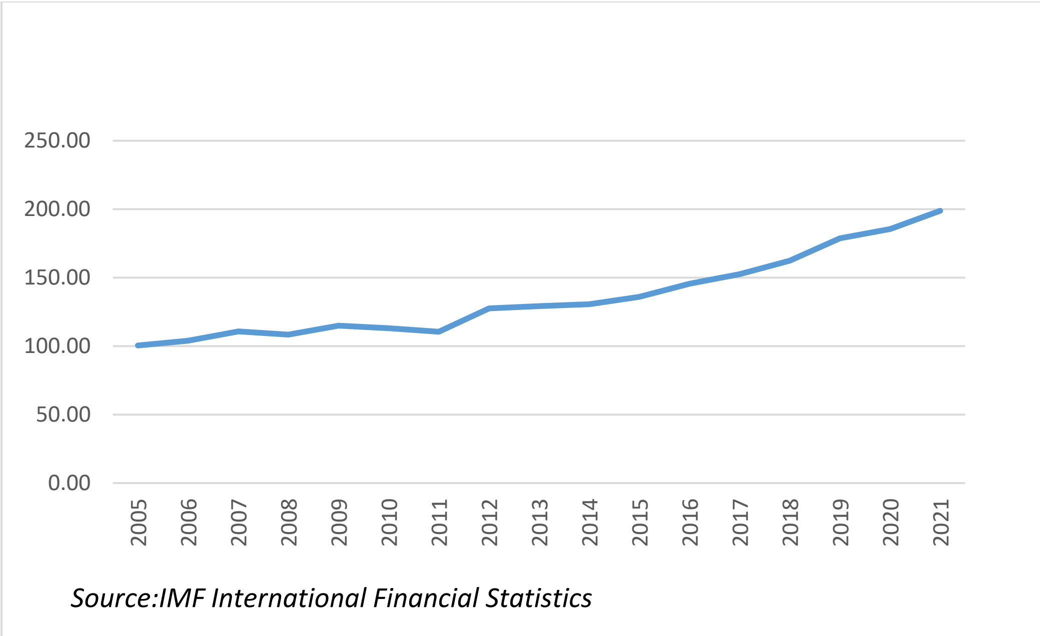


Figure 7-24: Exchange Rate(Sri Lankan Re per US dollar)

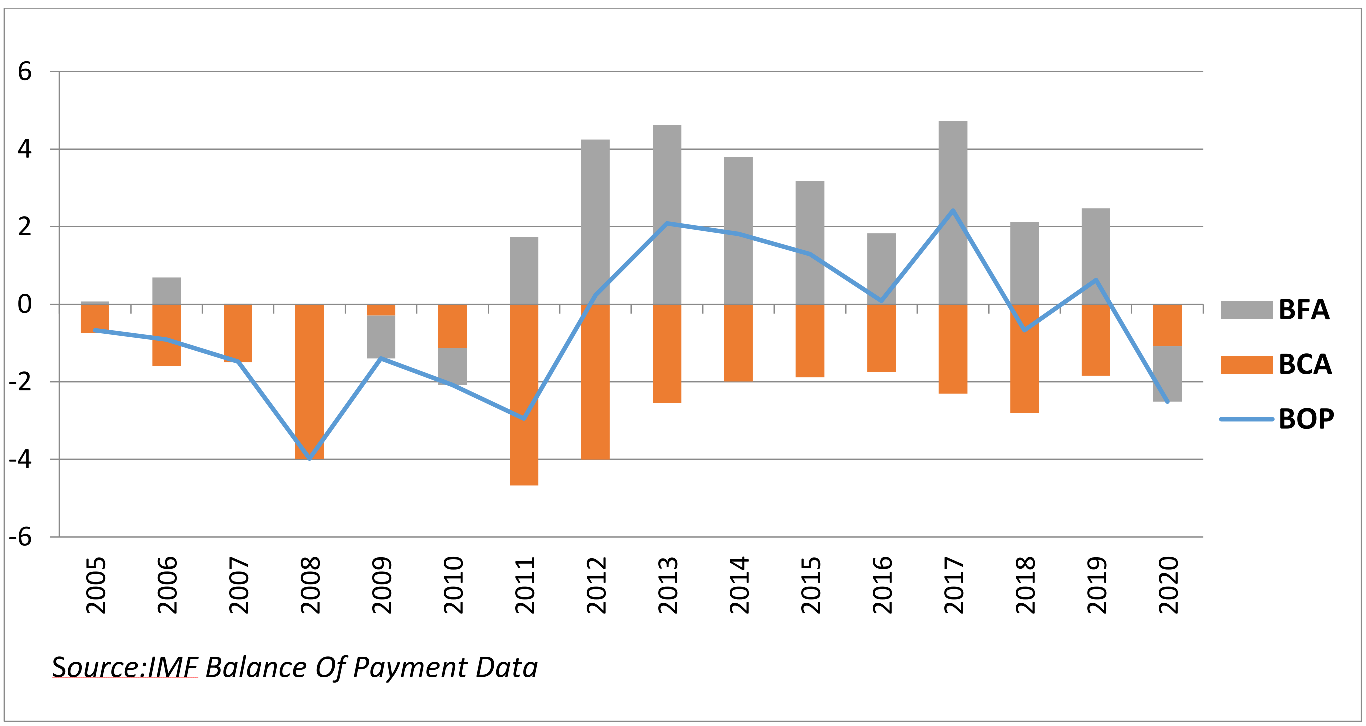
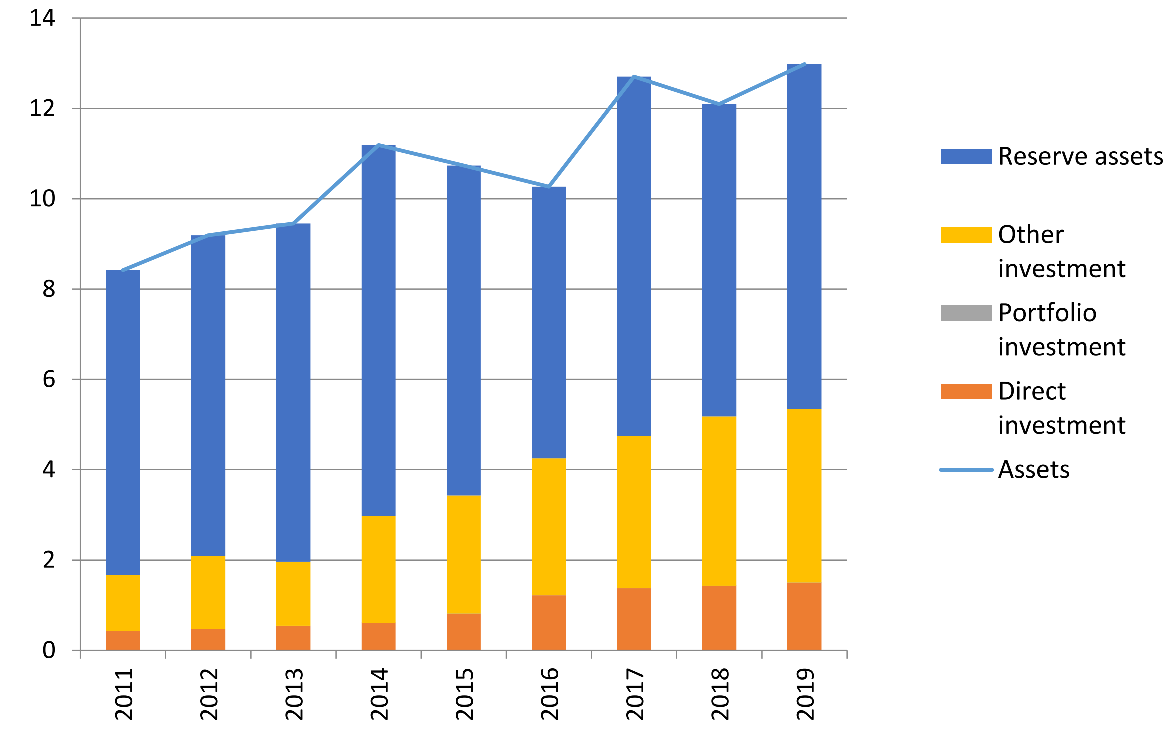
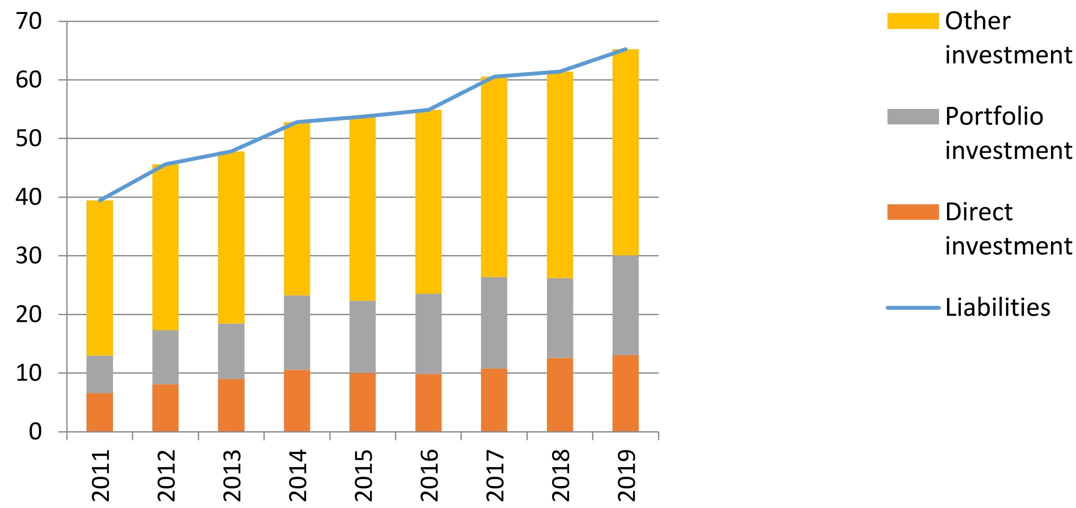


Figure 7-25: Balance of Payments of Sri Lanka: 2005 to 2020($bn)



Source: IMF Balance of Payment and International Investment Position

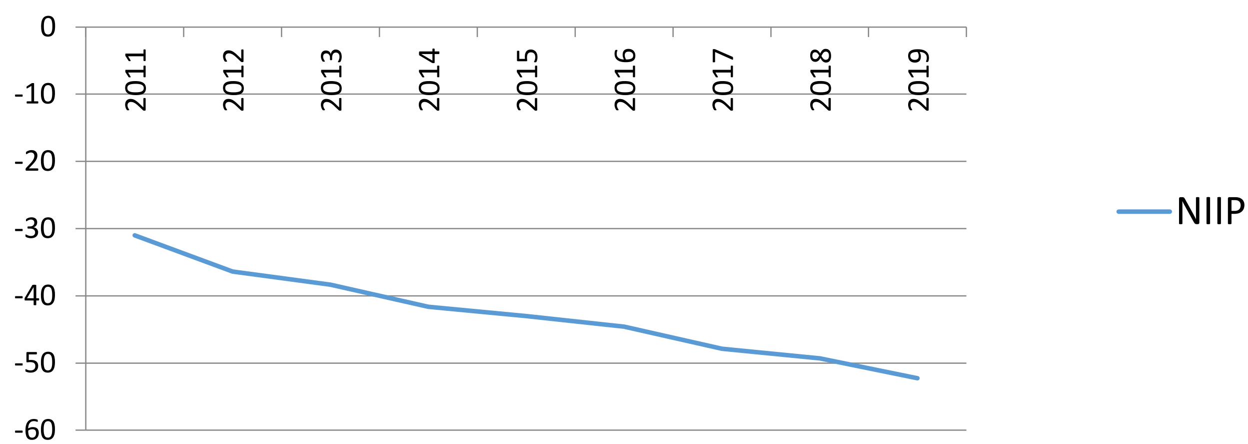
Figure 7-26:Composition of Assets of Sri Lanka($bn)



Source: IMF Balance of Payment and International Investment Position

Figure 7-27: Composition of Liabilities of Sri Lanka ($ bn)

The Net International Investment Position of Sri Lanka that is Assets- Liabilities has remained negative from 2011 to 2019 and has actually worsened over the years.(Figure 7-28)



Source: *IMF Balance of Payment and International Investment Position ,Author's Calculations*

Figure 7-28: NIIP ($ bn)

IMF Credit and Structural Adjustment Program

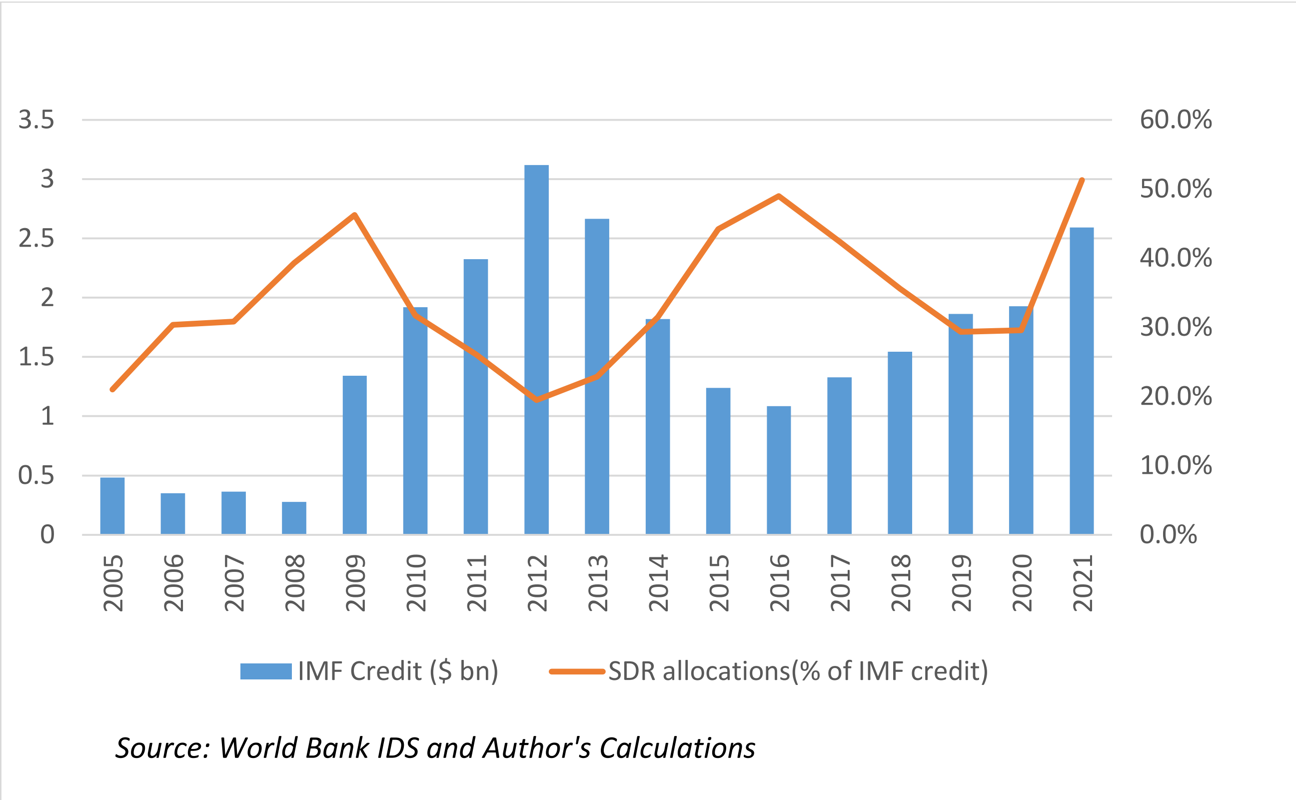


Figure 7-29: IMF Credit to Sri Lanka

There was a decline in IMF credit to Sri Lanka from $ 3.1 billion in 2012 to $ 1 billion in 2016 but SDR allocations as a % of total IMF credit increased from 19.5 % to 49%. (Figure 7-29) .In 2016, the Sri Lankan authorities requested a three-year arrangement with proposed access equivalent to SDR 1,070.78 million (185 percent of quota) to meet balance of payments needs.

Till now in total SDR 660.7 billion (equivalent to about US $ 943 billion) have been allocated to different countries of the world. This includes largest ever allocation of about SDR 456 billion (equivalent to US $ 650 billion) approved on August 2, 2021 to help countries cope with Covid 19 pandemic. The SDR (Special Drawing Rights) is an international reserve asset created by the IMF to supplement the official reserves of its member countries. SDRs can provide a country with additional liquidity. The SDR is not a currency. It is a potential claim on the freely usable currencies of IMF members. The value of the SDR is based on a basket of five currencies- the US Dollar, the euro, the Chinese renminbi, the Japanese yen and the British pound sterling. The allocation of SDRs to each member country is based on the member's IMF quota shares. The stronger a country's economy, the higher quota shares it has. The more quota shares that a country has, the more it pays into the IMF, which comes with greater voting power. For a general allocation of SDRs to occur, the allocation must meet the IMF's goal of "meeting the long-term global need to supplement existing reserve assets." The allocation must also receive an 85%

majority approval of the total voting power of members in the SDR Department. The Board states that the SDR basket is to comprise of the currencies of members or monetary unions "whose exports had the largest value over a five-year period, and have been determined by the IMF to be freely usable. “Freely usable," according to the IMF, is a currency that "(i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets. “Determining what is "freely usable" is gauged on metrics such as the number of shares of the currency in reserve holdings, the currency denomination of international debt securities, the volume of transactions in foreign exchange markets, cross-border payments, and trade finance. The IMF member states that hold SDRs can exchange them for freely usable currencies by either agreeing among themselves to voluntary swaps or by the IMF instructing countries with stronger economies or larger foreign currency reserves to buy SDRs from the less-endowed members. The interest rate on SDRs, or the SDRi, provides the basis for calculating the interest rate that is charged to member countries when they borrow from the IMF and paid to members for their remunerated creditor positions in the IMF. It is also the interest paid to member countries on their own SDR holdings and charged on their SDR allocation. The SDRi is determined weekly based on a weighted average of representative interest rates on short-term government debt instruments in the money markets of the SDR basket currencies, with a floor of five basis points (International Monetary Fund, n.d.) (Kenton, 2022)

When SDRs are initially allocated to an IMF member country, the member is given two positions. The two positions are the “SDR holdings” and the “SDR allocations.” Countries receive interest on their holdings and pay interest based on their allocations position. The interest amount for both positions is based on the SDR interest rate. The two positions’ values start out the same. Therefore, the interest received and interest paid cancel each other out. When a country trades SDRs for freely usable currencies, their holdings decrease and their foreign exchange reserves increase. This causes the holdings to fall below the allocations. When this happens, the interest payments associated with the two positions do not cancel each other out. The country will pay more interest than it receives. Alternatively, if a country trades freely usable currencies for SDRs, their holdings can increase above their allocations position. The country will then receive more interest than it pays out. (CFI, 2020)

The combination of unbalanced macroeconomic policies and a difficult external environment prompted the authorities to embark on the adjustment program in 2016, supported under the Extended Fund Facility (EFF) by the IMF. The Extended Fund Facility (EFF) provides financial assistance to countries facing serious medium-term balance of payments problems because of structural weaknesses that require time to address. To help countries implement medium-term structural reforms, the EFF offers longer program engagement and a longer repayment period. (International Monetary Fund, n.d.)

The key objectives of the Sri Lankan program were to: (i) implement a structural increase in revenues to reduce the fiscal deficit; (ii) reverse the decline in central bank foreign exchange reserves; (iii) reduce public debt relative to GDP and lower Sri Lanka’s risk of debt distress; and (iv) enhance public financial management and improve the operations of state owned enterprises. The program also aims to transition toward inflation targeting with a flexible exchange rate regime and to promote sustainable and inclusive economic growth by supporting trade and investment. (International Monetary Fund, 2016). Important progress was made through prudent monetary policymaking, earlier fiscal consolidation, and landmark reforms including a new income tax law and an automatic fuel pricing mechanism. However, program implementation was challenged by large unforeseen shocks.

Excessive reliance on International Sovereign Bonds

In the immediate aftermath of Sri Lanka's civil war in 2009, the country embarked on a mainly bilaterally-financed infrastructure investment program for investments in ports, energy, and transport. The Sri Lankan government issued $17 billion worth of ISBs from 2007 to 2019, in face value terms. According to a 2021 report by the Advocate Institute, Sri Lanka's ISBs were issued at high coupon rates (often between 5-8 percent), with some 36 percent of these ISBs being subject to classic collective action clauses, which make restructuring much harder for debtor governments. As a result the country's ratio of public external debt stock to GDP grew. (Nicholas & Illanperuma, 2023)

Numerous observers have described the loans made to Sri Lanka by the Exim Bank of China to build the Hambantota International Port and the Mattala Rajapaksa International Airport, which turned out to be unprofitable white elephants, as examples of debt-trap diplomacy and predatory lending. Debt-trap diplomacy is a term to describe an international financial relationship where a creditor country or institution extends debt to a borrowing nation partially, or solely, to increase the lender's political leverage. While there are no internationally agreed legal definitions for predatory lending, a 2006 audit report from the office of inspector general of the US Federal Deposit Insurance Corporation (FDIC) broadly defines predatory lending as "imposing unfair and abusive loan terms on borrowers", though "unfair" and "abusive" were not specifically defined. In 2007, the state-owned Chinese firms China Harbour Engineering Company and Sinohydro Corporation were hired to build the port for $361 million. Exim funded 85 percent of the project at an annual interest rate of 6.3 percent. After the project began losing money and Sri Lanka's debt-servicing burden increased, its government decided to lease the project to state-owned China Merchants Port on a 99-year lease for cash. The $1.12 billion lease to the Chinese company was used by Sri Lanka to address balance-of-payment issues. (Wikipedia, n.d.)

Shock to Economy and Subsequent Mismanagement

From 2016-2017, droughts led to poor harvests of rice and other crops threatening food security. Sri Lankan government provided relief to farmers, putting strain on the national budget.

In October 2018 President appointed Mahinda Rajapaksa as new Prime Minister dismissing the incumbent premier. Change of government adversely affected international investment.

In April 2019 fundamentalists targeted several churches and luxury hotels in terror attacks known as Easter Sunday bombings. This severely affected tourism.

The new government following the Presidential and Parliamentary elections (in November 2019 and August 2020, respectively), headed by President Rajapaksa of the Sri Lanka Podujana

Peramuna party, pledged to develop a people-centric economy through tax policy changes to promote production and reduce the cost of living. In this context, income tax and VAT were cut in late 2019, with estimated revenue losses exceeding 2 percent of GDP. The automatic fuel pricing mechanism was discontinued, raising fiscal risks from state-owned enterprise losses. Rating agencies downgraded Sri Lanka's sovereign credit rating, thus investors fled from Sri Lanka and Portfolio Foreign Investment became negative in 2020.(Figure 7-23). Sri Lanka has always had a current account deficit adding to this negative PFI led to an overall BOP deficit in 2020.(Figure 7-25)

During the first and second waves of COVID-19 (March-September 2020 and October 2020-March 2021), the government introduced strict containment measures, including a ban on air passenger arrivals as well as nationwide and localized lockdowns. The third wave (April-October 2021) caused by the Delta variant resulted in higher caseloads and deaths and prompted new lockdowns. Meanwhile, a strong vaccination campaign starting in 2021Q2 has double vaccinated close to 65 percent of the population. With most containment measures and border restrictions relaxed in October 2021, mobility indicators have largely recovered to their pre-pandemic levels. The spread of the Omicron variant has not led to a notable increase in cases as of January 2022. (International Monetary Fund, 2022).

The annual GDP growth rate declined to -4.6 % in 2020. There was a decrease in manufacturing and services, particularly tourism, which is a major source of foreign exchange for Sri Lanka due to Covid pandemic and associated lockdowns and containment measures. The annual growth recovered to 3.5 % in 2021 but was restricted by temporary restriction on the use and importation of chemical fertilizer, with an adverse impact on agricultural production, and by the negative effect of foreign exchange (FX) shortages and the suspension of certain imports (import restrictions) on industrial activity.

Moreover, the tea exports and tourism sector of Sri Lanka was negatively impacted by Russian invasion of Ukraine in 2022 because Russia happens to be the second biggest market for Sri Lanka's tea exports. (George, George, & Baskar, 2022).

As of February 2022, the country was left with only $2.31 billion in its reserves but faces debt repayments of around $4 billion in 2022, including a $1 billion international sovereign bond (ISB) maturing in July. ISBs make up the largest share of Sri Lanka's foreign debt at $12.55 billion, with the Asian Development Bank, Japan and China among the other major lenders. (Reuters, 2022)

In March 2022 thousands of Sri Lankans took to streets upset over the government's mishandling of the economy, fuel shortages and rolling blackouts. In May 2022 Sri Lanka's currency sharply depreciates sharply.In August 2022 Central Bank of Sri Lanka starts raising key interest rates to check inflation. In September 2022 inflation rate soared to 69.8%.Sri Lanka asked IMF for emergency aid. Sri Lanka increased the value added tax. In January 2023 Central Bank reduced key interest rates.In March 2023 IMF proposed $ 3 billion economic package with austerity measures. (DIONGSON, 2023)

Way Forward

The Sri Lankan economy has begun to show signs of recovery from its worst economic crisis since independence following the US$2.9 billion International Monetary Fund (IMF) reform program that commenced in late March 2023. Sri Lanka's foreign exchange buffers have improved thanks to the first instalment of the IMF loan, supplemental funding from the Asian Development Bank and the World Bank and rising migrant worker remittances and tourist arrivals. This has permitted the government to lift restrictions on essential imports. Inflation is gradually dissipating and long queues at fuel stations and mass street protests have ended (Athukorala, 2023).Another challenge that Sri Lanka faces in its efforts to restructure its debt is the need for a clear and credible path for future economic growth. This will require a commitment to fiscal discipline, the implementation of structural reforms, and a focus on investment in key sectors that can drive economic growth. In addition, Sri Lanka will need to work closely with its creditors and the international financial community to develop a clear and viable plan for debt restructuring. (Adrogué & Plant, 2023)

In 2022, global public debt – comprising general government domestic and external debt – reached a record USD 92 trillion. Developing countries owe almost 30% of the total, of which roughly 70% is attributable to China, India and Brazil.However, public debt has increased faster in developing countries compared to developed countries over the last decade. The rise of debt in the developing world has mainly been due to growing development financing needs – exacerbated by the COVID-19 pandemic, the cost-of-living crisis, and climate change – and by limited alternative sources of financing.Consequently, the number of countries facing high levels of debt has increased sharply from only 22 countries in 2011 to 59 countries in 2022. The burden of debt on development is intensified by a system that constrains developing countries access to development finance and pushes them to borrow from more expensive sources, increasing their vulnerabilities and making it even harder to resolve debt crises. When global financial conditions change or international investors become more risk-averse, borrowing costs can shoot up suddenly. Similarly, when a country's currency devalues, debt payments in foreign currency can skyrocket, leaving less money for development spending. The increasing share of public debt owed to private creditors presents two challenges. First, borrowing from private sources is more expensive than concessional financing from multilateral and bilateral sources. Second, the growing complexity of the creditor base makes it more difficult to successfully complete a debt restructuring when needed. When developing countries borrow money, they have to pay much higher interest rates compared to developed countries, even without considering the costs of exchange rate fluctuations. To address the global debt challenges and achieve sustainable development, the United Nations in the SDG Stimulus package and the Summit for the Future's International Financial Architecture policy brief outlines a clear way forward- i)Make the international financial system more inclusive ii)Tackling the high cost of debt and create a debt workout mechanism iii)Expanding contingency finance through strengthening SDR, a temporary suspension of IMF surcharges etc. iv) Expansion of multilateral development banks for long term affordable lending. (UN Global Crisis Response Group, 2023)

Chapter 8
ARGENTINA

Argentina stretches 4,000km from its sub-tropical north to the sub-Antarctic south. Its terrain includes part of the Andes mountain range, swamps, the plains of the Pampas and a long coastline. Argentina is rich in resources, has a well-educated workforce, and is one of South America's largest economies. In cultural terms, it has given the world major writers like Jorge Luis Borges

With a Gross Domestic Product (GDP) of approximately US$610 billion, Argentina is one of the largest economies in Latin America. Argentina has vast natural resources in energy and agriculture. Within its 2.8 million square kilometres of territory, it is endowed with extraordinary fertile lands, gas, and lithium reserves, and has great potential for renewable energy.

Argentina is a leading food producer with large-scale agricultural and livestock industries. In addition, it has significant opportunities in some manufacturing subsectors, and innovative services in high tech industries.

After the pandemic, economic activity has recovered faster than expected, with an increase of 10.4% of GDP in 2021 and 5.2% in 2022, after a fall of 9.9% in 2020 in the context of the crisis unleashed by COVID-19. However, economic activity has contracted in the last 4 months of 2022, affected by strict import controls to sustain the accumulation of reserves, while a historic drought limits growth in 2023. Inflation remains high, and as of February 2023, it exceeded a 100% per year (figure 1-1). The economy continues to show macroeconomic imbalances that limit the sustainability of economic growth.

In recent years, Argentina's GDP at constant prices (figure 8-2) has experienced fluctuations due

Figure 8-1:Inflation in Argentina

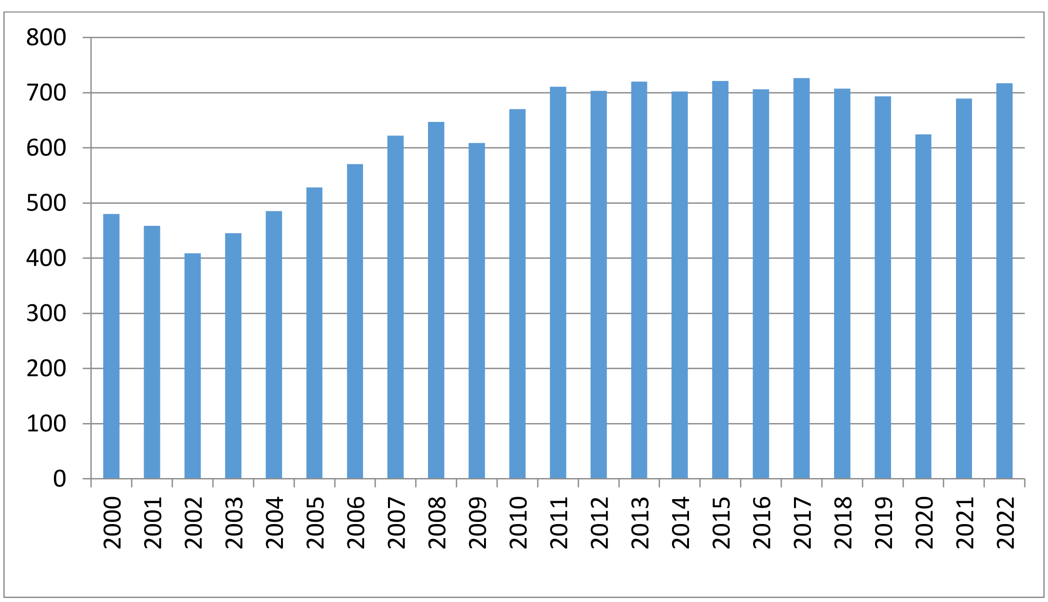


Figure 8-2:Argentina GDP (constant prices)

In recent years, Argentina's GDP at constant prices (figure 8-2) has experienced fluctuations due to various economic challenges, including inflation, debt issues, and economic policies.

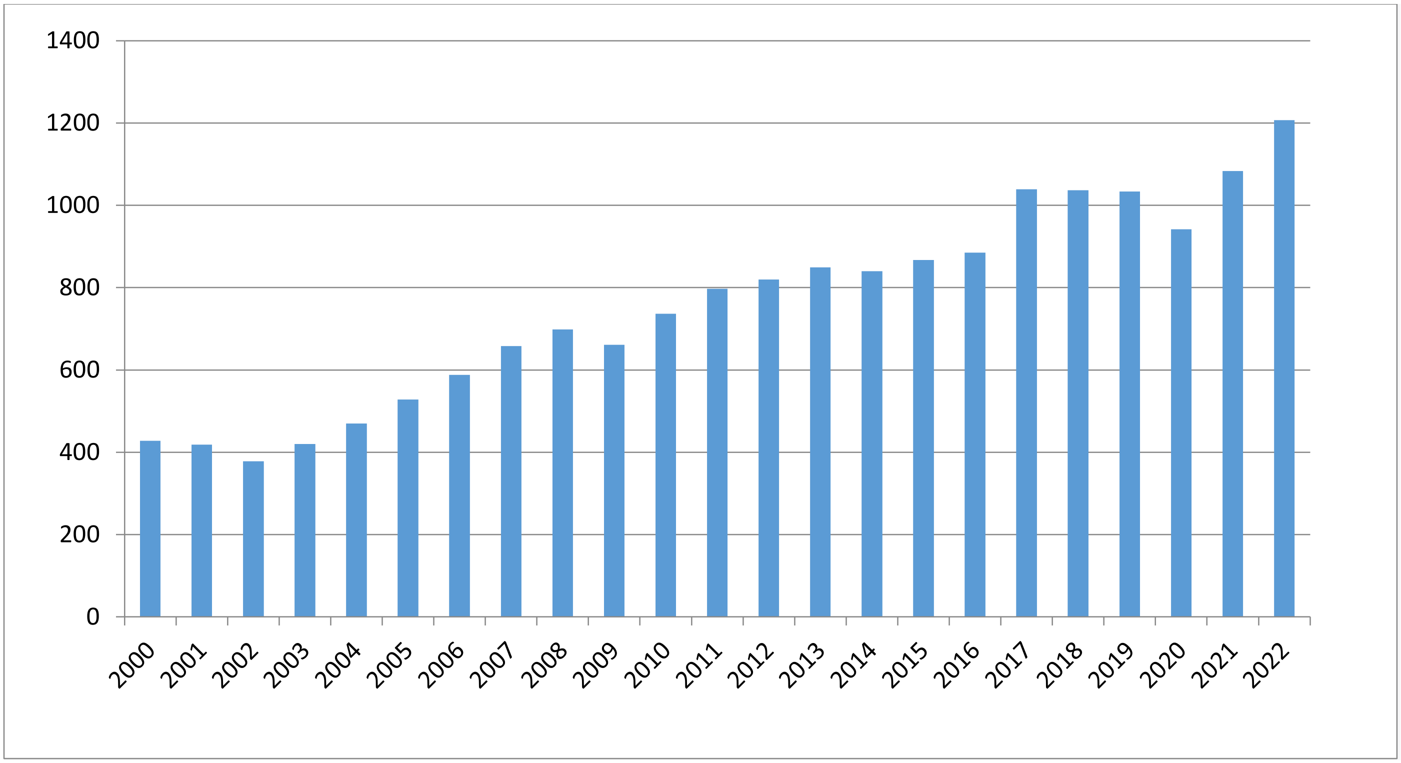


Figure 8-3:Argentina GDP, current prices (PPP)

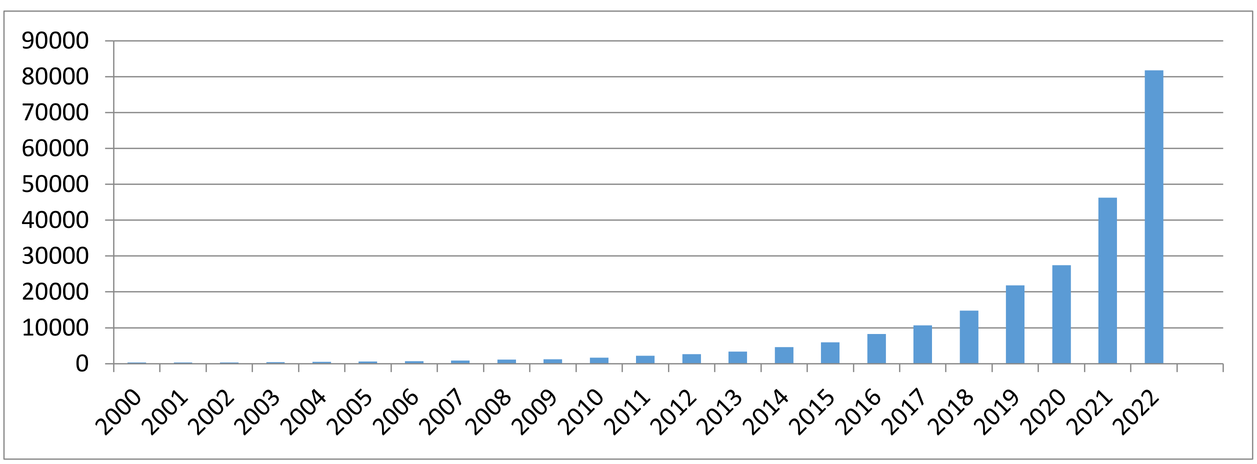


Figure 8-4:Argentina GDP, current prices

General Government Finances:

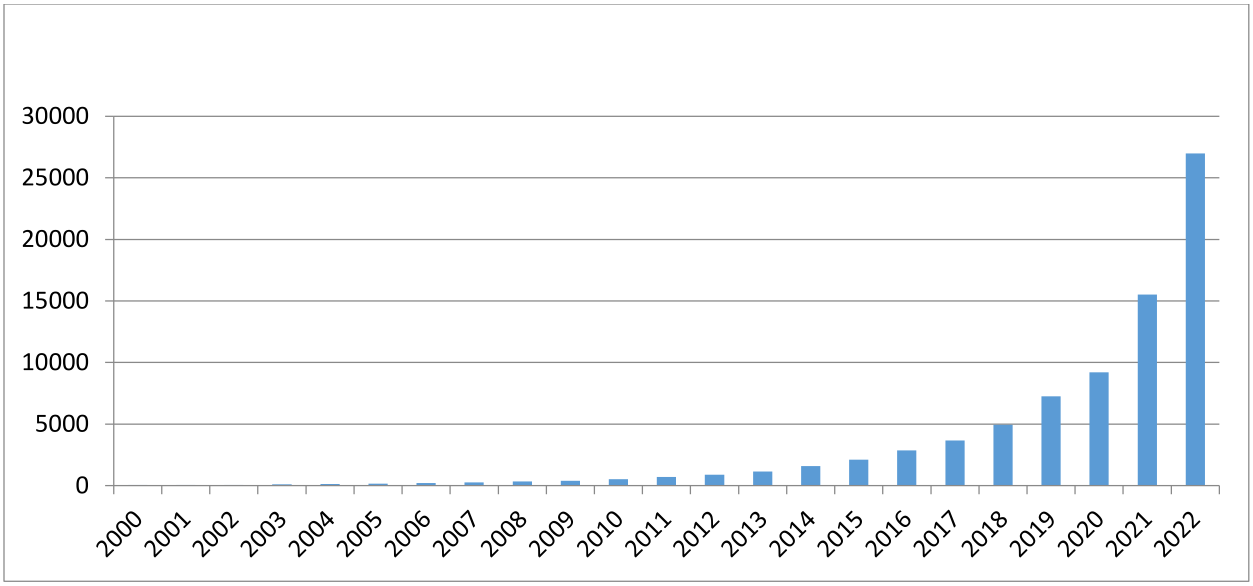


Figure 8-5:Government Revenue (national currency)

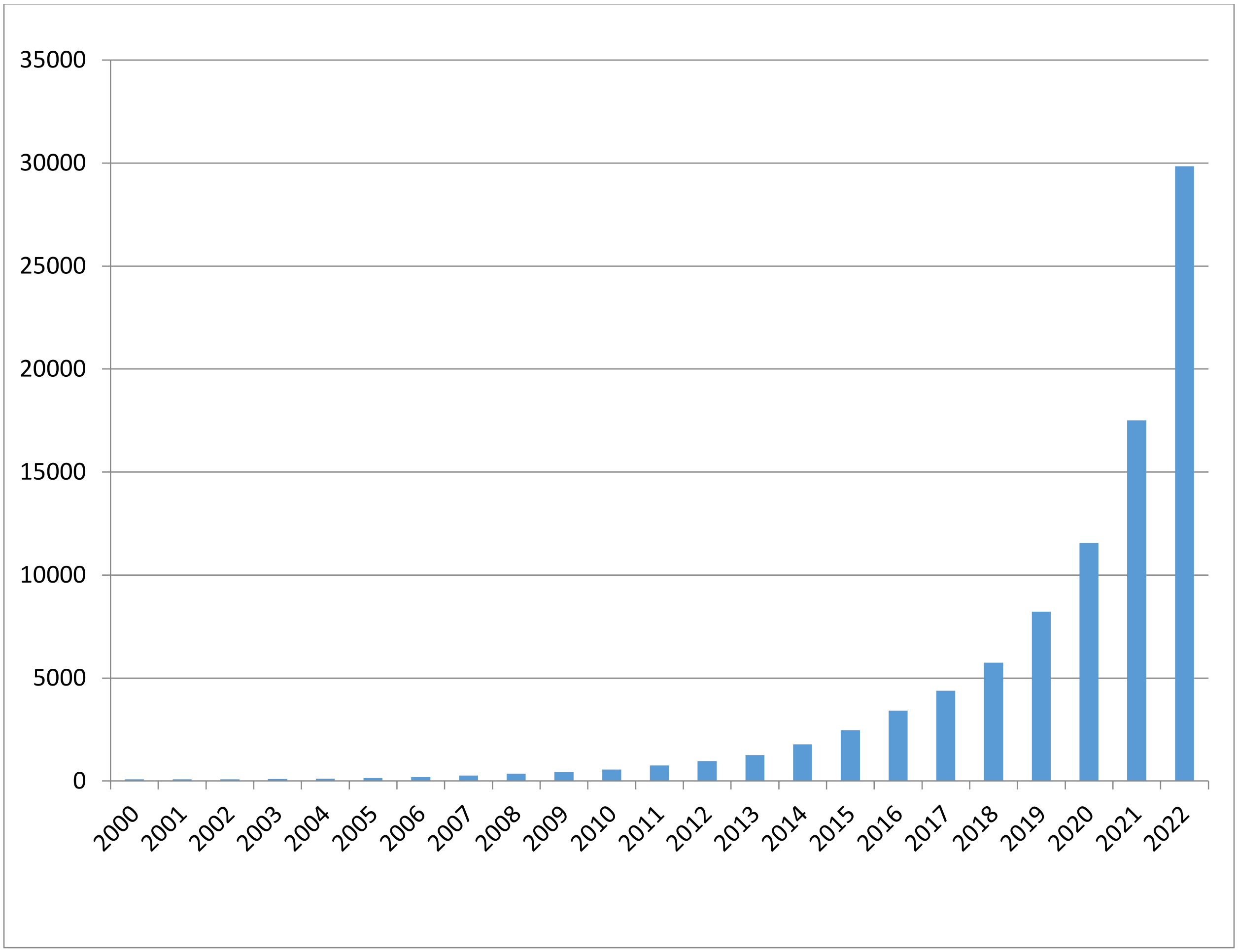


Figure 8-6:Government Total Expenditure (national currency)

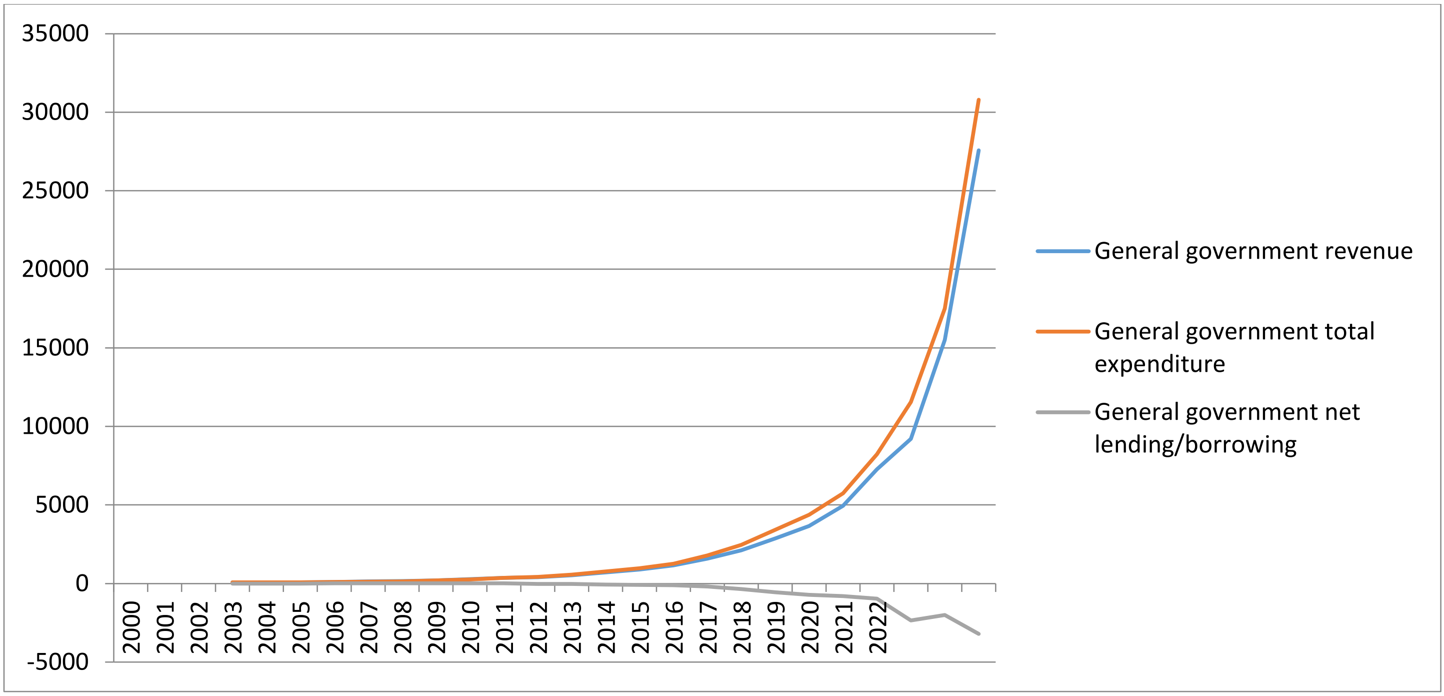


Figure 8-7:Government Finances for Argentina

Current Account:

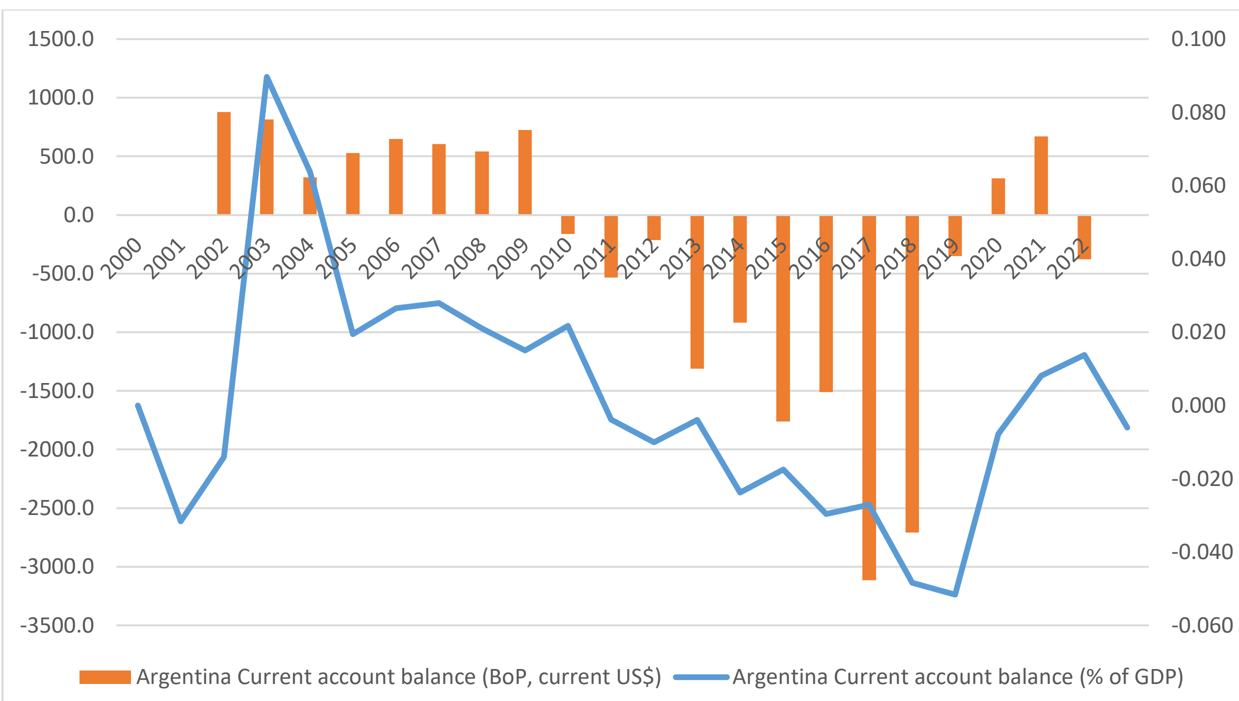


Figure 8-8:Argentina's Current Account Balance

The current account of Argentina started off with a negative trend in 2000 and 2001 but quickly gained a positive trend thereafter. There were some fluctuations in the account from 2002 to 2009 but Argentina maintained a positive trend but after 2009 the series went negative, and the deficit has been very large in years 2017 and 2018. Even so the government was successful in being surplus in 2020 and 2021 but again in 2022 CAD went negative. Such large deficitskeep occurring it can make it difficult for Argentina to import goods and services as it leads to shortage of foreign currency.

There are number of factors that have contributed to Argentina's negative CAD. One factor is that Argentina has a history of high inflation. This makes Argentine exports less competitive in the global market and imports more expensive. Another factor is that the Argentina has a large trade deficit with its major trading partners, such as China and America.

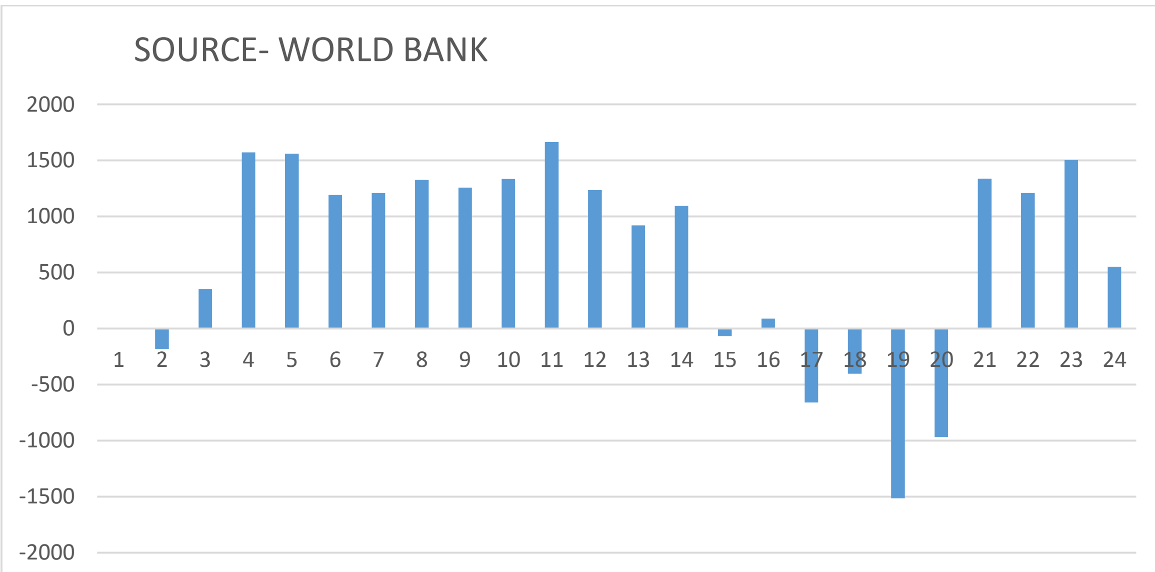


Figure 8-9:Argentina's Net Trade in goods and services

Financial Account

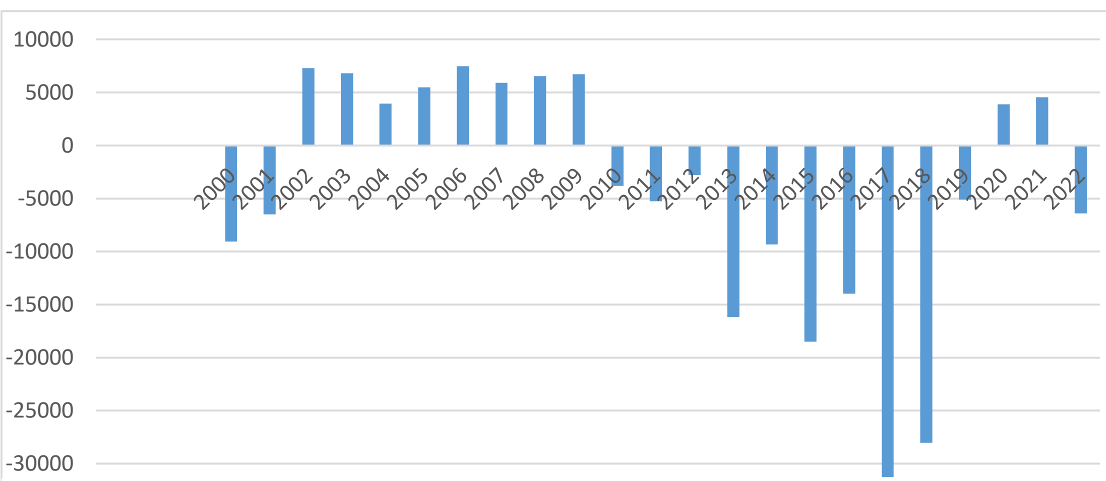


Figure 8-10:Net Financial Account for Argentina

Argentina's financial account (figure 1-10) has also fluctuated over time, but it has been negative in recent years. The high economic instability makes investors less likely to invest in Argentina. Argentina's elevated level of debt also makes it difficult for Argentina to borrow money from foreign lenders.

Even though Argentina is struggling for foreign investors to invest in the country, Argentina's FDI inflows (figure 1-11) has reached $6.5 billion, which is a significant increase from previous year. The main sectors attracting FDI was mining, energy, and manufacturing.

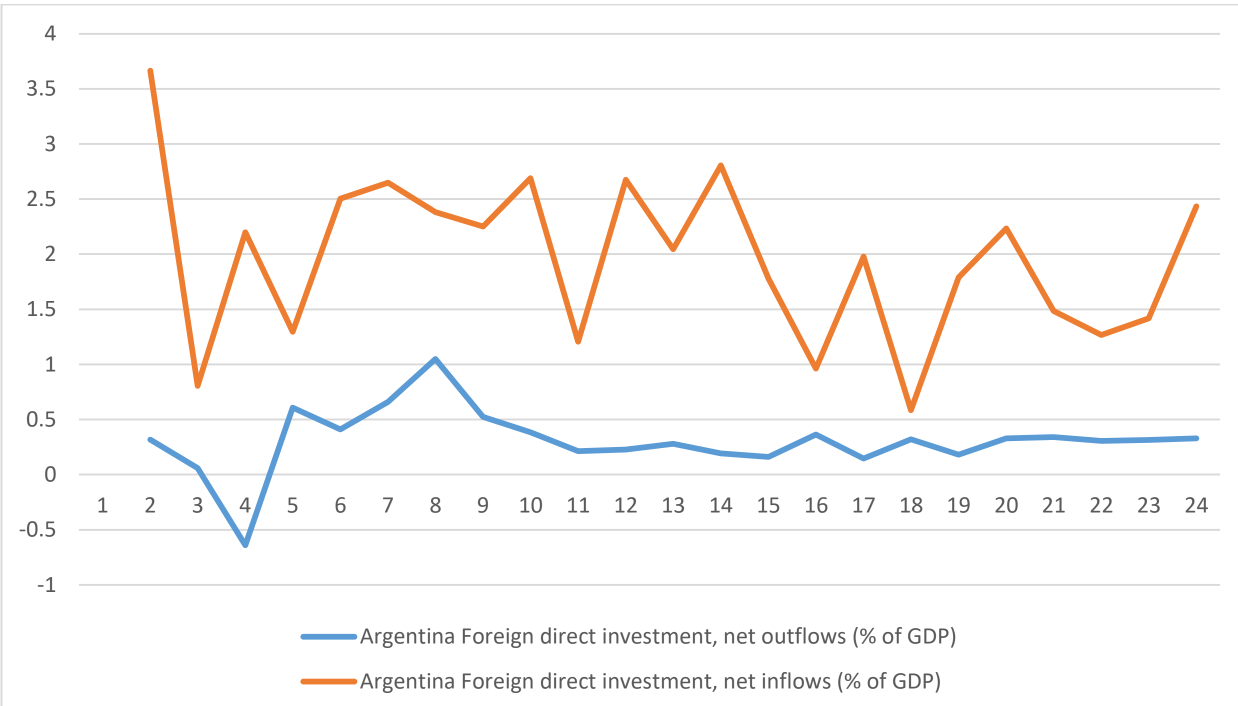


Figure 8-11:Argentina's FDI as a percentage of GDP

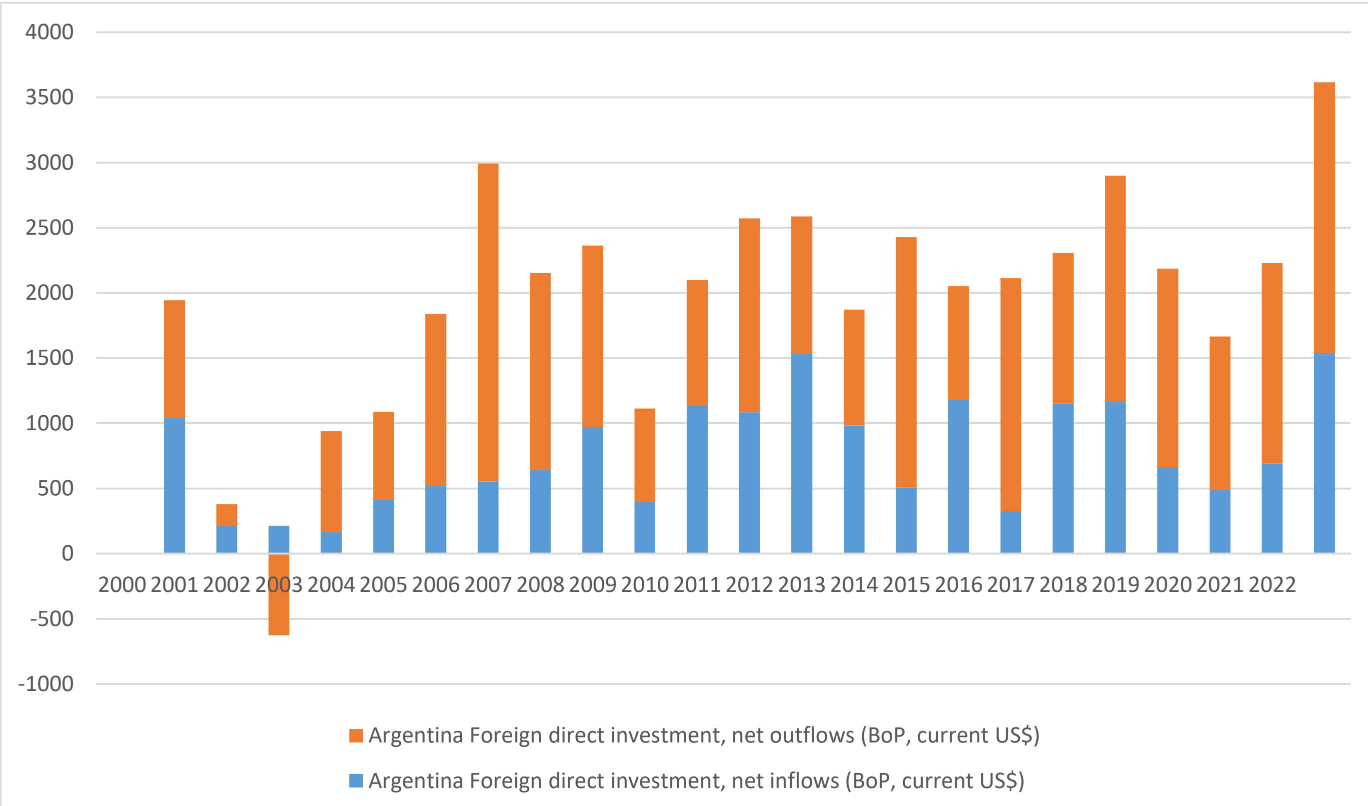


Figure 8-12:Argentina's FDI

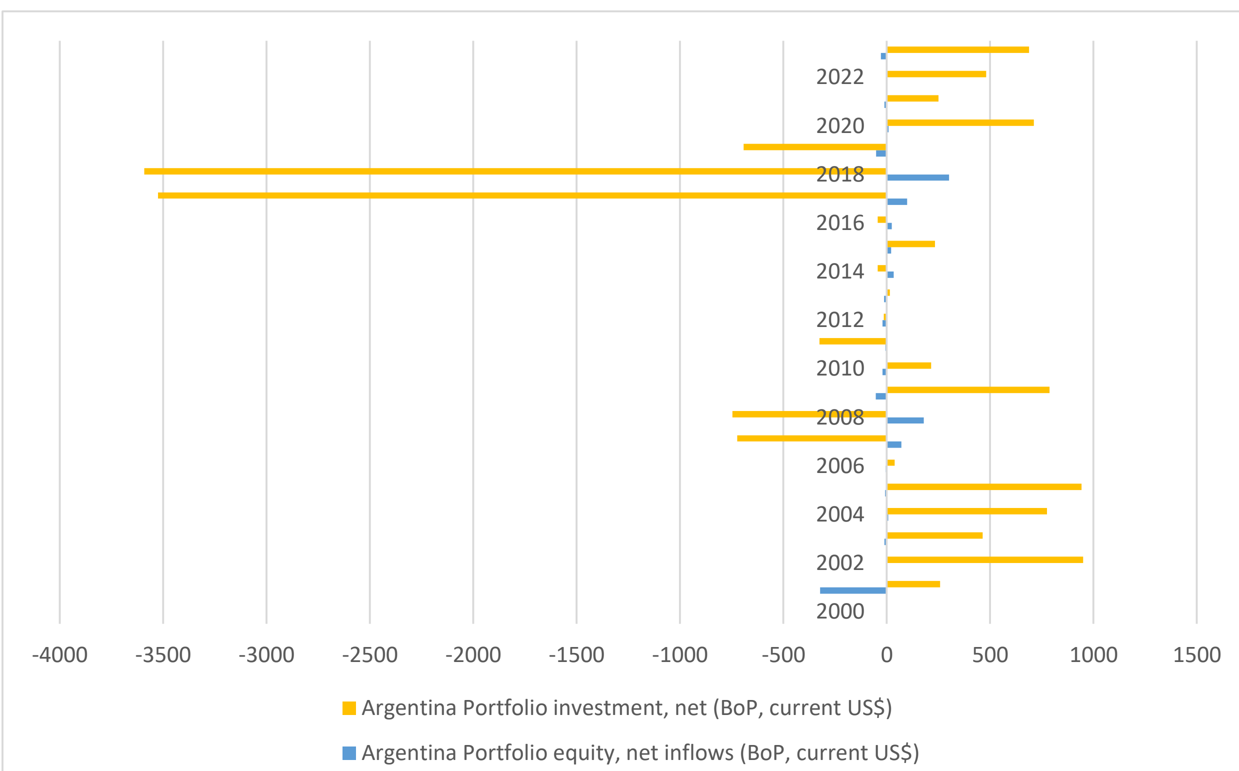


Figure 8-13:Argentina's FPI

Debt Situation in Argentina

Argentina's economic history has been marked by a series of cycles of prosperity and crisis, often intertwined with its relationship with debt. Here is an overview of key events that have shaped Argentina's debt situation and its economic history.

1. **The 2001 Economic Crisis and Default:**
    - The pegged exchange rate became unsustainable, leading to a sharp economic contraction and social unrest.
    - In 2001, Argentina defaulted on its debt once again, amid a deep economic crisis that resulted in widespread poverty and unemployment.
2. **Post-Crisis Period and Debt Restructuring (2000s - 2010s):**
    - Argentina underwent significant political changes and pursued heterodox economic policies.
    - The government engaged in debt restructuring negotiations with bondholders, resulting in a "haircut" on the value of the bonds.
3. **Return to International Capital Markets (2016 - 2019):**
    - Argentina returned to international capital markets under President Mauricio Marci, issuing new bonds to raise funds.
    - However, the country faced challenges in servicing its debt amid slow economic growth.
4. **Recent Developments (2020s):**
    - Argentina continues to grapple with high inflation, economic imbalances, and the impact of the COVID-19 pandemic on its economy.
    - As of my last update in September 2021, the specifics of Argentina's debt situation beyond that point are not available.

Argentina's economic history is complex and characterized by a cycle of borrowing, boom and bust cycles, and debt defaults. The country's relationship with debt has often been influenced by political factors, economic policies, and external shocks, leading to a pattern of recurring challenges and reforms.

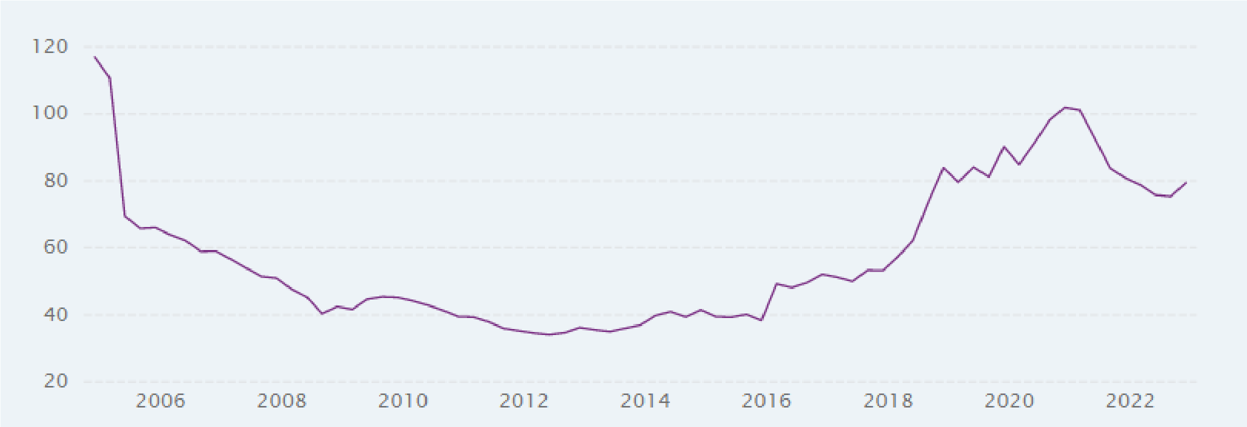


Figure 8-14:Government Debt (% of GDP)

Argentina's government debt as a percentage of GDP has experienced fluctuations over the years, reflecting the country's economic challenges and policy choices. From the early 2000s to 2021, the debt-to-GDP ratio exhibited notable shifts, ranging fromlows of about 44%. (in 2014) to highs of around 97% (in 2020) to 108% (in 2021)

These changes were influenced by factors including fiscal policies, economic growth, inflation, and external borrowing. Periods of economic expansion were often accompanied by reduced debt burdens, while economic crises and external shocks lead to increased debt levels.

The management of government debt remains a crucial consideration for Argentina's economic stability and long-term fiscal health, requiring a balance between addressing social needs, ensuring sustainability, and maintaining investor confidence.

Argentina's trajectory of external debt stocks as a proportion of Gross National Income (GNI) has been shaped by multifaceted interactions between economic, political, and external determinants.

1.Sovereign Default and Restructuring (Early 2000s): The pivotal event of Argentina defaulting on its sovereign debt in 2001 marked a dramatic juncture. Subsequent debt restructuring negotiations played a substantial role in recalibrating the external debt-to-GNI ratio, as restructured terms resulted in a reduction of nominal debt levels.

2. Economic Rebound and Commodity Boom: The mid-2000s witnessed a resurgence in Argentina's economic fortunes, propelled by global commodity price upswings. This positive trajectory augmented the country's capacity to lower the external debt-to-GNI ratio, underpinned by improved fiscal management and augmented export earnings.

3. Fiscal Policy and Macroeconomic Dynamics: Argentina's debt dynamics have been influenced by domestic fiscal policies and wider macroeconomic oscillations. Inflation and currency depreciation have direct repercussions on debt measurements, affecting the external debt ratio through their impact on GNI calculations.

4. Global Economic Perturbations: The external debt-to-GNI ratio also mirrors global economic variations. Shifts in global interest rates, demand for commodities, and global investor sentiment sway Argentina's debt dynamics by affecting the overall environment for debt management and servicing.

5. Recent Debt Renegotiations and COVID-19 Pandemic: Recent episodes of debt renegotiations, such as those in 2020, have had discernible effects on the trajectory of external debt ratios. Moreover, the unforeseen COVID-19 pandemic introduced additional complexities, reshaping the fiscal landscape and posing further challenges to debt sustainability.

Throughout the observed period, Argentina's external debt stocks as a percentage of GNI underwent notable fluctuations, reflecting the country's dynamic economic landscape and policy decisions.

On December 26, 2001, Argentina defaulted on a total of US$93 billion of its external debt (also known as external debt crisis of Argentina) it all led to a collapse in output, high levels of unemployment, and political and social turmoil.

The following year, 2015, saw a discernible uptick in the ratio to around 25.9%. This increase pointed toward a heightened reliance on external borrowing in relation to the country's economic output. This could be indicative of strategic borrowing decisions, potentially driven by the government's efforts to address fiscal and economic challenges.

The year 2016 witnessed a further expansion of the external debt stocks as a percentage of GNI, reaching approximately 31.1%. This rise might be associated with economic difficulties, where borrowing could have been utilized as a means of stabilizing the economy or funding critical development projects.

On the contrary, in 2017, there was a slight decrease in the ratio to about 29.7%. This adjustment has been influenced by targeted measures to manage the debt burden or to prioritize other economic objectives.

However, the trend shifted dramatically in 2018 as the ratio surged to approximately 45.8%. This substantial increase indicated a significant escalation in external borrowing relative to GNI. The factors contributing to this surge could include currency depreciation, fiscal pressures, or the need to address economic vulnerabilities.

The year 2019 continued this trajectory with the ratio reaching about 56.3%, underscoring an ongoing pattern of elevated external debt accumulation. Economic instability and the government's response to mitigate financial challenges have driven this trend.

Figure 8-15:Argentina's Total Reserves

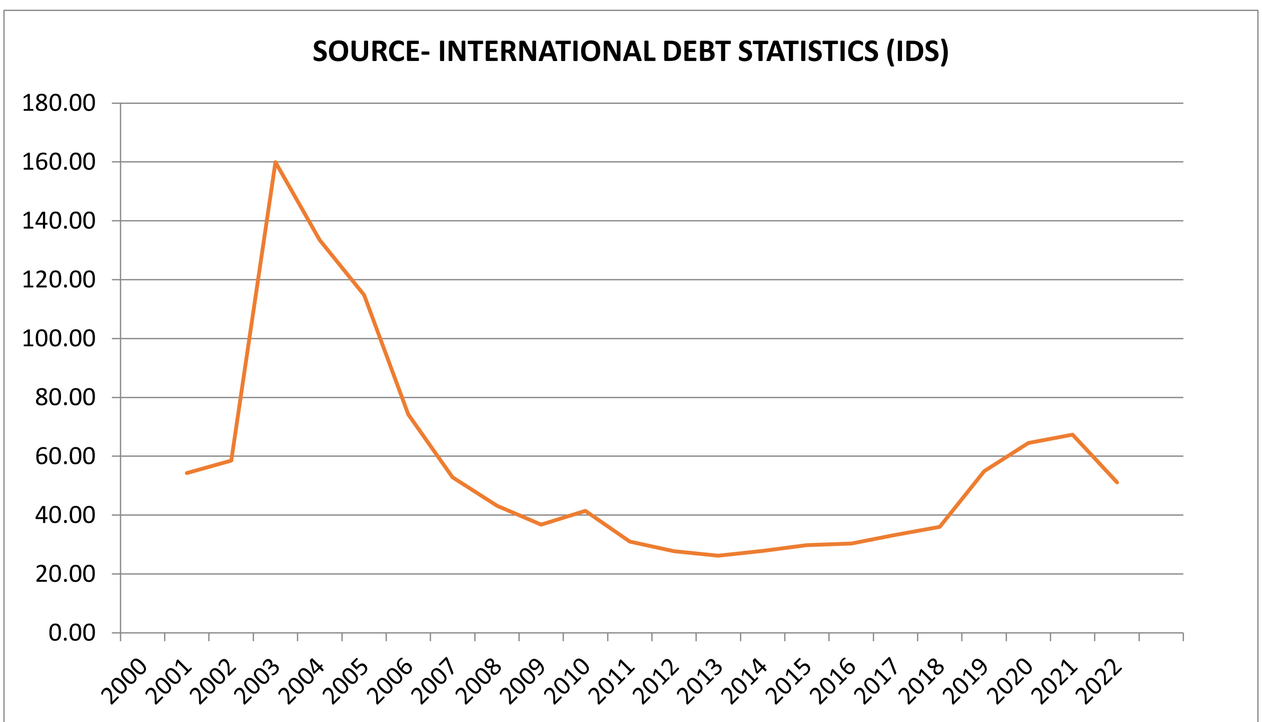


Figure 8-16:External Debt Stocks (% of GNI)

Argentina's reserves have seen a sharp decline post 2012 (figure 1-16) even after government took various steps to increase its reserves but only enjoyed some early years of success thereafter the country again plunged into a sharp decline of its reserves. Argentina's reserves totalled 23.03 billion USD, which is equivalent to only 4.78% of its GDP. This is below the recommended level of 20% of GDP for emerging market economies.

Also, the country's reserves are concentrated in only few assets. The majority of Argentina's reserves are held in US dollars and gold (figure 1-17). This makes its reserves vulnerable to fluctuations in the global financial markets.

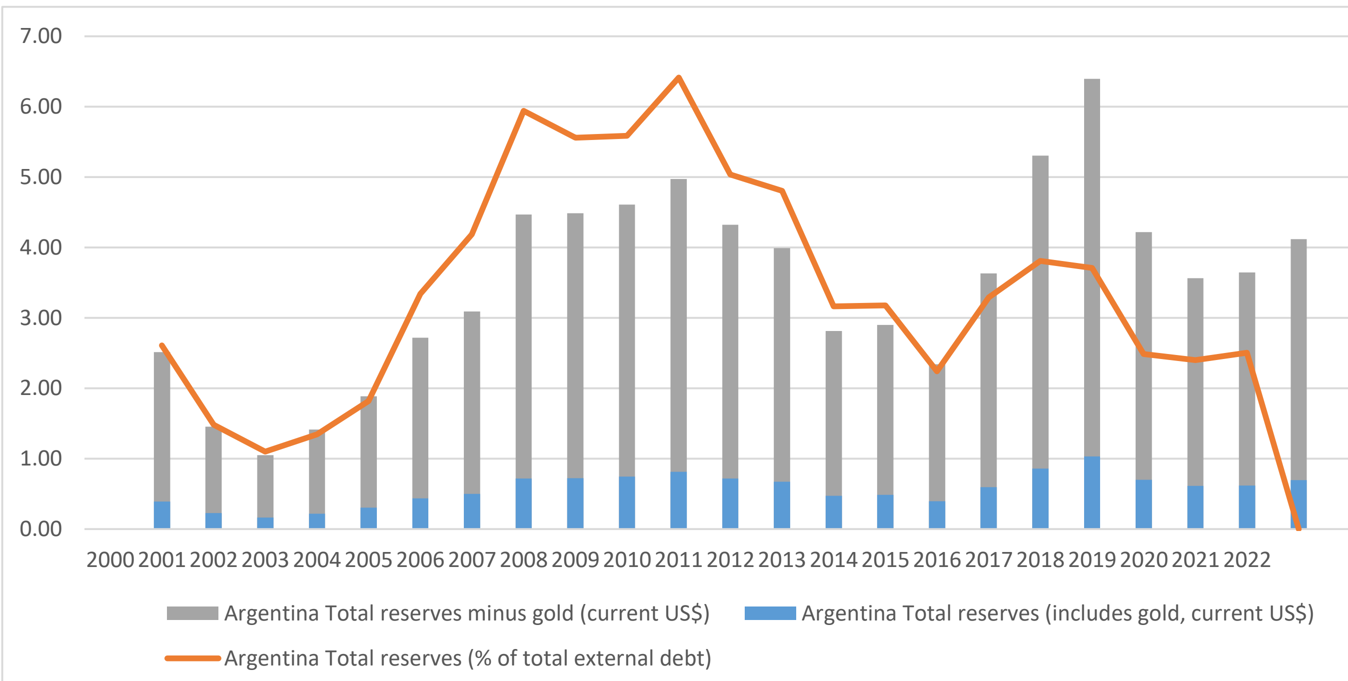


Figure 8-17:Argentina's Total Reserves (including gold, minus gold, % of total external debt)

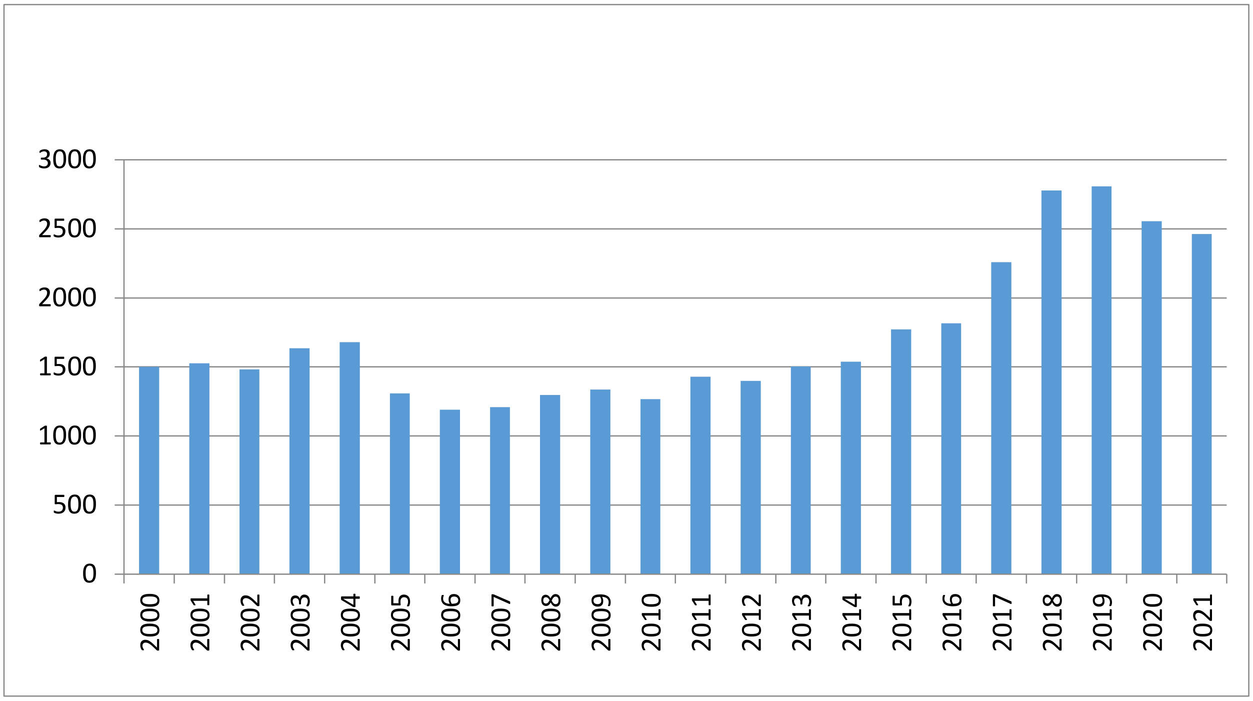


Figure 8-18:External debt stocks, total (current US$) for Argentina

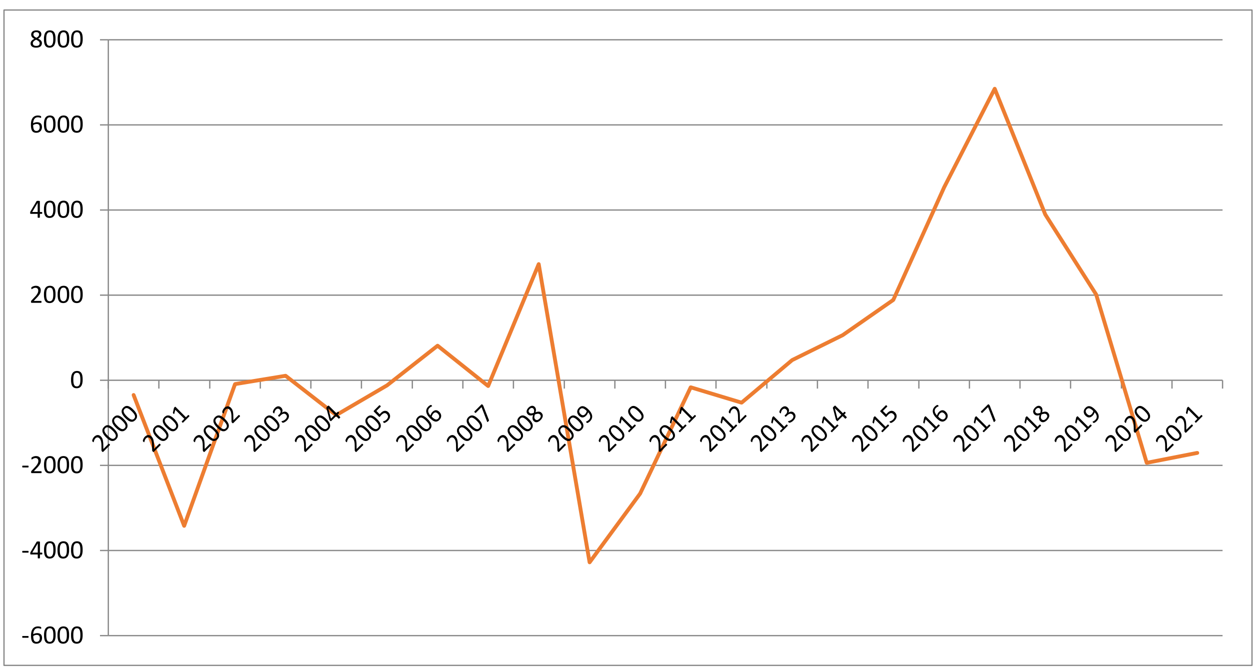


Figure 8-19:Argentina Commercial banks and other lending (PPG + PNG)

Overview of Argentina's Commercial Banks and Other Lending (PPG + PNG) from 2000 to 2021:

Over the past two decades, Argentina's commercial banks and other lending have undergone significant fluctuations (figure 5-6), reflecting the country's economic challenges, policy decisions, and external dynamics.

2000-2003: The early 2000s were characterized by a period of economic instability and financial crises in Argentina. This instability was mirrored in the lending landscape, with lending from commercial banks and other sources experiencing volatility. The country's economic challenges culminated in a severe crisis in 2001-2002, leading to a default on sovereign debt in 2001.

2004-2007: Following a challenging period, Argentina managed to stabilize its economy and implement some reforms. This stabilization was reflected in the lending landscape, where commercial banks and other lending sources might have shown gradual recovery.

2008-2009 (Global Financial Crisis): The global financial crisis had ripple effects on Argentina's economy, impacting lending activities. The country faced reduced access to international capital markets, potentially affecting both public and private lending.

2010-2013: During this period, Argentina continued to face economic challenges, including high inflation and restrictions on foreign exchange. These factors could have influenced lending practices by commercial banks and other lending sources.

2014-2015: Argentina experienced a change in government in 2015, which led to shifts in economic policies. Efforts to normalize relations with international creditors were notable during this period, which might have had implications for lending practices.

2016-2019: Economic reforms and policy changes under the new government could have influenced lending activities. It's important to consider the dynamics of external debt and access to international capital markets during these years.

2020 (COVID-19 Pandemic): Like many countries, Argentina faced economic challenges due to the COVID-19 pandemic. The pandemic's impact on economic activities, coupled with pre-existing vulnerabilities, could have implications for lending activities during this year.

2021:2021 marked an ongoing recovery from the economic challenges posed by the pandemic.

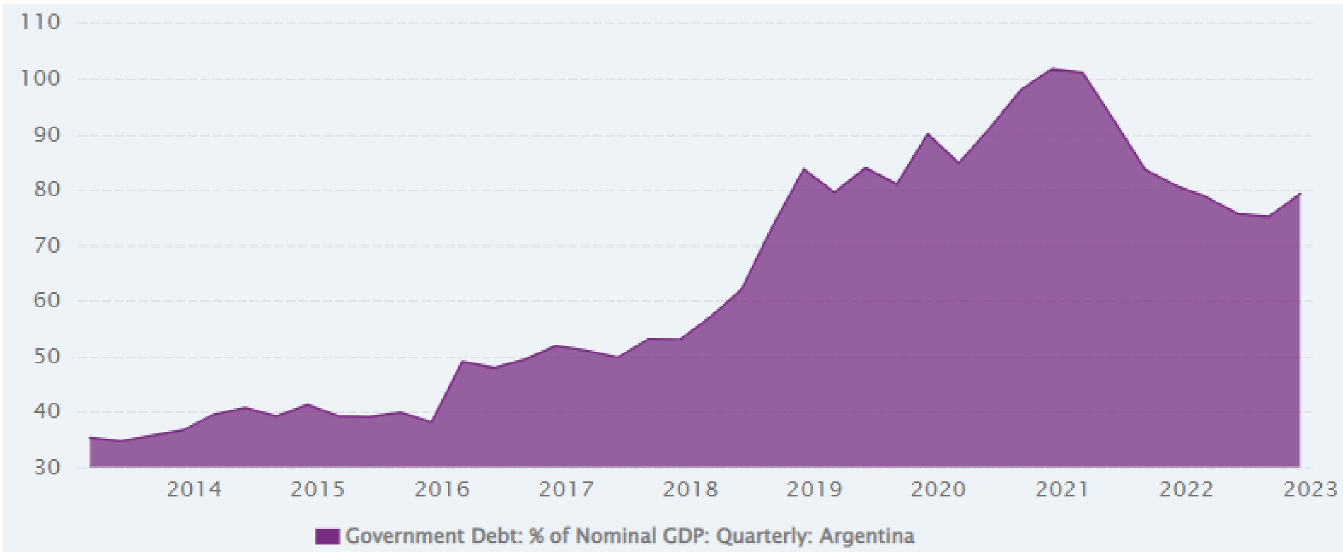


Figure 8-20:Argentina's Governemnt Debt (% of GDP)

Argentina's debt (figure 1-20) in 2014 was approximately 37.6%. It was due to the fact that the country had been experiencing economic challenges and had defaulted on some of its debt. (On July 31st, 2014, Argentina automatically defaulted on $29 billion of debt following a lengthy court case in which hedge fund bondholders sued the Argentinian government)

Thereafter Argentina's ratio further increased as it was country's efforts to return to international capital markets after its previous defaults. Even so the burden started increasing all because of various economic factors and policy efforts.

The situation got worse by Argentine peso depreciating in 2018 and by the end of 2019 the debt to GDP ratio in Argentina was around 94.2%. The COVID-19 pandemic and its economic repercussions had a significant impact on the country's economy and debt dynamics as the ratio surpassed the 100% mark.

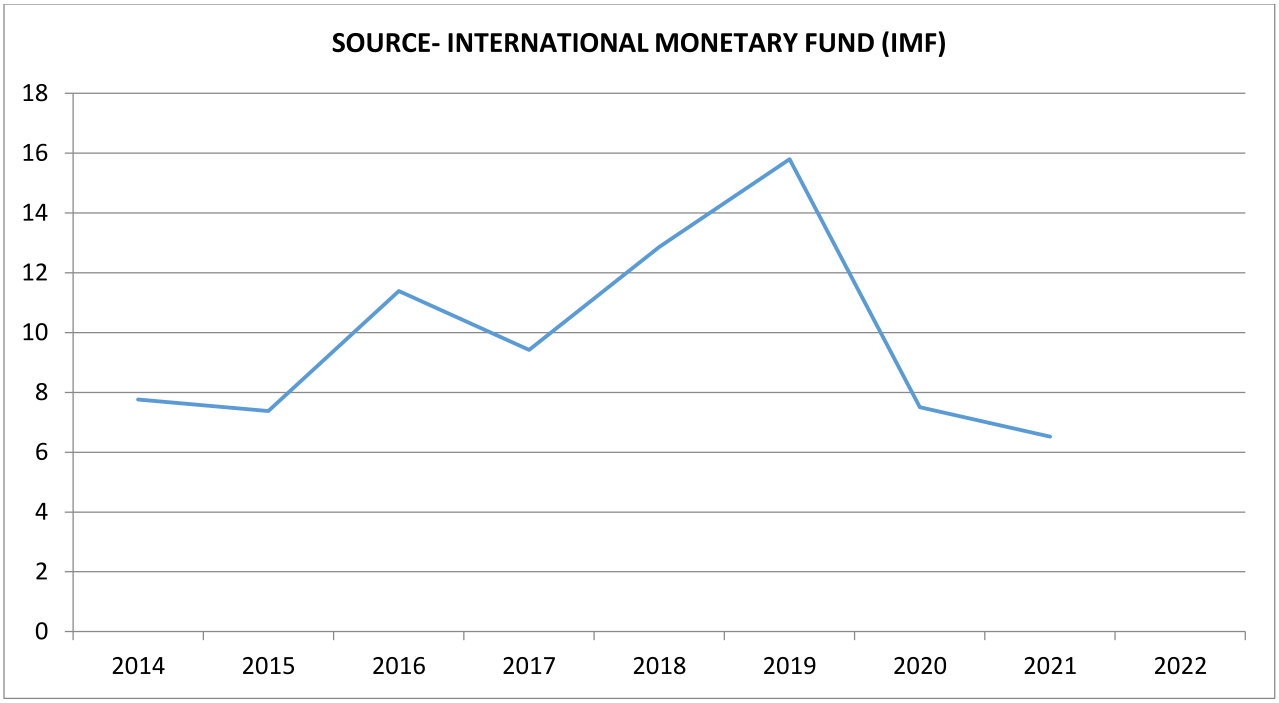


Figure 8-21:Interest Payments (% of expense) for Argentina

The 2015 economic crisis, which led to a sharp depreciation of the Argentine peso and a rise in inflation lead to a step increase in the interest payments (figure 1-21)). Thereafter some efforts were made to reduce the burden, but Argentine government failed to do so.

The COVID-19 pandemic, which caused a sharp decline in economic activity and led to a rise in government borrowing. Henceforth Argentina has received debt relief from some of its creditors, which has also reduced the amount of interest it has to pay.

However, it is important to note that Argentina's debt burden is still high, and the government will need to continue to make efforts to reduce it. If the government is unable to reduce its debt burden, interest payments could rise again in the future.

The government's ability to reduce its interest payments will depend on a number of factors, including the state of the economy, the government's fiscal policies, and the willingness of creditors to provide debt relief.

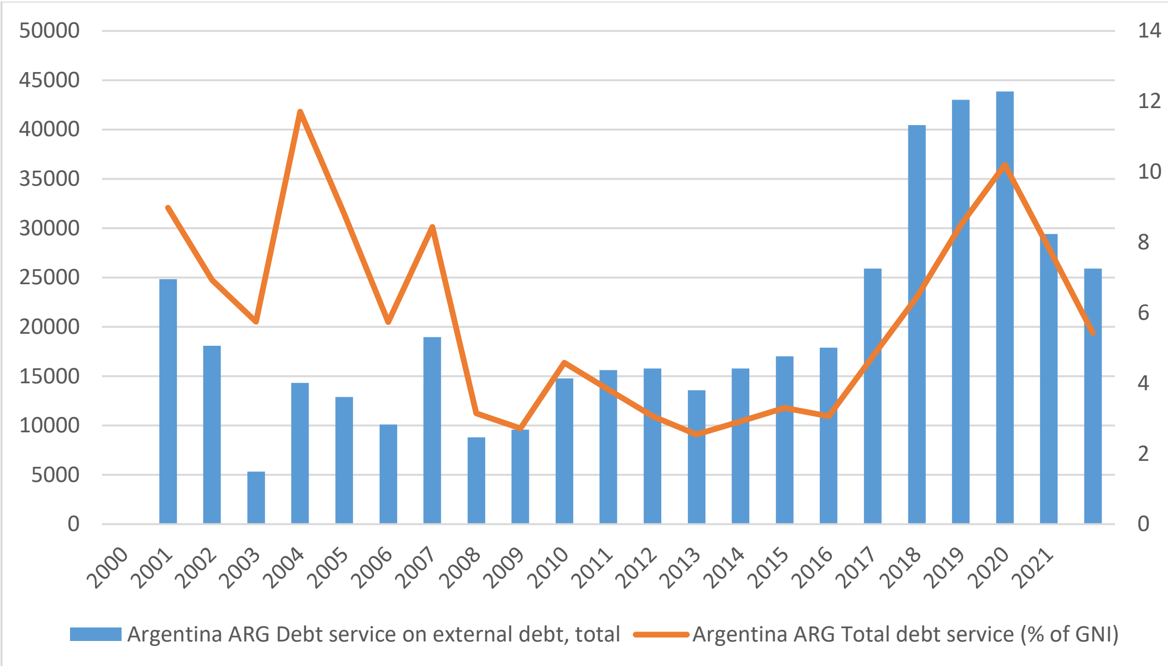


Figure 8-22:Argentina's Debt Service on External Debt and Total Debt Service

The graph above shows the total debt service of Argentina as a percentage of GNI (gross national income) and Total debt service on it's external debt from 2000 to 2021. The debt service is the amount of money that the government must pay each year to service its debt, including interest payments and principal repayments.

- Argentina's total debt service as a percentage of GNI has declined after some series of high fluctuations. The debt service peaked in 2003-04, during the financial crisis. Thereafter followed a decline trend with some fluctuation. Before the 2019 the pandemic the total debt service was increasing year by year for Argentina but the pandemic spiked this growth and again increased the debt servicing but soon after the end of pandemic there was a significant decline in the debt servicing by the government.

There are a number of factors that have contributed to the decline in Argentina's debt service, including:

- The government has taken steps to reduce its budget deficit, which has helped to lower the amount of debt that it has to service.
- Argentina has received debt relief from some of its creditors, which has also reduced the amount of debt service that it has to pay.

However, it is important to note that Argentina's debt burden is still high, and the government will need to continue to make efforts to reduce it.

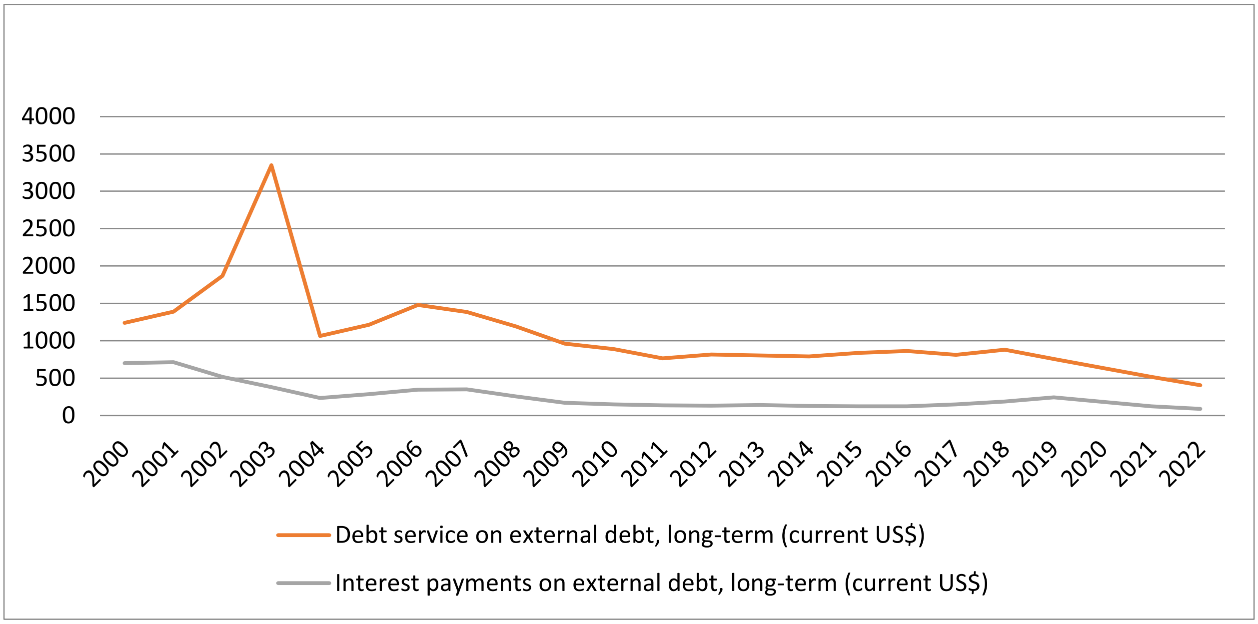


Figure 8-23:Debt Servicing Argentina

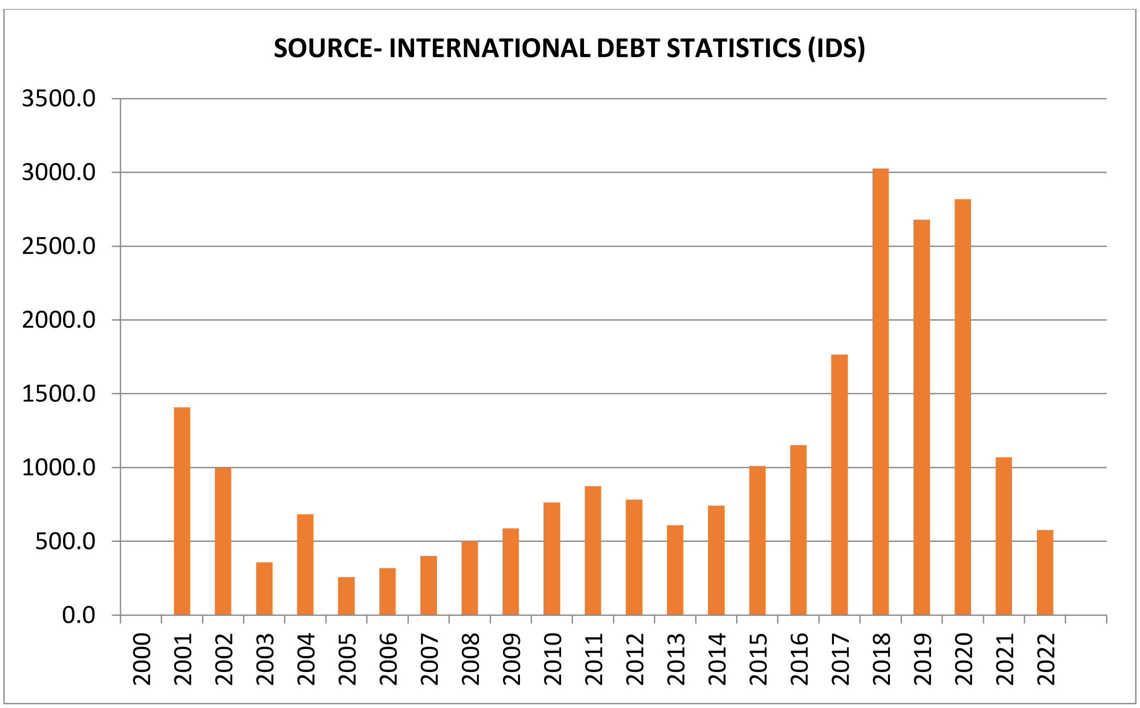


Figure 8-24:Argentina's Debt Service on External Debt (PPG)

Even though Argentina has taken various steps to reduce it’s debt servicing costs it’s still a major challenge for the country. The graph (figure 1-24) shows the efforts of the government as there is a sharp fall in the debt servicing cost from 2020 to 2021. Even so Argentina has a high level of debt, Argentina spends 5.43% of it’s GDP on debt servicing. As a result it makes difficult for government to invest in public goods and services, such as education and healthcare.

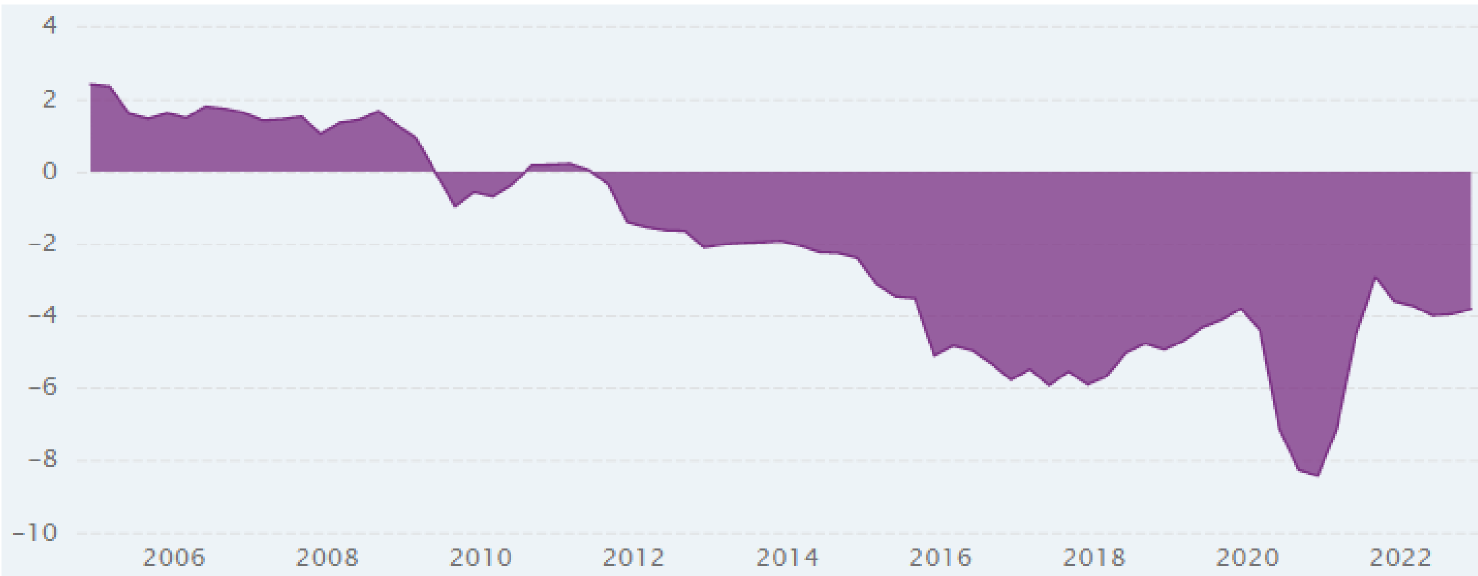


Figure 8-25: Argentina's Consolidated Fiscal Balance: % of GDP

Argentina's consolidated fiscal balance (figure 1-25), which is the combined balance of the central government, provinces, and municipalities, has been in deficit for most of the past decade. In 2023, the consolidated fiscal balance is estimated to be a deficit of 4.2% of GDP, according to CEIC data.

The main reason for Argentina's fiscal deficit is the high level of government spending. In 2023, government spending is projected to be 45.5% of GDP, which is one of the highest levels in the world. This high level of spending is due to a number of factors, including:

- The government's social security system, which is one of the most generous in the worldThe government's subsidies to public enterprises, which are often inefficient and loss-making.The government's high debt service costs, which are due to the country's high level of public debt.

The government's revenue has not been able to keep pace with its spending, which has led to the fiscal deficit. In 2023, government revenue is projected to be 39.7% of GDP, which is below the average level for emerging markets. This low level of revenue is due to a number of factors, including:

- The country's high level of informality, which means that a large number of businesses and individuals do not pay taxes.
- The country's high tax rates, which discourage investment and economic growth.
- The country's high inflation, which erodes the value of tax revenue.

The fiscal deficit has a number of negative consequences for the Argentine economy. It can lead to higher interest rates, which can make it more expensive for businesses to borrow money and invest. It can also lead to higher inflation, as the government prints money to finance the deficit. Additionally, the fiscal deficit can lead to a loss of confidence in the government, which can make it more difficult to attract foreign investment.

The government has taken some steps to reduce the fiscal deficit, including raising taxes and cutting spending. However, these measures have been met with resistance from the public and from interest groups. It is likely that the fiscal deficit will remain a challenge for the Argentine government for the foreseeable future (CEIC).

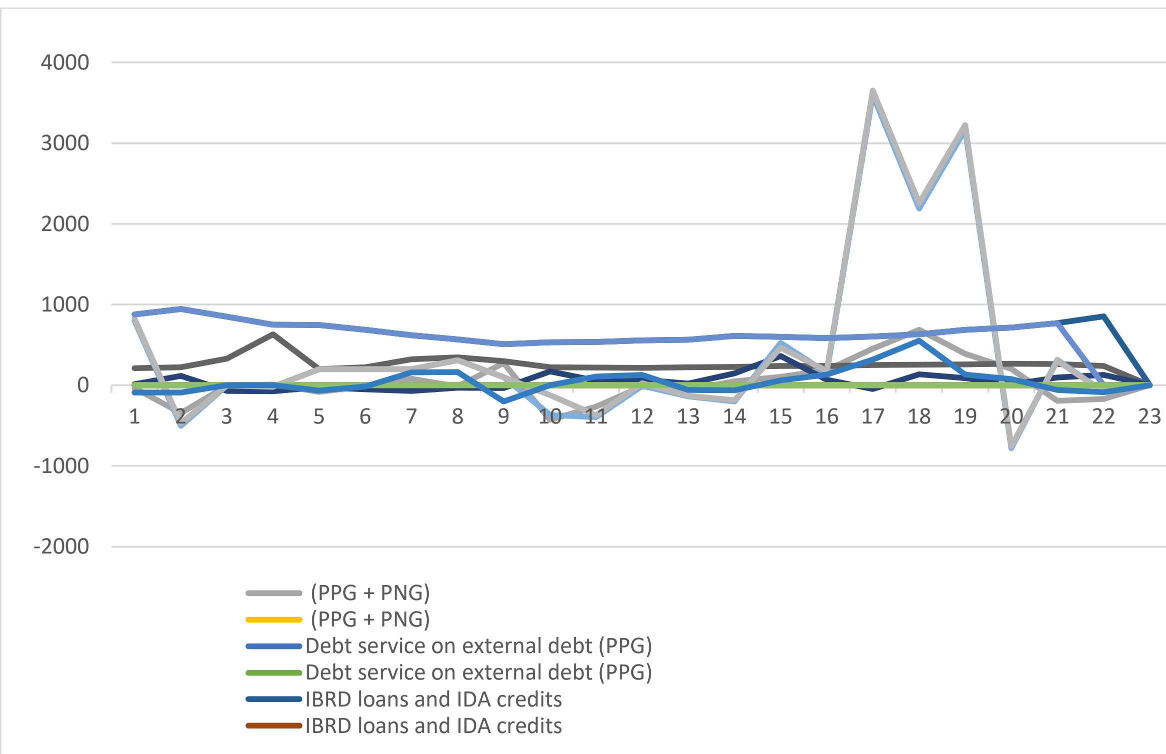


Figure 8-26:Argentina's Profile of Various Debt

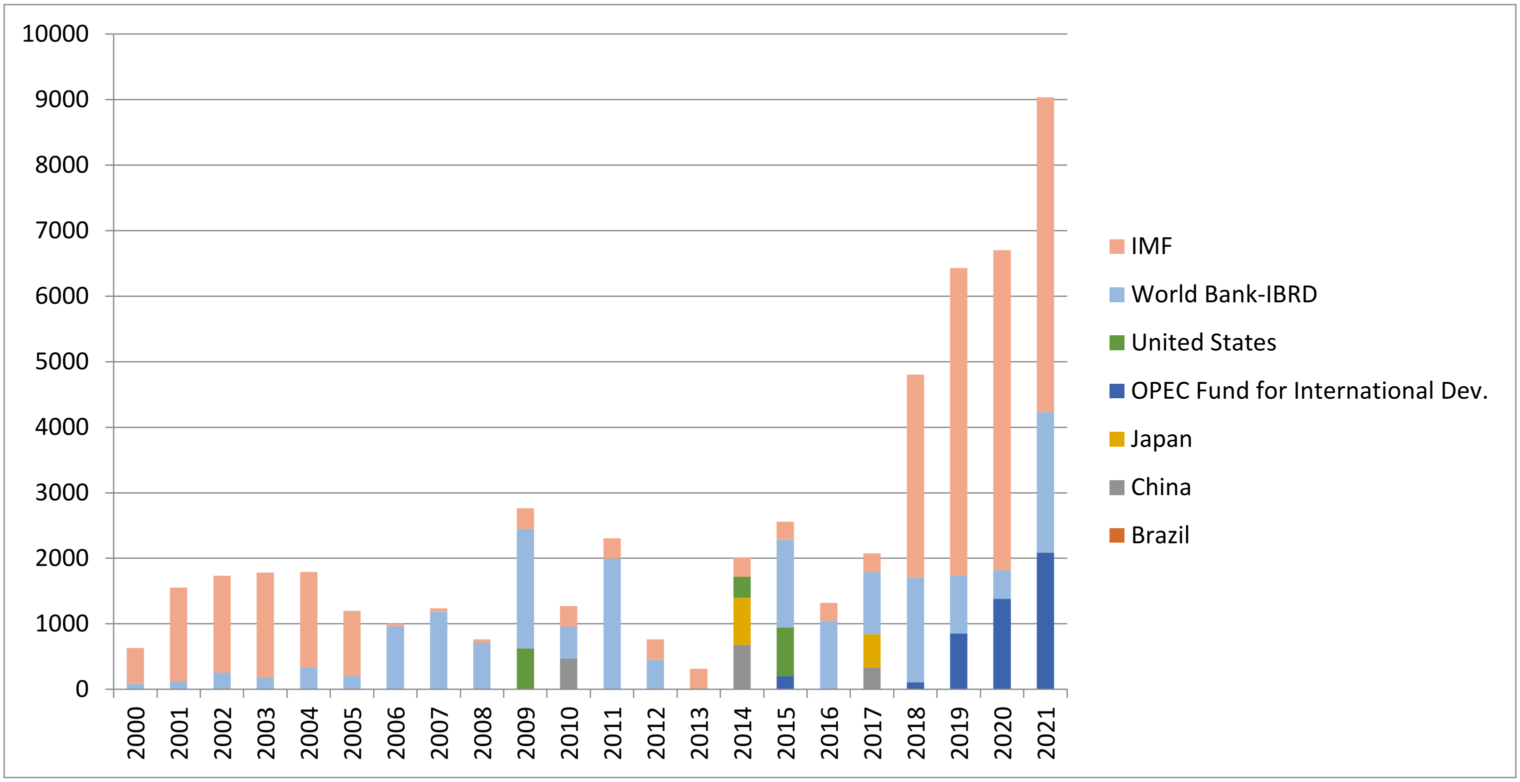


Figure 8-27: Argentina's Creditors Profile

Argentina's creditor profileis a complex one, with a wide range of creditors holding different types of debt. The largest creditors are:

<u>Argentina and IMF</u>

The International Monetary Fund (IMF): The IMF is the largest creditor to Argentina (figure 1-27), with a total exposure of over \$44 billion. The IMF has provided Argentina with several bailouts in recent years, most recently in 2018.

The International Monetary Fund (IMF) has provided Argentina with several loans in recent years. The most recent loan was approved in March 2022, and is worth SDR 31.914 billion (about US$44 billion). This loan is part of an extended arrangement under the Extended Fund Facility (EFF), which is a type of IMF loan that is designed to help countries address balance of payments problems and implement economic reforms.

The IMF has also provided Argentina with loans in the past, including:

- A loan of SDR 21.1 billion (about US$30 billion) in 2018.
- A loan of SDR 15.2 billion (about US$22 billion) in 2005.

- A loan of SDR 5.7 billion (about US$8 billion) in 1993.

The IMF's loans to Argentina have been controversial, with some critics arguing that the loans have not been effective in helping the country to address its economic problems. However, the IMF has defended its loans to Argentina, arguing that they have helped to stabilize the country's economy and to create conditions for economic growth.

The IMF's loans to Argentina have come with a number of conditions, including:

- The government must implement a number of economic reforms, such as reducing the budget deficit and increasing taxes.
- The government must maintain a floating exchange rate.
- The government must refrain from printing money to finance the deficit.

The IMF's conditions have been met with resistance from the Argentine government and from the public. However, the IMF has argued that these conditions are necessary to ensure that the loans are used effectively and that the country's economic problems are addressed.

The future of the IMF's loans to Argentina is uncertain. The government has been slow to implement some of the reforms required by the IMF, and there is a risk that the country could default on its debt again. However, the IMF has said that it is committed to supporting Argentina, and that it will continue to work with the government to address the country's economic problems.

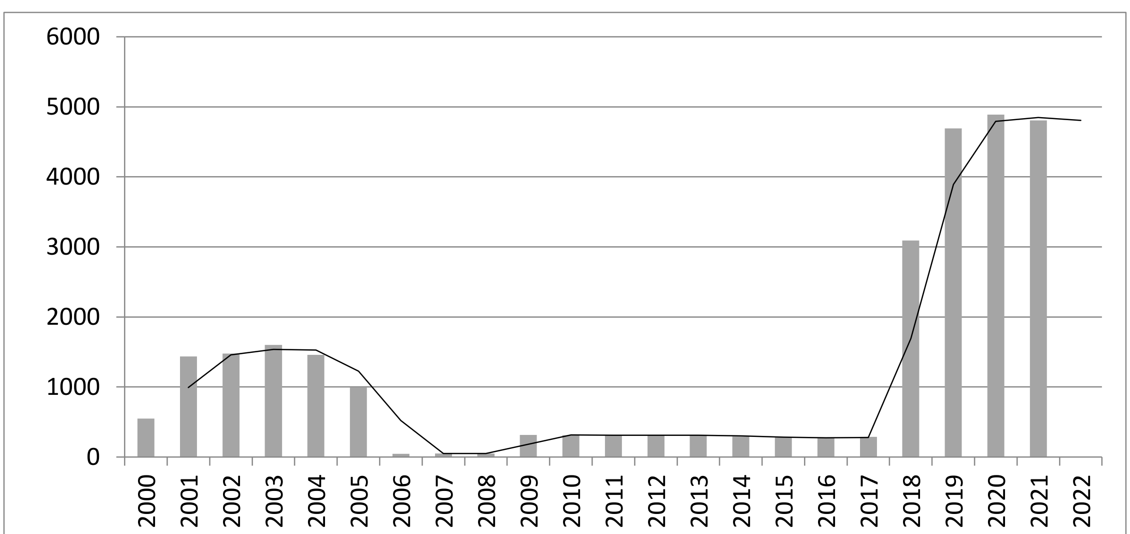


Figure 8-28:IMF's Credit to Argentina

The World Bank (figure 1-27) has provided Argentina with loans for a variety of projects, including:

- Education: The World Bank has provided loans to Argentina to support education reforms, such as increasing access to early childhood education and improving the quality of primary and secondary education.
- Health: The World Bank has provided loans to Argentina to support health reforms, such as improving access to essential healthcare services and reducing maternal and child mortality.
- Infrastructure: The World Bank has provided loans to Argentina to support infrastructure projects, such as roads, bridges, and water supply systems.

- Environment: The World Bank has provided loans to Argentina to support environmental projects, such as reducing pollution and promoting sustainable development.
- Social protection: The World Bank has provided loans to Argentina to support social protection programs, such as social security and unemployment benefits.

The World Bank's loans to Argentina have come with a number of conditions, including:

- The government must implement a number of reforms, such as improving transparency and accountability.
- The government must ensure that the loans are used for the intended purposes.
- The government must monitor the impact of the loans and report back to the World Bank.

The creditor profile of Argentina is constantly evolving, as new creditors emerge and existing creditors restructure their debt. The government's ability to manage its debt will depend on its ability to maintain a good relationship with its creditors and to negotiate favorable terms for debt restructuring.

Here are some of the challenges that Argentina faces in managing its debt:

- The country's high level of debt: Argentina's debt-to-GDP ratio is one of the highest in the world, at over 100%. This makes it difficult for the government to service its debt and to attract foreign investment.

- The country's history of default: Argentina has defaulted on its debt several times in the past, most recently in 2001. This makes it difficult for the government to attract new creditors and to negotiate favorable terms for debt restructuring.
- The country's economic volatility: Argentina's economy is volatile, and has been hit by several economic crises in recent years. This makes it difficult for the government to predict its future revenue and to make accurate projections for its debt service.

Despite these challenges, Argentina has taken steps to improve its debt management. The government has implemented a number of fiscal reforms, including raising taxes and cutting spending. The government has also reached agreements with some of its creditors to restructure its debt. These measures have helped to reduce the country's debt burden and to improve its creditworthiness.

The future of Argentina's debt is uncertain, but the government's efforts to improve its debt management are a positive sign. If the government can continue to make progress on these reforms, it will be in a better position to manage its debt and to attract foreign investment.

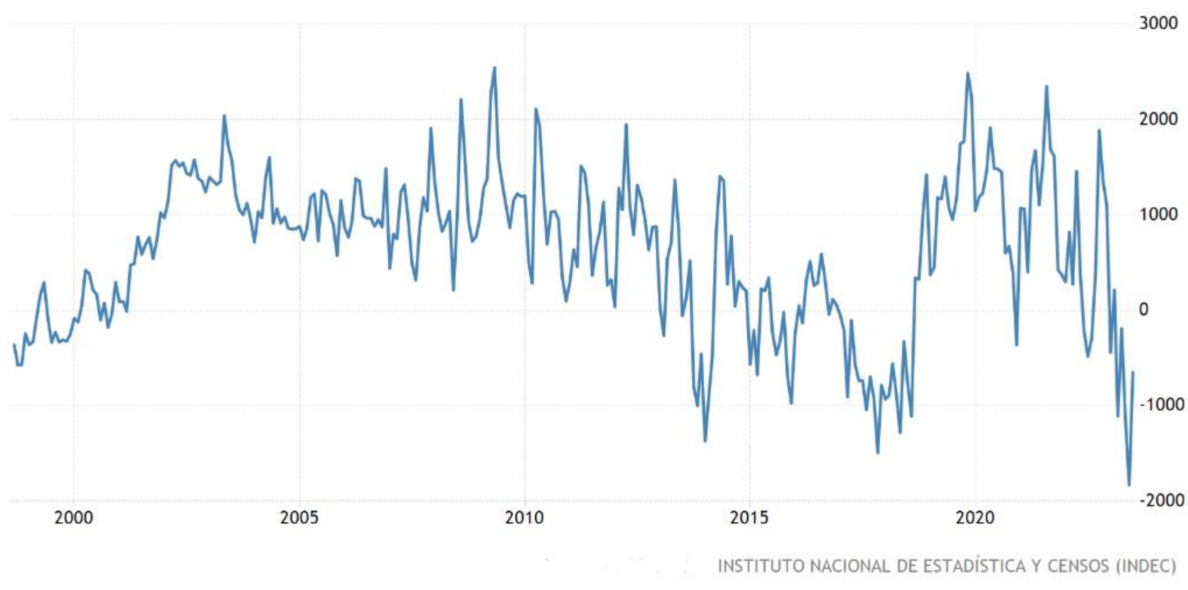


Figure 8-29:Argentina's Balance of Trade

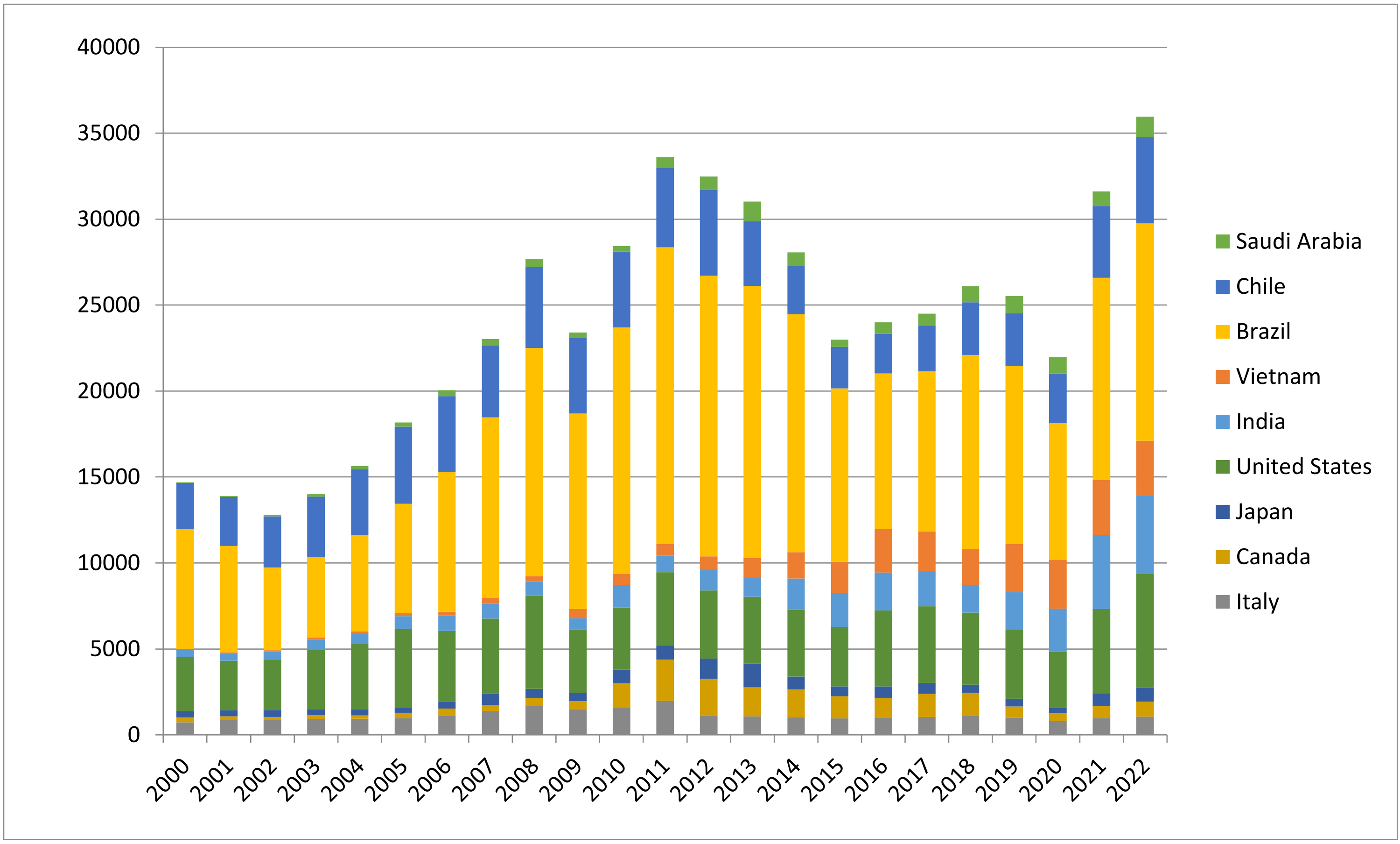


Figure 8-30:Argentina Exports

Argentina is a major exporter of agricultural products, including soybeans, corn, wheat, and beef. The country is also a major exporter of industrial products, such as machinery, chemicals, and automobiles.Exports are important to the Argentine economy for a number of reasons. First, they help to generate foreign exchange, which the country needs to import essential goods and services. Second, exports create jobs and boost economic growth. Third, exports help to diversify the economy and make it less reliant on imports.Exports have helped to boost Argentina's economy in recent years. In 2021, exports totalled US$68.7 billion, an increase of 12% from 2020. This growth was driven by strong demand for agricultural products, such as soybeans and corn.The government is taking steps to further boost exports. These steps include improving the country's infrastructure, such as roads and ports, and providing financial support to exporters. The government is also working to diversify the country's exports, by promoting the export of industrial products, such as machinery and chemicals.

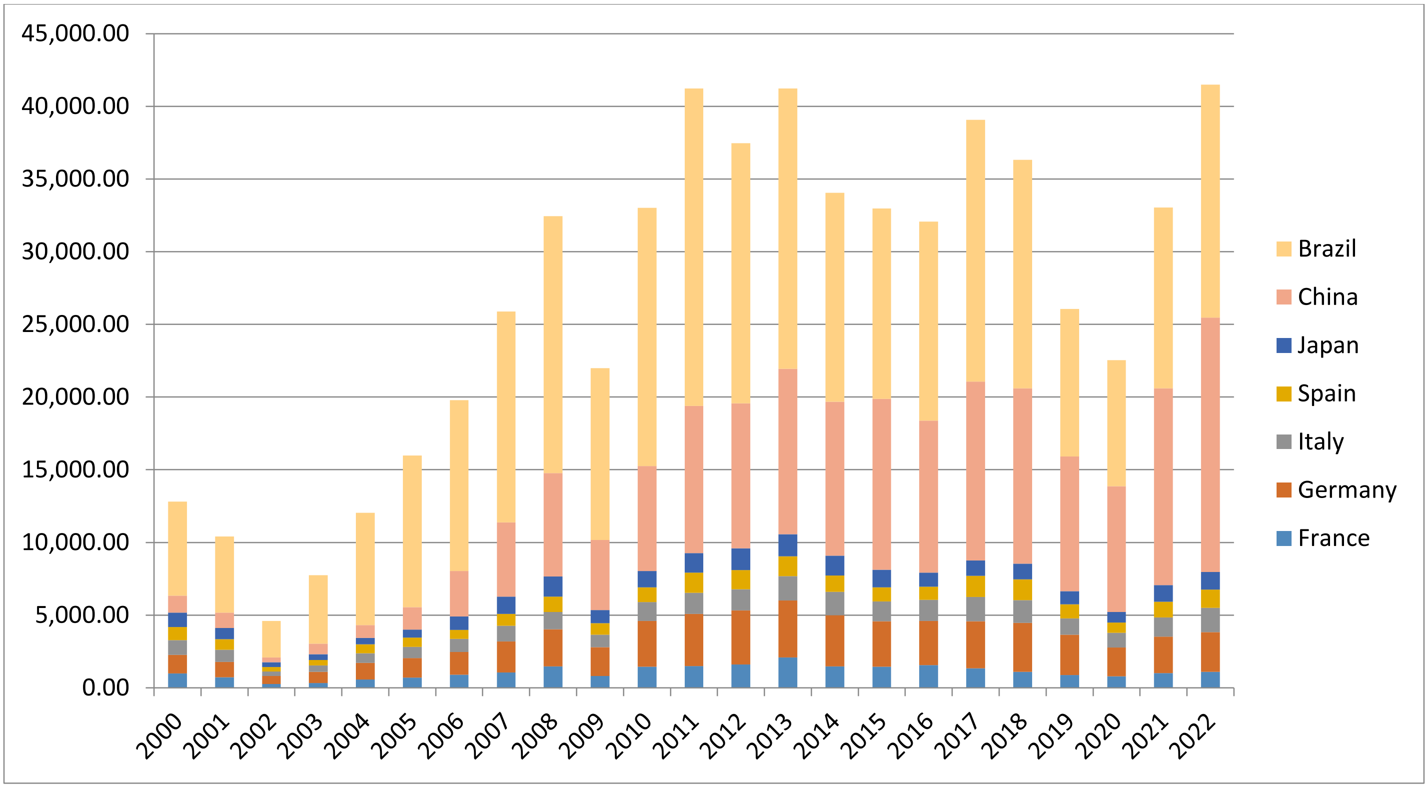


Figure 8-31:Argentina's imports

Argentina is a major importer of a variety of goods and services, including machinery, transportation equipment, chemicals, and fuels. The country also imports food and beverages, as well as consumer goods such as clothing and electronics. Imports are important to the Argentine economy for a number of reasons. First, they help to meet the needs of consumers and businesses. Second, they help to keep prices low for consumers. Third, they help to promote competition in the economy.

Recommendations:

Argentina is an agriculture-dependent economy, and it can use trade to help in repaying its loans and growth of economy in the following ways:

- Export more agricultural products: Argentina can increase its exports of agricultural products by improving its productivity and quality. This can be done by investing in research and development, providing farmers with better access to credit and inputs, and improving infrastructure.

- Diversify its export markets: Argentina can also diversify its export markets by targeting new markets for its agricultural products. This can be done by participating in trade fairs and missions, and by building relationships with buyers in other countries.

- Reduce its imports: Argentina can reduce its imports by producing more of the goods and services it needs domestically. This can be done by investing in manufacturing and other industries, and by providing incentives for businesses to invest in Argentina.

- Attract foreign investment: Argentina can attract foreign investment by improving its business climate and making it easier for foreign investors to operate in the country. This can be done by reducing bureaucracy, improving the legal system, and providing tax breaks.

By taking these steps, Argentina can use trade to help in repaying its loans and growth of economy.

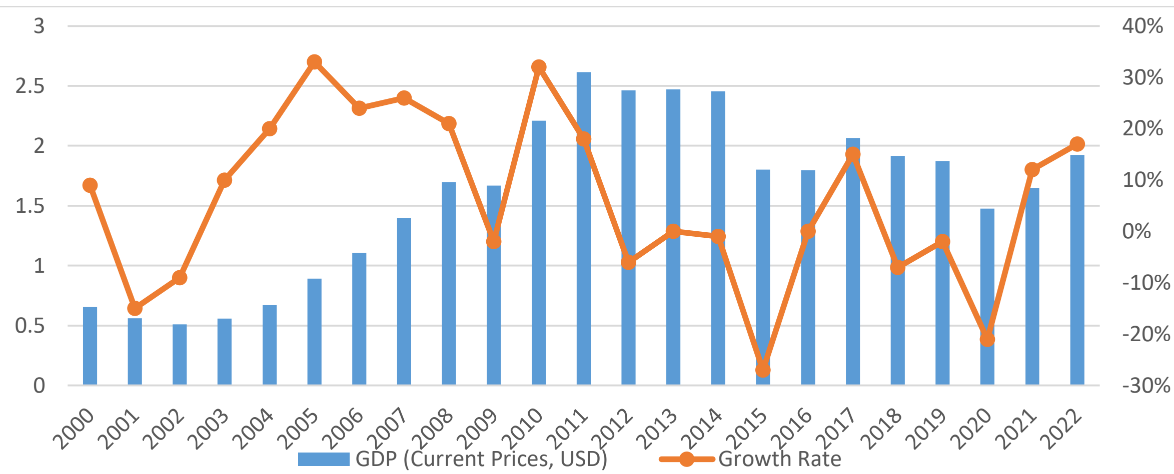
Chapter 9

Brazil

Overview of Brazil's Economy

Brazil is a Latin American country with a population of 214 million (World Bank Open Data, 2023). It is the 10th largest economy(nominal) with 1.92 trillion USD in 2022. And it also comes under Upper Middle Income (UMI) group with a GDP Per capita of 8955 USD in 2022. And it comes under Emerging and Developing Economies category (IMF Data, 2023). It is also Comes under IBRD Lending Category1 (World Bank, 2022). It is also one of the top ten largest external debt borrowers in low & middle income category excluding China. It has an external debt of $606.48 billion as of 2021. (Databank, International Debt Statistics, 2023).

The Brazil Economy increased three times from 2000 to 2022 i.e. around 0.655 trillion U.S. Dollars to $1.92 trillion (Figure 9-1). But the Brazil Economy was $2.6 trillion in 2011. It maintained this level above $2 trillion around 2010-2014. After 2014 the Brazil economy collapsed due to the economic crisis (Arruda de Almeida & Zagaris, 2015).



Source: WEO Database. IMF & Author's Calculations

[1] IBRD lends to Governments of Middle income & Creditworthy low income countries.

Figure 9-1: GDP of Brazil (in USD Trillions)

The nominal growth rate also went down from 18% in 2011 to -27% in 2015. The Petrobras scandal[2] which leads to political crisis is the major reason for the Brazil's Economic Crisis (2014-2016) (segal, 2015). Post-covid, the Brazil economy is gradually recovering. Brazil registered a recovery from negative growth rate of 21% in 2020 to a positive rate of 17% in 2022 (Figure 9-1).

The GDP per capita of Brazil is $8995 in 2022. And Brazil comes under Upper Middle Income (UMI) group (World Bank Open Data, 2023). The Brazilian economy was all time high in 2011[3] due to several factors like increase in private consumption & broad gains in real wages due to increase in minimum wages (IMF Data, 2023), decrease in unemployment rate (Figure 9-3), increase in balance of payments (Figure 9-6).

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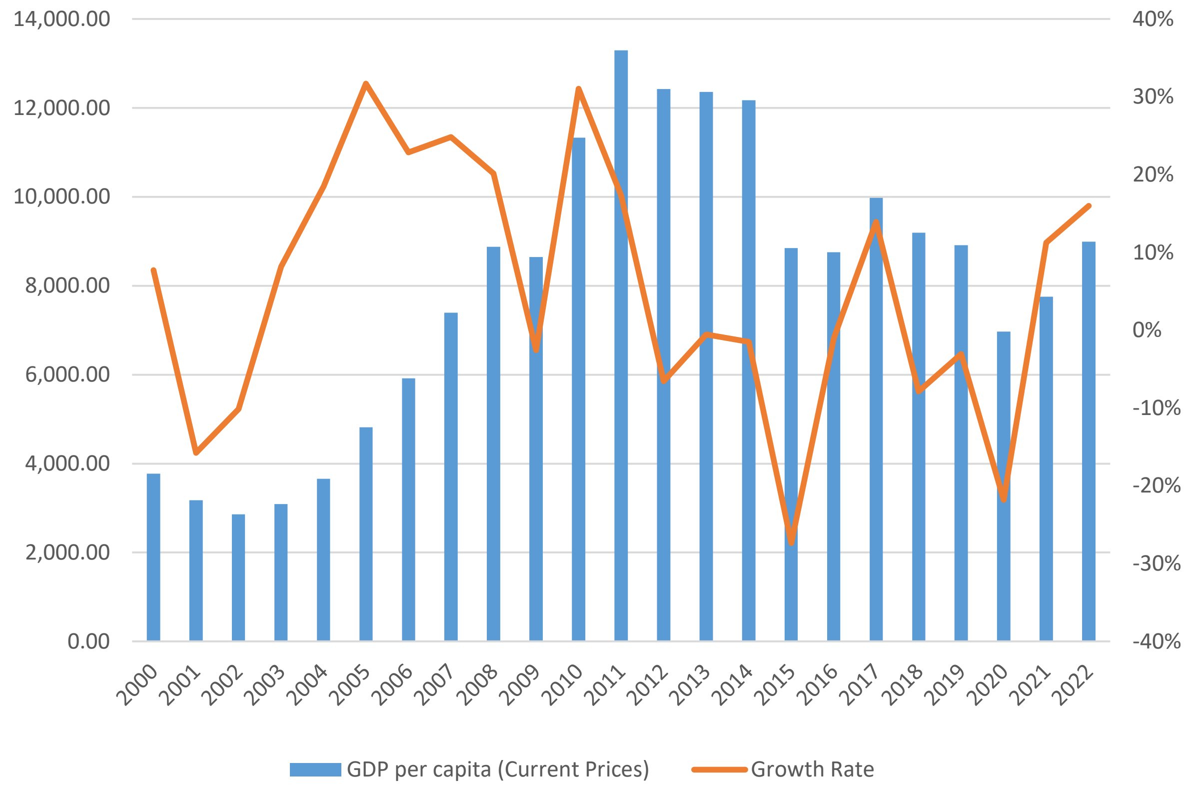
[2] Petrobras is Brazil's State owned MNC in petroleum industry. Brazilian Petrobras scandal beginning in 2014 that involved the indictment of dozens of high-level businesspeople and politicians as part of a widespread investigation alleging that many millions of dollars had been kicked back to officials of Petrobras, Brazil's huge majority-state-owned oil company, and to politicians, especially members of the ruling Workers' Party of President Dilma Rousseff, by prominent Brazilian corporations in return for contracts with Petrobras (Sotero, 2022)

[3] As GDP was calculated in current prices, a part of the increase comes from the inflation rate & The inflation rate also increased from 5.03% in 2010 to 6.63% in 2011 (*Figure 9-3*)

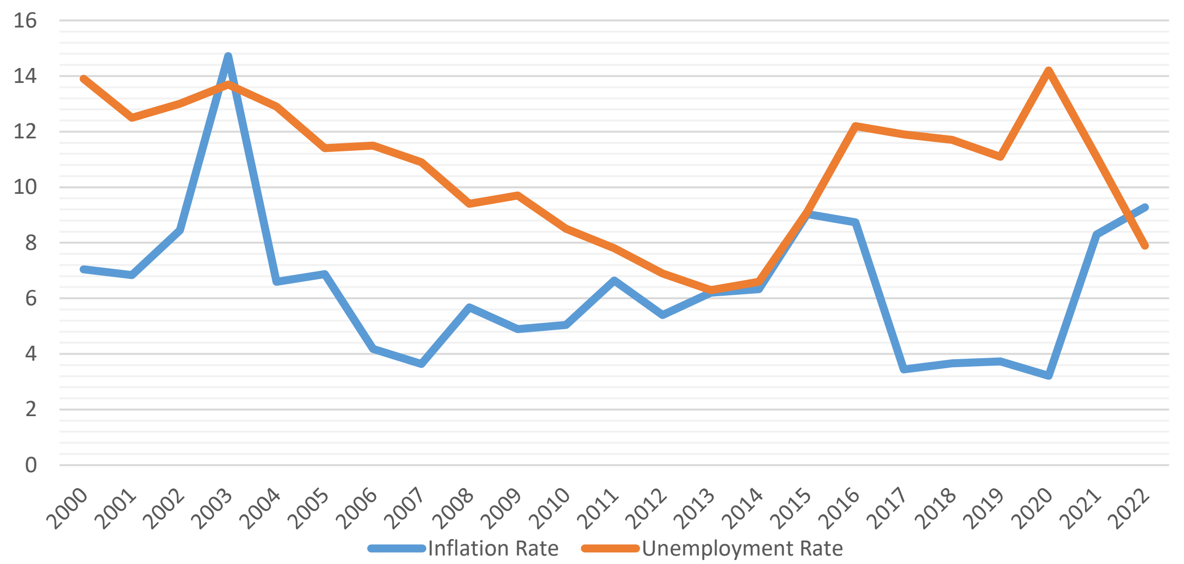


Source: WEO Database, IMF & Author's Calculations

Figure 9-2: GDP Per capita of Brazil (in USD)

And the Economic Crisis 2014-16 showed that how political crisis leads to Economic Crisis. This increased the unemployment rate and inflation rate of economy (Figure 9-3). And even the gap between Government expenditure and revenue also increased which lead to the increase in government net borrowing. (it is 157 billion real in 2013 which increased to 613 billion real in 2015) (World Economic Outlook Database, 2023).

Even in the external sector also the situation is the same. And the Net International Investment Position also deteriorated from -$705.91 billion in 2014 to -$374.68 in 2015 i.e. the overall external liabilities increased at a far faster pace compared to the external assets (Figure 9-7). And The CBPR (Central bank policy rate) was increased from 10% in 2013 to 14.25% in 2015 by Brazil’s Central bank to fight the rise in inflation rates (6.2% in 2013 to 9% in 2015) (IMF Data, 2023).



Source: WEO Database, IMF & Author's Calculations

Figure 9-3: Inflation Rate & Unemployment Rate of Brazil

External Sector of Brazil

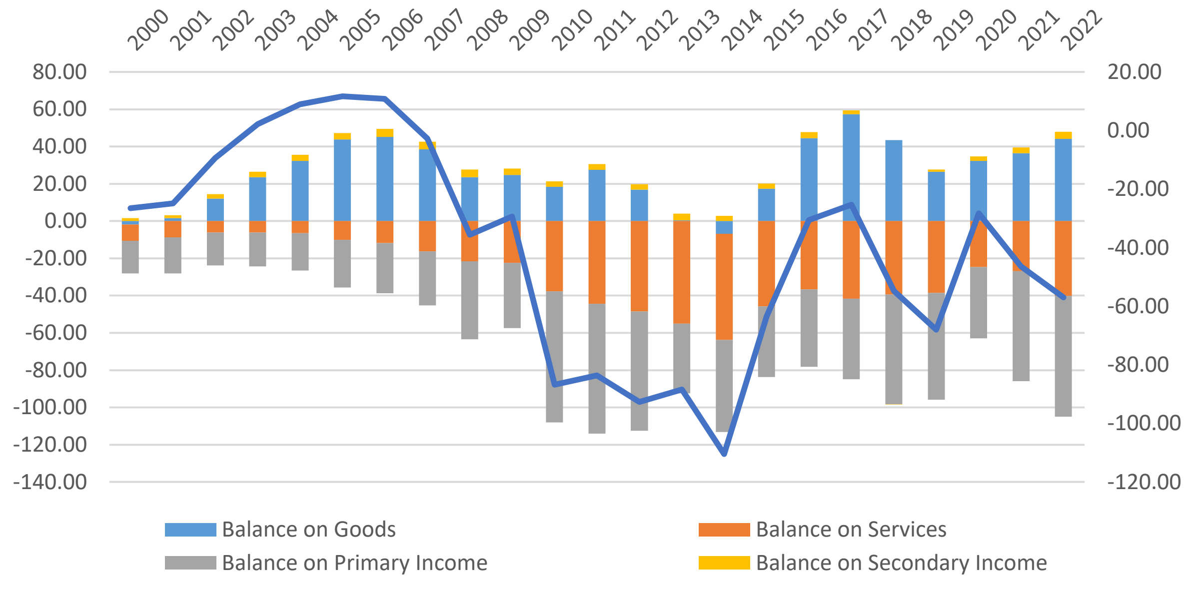
Over the years, Brazil economy had a negative Current account balance and a positive cash inflow from financial account balance.

In the Current account, the Brazil has a positive Balance on goods and a positive Balance on secondary income. And Brazil also has a negative balance on primary income and a negative balance on services.

(1) The Balance on Goods is $44.15 billion in 2022 i.e. it is exporting $44.15 billion more goods than its imports. But during the period between 2013-14, the Balance of goods become less than one billion in 2013 and even went to negative in 2014 (-$6.74 billion). Because nearly 18% of its exports is for China and in 2013-2014, China faced issues with its economy (IMF Data, 2023) and the prices also decreased due to depreciation of Real (Figure 9-17).

(2) The Balance on services was a negative for Brazil economy and is -$40.02 billion in 2022. It is having a negative in Service most of the services like Transportation (-$19 billion), Travel (-$7.23 billion), Insurance & Pension services (-$1 billion), Telecommunication, computer & Information services (-$4.21 billion), Business services (-$1.8 billion) has mostly imported than exported (IMF Data, 2023).

(3) The Balance on Primary income was -$64.93 billion in 2022. It is because that it has huge inflow of invest income to the country (-$65.03 billion) (IMF Data, 2023).



Source: IMF E-Library

Figure 9-4: Current Account Balance of Brazil

(4) The Balance on Secondary income which is at $3.8 billion in 2022 is small in its relative significance compared to the other developing economies. However other than the positive goods balance, Brazil too has a net inflow on the remittances front.

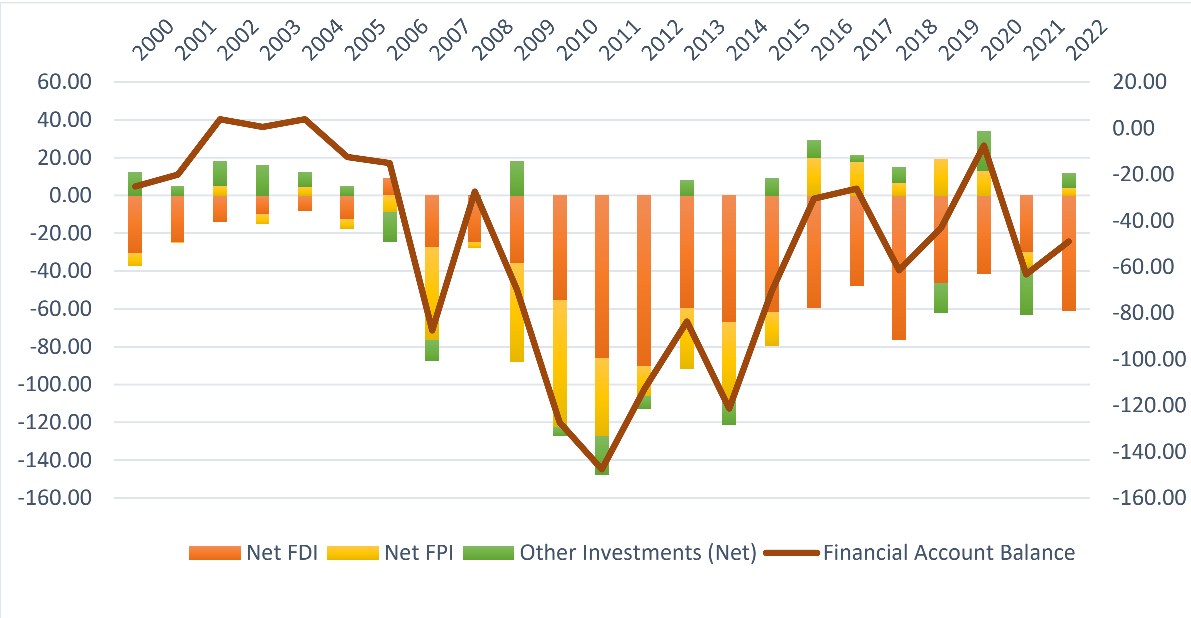
So, The Current account balance of Brazil is Mostly negative i.e. Most of the cash was outflowed from country due to Primary income and services. And the Current account balance during 2013-14 was most negative (-$110.4 billion) due to change of balance of goods from positive to negative (Figure 9-4).

(1) The Net Foreign Direct Investment was -$60.81 billion in 2022. And mostly for the Brazil, there is inflow of FDI. Except in 2006, there has always been a net inflow of FDI in all other years.

(2) There was a huge inflow of portfolio investment during the period of 2007-14 (-$48.7 billion in 2007 to -$41.4 billion in 2014) except in 2008 (-$2.9 billion due to Global financial crisis). Due to 2015 economic crisis in Brazil, the Net FPI become positive i.e. there is outflow of

FPI (since 2016). Still now (in 2022) there is an outflow of FPI ($4.09 billion) but it is slowly decreasing.

(3) The other investments are the most unstable and have been highly volatile. Sometimes there is an inflow of investment and sometimes there is an outflow of investment. In 2022, there is an outflow of other investment i.e. $7.75 billion.



Source: IMF E-Library

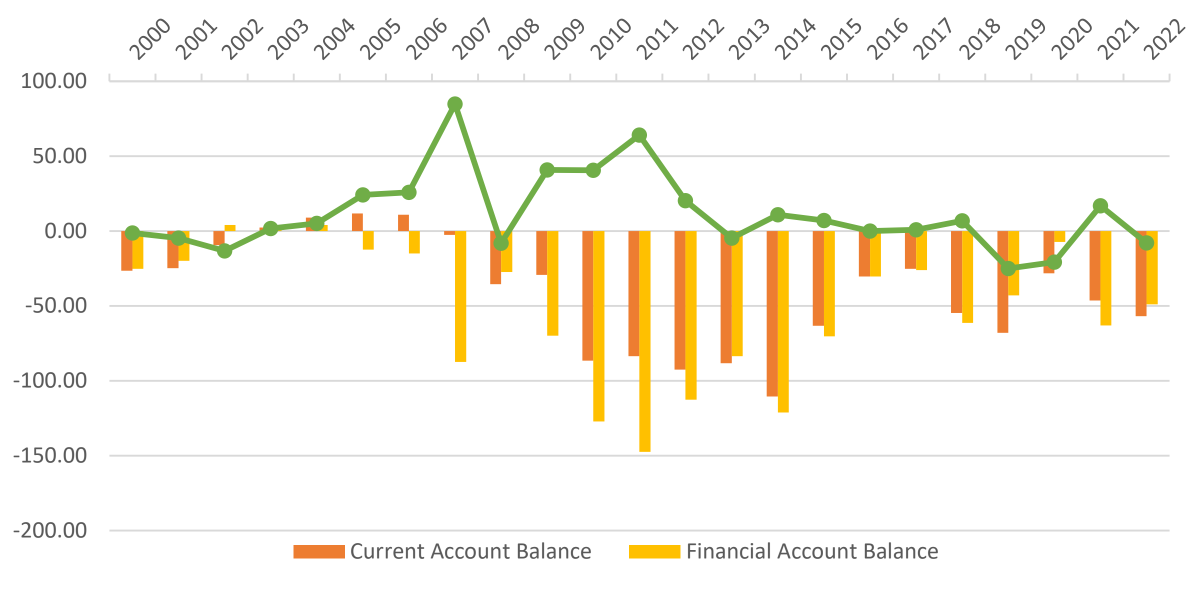
Figure 9-5: Financial Account Balance of Brazil[4]

Overall, there is huge inflow on the financial account. And it most inflows are coming from the foreign direct investment.

In 2022, there is an outflow of Current account (-$57 billion) and an inflow of financial account (-$48.96 billion). in 2022, there is negative balance of payments (-$8.03 billion) i.e. outflow. the balance of payments of Brazil was mostly positive due to outflows of Current account was covered by inflows of financial account in which mostly by inflows from foreign direct investment.

[4] Financial account was calculated by IMF's method i.e. (Assets-liabilities). so The negative sign in Financial account indicates net inflow of cash for the country.

Net International investment position of Brazil was always highly negative i.e. the stock of external liabilities has bene higher than the stock of external assets, in particular that of foreign direct investment (*Figure 9-7*). As of 2022, out of the total assets[5] of $952.49 billion, there is a $324.7 billion of Reserve assets like monetary gold, Special Drawing Rights and other reserve assets. i.e. 34.08% of total assets are reserve assets which is a major outflow from Brazil (IMF Data, 2023). This is typical of any developing country which would like to invest in a safe asset, mostly US Treasuries, As of 2022, Net IIP as % of GDP is -40.1% (Figure 9-7).



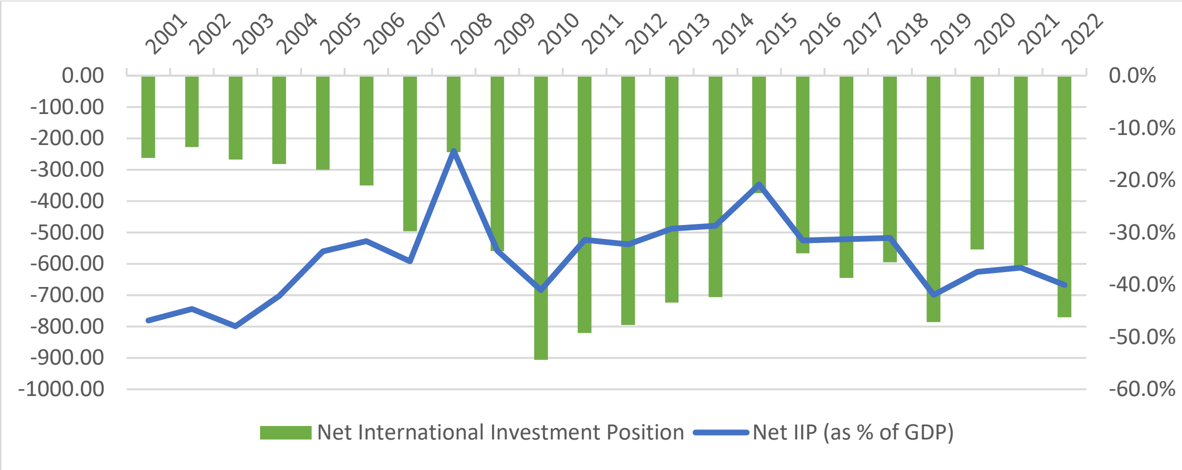
Source: IMF E-Library

Figure 9-6: Balance of Payments of Brazil[6]

During the period 2014-2022, the assets (outflows) maintained its level between 800 bn to 1000 bn USD whereas the liabilities (inflows) maintained its level between $1400 billion to $1700 billion (except 2015 ($1183 billion) & 2016 ($1396 billion)).

[5] Assets includes FDI, FPI, Other investment outflows and Reserve assets of a country

[6] Excludes Reserves & related items and net errors and omissions (IMF Data, 2023)

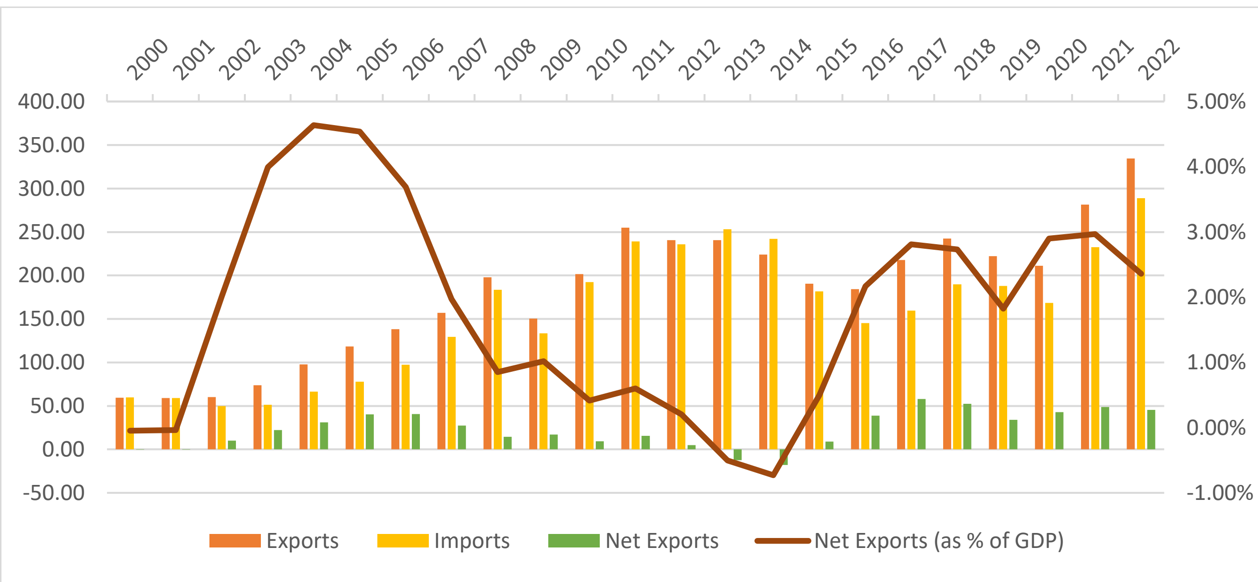


Source: IMF E-Library data & WEO Database

Figure 9-7: Net IIP of Brazil[7]

The inflows was all time high in 2022 ($1723 billion). So we can say that the inflows of investment was increasing gradually which is a good sign for an economy. (IMF Data, 2023).

External Goods Trade of Brazil



Source: IMF E-Library & WEO Database

[7] In IIP negative sign indicates an inflow of investment coming to the country (IMF Data, 2023)

Figure 9-8: Net Exports of Brazil[8]

Brazil exports more goods than its imports. In 2022, the exports was $334.46 billion and the imports was at $289.06 billion. Therefore, the net exports of Brazil was a surplus of $45.4 billion. In 2013-14, the exports valuation was lower because of the decrease in prices of the goods. After that there is a decrease in exports & imports in 2015-16 due to economic crisis. As of 2022, the net exports as a % of GDP is 2.36 (Figure 9-8).

As of 2022, China is the largest importer of Brazil goods ($89.72 billion), Followed by USA ($38.15 billion) & Argentina ($11.99 billion). The share of top ten countries also increased significantly from $30.46 billion in 2000 to $202.42 billion in 2022. And the share of these top ten countries increased from 51.07% in 2000 to 60.52% in 2022. (IMF Data, 2023).

Iron ore is the most exported item from Brazil ($46.21 billion as of 2021) i.e. 16.44% of exports are iron ore. And its second biggest export is soyabeans ($39 billion as of 2021) i.e. 13.87% of exports. (Figure 9-11) And Brazil is the biggest exporter of soyabeans in the world as of 2021. (Observatory of Economic Complexity, 2023) . Other than these, Brazil also exports Crude petroleum ($30.72 billion), raw sugar ($10 billion) etc. (classified under HS4)[9].

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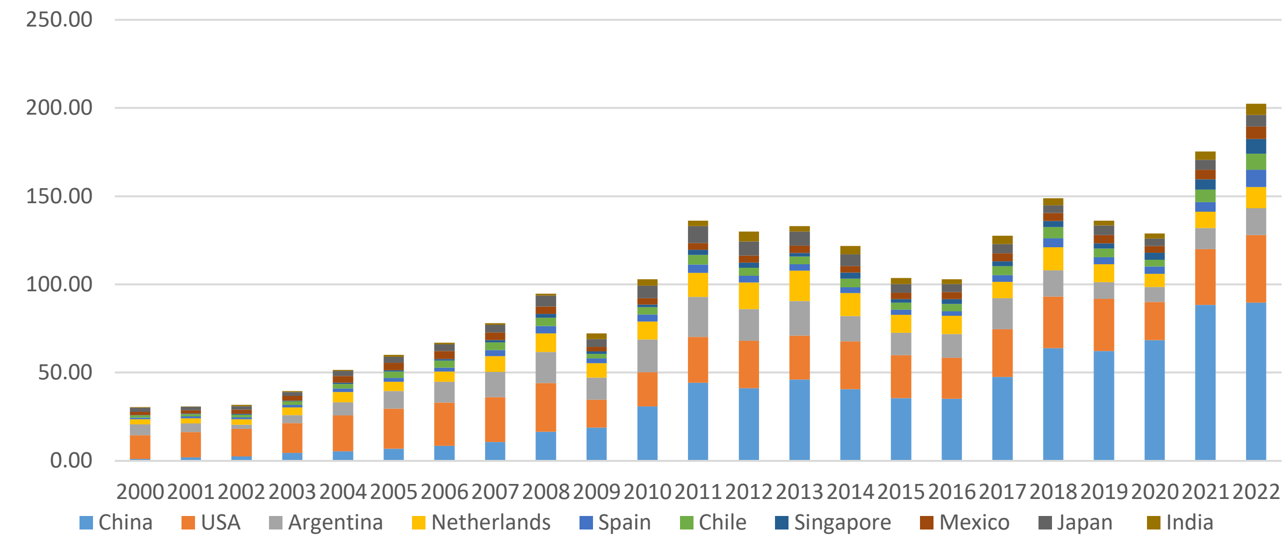
[8] Includes only trade of Goods and not the services

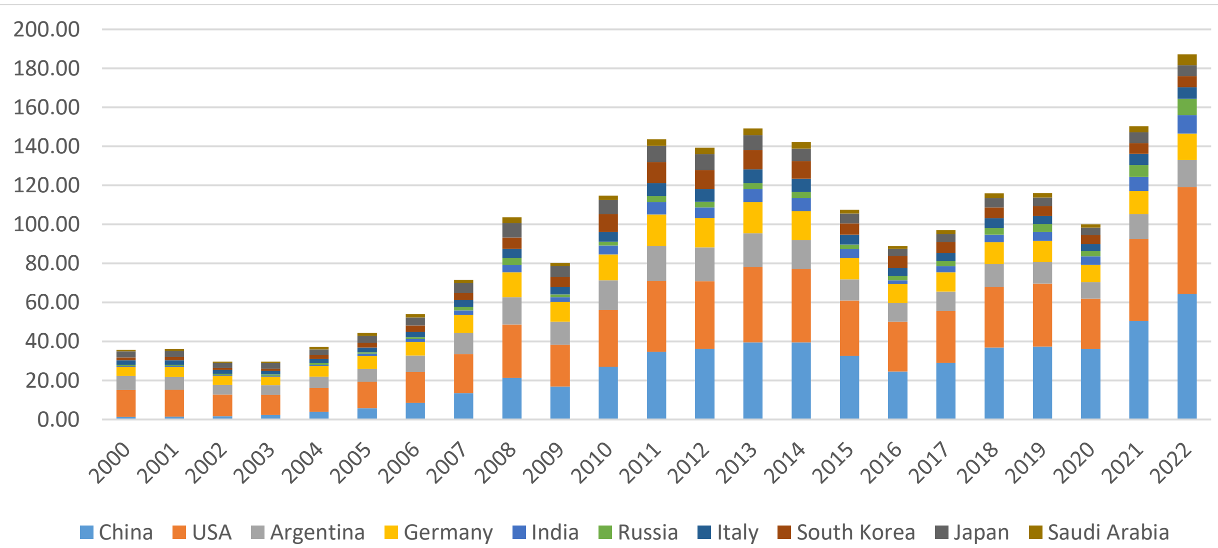
[9] The Harmonized System (HS) is an international nomenclature for the classification of products. The first two digits (HS-2) identify the chapter the goods are classified in, e.g., 09 = Coffee, Tea, Maté and Spices. The next two digits (HS-4) identify groupings within that chapter, e.g., 09.02 = Tea, whether or not flavoured. The following two digits (HS-6) are even more specific, e.g., 09.02.10 Green tea (not fermented). (UN Statistics, 2023)



Source: IMF E-Library & WEO Database

Figure 9-9: Brazil Exports to Top 10 Countries

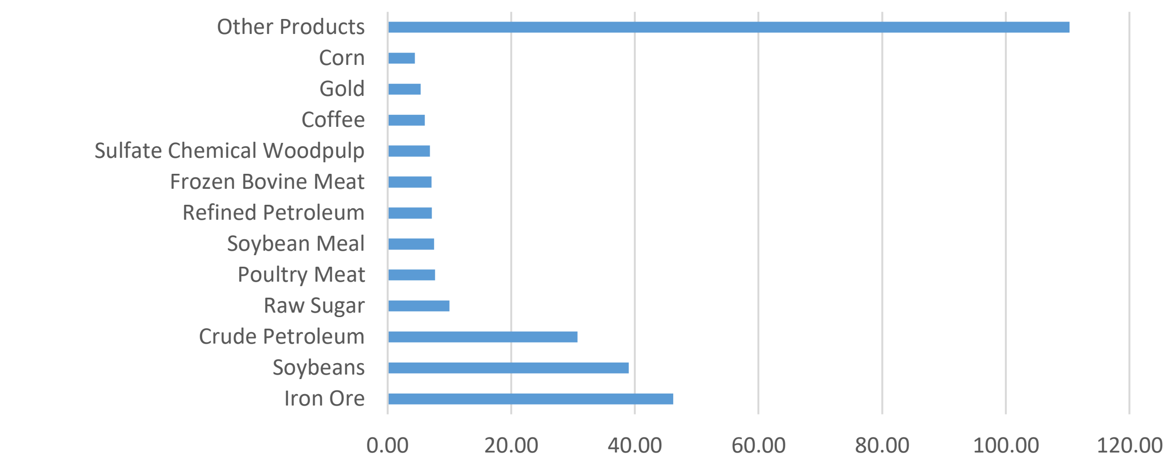
China is the fastest Growing Export market for Brazil. The growth rate is 29.9% ($20.3 billion) as of 2020-21. (Observatory of Economic Complexity, 2023). As of 2022, China is the largest exporter for Brazil ($64.39 billion) as of 2022, followed by USA ($54.81 billion) & Argentina ($13.89 billion). And the share of Top 10 countries increased from $35.77 billion in 2000 to $187.3 billion in 2022. As a percentage of total imports, these countries share increased from 59.66% in 2000 to 64.79% in 2022 (IMF Data, 2023).



Source: IMF E-Library Data

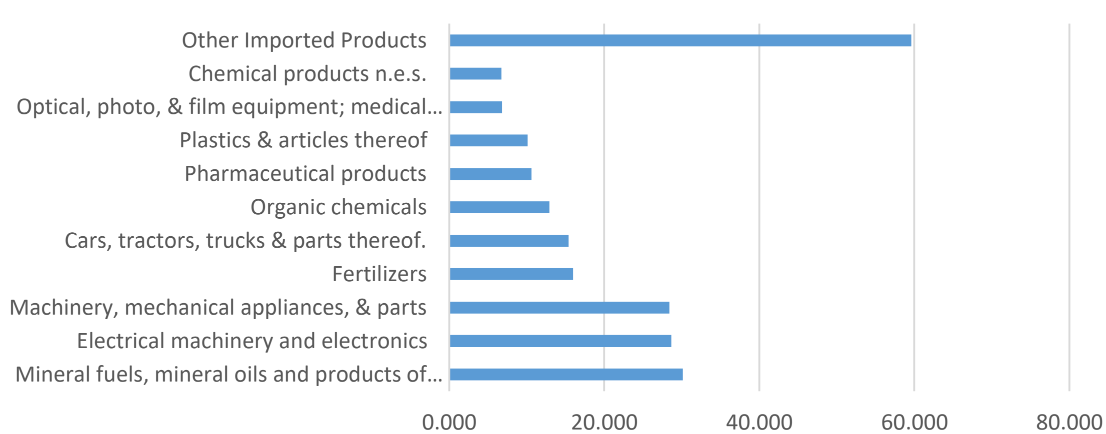
Figure 9-10: Brazil Imports from Top 10 Countries

Mineral fuels, mineral oils are the largest item imported to Brazil ($30.12 billion) (Figure 9-12). In that it imports refined petroleum most ($13.1 billion) as of 2021. Followed by electrical machinery and electronics ($28.7 billion) & Machinery, mechanical appliances & parts ($28.4 billion). Other than these Brazil also imports fertilizers ($16 billion), cars, tractors, trucks & parts ($15.4 billion). Also, Brazil is the largest importer of chemical fertilisers ($6.37 billion) (Observatory of Economic Complexity, 2023).



Source: Observatory of Economic Complexity, MIT, 2021

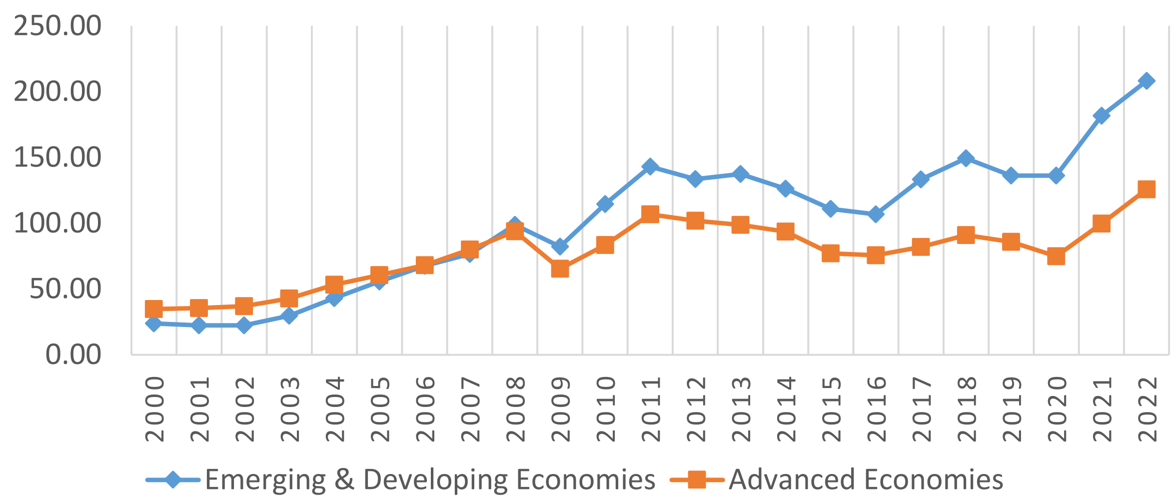
Figure 9-11: Trade Value of Brazil Exports



Source: Observatory of Economic Complexity, MIT, 2021

Figure 9-12: Trade Value of Brazil Imports

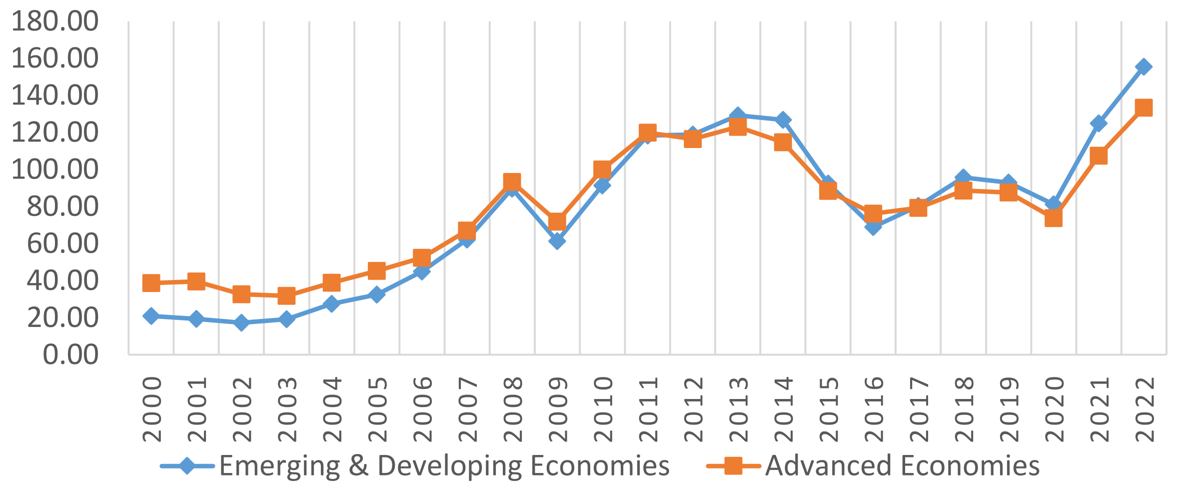
Overall, China is the biggest importer of Brazil as well as biggest exporter of Brazil followed by USA & Argentina (as of 2022) (IMF Data, 2023).



Source: IMF E-library Data

Figure 9-13: Exports to Emerging & Developing Economies and Advanced economies

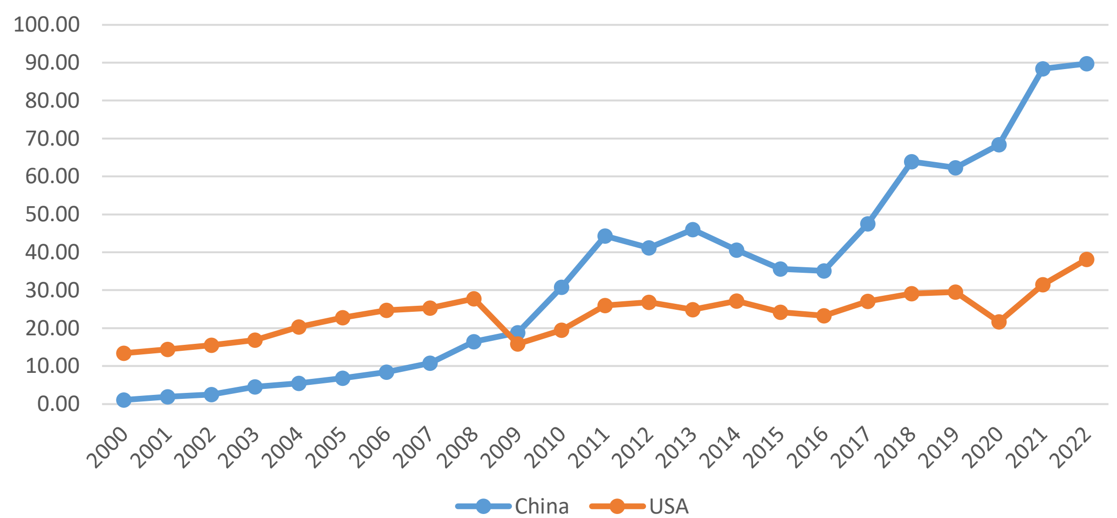
In 2000, Brazil exported less for both emerging & developing economies ($23.85 billion) compared to advanced economies ($34.64 billion) (Figure 9-13). But after 2008 it exported more to emerging & developing economies ($82.17 billion) compared to Advanced economies ($65.44 billion). As of 2022, Brazil exporting $208.22 billion to emerging & developing economies and $125.81 billion to Advanced economies. the gap between the curves has been widening (Figure 9-13). In 2009 the difference between two categories was $16.73 billion and in 2022 the gap was $82.41 billion. As of 2022, Brazil exports 1.65 times more to emerging & developing economies than the advanced economies. (IMF Data, 2023)



Source: IMF E-library Data

Figure 9-14: Imports from Emerging & Developing Economies and Advanced economies

But as far as imports are concerned, there isn't much difference in emerging & developing economies and advanced economies. In 2000, the imports from advanced economies are $38.74 billion whereas $20.90 billion from emerging & developing economies. In 2022, Brazil imports more from emerging and developing economies ($155.4 billion) compared to advanced economies ($133.34 billion). (Figure 9-14).



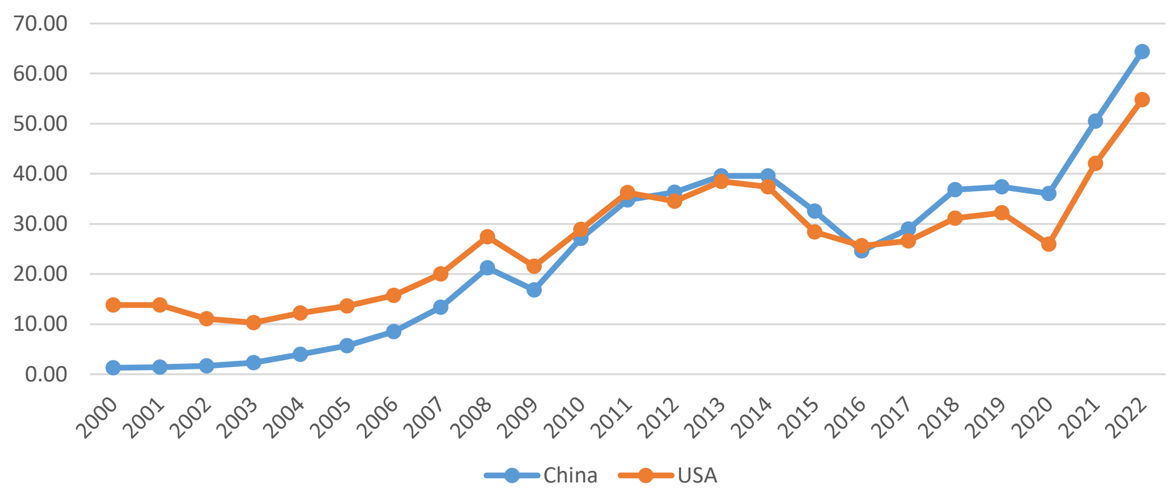
Source: IMF E-Library Data

Figure 9-15: Exports to China & USA

As we can see in Figure 9-13 in 2000 Brazil mostly exported to advanced economies. And we can clearly see from Figure 9-15, it exports more to USA ($13.38 billion) compared to China ($1.09 billion) in 2000. But after global financial crisis in 2008, direction of exports from Brazil has been more towards China. And Brazil exports to China has gradually increased from $30.79 billion in 2010 to $89.72 billion in 2022.

As of 2021, Brazil exports iron ore ($28.9 billion), soyabeans ($27.2 billion), crude petroleum ($14.2 billion) and remaining products ($17.9 billion) to China. Brazil exports crude petroleum ($3.1 billion), semi-finished iron ($1.87 billion) and other products ($25.23 billion) to USA. (Observatory of Economic Complexity, 2023).

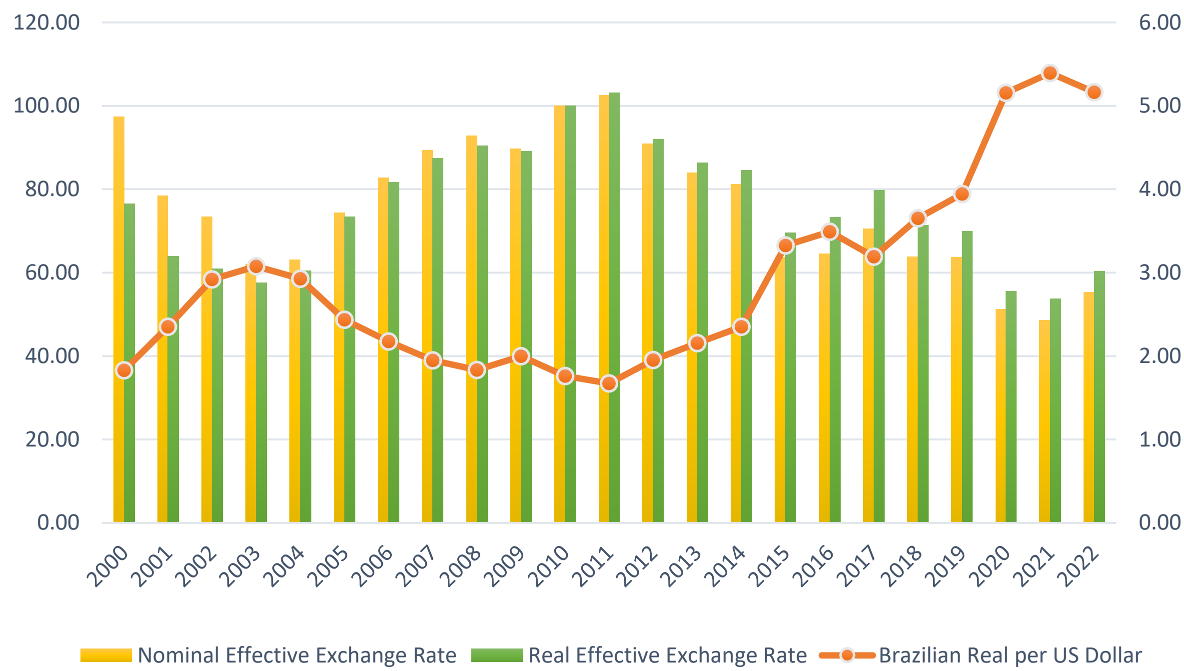
There is only slight difference in the exports of China and USA. But in 2000, USA ($13.78 billion) exported more than China ($1.30 billion). But as of now 2022, China ($64.39 billion) exporting more than USA ($54.81 billion) (*Figure 9-16*). as of 2021, China exports electrical machinery & electronics ($15.4 billion), Machinery, mechanical appliances & parts ($8.66 billion) and other products ($29.74 billion) to Brazil. And USA exports mineral fuel, mineral oils ($13.9 billion), mechanical appliances & parts ($4.57 billion), Pharmaceutical products ($3.25 billion) and other products ($17.58 billion) to Brazil. (Observatory of Economic Complexity, 2023).



Source: IMF E-Library Data

Figure 9-16: Imports from China & USA

The exchange rate has increased from 1.83 Real per $ in 2000 to 5.16 Real per $ (*Figure 9-17*). And During 2015-16, The real effective exchange rate has been depreciated due to increase in inflation (de Mello Jr & Carneiro, 1997).



Source: IMF E-library Data

Figure 9-17: Exchange Rate of Brazil

External Debt of Brazil

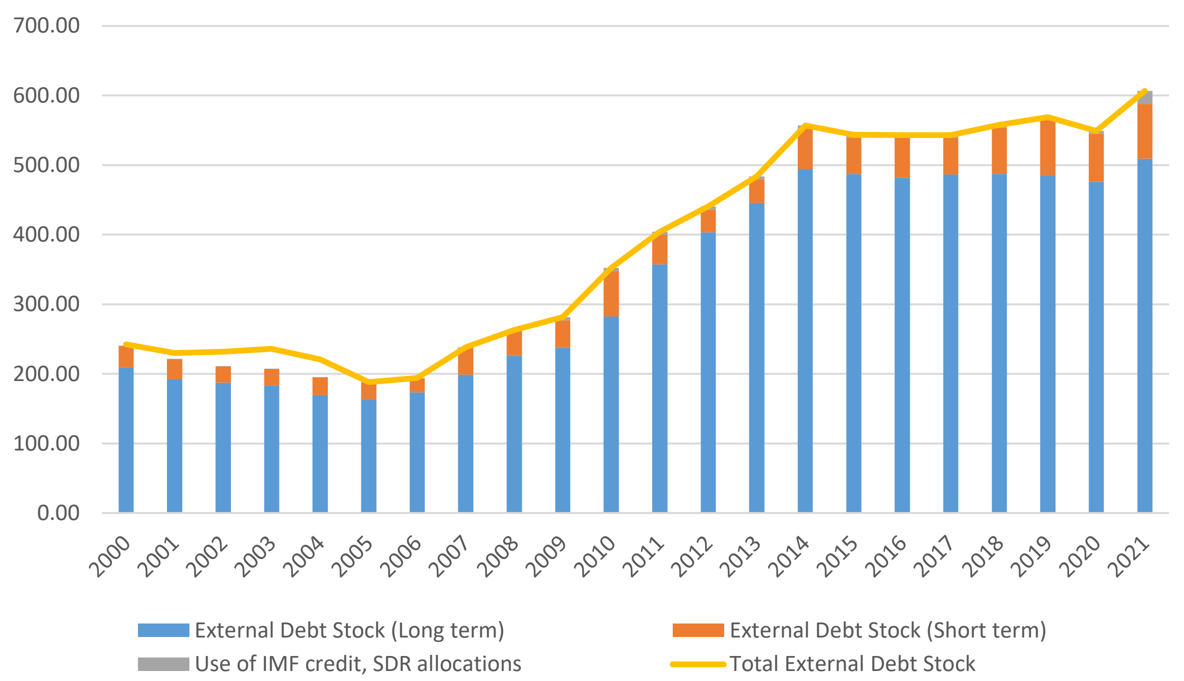
Brazil comes Under IBRD (International Bank for Reconstruction and Development) lending category.[10] Its total external debt stock was $606.48 billion in 2021. And Brazil is among top ten largest borrowers in low and middle income countries excluding China (World Bank, 2022). Total external debt of all countries is $9 trillion as of 2021. And Brazil's share of total external debt stocks is 6.73% in 2021.

In 2021, it has $508.88 billion long term external debt stock, $78.75 billion as external debt of short-term duration & $18.85 billion SDR allocations & Use of IMF Credit. And During 2009-14,

[10] The International Bank for Reconstruction and Development (IBRD) lends to governments of middle-income and creditworthy low-income countries. (World Bank, 2022)

the Total external debt stocks has gradually increased from $281.65 billion in 2009 to $556.92 billion in 2014.

During 2014-21, the short-term external debt stock has gradually increased from $58.18 billion in 2014 to $78.75 billion in 2021 (Figure 9-18. There is an increase in short term to external debt stocks (%) from 10% in 2017 to 13% in 2021. This is other than the rise in the share of loans under residual maturity (World Bank, 2022).

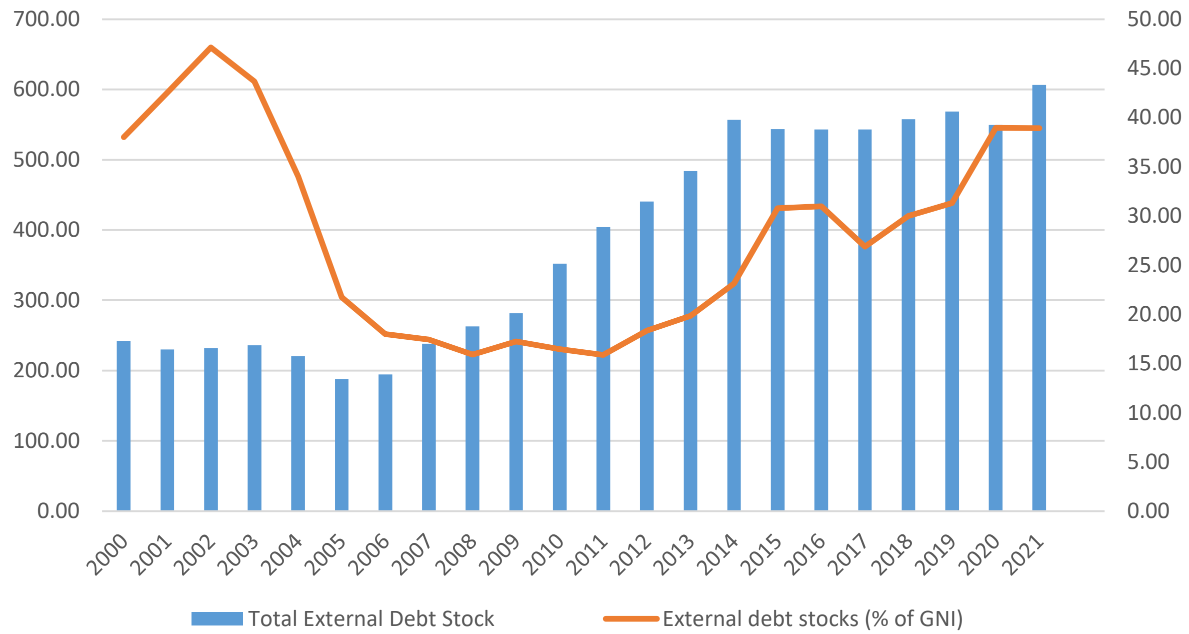


Source: International Debt Statistics, World bank, 2022

Figure 9-18: External Debt Stocks of Brazil

Even though the total external debt stocks nearly doubled between 2010 ($352 billion) & 2021 ($606 billion), the reserves to external debt stocks (%) has significantly decreased from 81% in 2010 to 58% in 2021 (World Bank, 2022).

External stocks to GNI (%) has gradually increased from 16.48% in 2010 to 38.91% in 2021. This is bad sign for a developing country like Brazil (Ortiz & Sapena, 2020). The ratio gradually increasing signifies that even though the GNI increases, the external debt of Brazil is increasing at faster pace. (Figure 9-19) External debt stocks to exports increased from 141% in 2010 to 212% in 2020. But it is slowly recovering as 2021's ratio has decreased to 175%.

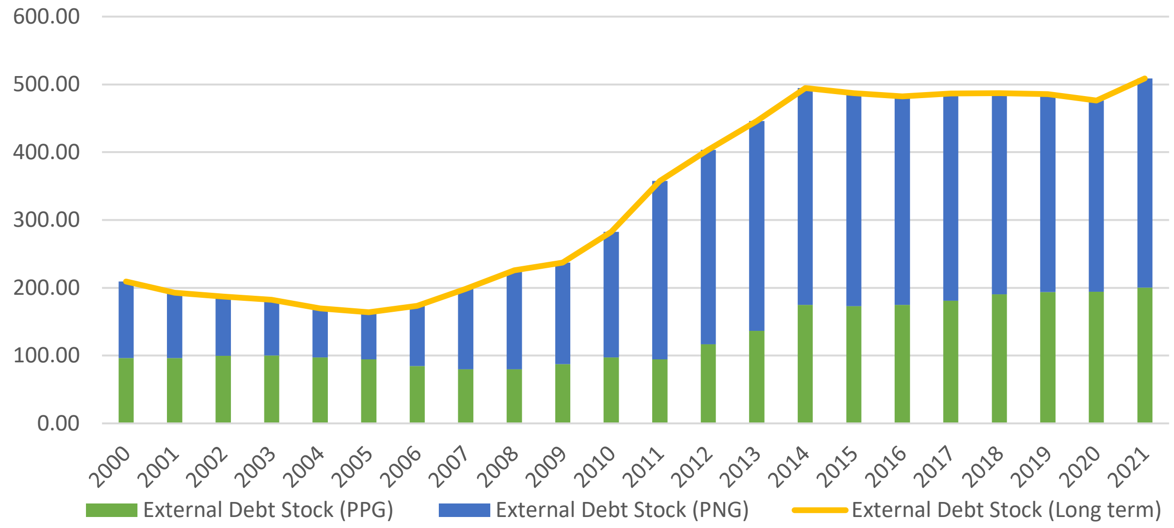


Source: International Debt Statistics, World bank, 2022

Figure 9-19: External Debt Stocks (as % of GNI)

General Government gross debt to GDP is 85.90% as of 2022 which is very high. During 2014-22, Gross debt to GDP ratio has increased from 62.31% in 2014 to 85.90% in 2022. *(World Economic Outlook Database, 2023)*.

As of 2021, PPG (public & publicly guaranteed) is $200.52 billion & PNG (Publicly Non-Guaranteed) is $308.36 billion. The PNG was higher than PPG except during 2001-2005 (*Figure 9-20*). the private companies are taking most of the external debt compared to the public & publicly guaranteed companies. And under cases of any default of the PNG loans, at times the sovereigns would have to step in in case this ends up affecting the macroeconomic environment.



Source: International Debt Statistics, World Bank, 2022

Figure 9-20: Long Term External Debt Stocks of Brazil

The Disbursements (long term) increased from $85.37 billion in 2010 to $156.03 billion in 2021 in which majority of the disbursements are from PNG (in 2021, PNG Disbursements are $139.4 billion whereas PPG Disbursements are $16.62 billion). (World Bank, 2022)

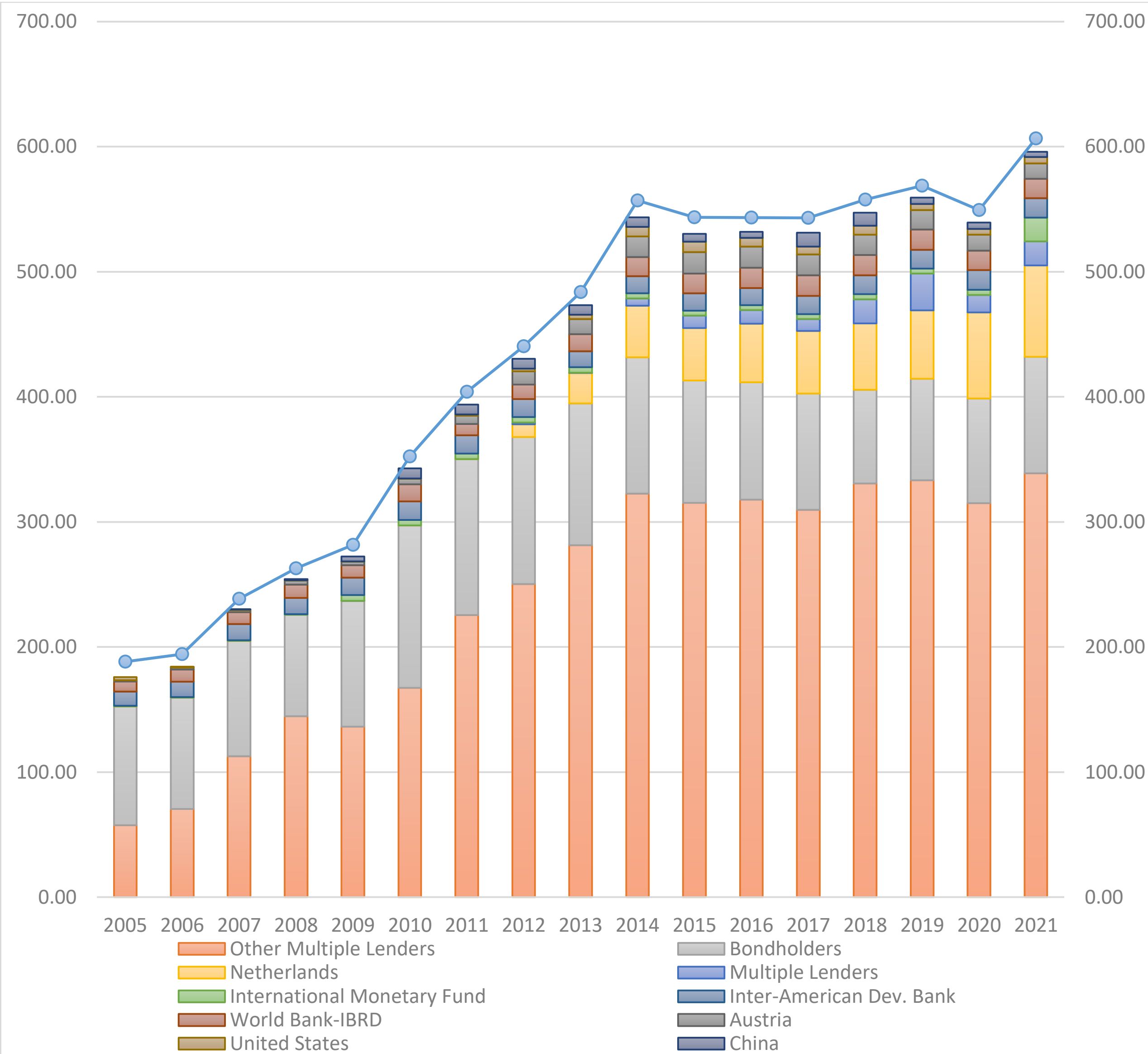
The principal repayments (long term) increased from $32.02 billion in 2010 to $125.91 billion in 2021 (almost 4 times increase from 2010 to 2021). Here also majority is from PNG (in 2021, PNG Principal repayments are $111 billion whereas PPG Principal repayments are $13.98 billion) (World Bank, 2022).

The Interest Payments (long term) increased from $13.1 billion in 2010 to $28.68 billion in 2021 (doubled). (World Bank, 2022)

In 2021, In PPG, $111 billion is from commercial banks, $46 billion from bondholders, $43 billion from official creditors. And In PNG, $260 billion from commercial banks and $48 billion from bondholders. (World Bank, 2022).

The major creditors of Brazil are other multiple lenders category who lend $338.95 billion (55.88% of total external debt) followed by bond holders ($93.18 billion i.e. 15.36% of total external debt) & Netherlands ($72.96 billion i.e. 12.03%) (Figure 9-21).

As of 2021, there are total 15 countries who credited to Brazil those are (1) Netherlands ($72 billion) (2)Austria ($12 billion) (3)United States ($5.1 billion) (4)China ($4.2 billion) (5)France ($2.6 billion) (6)Sweden ($2 billion) (7)Japan ($1.5 billion) (8)Germany ($0.69 billion) (9)Spain ($0.35 billion) (10)Luxembourg ($0.3 billion) (11)Canada ($0.13 billion) (12)United Kingdom ($0.095 billion) (13)Italy ($24.6 million) (14)Bahamas ($17 million) (15)Venezuela ($224000).



Source: International Debt Statistics, World bank, 2022

Figure 9-21: Credit Composition of Brazil (External Debt)

Multilateral Creditors & Banks who are giving credit as of 2021 are IMF ($19 billion), Inter-American Development Bank ($16 billion), World bank ($15 billion), Corporation Andina de Fomento ($2.5 billion), Plata Basin Financial Development Fund ($0.22 billion), International Fund for Agricultural Development ($0.1 billion), European Investment Bank ($91 million), Nordic Investment Bank ($9091000). Multilateral credit to total external debt stocks is constantly 6% from 2017-21. And it also signifies that Brazil's multilateral credit is low. most of its credit is from multiple lenders in which Commercial banks, manufacturers are included.

Chapter 10

Mexico, located in North America, boasts a population of around 126 million people and has Spanish as its official language, employing the Mexican Peso as its currency. Gaining independence from Spain on September 16, 1810, Mexico's diverse economy thrives on industries like manufacturing, agriculture, petroleum, and tourism. As of my last knowledge update in September 2021, Andrés Manuel López Obrador was serving as the President of Mexico, but it's advisable to verify the current leadership for 2023.

Economy

Mexico's economic landscape is that of a developing mixed-market economy, positioned 14th globally in nominal GDP and 13th in purchasing power parity (PPP terms), as per the International Monetary Fund (IMF). Since the 1994 crisis, successive governments have been committed to fortifying the nation's macroeconomic stability. Mexico successfully navigated the 2002 South American crisis with minimal disruption and achieved positive albeit modest growth rates following a brief stagnation in 2001. However, the global recession in 2008 dealt a harsh blow to Mexico, leading to a GDP contraction of more than 6%.

Despite these economic fluctuations, Mexico has achieved remarkable macroeconomic stability, resulting in a significant decrease in inflation and historically low interest rates. Nevertheless, notable economic disparities persist among diverse population segments, spanning urban and rural areas, northern and southern regions, and varying income groups. Mexico confronts ongoing challenges such as the modernization of infrastructure, tax system reforms, labour law enhancements, and the reduction of income inequality. Tax revenues in 2013 represented a mere 19.6% of GDP, ranking Mexico among the OECD countries with the lowest figures.

Mexico's economy is defined by the rapid growth of modern industrial and service sectors, notable for the increasing prevalence of private ownership. Recent governmental administrations have actively fostered competition in pivotal areas such as ports, railroads, telecommunications, electricity generation, natural gas distribution, and airports, all with the aim of elevating infrastructure standards. With over 90% of its trade conducted under free trade agreements (FTAs) involving more than 40 nations, including the European Union, Japan, Israel, and various Central and South American countries, Mexico's economy is distinctly export oriented. The United States–Mexico–Canada Agreement (USMCA), which took effect in 2020 and was signed in 2018, is the most influential FTA. In 2006, trade with Mexico's two northern partners, the United States and Canada, constituted nearly 90% of its exports and 55% of its imports. Notably, Mexico's Congress recently enacted significant reforms pertaining to taxes, pensions, and the judicial system, while discussions persist regarding reforms in the oil sector. In 2016, 16 companies from Mexico figures in the Forbes' Global 2000 list of world's largest corporations. (Wikipedia)

In 2015, Mexico's labour force was 52.8 million strong. Recognized by the OECD and WTO for their strong work ethic, Mexican workers rank among the world's hardest workers based on annual hours worked. Yet, challenges persist, including relatively low hourly wages. Mexico's economy, marked by stability and global trade agreements, faces economic disparities and the need for reforms. Addressing these issues is vital for Mexico's equitable growth on its path to development.

Sector	**Share in GDP**	**Percentage of Workforce Employed**
Agricultural	4.1%	12.3%
Industrial	32.1%	25.6%
Service	58.8%	62.1%

Table 1-1: Contribution in GDP of Mexico in 2022

GDP at current prices adjusted for Purchasing Power Parity comparison of Mexico

As per the data in current international dollars based on the 2011 ICP round, Mexico's GDP at current prices adjusted for PPP per capita reflects its position as an emerging economy with a level of economic development higher than many other emerging and developing nations but still below that of advanced economies(Figure 10-1). Mexico's position in the middle ground between advanced and emerging economies reflects both opportunities and challenges. It has economic strengths, such as a diverse economy, trade relationships, and investment opportunities, but it also faces challenges like structural issues, corruption, and the need for continued reforms to further economic growth. (Central bank of Mexico)

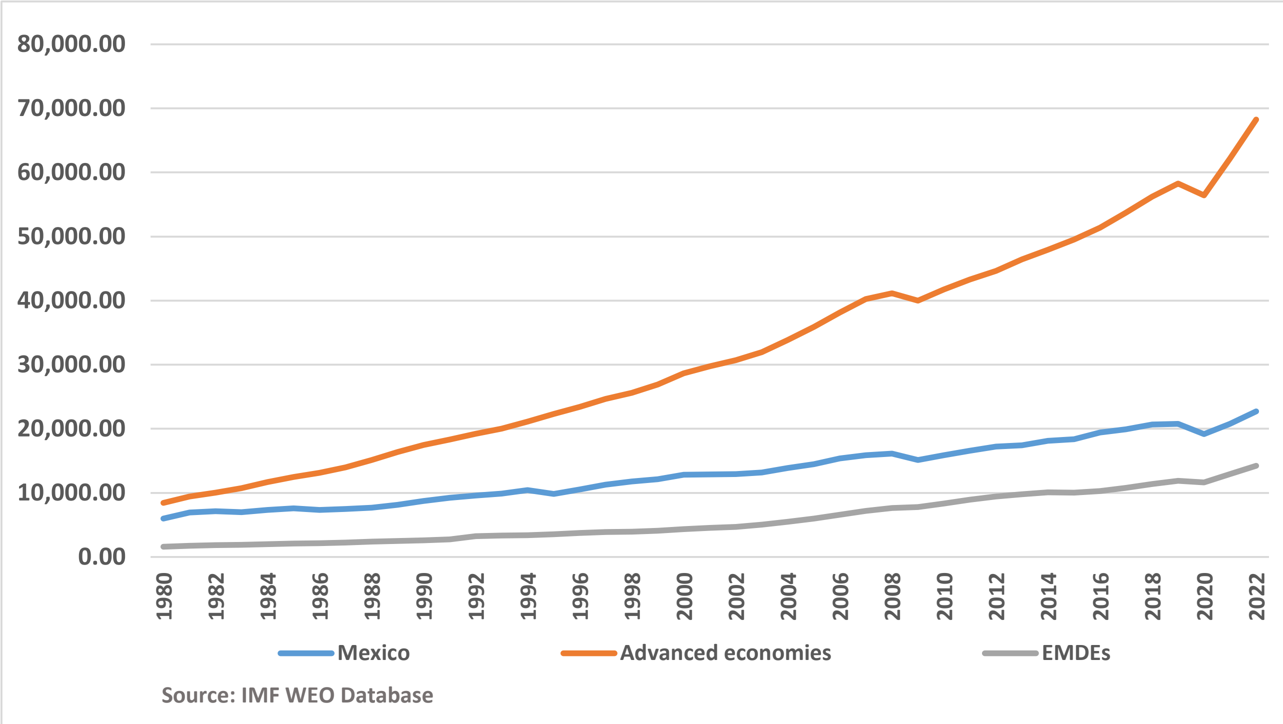


Figure 10-1: GDP at current prices adjusted for purchasing power parity (Int $) comparison of Mexico

Growth and Inflation of Mexico

In 1987, Mexico grappled with a rapidly escalating inflation rate, teetering on the precipice of hyperinflation. The inflation rate in Mexico soared to 159.17% in 1987, marking a staggering increase of 53.42% compared to the previous year, 1986, and a whopping 107.51% surge compared to the following year, 1988. The economic policies that had been put in place from 1983 to 1987, aimed at addressing the daunting debt crisis, had proved futile in restoring price stability. The inflationary spiral was fueled by the expansion of credit, primarily to bridge fiscal deficits, and adjustments made to official and public sector prices as part of the fiscal adjustment strategy. Moreover, it appeared that the authorities were pursuing a strategy of targeting the real exchange rate to counter the adverse impacts of the debt crisis, plummeting export prices, and other external shocks. Contrary to some claims, the Mexican economy exhibited the hallmarks of chronic-inflation economies. Inflation displayed both persistence and heightened volatility, characterized by frequent revisions of the minimum wage and widespread informal indexation practices linked to past inflation. During this period, the Mexican economy lacked a reliable nominal anchor, exacerbating its battle against inflation. (International Monetary Fund World Economic Forum)

The Mexican Pacto initially incorporated elements of unorthodox economic programs. However, it gradually transitioned into a more orthodox strategy, emphasizing fiscal discipline and an exchange rate anchor. This transformation entailed the gradual removal of price and wage controls. Broadly speaking, the policy measures centered around stringent fiscal restraint, while monetary policy adopted a more passive role within the new exchange rate regime. Unlike prior fiscal adjustments, which heavily relied on slashing public sector expenditures, rectifying the fiscal deficit during this phase primarily entailed expanding the tax base and enhancing tax compliance. Furthermore, the prospects of the stabilization process were buoyed by the 1989 external debt renegotiation, which alleviated Mexico's debt burden. (Musacchio)

Various structural measures were also implemented, including unilateral trade liberalization and subsequent integration into NAFTA. In 1988 alone, a notable enhancement in the primary budget surplus played a pivotal role in curbing the overall budget deficit. Although the primary surplus remained relatively stable from 1989 to 1992, the reduction in inflation rates and the Brady deal alleviated the debt service burden on both domestic and foreign debt, facilitating further reductions in the overall deficit. However, fiscal positions weakened in 1993 due to an economic slowdown, and this deterioration persisted into 1994. Since the early 2000s, numerous emerging market economies, Mexico included, have embraced flexible exchange rate systems and adopted an inflation targeting framework for monetary policy. This approach, coupled with fiscal discipline and manageable public debt, effectively curbed inflation and stabilized inflation expectations in Mexico. The adoption of an inflation targeting regime has empowered monetary authorities to adeptly navigate domestic economic shocks (Figure 10-2).

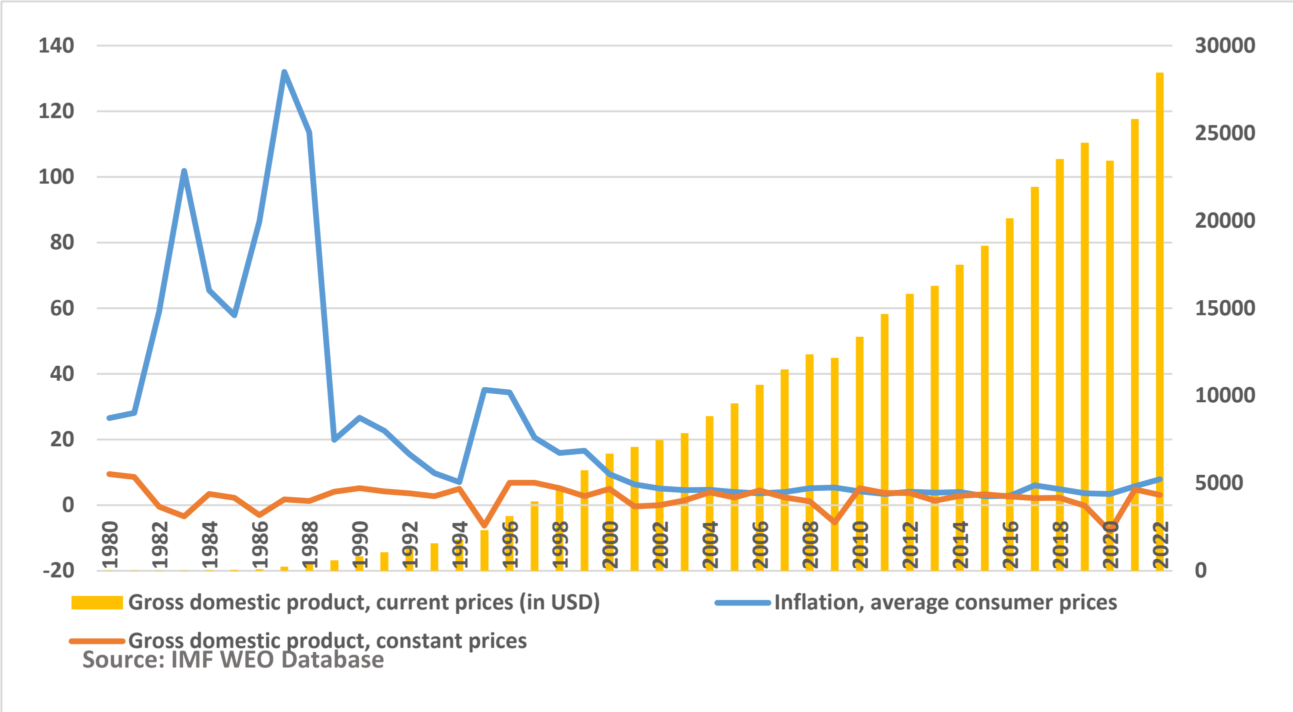


Figure 10-2: Growth and Inflation of Mexico

Unemployment rate of Mexico

Since the early 1980s, investment in Mexico, much like the global landscape, has been shaped by the parameters set by financial globalization. However, Mexico has faced challenges in establishing a favourable environment for capital accumulation that would fuel robust economic growth.

The 1990s was witness to a significant divergence between different regions within Mexico. Unemployment rates were on a downward trajectory in less urban areas, but they were steadily rising in more urbanized regions. This disparity became more pronounced in 1995, with urban areas bearing the brunt of an economic downturn. Although the gap showed signs of narrowing through 1997, it experienced a slight expansion in 1998. Over the span from 1991 to 1998, the number of unemployed individuals in urban areas increased at an annual rate of 7.7 percent, whereas it decreased in less urban areas. During this period, the informal sector emerged as a key player in stabilizing employment amid economic downturns. Informal employment indicators consistently outpaced overall employment, while formal employment indicators all exhibited declines. Employment in larger establishments with six or more employees, positions offering employment benefits, and roles covered by social security all saw annual declines ranging between 1 percent and 2 percent. (Martin)

Analyzing statistics, it is worth noting the challenges Mexico has faced in adjusting the Unemployment variable to pre-2008 global financial crisis levels when it averaged a 2.96% quarterly rate. This has raised questions within Mexico's economic landscape regarding labor policies and plans, especially as recent presidential administrations have seen the average unemployment rate rise to 4.93% during similar time frames, indicating reduced labor stability in the long term. The evolution of Mexico's unemployment rate from 1999 to 2014 reveals a consistent upward trend, with a notable shift following the peak unemployment rate of 5.15% in 2009 during the global liquidity crisis. While unemployment rates surged during the COVID-19 pandemic in 2019, they subsequently declined as the pandemic's effects subsided.

The significance of understanding Mexico's unemployment dynamics lies in its ability to respond effectively to the persistent challenges of unemployment, not only in terms of social protection and recent labor reforms but also from the perspective of macroeconomic stabilization policies(Figure 10-3).

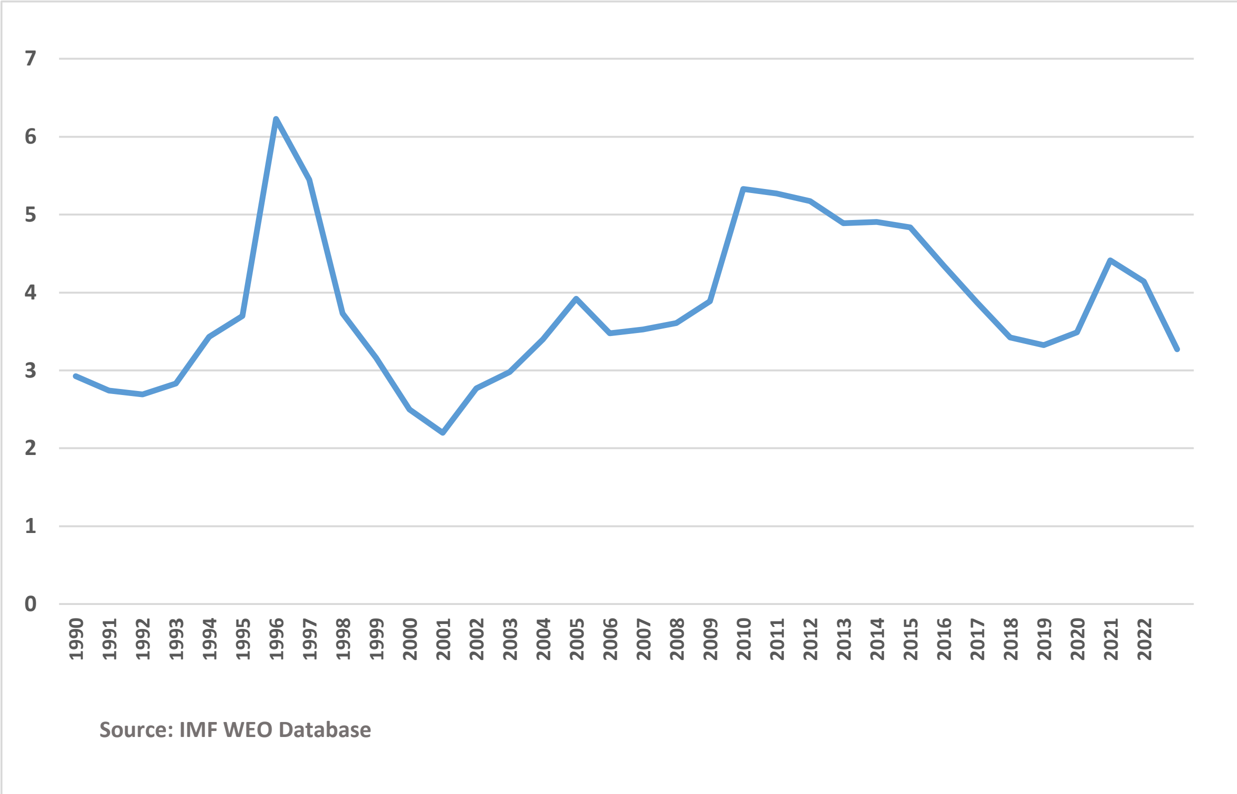


Figure 10-3: Unemployment rate of Mexico

General Government Primary Net Lending and Borrowing of Mexico

General Government Primary Net Lending and Borrowing is a significant fiscal indicator utilized by organizations like the International Monetary Fund (IMF) to evaluate a country's government finances. This metric calculates the difference between government revenue (excluding grants) and government expenditures (excluding interest payments on debt). It serves as a key tool for assessing a government's fiscal sustainability, its ability to meet financial obligations, invest in public services, and manage its debt.When government revenue surpasses expenditures, a surplus is noted, indicating positive net lending. Conversely, if government expenditures exceed revenue, the government is in a deficit, indicating negative net borrowing.

In the case of Mexico in 1994, this indicator reflected a challenging scenario as the country confronted a severe financial crisis, marked by currency devaluation and high inflation. To offset this primary deficit, the Mexican government likely had to secure funds through the issuance of debt securities or loans from domestic and international sources. This increased borrowing further exacerbated the government's overall debt levels. Factors such as economic recession, reduced government revenue due to external shocks, or a decline in economic activity added to the borrowing pressures in the late 1990s.

An upward trend in the early 2000s signifies an improvement in Mexico's fiscal situation during that period. However, a drop in 2009 reveals a fiscal setback, possibly linked to the global financial crisis of 2008, which had far-reaching impacts on economies worldwide, including Mexico. The economic contraction and reduced tax revenues contributed to a deterioration in the country's fiscal conditions.In 2009, Mexico managed to recover from the fiscal challenges encountered during the global financial crisis, driven by government policies, economic growth, or fiscal adjustments. The year 2015 possibly indicates a sustained period of fiscal improvement. It's noteworthy that government fiscal policies, encompassing changes in tax rates, public spending priorities, and stimulus measures, played a pivotal role in influencing these borrowing trends. Additionally, 2015 coincided with midterm legislative elections in Mexico, which could have contributed to the evolving fiscal landscape(Figure 10-4).

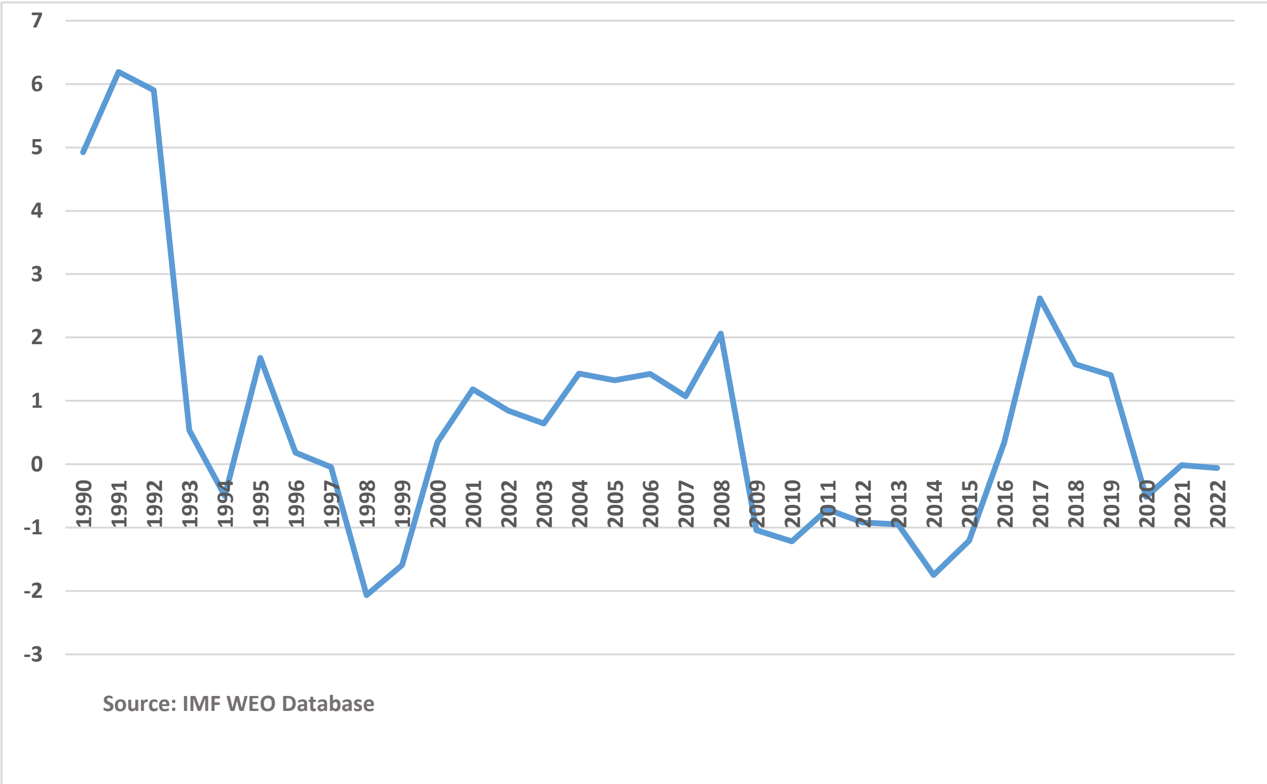


Figure 10-4: General Government Primary Net Lending and Borrowing of Mexico

Exchange Rate of the Mexican Peso

The Mexican financial crisis that unfolded during 1994-1995, commonly referred to as the "Tequila Crisis," was triggered by Mexico's decision to devalue its peso in December 1994. This event set in motion a series of profound economic challenges for Mexico, including the most severe banking crisis in the nation's history, spanning from 1995 to 1997. Notably, this crisis marked one of the most substantial depreciations of a currency within a single year, with the peso's value plummeting from approximately 5.3 pesos per U.S. dollar to well over 10 pesos per U.S. dollar, spanning from December 1994 to November 1995. This period was also marred by the worst economic recession Mexico had experienced in more than a decade. Similarly, during the global financial crisis of 2007-2008, risk aversion tactics came into play. On July 30, 2008, the peso's exchange rate was 10.0345 pesos per U.S. dollar. However, as the financial crisis deepened, ultimately leading to the Great Recession, investors began to seek refuge in safe-haven assets like U.S. Treasuries. This shift in investment behavior led, in part, to a substantial depreciation of the peso, which weakened by more than 53%, reaching 15.4060 pesos per U.S. dollar by March 2, 2009. (International Monetary Fund International Financial Statistics)

The peso also experienced a decline against the U.S. dollar amid the COVID-19 pandemic and the resultant economic downturn in 2020. Starting at 18.86 pesos per U.S. dollar on December 31, 2019, the pandemic prompted investors to channel their funds into safe assets, including U.S. Treasuries. This capital flight from Mexico caused the peso to depreciate by over 33%, reaching 25.13 pesos per U.S. dollar by March 24, 2020(Figure 10-5). While the peso has shown some recovery, closing at 20.51 pesos per U.S. dollar by December 30, 2021, it's worth noting that the U.S. dollar's value relative to the peso has essentially doubled since July 2008.

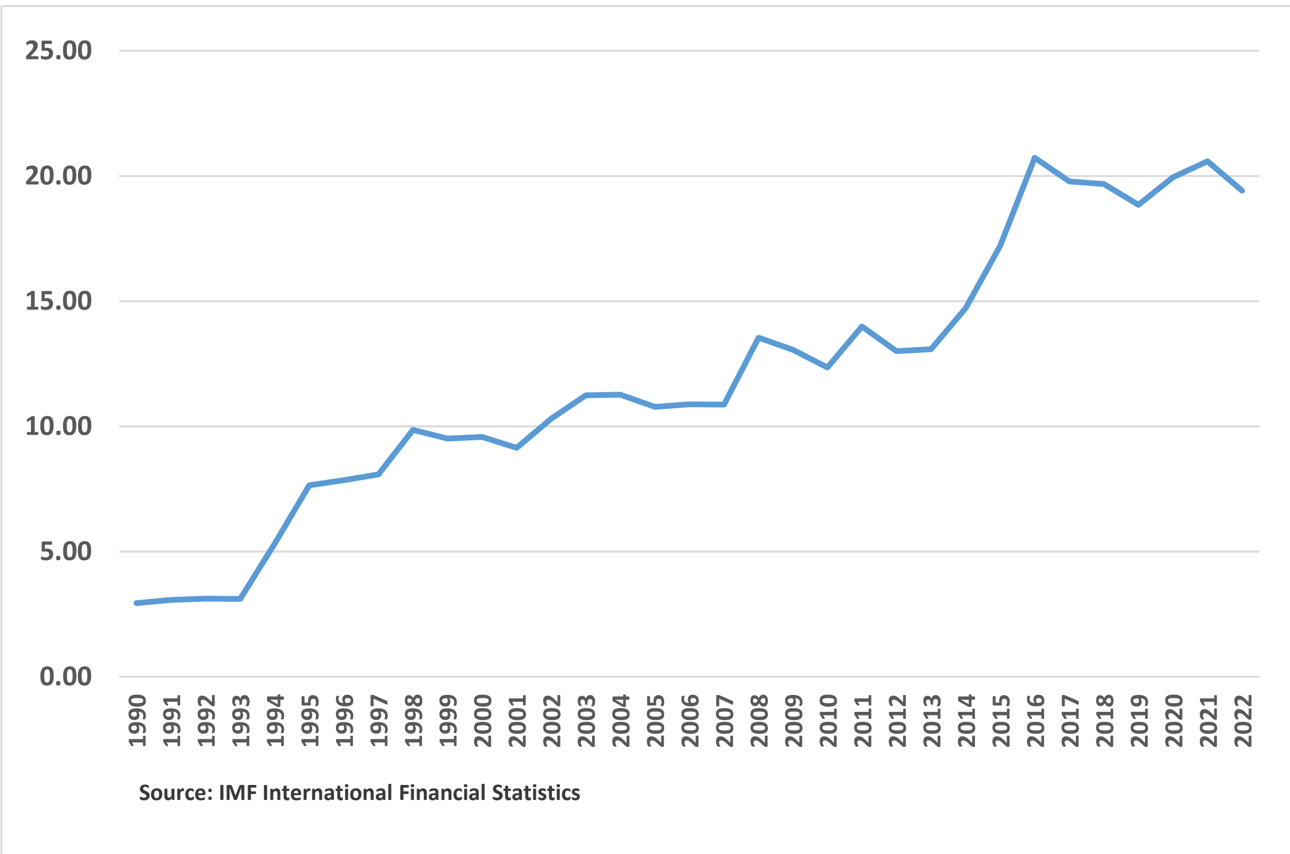


Figure 10-5: Exchange Rate of the Mexican Peso

Total external debt stocks to gross national income of Mexico

Total external debt stocks to gross national income. Total external debt is debt owed to nonresidents repayable in currency, goods, or services. Total external debt is the sum of public, publicly guaranteed, and private nonguaranteed long-term debt, use of IMF credit, and short-term debt. Short-term debt includes all debt having an original maturity of one year or less and interest in arrears on long-term debt. GNI (formerly GNP) is the sum of value added by all resident producers plus any product taxes (less subsidies) not included in the valuation of output plus net receipts of primary income (compensation of employees and property income) from abroad(Figure 10-6).

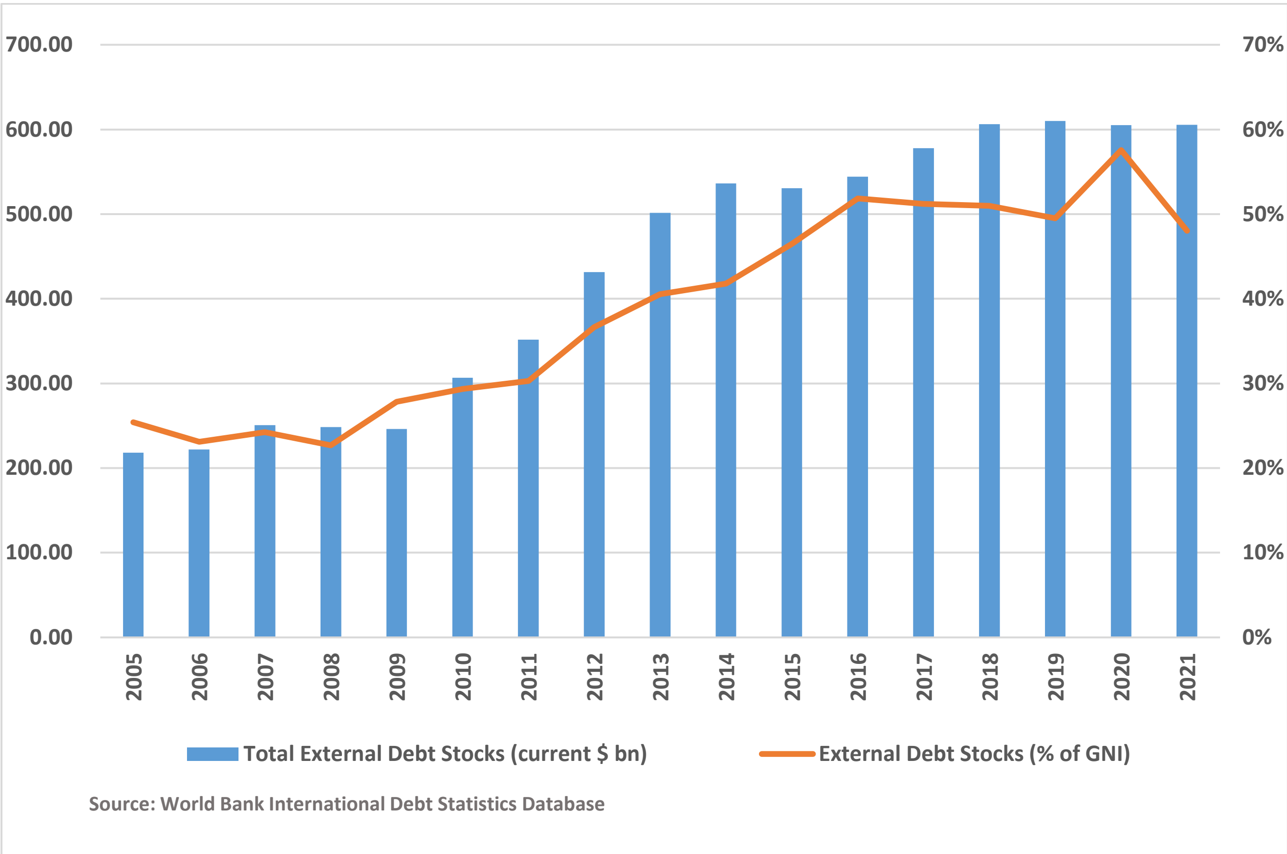


Figure 10-6: Total external debt stocks to gross national income of Mexico

Debt based on maturity of Mexico

Short-term debt refers to debt with an original maturity of one year or less, including overdue interest on long-term debt. Total external debt encompasses what is owed to foreign entities, repayable in various forms. It comprises public, publicly guaranteed (PPG) , and privately non guaranteed (PNG) long-term debt, IMF credit utilization, and short-term debt.It's noteworthy that there hasn't been much focus on recent changes in the debt maturity patterns of non financial firms, and there is a lack of research on current trends in the debt maturity of sovereign nations. Additionally, there's a need for updated analyses concerning what factors determine debt maturity for both firms and governments.Understanding the structure of debt maturity is crucial as it can impact the risk of rollover crises. Short-term debt, typically maturing within a year, exposes borrowers to rollover risk, where the terms of financing are renegotiated to their disadvantage. This risk can occur due to self-fulfilling panic, worsening economic conditions, or global factors. (CEIC Data)

Existing research has shown that higher levels of short-term debt are linked to a greater likelihood of financial crises.Furthermore, the maturity of debt has tangible effects on the real economy. For instance, during the Global Financial Crisis (GFC), companies with a significant portion of their debt maturing in the short term experienced more severe cuts in investment compared to those without short-term debt obligations.Regarding the conditions of long-term to total external debt, these conditions refer to the composition of a country's external debt. It's important to understand the balance between long-term and short-term debt in a country's external debt portfolio, as excessive reliance on short-term debt can heighten vulnerability to financial crises and economic shocks(Figure 10-7).

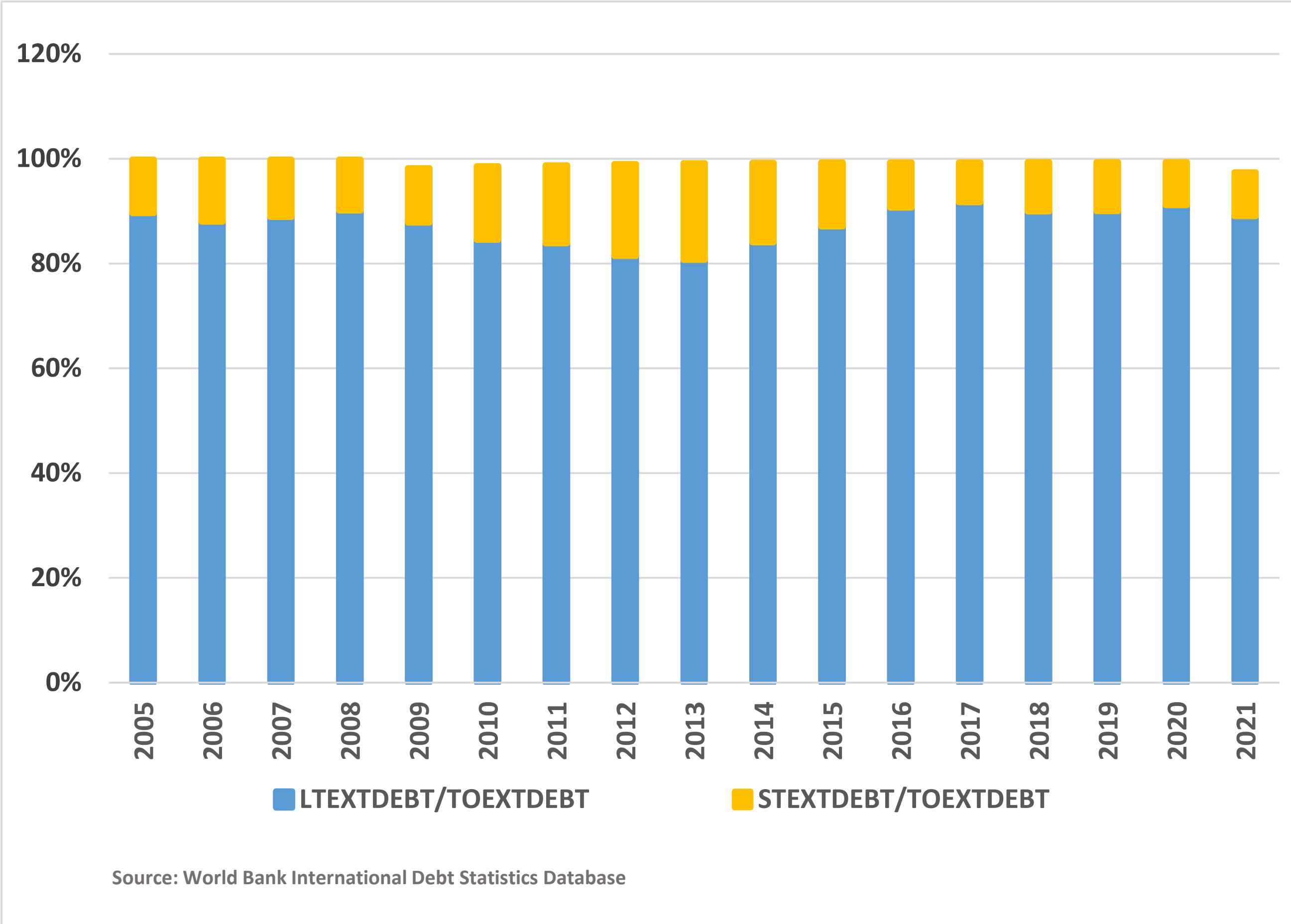


Figure 10-7: Debt based on maturity of Mexico

External debt stock (PPG to total external debt stock and PNG to total external debt stock) of Mexico

PPG (Public and Publicly Guaranteed) Debt: PPG debt refers to the debt incurred or guaranteed by the government and government-related entities. This type of debt is typically more transparent and subject to government control and oversight. PPG debt often includes government bonds, loans from international financial institutions, and other forms of public borrowing. Managing PPG debt is crucial for governments to maintain fiscal stability and credibility in financial markets(Figure 10-10).

PNG (Private Non-Guaranteed) Debt: PNG debt represents debt incurred by private entities, such as corporations and private financial institutions, without any government guarantee. This type of debt is often used for various development projects, infrastructure investments, or corporate financing. PNG debt can be a significant driver of economic growth, but it also carries risks, especially if not managed prudently. In Mexico, the increasing reliance on PNG debt reflects the private sector's role in financing the nation's development and economic activities which has been in average range of 50% (Figure 10-9).

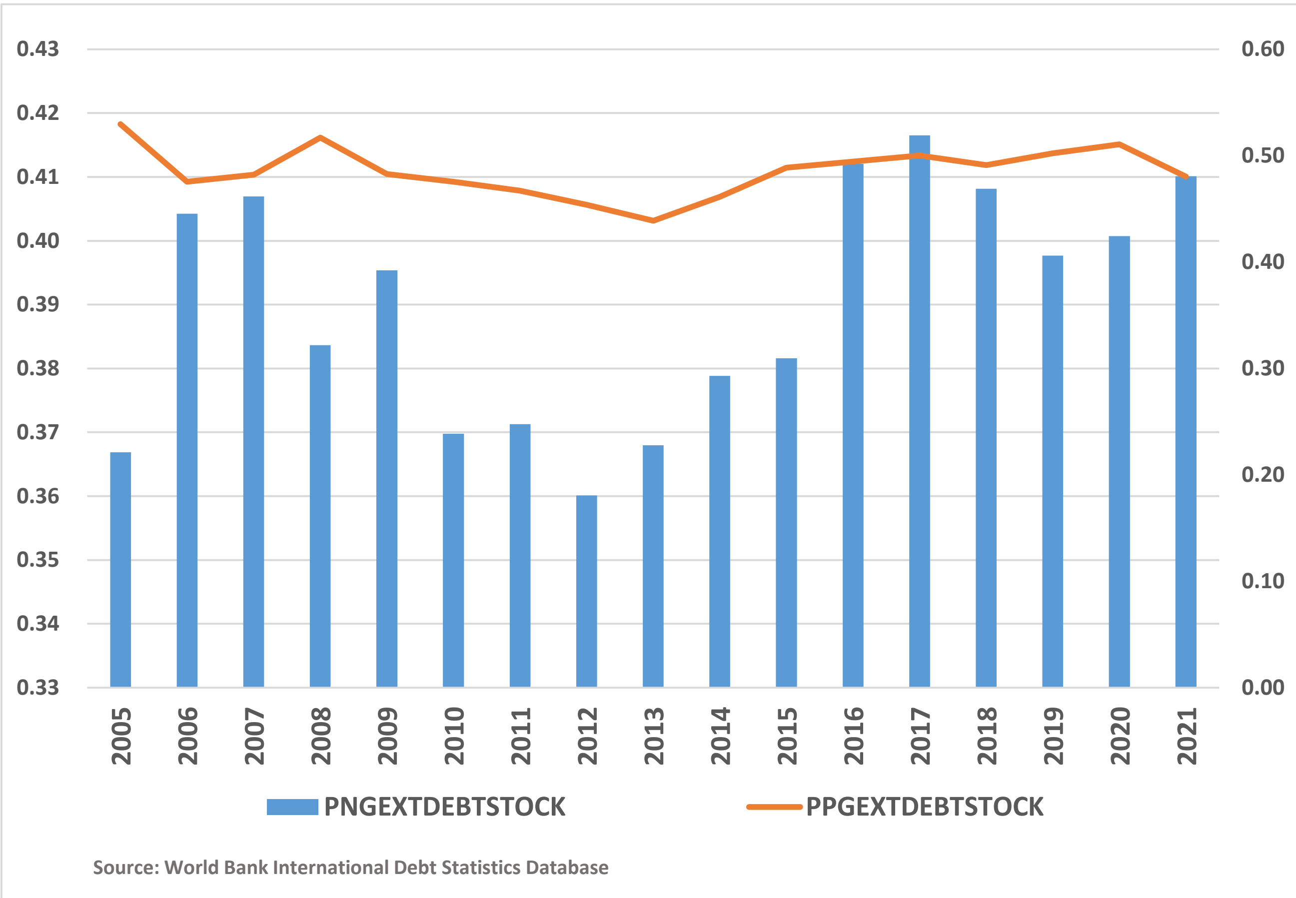


Figure 10-8: External debt stock (PPG to total external debt stock and PNG to total external debt stock) of Mexico

Pre-2005 Era: Mexico began this period with a relatively stable debt situation, benefiting from responsible fiscal policies and prudent debt management. The government's focus on maintaining a healthy balance between public and private borrowing played a pivotal role in its financial stability.

Rise of Private Sector Borrowing (2005-2010): In the mid-2000s, Mexico witnessed a gradual increase in private sector borrowing, which contributed to a notable rise in private sector-generated

(PNG) debt from 37% to almost 40%. This shift indicated growing reliance on private entities for financing development projects, mirroring a global trend toward public-private partnerships.

Debt Stability (2010-2015): In the years that followed, Mexico enjoyed a period of debt stability. The country maintained manageable levels of public debt (PPG) while continuing to rely on private sector involvement to bolster economic growth.

Economic Challenges (2015-2021): The mid-2010s marked a turning point for Mexico's debt landscape. Economic challenges, including fluctuating oil prices, a crucial revenue source, forced the government to increase its public borrowing from 38% in 2015 to 41% in 2021. Simultaneously, private sector borrowing, especially for infrastructure and development projects, continued to surge. This resurgence in borrowing raised concerns about the sustainability of Mexico's debt(Figure 10-8).

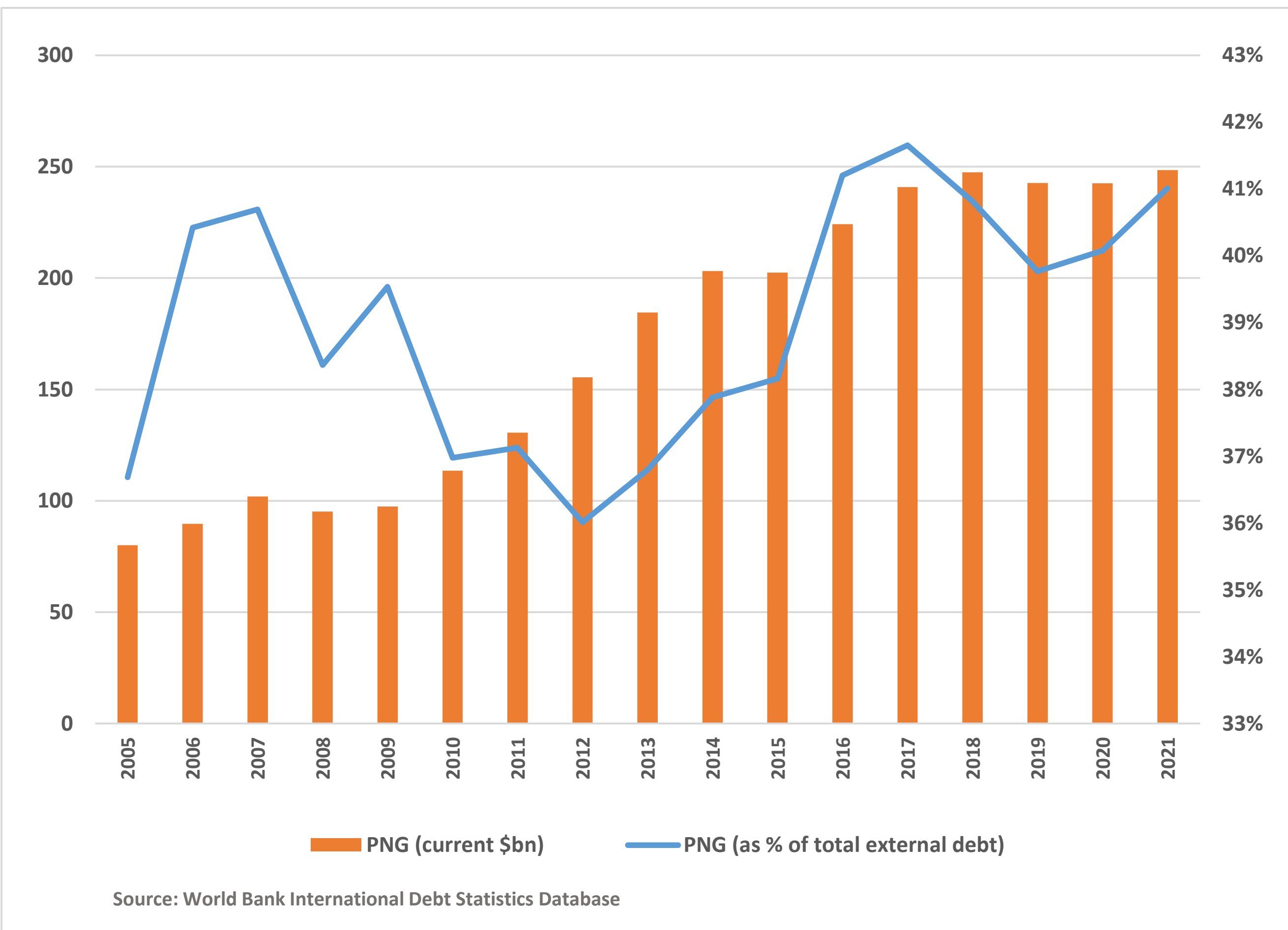


Figure 10-9: Private Non Guaranteed Debt of Mexico

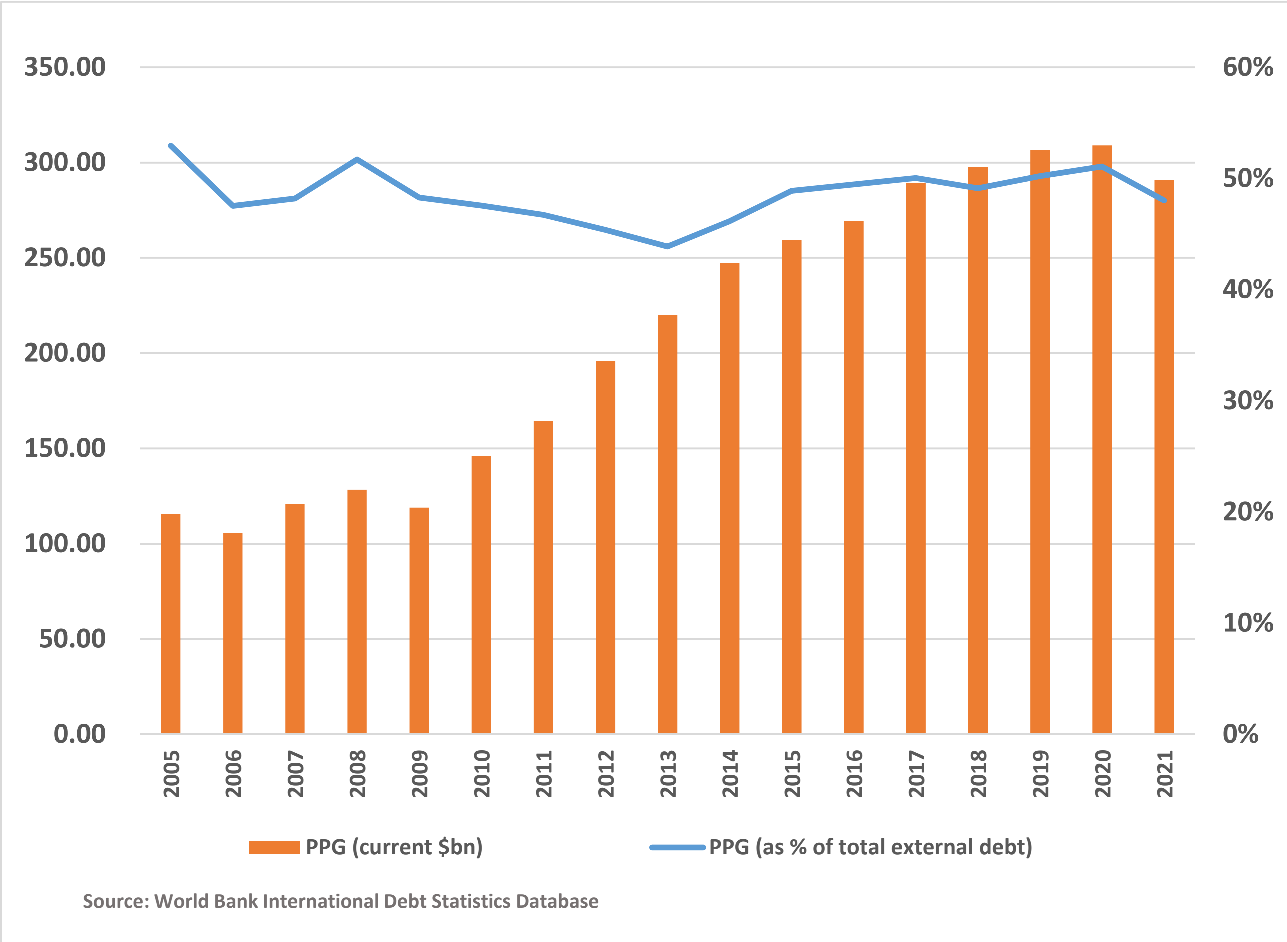


Figure 10-10: Public and Publicly Guaranteed Debt

PPG vs. PNG Debt: Similar to the earlier periods, Mexico experienced a shift in the composition of its debt. The percentage of public debt in relation to the total debt stock exhibited a downward trend, indicating an increasing reliance on private sector financing for various initiatives. Conversely, the percentage of PNG debt within Mexico's total debt increased, reflecting the nation's growing dependence on private sector borrowing for development projects. In the present day, Mexico grapples with mounting concerns regarding the sustainability of its debt. The accumulation of both public and private debt poses significant economic challenges, impacting fiscal policies, economic stability, and social spending, with far-reaching implications for the nation's future development and stability. Balancing these dynamics will be crucial for Mexico's financial health and long-term prosperity.

GDP growth (annual %) of Mexico

In 2008, Mexico faced significant economic challenges that affected its GDP. Firstly, the global economic downturn, particularly in the United States, resulted in a decline in Mexico's exports and worsened its terms of trade. This situation, coupled with international investors' extreme risk aversion and the global deleveraging process, limited Mexico's access to international financial markets. The country's fiscal situation weakened due to reduced oil revenues, partly stemming from the global economic downturn and decreased domestic oil production. These circumstances, combined with the inflexibility of public expenditure, raised concerns about the sustainability of fiscal policy. Concurrently, the deteriorating outlook for external revenues cast doubt on Mexico's ability to finance the growth in the current account deficit for 2009. Furthermore, the challenging labor market conditions in the United States had adverse effects on immigrant workers, making it more difficult for them to find and maintain employment, consequently impacting the flow of remittances to Mexico. Many Mexican immigrants were employed in the construction sector, explaining the close correlation between remittance flow and the performance of that sector.

In contrast, Mexico's GDP dip in 2013 can be attributed to different factors. Firstly, global economic conditions in 2013, marked by sluggish growth or recession in numerous developed economies, had repercussions for Mexican exports. Mexico's heavy reliance on exports, particularly to the United States, left it vulnerable to reduced demand from its largest trading partner, substantially affecting its economic performance. Secondly, fiscal reforms enacted in 2013, including an increase in the value-added tax (VAT) and modifications to income tax regulations, had a short-term adverse impact on consumer spending and business investment. Thirdly, security concerns stemming from drug-related violence and organized crime in 2013 discouraged foreign investment and economic activity in affected areas, thereby diminishing overall economic growth. Additionally, the monetary policy decisions of Mexico's central bank, the Banco de México, played a role in GDP growth in 2013. (Central Bank of Mexico) The central bank adjusted interest rates and implemented policies to combat inflation, measures crucial for economic stability but occasionally subduing short-term economic growth. Lastly, Mexico's susceptibility to external economic shocks, such as fluctuations in oil prices, also affected its GDP in 2013. The country experienced volatility in oil prices during that period, impacting its revenue since Mexico is a substantial oil exporter(Figure 10-11).

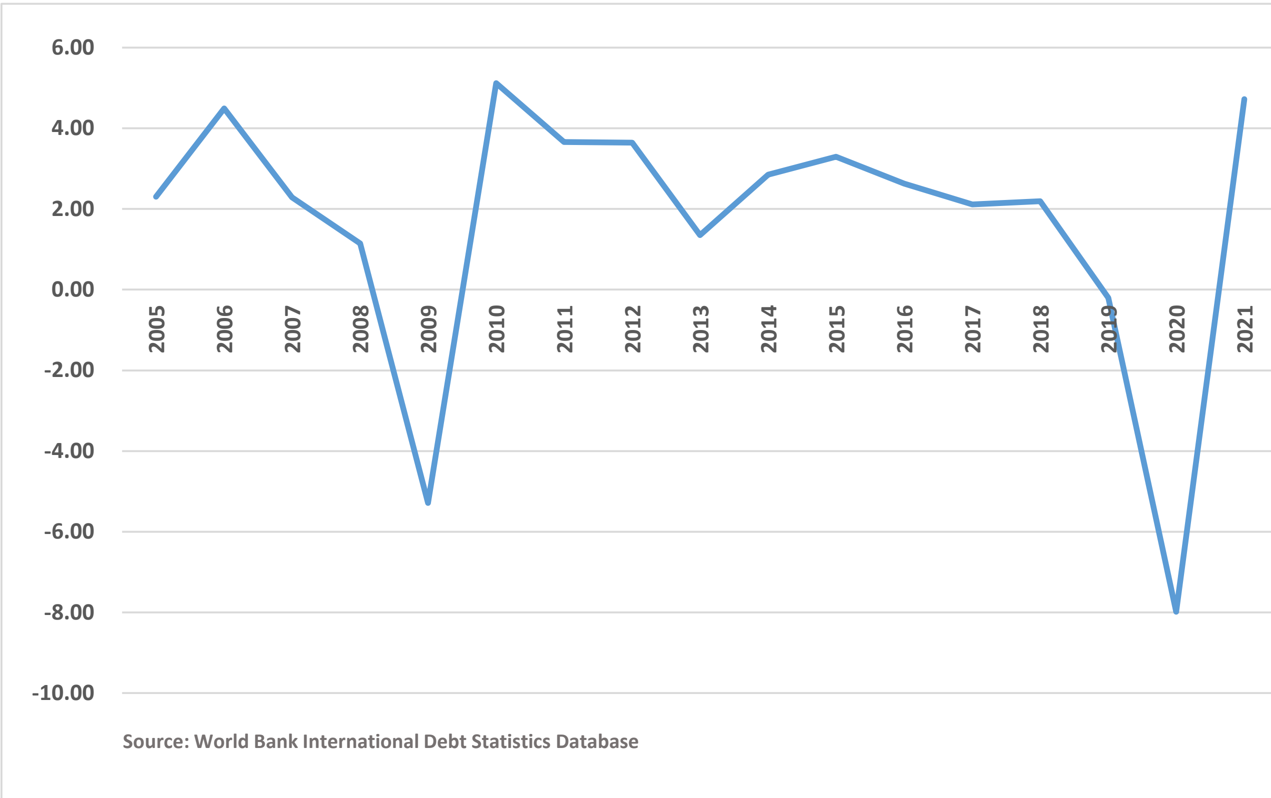


Figure 10-11: GDP growth (annual %) of Mexico

Balance on Current Account of Mexico

The current account of the country had been sailing in deficit waters, from as far back as 2005. It seemed like a persistent trend, an economic backdrop that had become almost a fixture in the financial landscape. Year after year, the numbers showed more imports than exports, more spending abroad than earnings from overseas. COVID-19 disrupted supply chains, altered consumer behavior, and upended traditional economic patterns, it inadvertently played a role in reshaping the country's current account, a surplus of 26 billion dollars emerged on the horizon.This reversion speaks of the continued weakness in the domestic market and the external market's resilience after the significant contraction of global economic activity caused by the COVID-19 pandemic during the second quarter of 2020.

From 2005 to 2021, Mexico's Balance on Primary Income (BoPI) consistently displayed a deficit, indicating that the country's primary income flows, which typically include earnings from investments and wages, were lower than its primary income payments to foreign entities. Conversely, Mexico's Balance on Secondary Income (BoSI) consistently showed a surplus during this period. This surplus in the BoSI suggests that Mexico received more secondary income, which often includes transfers and grants, from foreign sources than it paid out. These trends in the BoPI and BoSI highlighted the dynamics of Mexico's international financial interactions, with deficits in primary income and surpluses in secondary income playing distinct roles in the country's overall balance of payments during this time frame.

For over a decade, Mexico's trade balance had been caught in a persistent deficit cycle, stretching all the way back to 2005. It was a familiar story of more goods flowing into the country than heading out, a financial challenge that seemed deeply ingrained in the economic landscape. However, a remarkable shift occurred in 2019, and it was further emphasized in 2020, with an unexpected twist that was largely attributed to the global upheaval caused by COVID-19. These were the years when the trade balance displayed a surplus, something that had been elusive for years. While Mexico's trade balance saw a surprising shift to surpluses in 2019 and 2020, the balance on services told a different story. For years, it had consistently shown a deficit, making it a persistent feature of Mexico's economic landscape(Figure 10-12).

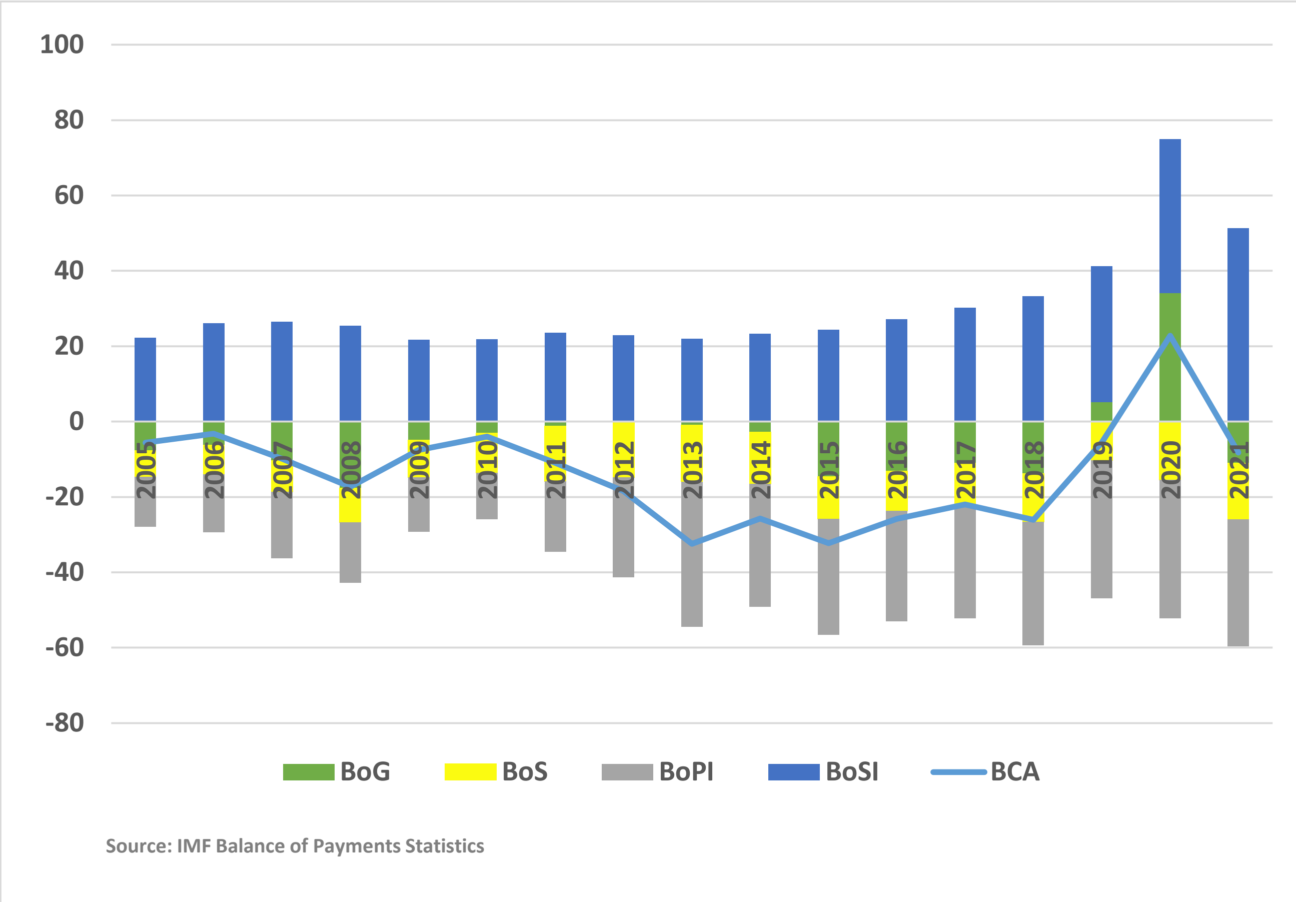


Figure 10-12: Balance on Current Account of Mexico

Balance on Financial Accounts of Mexico

A portfolio investment is ownership of a stock, bond, or other financial asset with the expectation that it will earn a return or grow in value over time, or both. It entails passive or hands-off ownership of assets as opposed to direct investment, which would involve an active management role.In the context of portfolio investment, it's common to observe deficits during times of economic crisis or uncertainty, such as the period from 2005 to 2009 and during the COVID-19 pandemic in Mexico because in times of uncertainty, foreign investors withdrew capital from Mexico, leading to a reduction in portfolio investments and associated income.Central banks' actions, such as lowered the interest rates to stimulate the economy during a crisis, which affect the returns on fixed-income investments.

Foreign Direct Investment (FDI) refers to the investment made by individuals, companies, or entities from one country (the home country) into business interests located in another country (the host country). FDI involves a significant level of ownership or control in a foreign enterprise, implying a long-term interest and active management involvement in the foreign operation.Mexico's large and growing consumer market offers significant opportunities for foreign companies to establish a presence and tap into a substantial customer base. It has become a global manufacturing hub, particularly in industries like automotive and electronics which has attracted substantial FDI into manufacturing facilities and supply chain operations.This contributed to Mexico's consistent FDI surplus during this period, reflecting the country's appeal as an investment destination and its ability to provide a conducive environment for foreign investors.

Other investments include private equity, venture capital, hedge funds, managed futures and collectables like art and antiques. Commodities and real estate can also be classified as other investments.

The balance on the current account in Mexico has painted a picture of remarkable resilience over the years, consistently remaining positive from 2005, with one notable exception - the year 2020. However, the year 2020 marked an exception in this narrative. The COVID-19 pandemic disrupted global trade, tourism, and economic activities, impacting Mexico's trade and service sectors. Lockdowns, reduced international travel, and supply chain disruptions led to challenges in maintaining the positive current account balance(Figure 10-13).

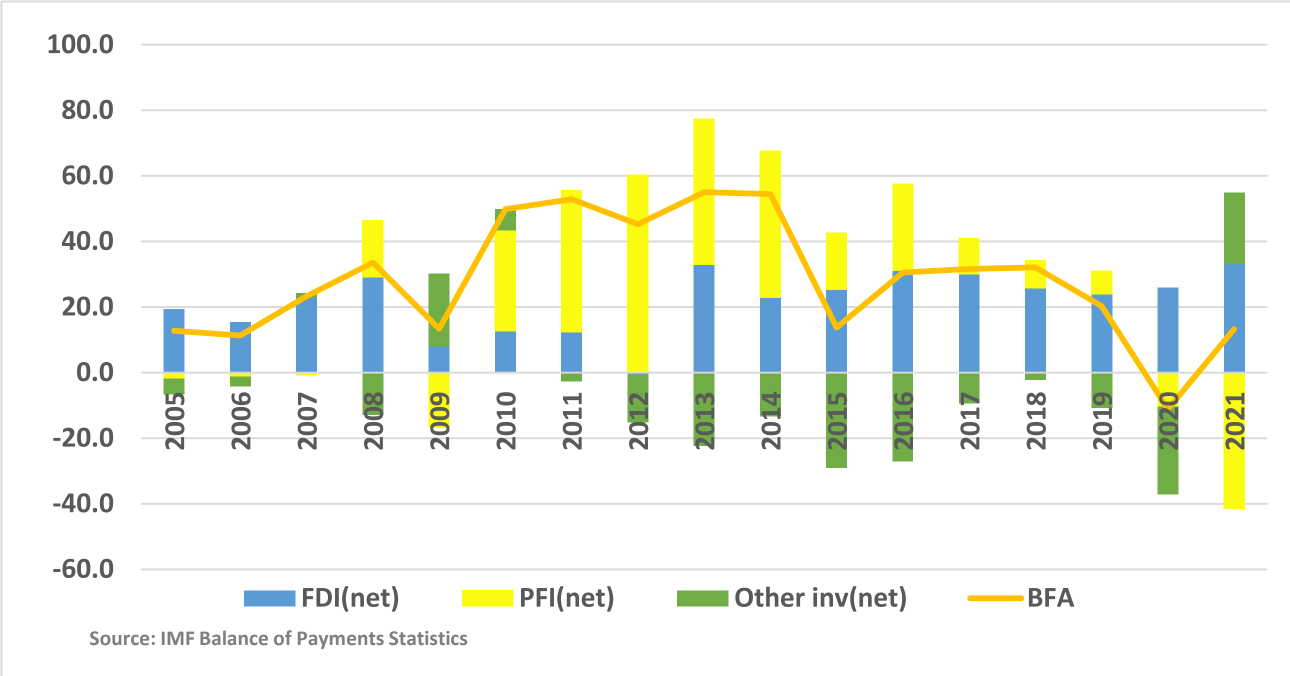


Figure 10-13: Balance on Financial Accounts of Mexico

Balance of Payments of Mexico

Mexico is a significant oil producer and exporter. The sharp decline in global oil prices that began in 2014 and continued into 2015 had a substantial impact on Mexico's export revenue. Lower oil prices can lead to reduced export earnings and potentially a BoP deficit(Figure 10-14).

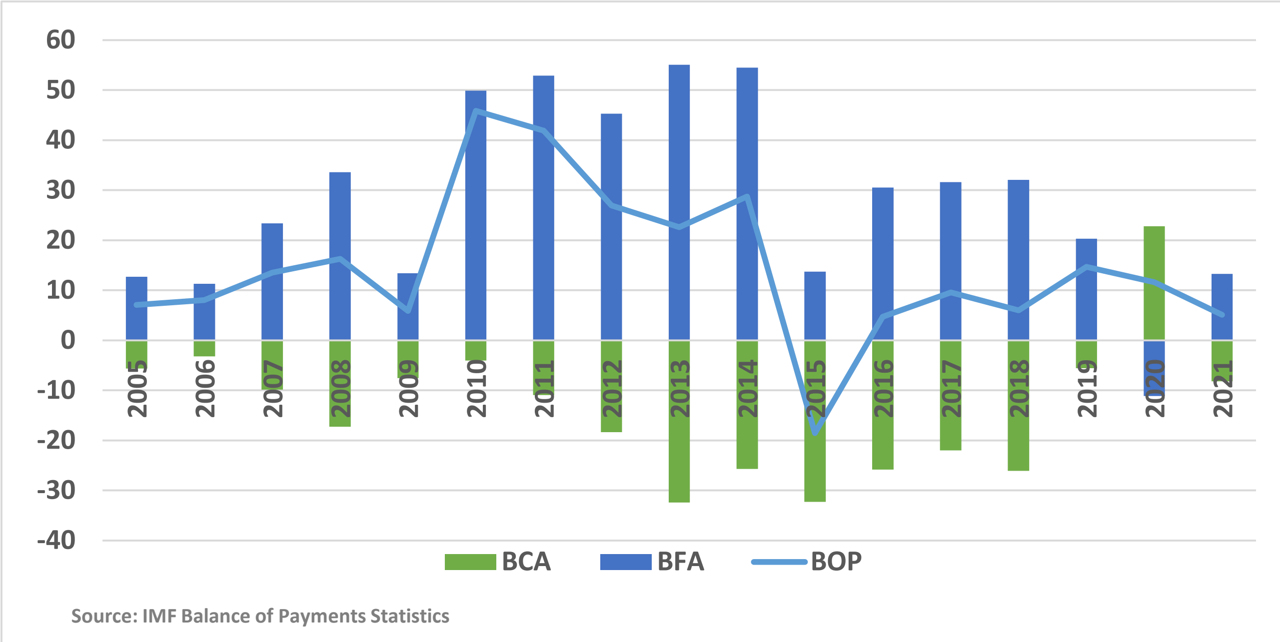


Figure 10-14: Balance of Payments of Mexico

External Assets of Mexico

Mexico's asset landscape underwent a remarkable transformation from 2005 to 2021, witnessing a substantial surge from approximately 200 billion to nearly 700 billion. This growth was not uniform across the entire period, with the years 2007 to 2009 representing a relative plateau. However, from 2010 onward, Mexico's asset base embarked on an enduring upward trajectory.The primary driving force behind this expansion was the remarkable increase in both direct investments and reserve assets. These two categories showcased robust growth, signifying a favorable climate for foreign investments and sound fiscal management. In parallel, portfolio investments also expanded, although at a more moderate pace compared to other asset classes.The data underscores Mexico's economic resilience and prudent financial strategies, as it navigated through both domestic and international challenges during this period. The nation's ability to attract direct investments and bolster its reserve assets speaks to its attractiveness as a destination for capital, while portfolio investments, though growing more steadily, also played a role in augmenting its asset base. This dynamic evolution paints a picture of Mexico's economic vigour and adaptability over the years. Based on historical trends, Mexico's external reserve assets have increased over time.(Figure 10-15)

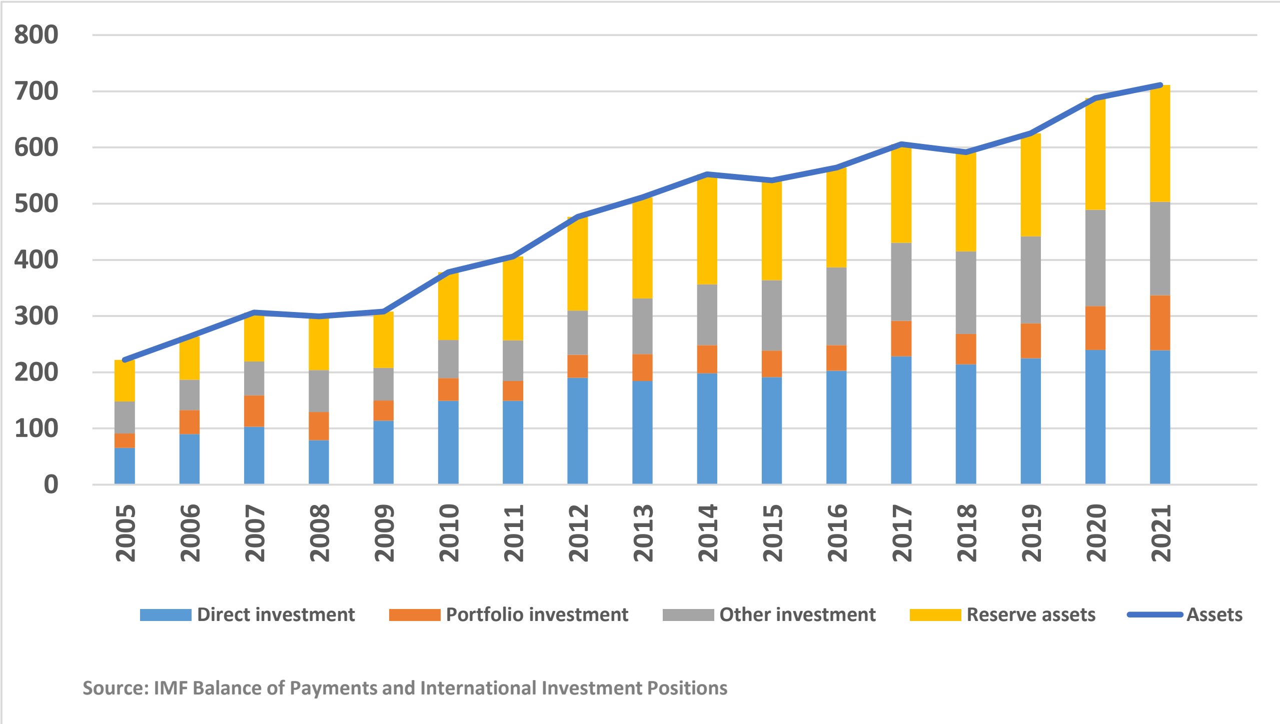


Figure 10-15: External Assets of Mexico

External Liabilities of Mexico

The growth in Mexico's liabilities from roughly 550 billion in 2005 to nearly 1300 billion in 2021 reflects a significant financial shift during this period. Notably, between 2007 and 2009, liabilities remained relatively stable before a noticeable uptick post-2011.This increase in liabilities can be attributed to various factors. Direct investments and portfolio investments both expanded, with direct investments experiencing the most substantial growth. These developments suggest that Mexico attracted more foreign investments, bolstering its economic activities. Additionally, the uptrend in direct investment liabilities outpacing portfolio investment liabilities indicates increased confidence from foreign entities in Mexico's long-term prospects.

Overall, Mexico's strategy of attracting direct investments and expanding its portfolio investments, combined with a relatively stable period during the global financial crisis, contributed to the growth in liabilities seen from 2011 onward. This evolving financial landscape underscores Mexico's ability to navigate economic challenges and leverage foreign investments for its economic development (Figure 10-16).

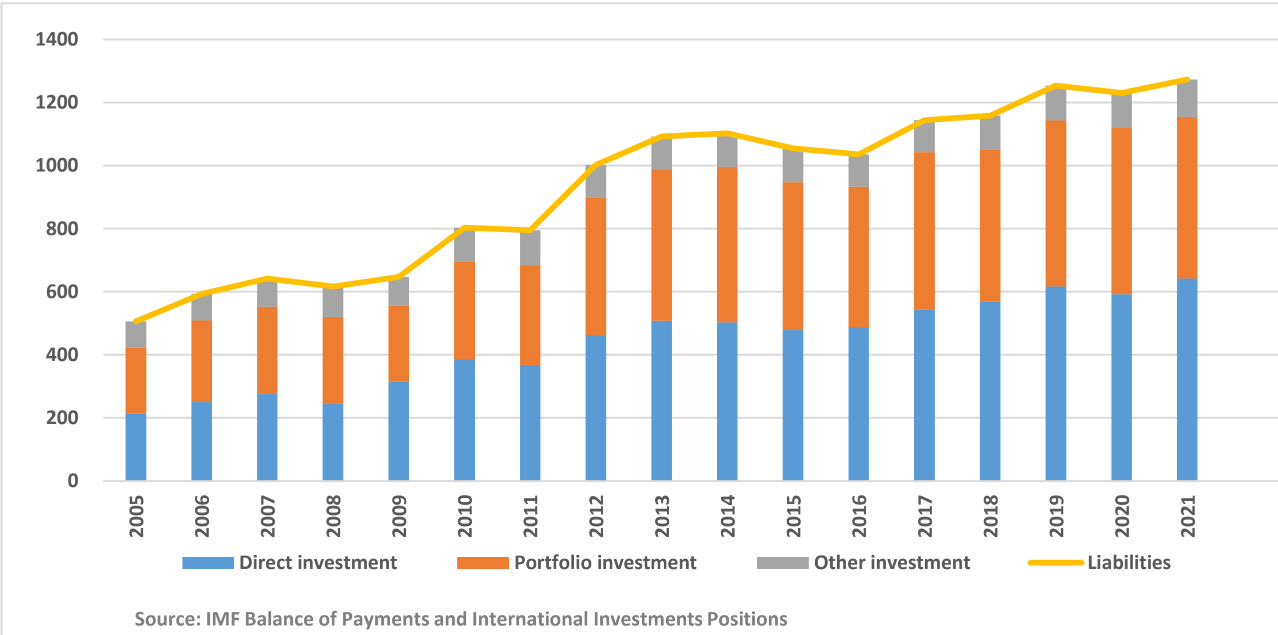


Figure 10-16: External Liabilities of Mexico

Net International Investment Positions (NIIP) of Mexico

Mexico's negative net investment position signifies that it owes more to foreign entities and investors than it has invested in foreign assets. In other words, it indicates that Mexico has accumulated more foreign liabilities (such as debt or obligations) than foreign assets (such as investments or holdings), which can have implications for its economic stability and financial obligations(Figure 10-17).

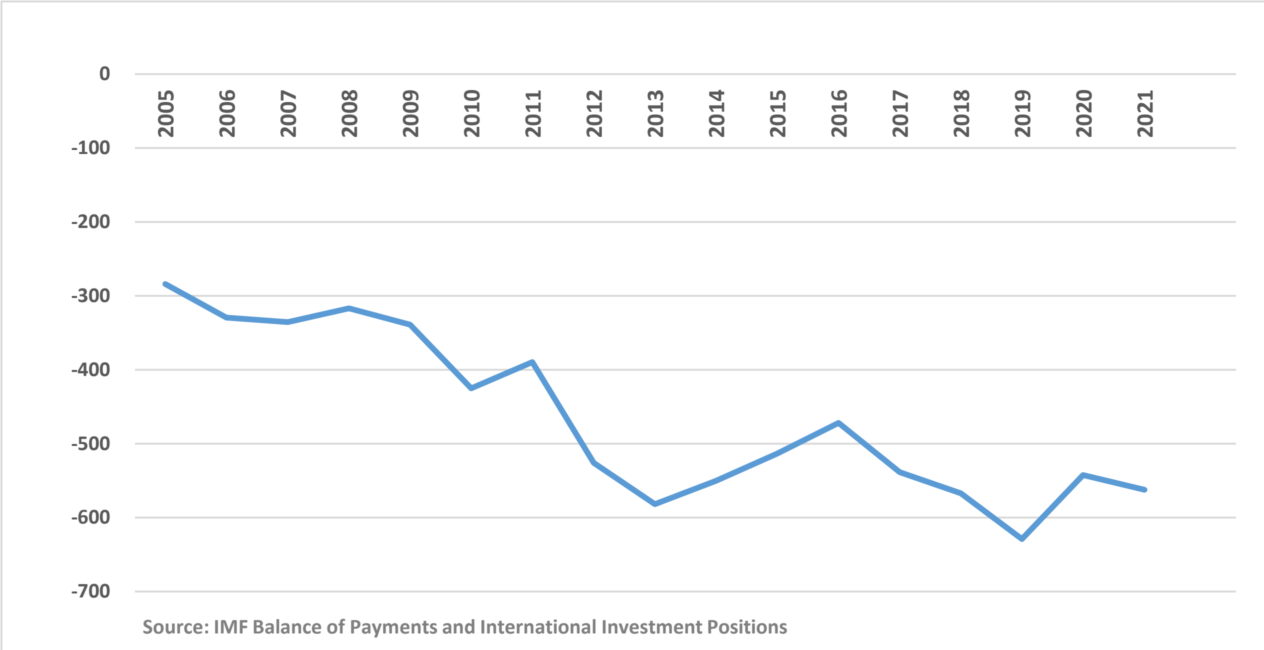


Figure 10-17: Net International Investment Positions (NIIP) of Mexico

Net International Investment Positions (as % of GDP) of Mexico

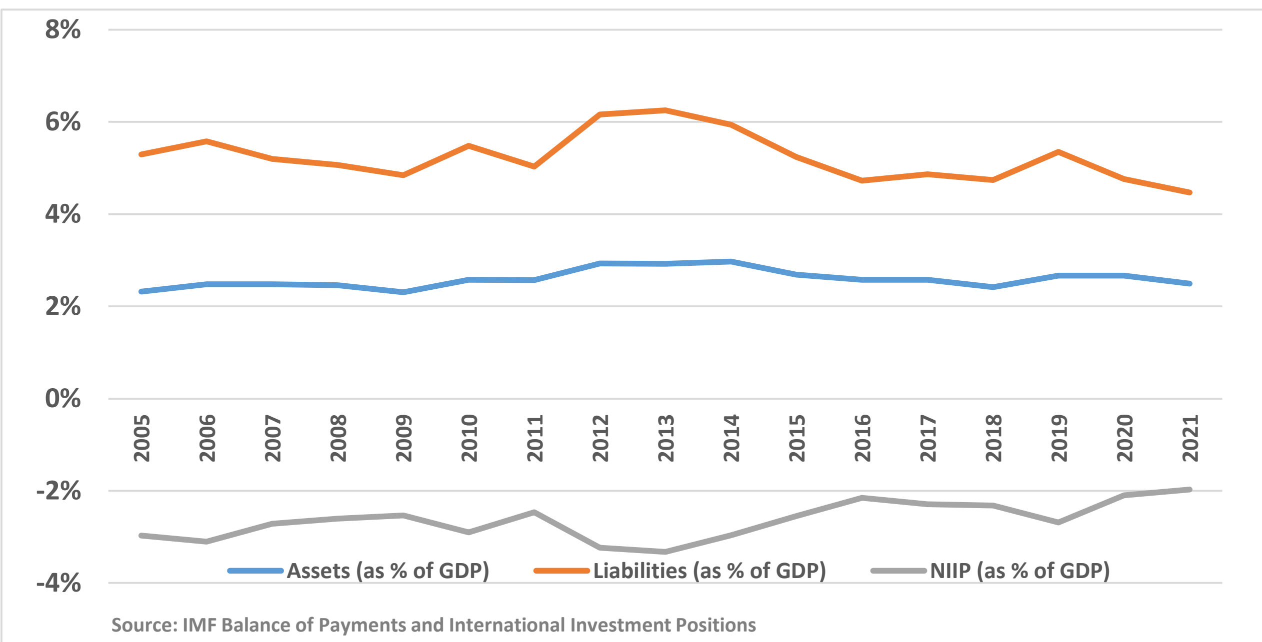


Figure 10-18: Net International Investment Positions (as % of GDP) of Mexico

Trade Patterns of Mexico

Mexico operates as a trade-focused economy, where imports and exports together accounted for 78% of its GDP in 2019. It holds a prominent position in the global trade landscape, marked by the value of goods traded and the extensive network of free trade agreements it has established. In 2020, Mexico ranked as the world's eleventh-largest exporter of merchandise and the thirteenth-largest importer, contributing 2.4% and 2.2% to global trade, respectively (World Trade Organization). Notably, if we consider the European Union as a single trading entity, Mexico's rankings rise to seventh for exports and ninth for imports.

Over the period from 1991 to 2020, Mexican trade witnessed an impressive sixfold increase. Mexico stands out as the primary exporter and importer in Latin America. In 2020, Mexico's individual exports reached a staggering US$417.7 billion, approximately equivalent to the combined exports of the next five largest Latin American exporters, which include Brazil, Chile, Argentina, Peru, and Colombia. Mexico's trade activities are intricately connected with its North American partners, with around 80% of its exports and half of its imports conducted with the United States and Canada in 2019.This highlights Mexico's pivotal role in the global trade landscape and its ability to foster trade relations with diverse regions, underlining its position as a major player in international commerce(Figure 10-19).

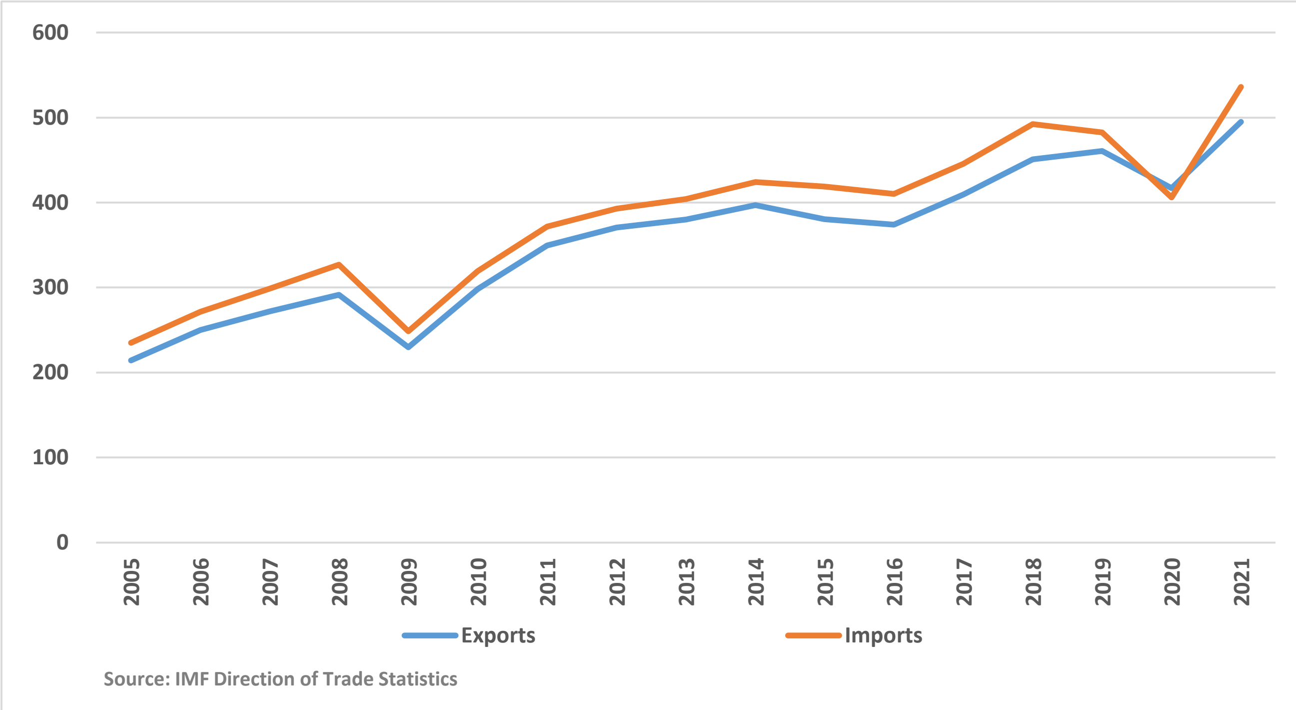


Figure 10-19: Trade Patterns of Mexico

A) **Imports of Mexico**

The import products of Mexico includes metalworking machines, steel mill products, agricultural machinery, electrical equipment, automobile parts for assembly and repair, aircraft, aircraft parts, plastics, natural gas, and oil products.

In 2009, the Mexican economy experienced a significant contraction of 6.7%, primarily due to a widespread decrease in overall demand caused by the global economic downturn. This economic downturn resulted in reduced wages and credit availability, which, in turn, led to a decline in consumer spending. As the year progressed, the recessionary trends deepened, and investment levels dropped by over 10%, according to estimates. The primary conduits through which the global crisis affected Mexico were a decrease in global trade and, to a lesser extent, reduced foreign investments, tourism, and remittances from overseas workers. It's not surprising that several factors contributed to the sharp decline in international trade in 2015. Some of these factors had mostly nominal effects, while others seemed to have more structural implications. The drop in commodity prices and the strengthening of the US dollar were the most significant contributors to the nominal decline in global trade. Particularly, the price of oil decreased from an average of over US$ 100 per barrel in 2014 to approximately US$ 50 in 2015. Given that energy products constitute a substantial portion of global trade, this decline significantly impacted the overall value of international trade. Furthermore, in 2020, Mexico faced a 6% decline in imports from the United States compared to 2019, mainly as a result of the severe economic shocks triggered by the COVID-19 pandemic(Figure 10-20).

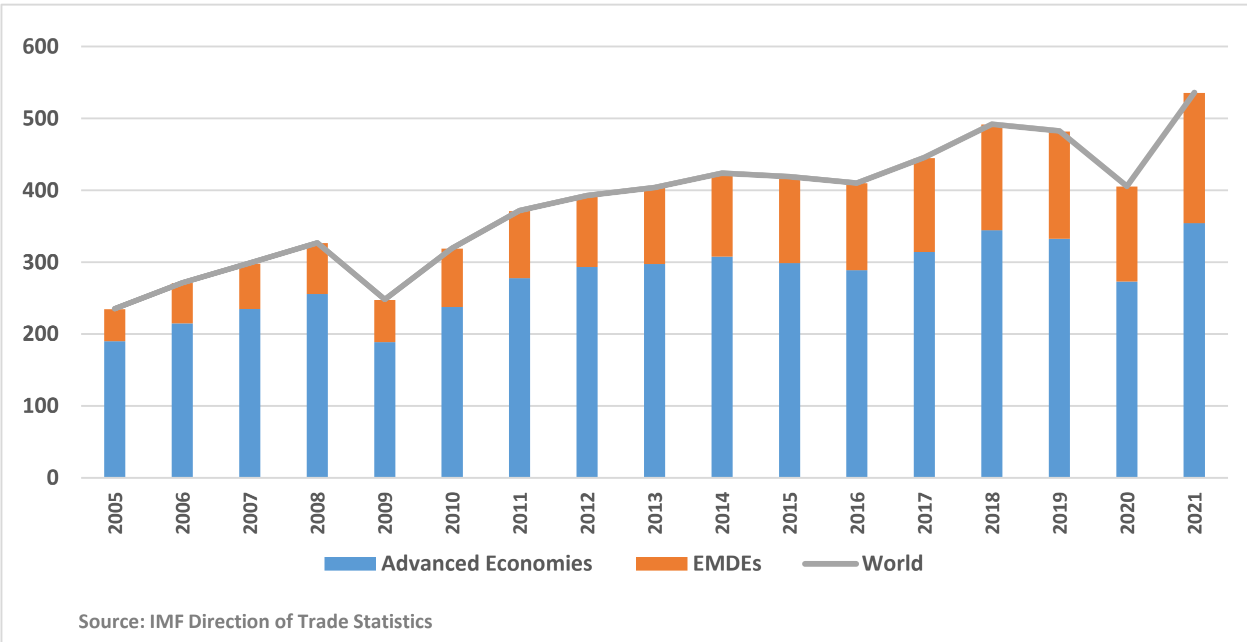


Figure 10-20: Imports of Mexico

B) **Exports of Mexico**

The export products of Mexico includes manufactured goods, electronics, vehicles and auto parts, oil and oil products, silver, plastics, fruits, vegetables, coffee, cotton.

In 2009, Mexico saw a significant drop in its exports, around 20%, due to the global economic downturn. This decline was a consequence of reduced demand for imports and U.S. exports caused by the economic crisis, affecting not only Mexico but also the majority of the U.S.'s major trading partners. The impact of the crisis was evident in various countries, with changes in the drivers of aggregate demand. Notably, the importance of the domestic multiplier effect increased in countries like Argentina, the Dominican Republic, Guatemala, Honduras, Paraguay, and Uruguay, while it remained stable in Mexico. Mexico's textile and apparel (T&A) exports in 2016 amounted to USD$6,441 million, marking a 5.1% decrease from 2015. Within these exports, approximately 63% were apparel, equivalent to USD$4,061 million, while the remaining 37% represented textiles, totaling USD$2,379 million.The T&A industry in Mexico faced challenges due to the appreciation of the Mexican Peso against the U.S. dollar and the uncertainty surrounding the renegotiation of NAFTA. Consequently, Mexico's apparel exports declined further by 7.2% in the first half of 2017(Figure 10-21).

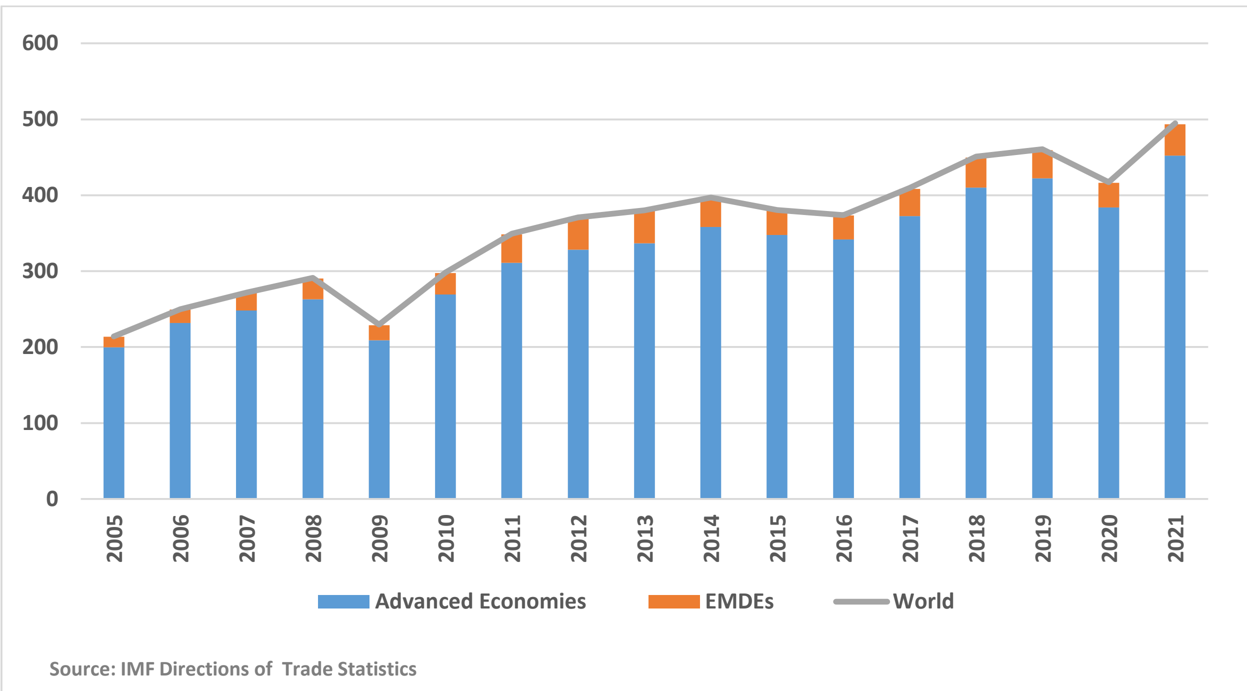


Figure 10-21: Exports of Mexico

❖ Percentage of Mexico's Imports from the World

Over the observed period, there is a discernible decline in the proportion of imports originating from advanced countries, with this figure diminishing from nearly 80% in 2005 to approximately 66% by 2021. Concurrently, there is a notable upward trajectory in the share of imports sourced from EMDEs especially Asian nations, which has steadily risen from 20% in 2005 to reach 34% in 2021(Figure 10-22). These trends underscore Mexico's shifting import landscape, signifying a reduced reliance on advanced economies and an increasing dependence on emerging and Asian markets for its imported goods. This transformation may reflect evolving trade relationships and changing global economic dynamics that have shaped Mexico's import preferences over the years.% of exports to the world.

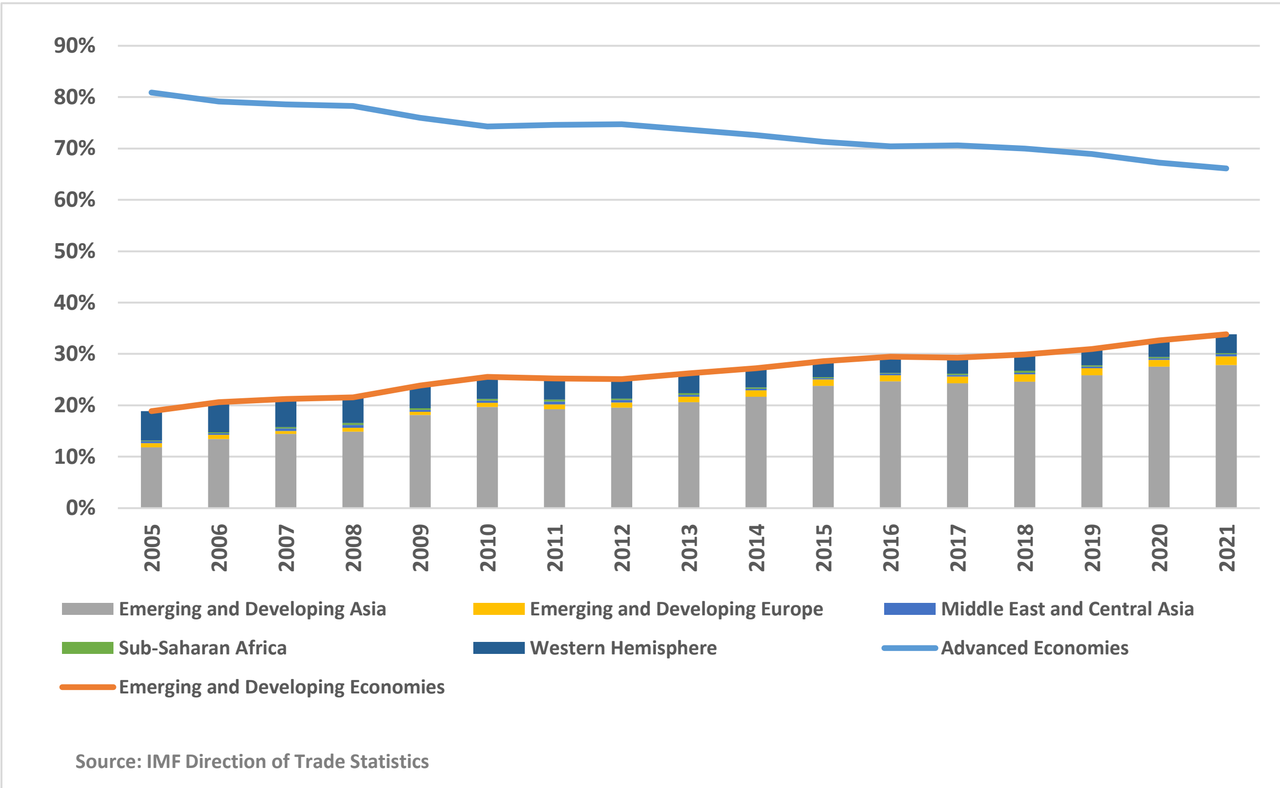


Figure 10-22: Percentage of Mexico's Imports from the World

❖ **Percentage of Mexico's Exports to the World**

The graph reveals a striking pattern in Mexico's export destinations. It is evident that the proportion of exports from Mexico to advanced countries has displayed remarkable stability, hovering consistently around the 90% mark with negligible fluctuations spanning the period from 2005 to 2021. In contrast, the exports to emerging and Asian countries have maintained a relatively constant share of almost 10% throughout this time frame, showing little variation from 2005 to 2021. This data highlights Mexico's enduring reliance on advanced economies as its primary export partners, with their share in total exports remaining steadfast. Simultaneously, the share of exports to emerging and Asian nations has exhibited resilience, remaining largely unchanged over the years. These export dynamics reflect Mexico's enduring trade relationships with advanced nations while also sustaining connections with emerging and Asian markets(Figure 10-23).

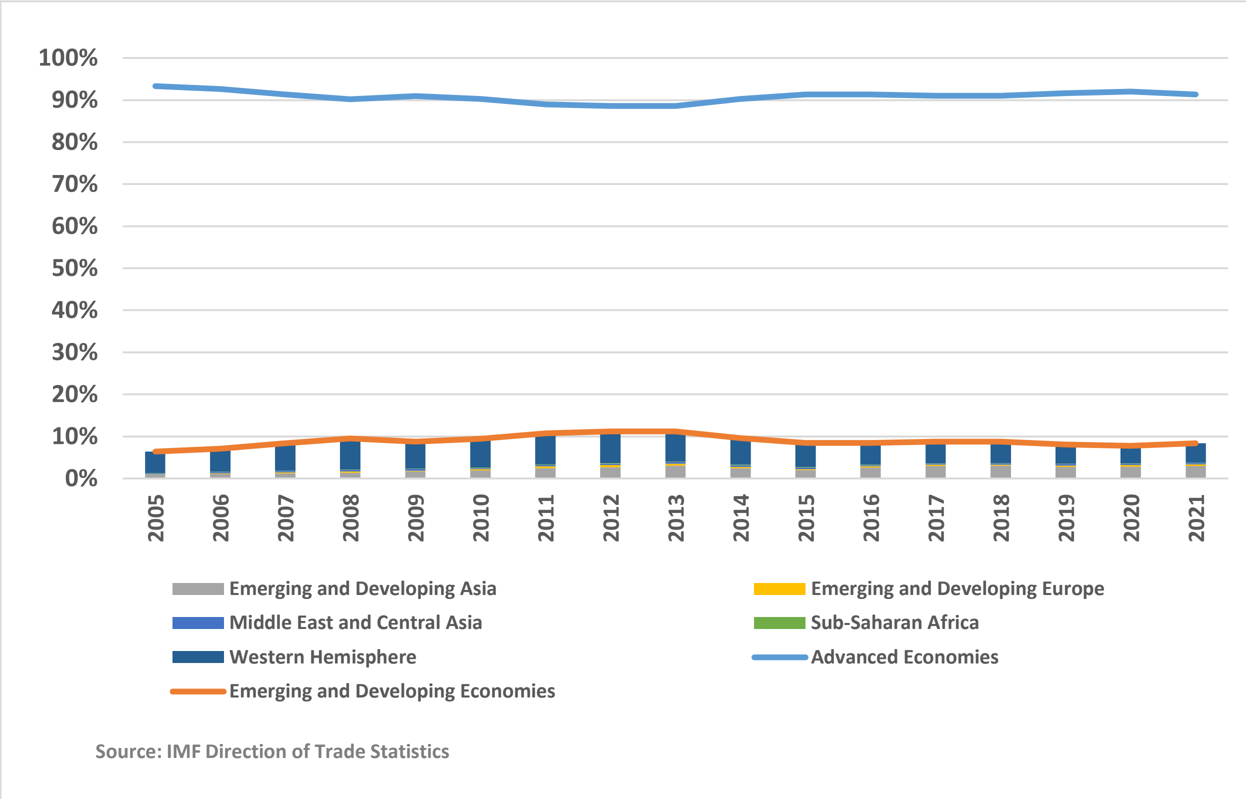


Figure 10-23: Percentage of Mexico’s Exports to the World

❖ Top 10 Importers from Mexico

It's evident that Mexico's total exports to the global market have witnessed a substantial increase, climbing from approximately $220 billion in 2005 to a significant $550 billion in 2021. The United States has traditionally been the dominant destination for Mexican exports, representing a substantial portion of this trade. However, what stands out is the recent emergence of China as the second-largest importer of Mexican goods. This shift highlights a noteworthy transformation in Mexico's export destinations. While the United States maintains its pivotal role, the growing importance of China as a trade partner underscores the evolving dynamics of Mexico's export sector(From 1.1 billion USD in 2005 to 9.8 billion USD). These developments reflect Mexico's expanding presence in international markets and the diversification of its export relationships(Figure 10-24).

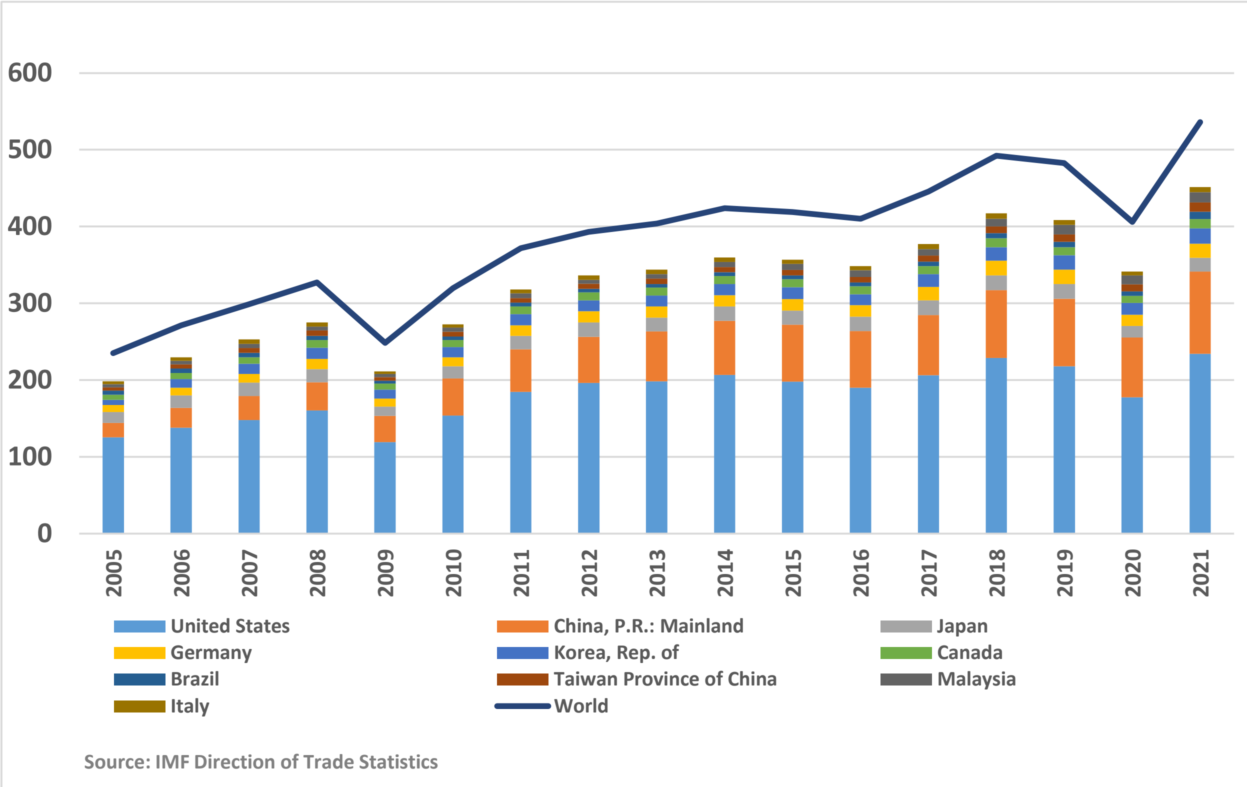


Figure 10-24: Top 10 Importers from Mexico

❖ Top 10 Exporters to Mexico

It is evident that Mexico's total imports from the global market have experienced substantial growth, surging from approximately $200 billion in 2005 to a remarkable $500 billion in 2021. The bulk of these imports has historically been attributed to the United States, primarily a consequence of the North American Free Trade Agreement (NAFTA). However, what is particularly noteworthy is the substantial increase in imports from China, Japan, and Germany, signifying a notable shift in Mexico's import sources. This transformation underscores Mexico's evolving trade landscape, with these three countries playing an increasingly significant role in supplying goods to the Mexican market alongside its longstanding trade relationship with the United States (Figure 10-25).

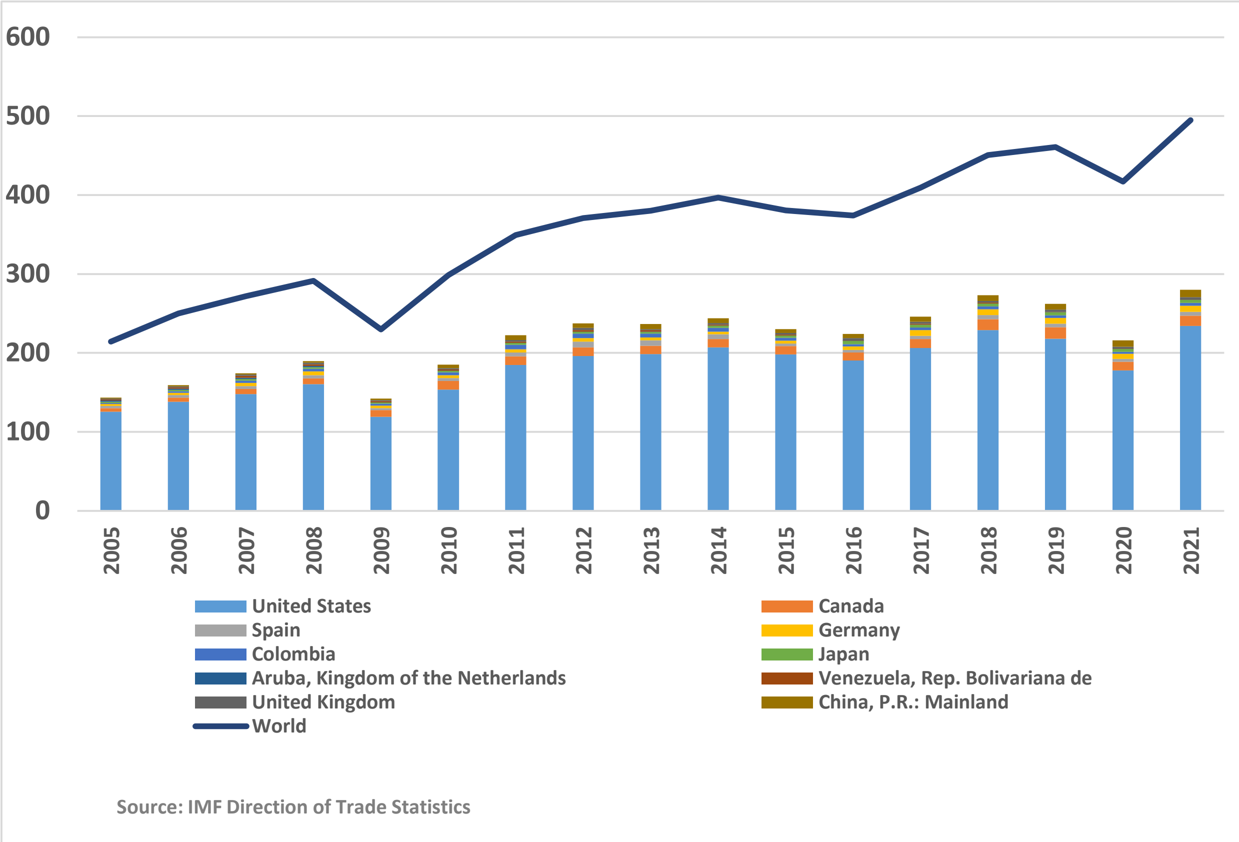


Figure 10-25: Top 10 Exporters to Mexico

Mexico's successful debt restructuring agreement with its foreign government creditors, along with the pivotal role played by key stakeholders such as the United States, marks a significant breakthrough for other debt-burdened nations grappling with protracted negotiations. The United States, as a substantial official creditor to Mexico, has been instrumental in facilitating this deal, underlining its commitment to regional economic stability. Furthermore, the support of international financial institutions, including the International Monetary Fund (IMF), which has provided crucial assistance in the form of a bailout plan, holds the potential to bolster Mexico's fragile economic situation. Mexico's engagement with its international bondholders, as they enter into non-disclosure agreements (NDA) with the government, represents a pivotal step toward commencing formal discussions to restructure a substantial portion of its international bonds. This development reflects Mexico's commitment to finding sustainable solutions to its debt challenges and sets a promising precedent for other nations navigating similar financial hardships.

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