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

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OUTLINE

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

Disclaimer: The views expressed in this presentation are those of the author and do not necessarily reflect the views of the Arab Fund for Economic and Social Development (AFESD).
1. The debt-overhang in the Highly-Indebted Arab Countries (HIAC)

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

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

**Public External Debt to GDP ratio (%) in Arab countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>Bahrain</td>
<td>76.7</td>
<td>100.6</td>
</tr>
<tr>
<td>Comoros</td>
<td>19.0</td>
<td>47.1</td>
</tr>
<tr>
<td>Djibouti</td>
<td>69.0</td>
<td></td>
</tr>
<tr>
<td>Egypt</td>
<td>50.4</td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td>36.1</td>
<td></td>
</tr>
<tr>
<td>Mauritania</td>
<td>27.9</td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>10.1</td>
<td></td>
</tr>
<tr>
<td>Oman</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>44.4</td>
<td>50.4</td>
</tr>
<tr>
<td>Somalia</td>
<td>6.0</td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td>100.6</td>
<td></td>
</tr>
<tr>
<td>Yemen</td>
<td>44.4</td>
<td></td>
</tr>
</tbody>
</table>


**External Debt Service to Exports (%) in some Arab countries in 2022**

<table>
<thead>
<tr>
<th>Country</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>Comoros</td>
<td>2.7</td>
<td>8.0</td>
</tr>
<tr>
<td>Djibouti</td>
<td>1.6</td>
<td>10.1</td>
</tr>
<tr>
<td>Egypt</td>
<td>23.2</td>
<td>32.7</td>
</tr>
<tr>
<td>Jordan</td>
<td>21.4</td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td>8.0</td>
<td></td>
</tr>
<tr>
<td>Mauritania</td>
<td>10.1</td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>Somalia</td>
<td>2.9</td>
<td></td>
</tr>
<tr>
<td>Sudan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td>17.8</td>
<td></td>
</tr>
</tbody>
</table>

Source: International Debt Statistics.

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

Warning external indebtedness: Bahrain, Djibouti, Egypt, Jordan, Mauritania, and Tunisia.

Actual default: Lebanon, Palestine, Sudan, Syria, and Yemen.
The debt-overhang of the High-Indebted Arab Countries (HIAC)...

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

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

The inverted-U relationship between debt and growth in HIAC (2015, 2020, 2022) turns at 35-40% (5). The external debt damps the economic growth through two channels: weak physical capital accumulation (1/3 on average) and negative effects on total factor productivity (2/3 on average) (6).

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

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

External Debt to GDP (%) R² = 0.2857

Evolution of the GDP growth determinants in 7 HIAC

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

TFP is the dominant factor accounting for the difference in development levels (9) (e.g. 75% of South Korea’s growth during 1960-2005 is attributable to TFP. (10))
...is reducing the fiscal space in HIAC at the expense of education, health and capital expenditure.
• Most of the HIAC have registered slow progress in achieving the SDGs and face huge climate finance gap

• Huge financing gap:

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

$71.2 billion per year until 2030

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

(13) Comoros, Djibouti, Egypt, Iraq, Jordan, Mauritania, Morocco, Palestine, Somalia, Sudan, and Tunisia.

• **Developing Human capital is crucial for an inclusive economic growth in the HIDC ...**

• **“Human capital is the primary factor driving the wealth disparity between high and low-income nations, eclipsing the contributions of both natural resources and physical assets.”** (15)

![Diagram showing the relationship between Youth NEET and Learning-adjusted years of schooling in Arab Countries and the world.](image)

**Human capital (quality of education)**

**Market efficiency**

**Infrastructure**

**Innovation institutions** (16), (17).

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(15) Patrinos et al. (2024); (16) Kim and Loayza (2019); (17) Makdisi, Fattah, and Limam (2007).
2. Addressing debt-overhang within a holistic development approach

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

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

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

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

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(19) Botswana, Brazil, China, Hong Kong, Indonesia, Japan, Malaysia, Malta, Oman, Singapore, South Korea, Taiwan, Thailand.
Lessons learnt from countries' experiences

• Ibn Khaldun (1332–1406): The rise and fall of societies are the results of dynamic interrelationships between social, moral, economic, political, historical and demographic factors. (21)

• Acemoglu and Robinson (2012): “All successful sustained experiences of economic growth feature inclusive economic institutions that create broad based incentives and opportunities in societies.” (22)

• “Struggling with debt, Puerto Rico’s government needed a comprehensive plan to reduce its liabilities and restore economic prosperity...What Puerto Rico needed was a plan to reduce debts to a sustainable level, ensure adequate investment in the people and resources the economy needs, and create a viable path forward for economic growth, opportunity, and hope... » (23)

• « Jamaica stands out for reducing its debt from 144 percent of GDP to 72 percent over the last decade, a record achieved by running large, persistent primary budget surpluses. Well-designed fiscal rules combined with social partnership agreements making for fiscal ownership are at the root of its achievement. » (24)
• Addressing Debt-overhang in HIAC requires a policy agenda that combines fiscal consolidation with transformative investments and growth-boosting reforms.

A holistic framework for successfully addressing debt-overhang in HIAC

Ability to conduct the economic reforms (including fiscal consolidation)

Transformative investments in impactful and sustainable sectors

Social adhesion to the reforms

Regional cooperation

Debt Relief (ADRI)

Government, Private Sector PPP

DFIs

TA

AMF, API, IMF...

Facilitate conducting the reforms

Space of successfully addressing debt-overhang in HIAC

Building confidence and patience that policymakers need to implement costly short-term reforms with expected long-term gain. (26)

Source: The author inspired by (27).

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

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

<table>
<thead>
<tr>
<th>Social infrastructure</th>
<th>Economic infrastructure</th>
<th>Cross-cutting objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>Water</td>
<td>Create jobs and economic growth</td>
</tr>
<tr>
<td>Healthcare</td>
<td>Energy</td>
<td>Reduce inequalities</td>
</tr>
<tr>
<td></td>
<td>Transport and Logistics</td>
<td>Support adaptation and resilience</td>
</tr>
</tbody>
</table>

Active engagement of MCs to target specific priorities

Provision of end-end project finance support

Crowding-in of other financiers (institutional and private investors) to multiply funding

Create jobs and economic growth

Reduce inequalities

Support adaptation and resilience

Enable regional integration and collaboration

Support technology, innovation and digital transformation
4. AF’s call for an Arab Debt Relief Initiative (ADRI)

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

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

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

- **Grounded in a comprehensive approach to development** tied to *economic reforms* (targeting macroeconomic soundness, the modernization of the public sector, the unleashing of the private sector potential), and *building resilience towards climate change-related risks* (including water and food security), whilst *leveraging on digital transformation*.

- **Based on FASTER principles:** *Feasibility* (Progressivity), *Achievability*, *Solidarity & Cooperation*, *Transparency*, *Enforceability*, and *Reengagement*.

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

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

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

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

Source: The author based on (36)

(30) Abcarian et al. (2019); (31) Stiglitz et al. (2009); (32) ESCWA (2021); (33) Ghosh and Nabi (2020); (34) Ghosh (2023); (35) Paduano (2024); (36) Nabi et al. (2024).
AFESD’s contributions to the SDGs in Arab countries

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

شكراً

Thank you