

The UNCTAD Sustainable Development Finance Assessment: theoretical framework and possible applications

GUSTAVO BHERING & CARLOS SCHÖNERWALD, JULY 6TH 2022

SHARING LESSONS AND POLICY EXPERIENCES FOR MOBILISING FINANCIAL RESOURCES FOR DEVELOPMENT IN THE TIME OF CRISIS

UNCTAD SDFA Framework

- UNCTAD Sustainable Development Finance Assessment (SDFA) is a framework to evaluate a country's developing finance needs to achieve the SDGs with external finance and public sector sustainability in the long run. In this project, the first four SDGs.
- The achievement of the SDGs is, in general, connected with the need of scaling up public investment, which impacts fiscal policy. This may increase both public sector debt as well as external debt and liabilities, which might be financially unsustainable.
- Sustainability is defined, following Domar (1944), as the condition that net liabilities relative to some repayment capacity (sustainability indicator) does not grow indefinitely in the long run. In this sense, we use **sustainability as a synonym for long run solvency in SDFA framework.**

UNCTAD SDFA Framework

- The SDFA framework differs from DSA mainstream approaches in two main aspects:
- (i) The achievement of the SDGs is at the centre of the analysis and it goes beyond the assessment of debt sustainability, also considering the broader dimension of external finance sustainability.
- (ii) Long run growth is demand-led and the balance of payments represent the relevant constraint for developing countries, that do not issue an international currency (predominantly, the US dollar).
- Public sector sustainability, when subject to this external constraint, determines the policy space available for achievement the SDGs through public investment.

External Accounts

- Within a post-Keynesian tradition, the main theoretical references are
 - The literature on the Kaldor-Thirlwall models (Thirlwall, 1979; Moreno-Brid, 1998, 2003; Barbosa-Filho, 2001, Thirlwall, 2011)
 - The works of Domar (1944) and Pasinetti (1998) on debt sustainability
 - The recent contribution by Bhering et al (2019) where the analysis for the external account is considered in a model that deals with currency mismatches

External Accounts

- A country faces an external solvency problem when there is an overall scarcity of foreign currency in the long run. This general problem is necessarily a relation between, on the one hand, the difference between total external liabilities and total external assets and, on the other hand, some flow that measures repayment capacity
- The total external liabilities net of total external assets is measured by the negative value of the Net International Investment Position (NIIP). We call it Net External Liabilities (NEL)

External Accounts

- For the repayment capacity, we consider two key elements, that represent a free of cost inflow of foreign currency in the current account:
 - Exports of goods and services
 - Remittances, defined here, for simplicity, as compensation of employees (primary income account) and personal transfers (secondary income account) of the current account in BPM6 methodology.
- Thus, the flow variable used as a “repayment capacity” is defined by the sum of exports of goods and services plus remittances, which we call “augmented exports”.

External Accounts - Accounting

- The basic accounting is:

$$BP = \text{Current Account} + \text{Capital Account} + \text{Financial Account} = 0$$

- To connect BoP flows with the stock of NEL, the framework must guarantee that it is stock-flow consistent

- Changes in NEL (stock) must reflect not only BoP flows, but also holding gains (HG):
changes in asset and liability prices

$$\Delta NEL = \text{Current Account Deficit} - \text{Capital Account} - HG$$

External Accounts - Sustainability

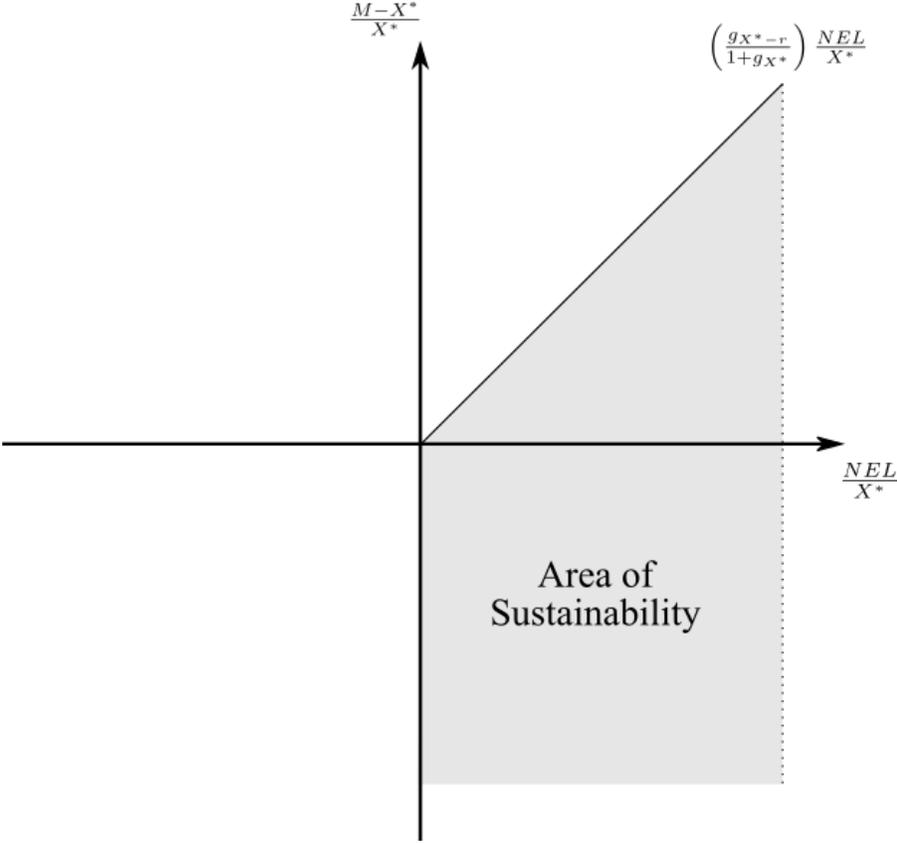
- The sustainability condition for the external accounts:
 - *Adjusted trade deficit over augmented exports* = Snowball Effect \times *NEL over augmented exports*
 - The snowball effect represents the growth in NEL stemming from the difference between the net average cost of NEL (including HG) and the growth rate of augmented exports

External Accounts - Sustainability

- This relation entails two conditions:
 - (i) In the presence of an adjusted trade deficit , the growth rate of augmented exports must be greater than the average net cost of NEL
 - (ii) Imports must grow as fast as augmented exports
- The sustainability condition can be interpreted, following a similar reasoning as Pasinetti (1998), as a menu choice between the adjusted trade deficit and the levels of NEL over augmented exports

External Accounts - Sustainability

○



Public Sector

- In the SDFA Framework, public sector refers to federal, state, and municipal administrations, as well as the central bank, state enterprises, and banks
- To build the indicator for sustainability, the SDFA framework follows a similar approach regarding the external accounts
- We consider Public Sector Net Liabilities (PSNL) over GDP

Public Sector - Accounting

- The basic accounting is
 - Government spending is financed by:
 - Tax revenues
 - Variation in monetary base
 - Variation in net public internal debt
 - Variation in net public external debt

Public Sector - Accounting

- Again, the basic accounting must be stock-flow consistent
- It has to consider the impact of inflation and asset and liability prices on stocks

Public Sector - Sustainability

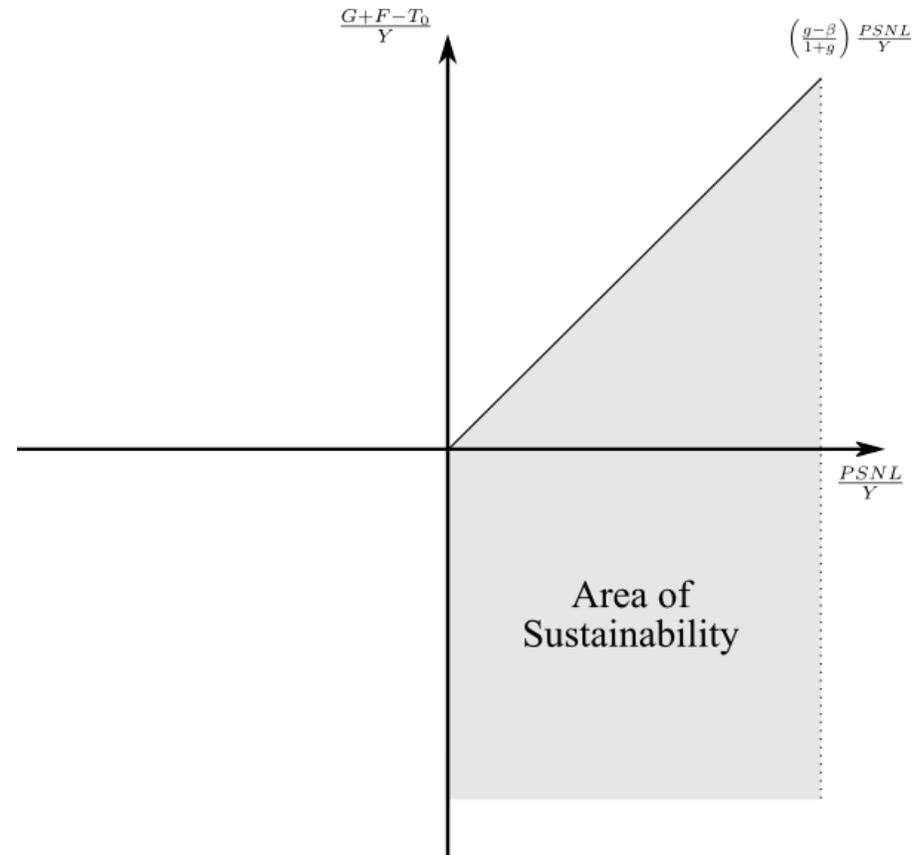
- The sustainability condition for the public sector:
- *Primary fiscal deficit over GDP = "Snowball Effect" × PSNL over GDP*
- The snowball effect represents the growth in PSNL stemming from the difference between the net average cost of PSNL (discounted for inflation) and the output growth rate
- This net average cost includes, for example, the policy rate set by central banks

Public Sector - Sustainability

- This relation entails at least one condition:
 - In the presence of a primary fiscal deficit the rate of growth of GDP must be greater than the average net cost of PSNL
- The sustainability condition can also be interpreted, following a similar reasoning as Pasinetti (1998), as a menu choice between the primary fiscal deficit and the levels of PSNL over GDP

Public Sector - Sustainability

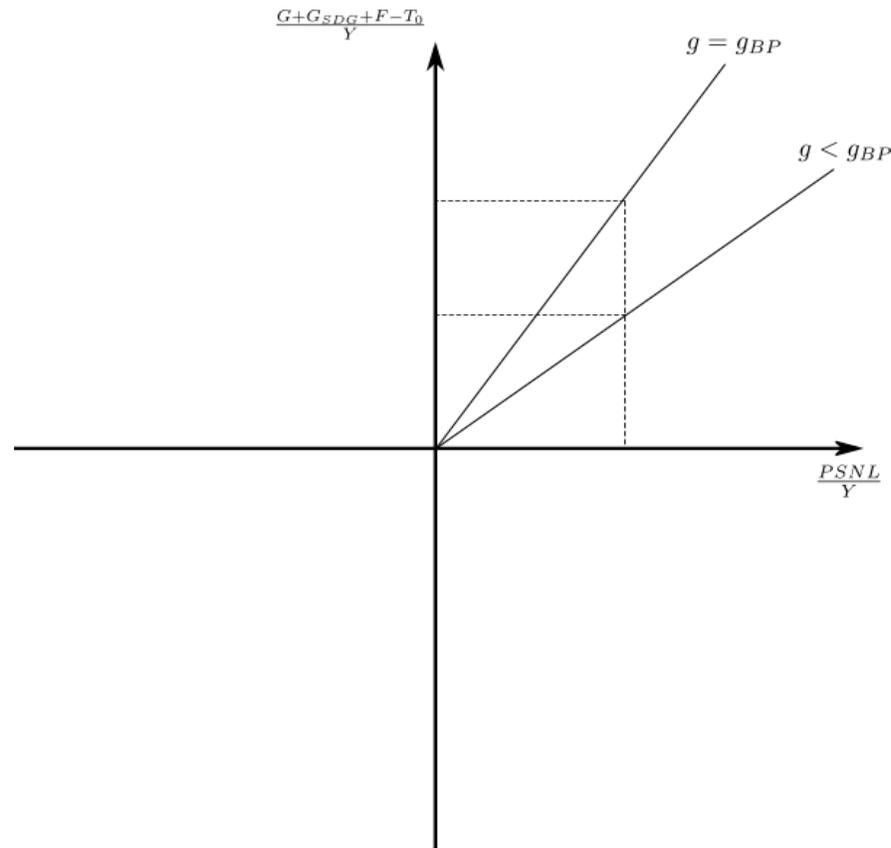
○



Connecting External and Public Sector

- The BoP constraint is the most relevant economic constraint on growth for a developing country.
- The condition that imports must grow as fast as augmented exports yields a specific growth rate of output compatible with external accounts sustainability (g_{BP})
- This specific growth rate of output is plugged into the public sector sustainability condition
- This provides the relation between primary fiscal balance and PSNL over GDP that is also compatible with external accounts sustainability

Connecting External and Public Sector



Policy implications

- The achievement of the SDGs relies heavily on public investment since it depends on the provision of public goods and services . Thus, fiscal and monetary policy plays a key role in attaining these goals in the long run.
- At the same time, policies that promote exports and aim at reducing import dependence also matter to decrease BoP constraints.