

BA Business and Management

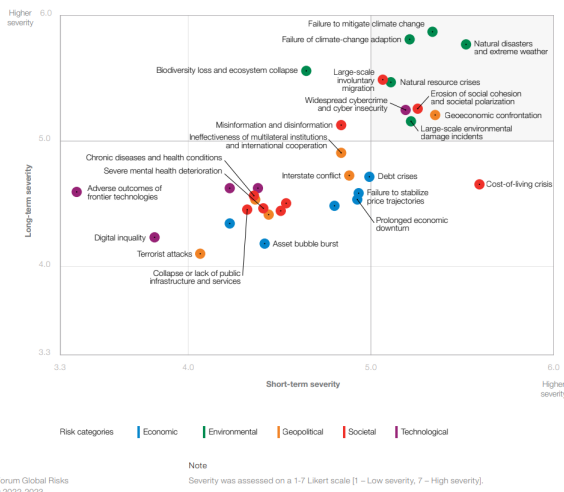
Economics of sustainability: BMSP6007

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Assessment 2: 2500 word report regarding WEF risk analysis

Executive Summary

This report has been commissioned to examine the *global debt crises* element of the WEF Global Risks Report. Shown in the image below, it is evident that the decade ahead will be of great importance in determining the trajectory of many aspects of society.



Sovereign debt, the main element of this report, is summarised as non-contingent, often contract-bound, debt incurred by governments.

The WEF report is split into five sections summarising the current situation. Concluding

their analysis of the situation, the biggest risks are worsening stagflation, tight labour markets and the very severe potential repercussions of a systemically important economy defaulting on its debts.

As part of the analysis in this report, the Malthusian theory that population should be kept in check to avoid suffering and misery was analysed from the point of view of both Malthusian and Neoclassical thinkers refuting the idea. Overall, the Neoclassical ideals prevailed as mathematical analysis disproved the models used.

Four recommendations were offered to ameliorate the crisis by the ODI. Of these solutions, boosting alternatives to borrowing was the most feasible long-term solution as many low-income countries could stand to improve their tax collection procedures and require less borrowing. Still, however, many low-income countries would be forgiven for seeing this move simply as a way to shift the responsibility of debt onto them without providing any real aid of substance. As this is an extremely nuanced situation, care must be taken to monitor it as it unfolds over the next decade to prevent financial institutions from unravelling.

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Introduction

This report has been made to examine one element of the second chapter of the World Economic Forum's Global Risks Report (WEF, 2023) and determine the impact of global debt crises on efforts regarding sustainable development — defined by Mitlin (1992) as combining the typical goals of economic and social development with the conditions necessary for sustainability and by the UN's (n.d.) 17 goals. In addition, population growth will be analysed as a potential contributor to this risk. The second chapter concerns risks with the potential to become crises within the following decade.

As shown in the image below, it is evident that the decade ahead will be of great importance in determining the trajectory of society. Risks will require careful management on five fronts; because of the nature of risk management of this scope and solemnity requiring great nuance, one risk will be chosen to be examined, using relevant theory where applicable, and recommendations for effective risk management will be offered.

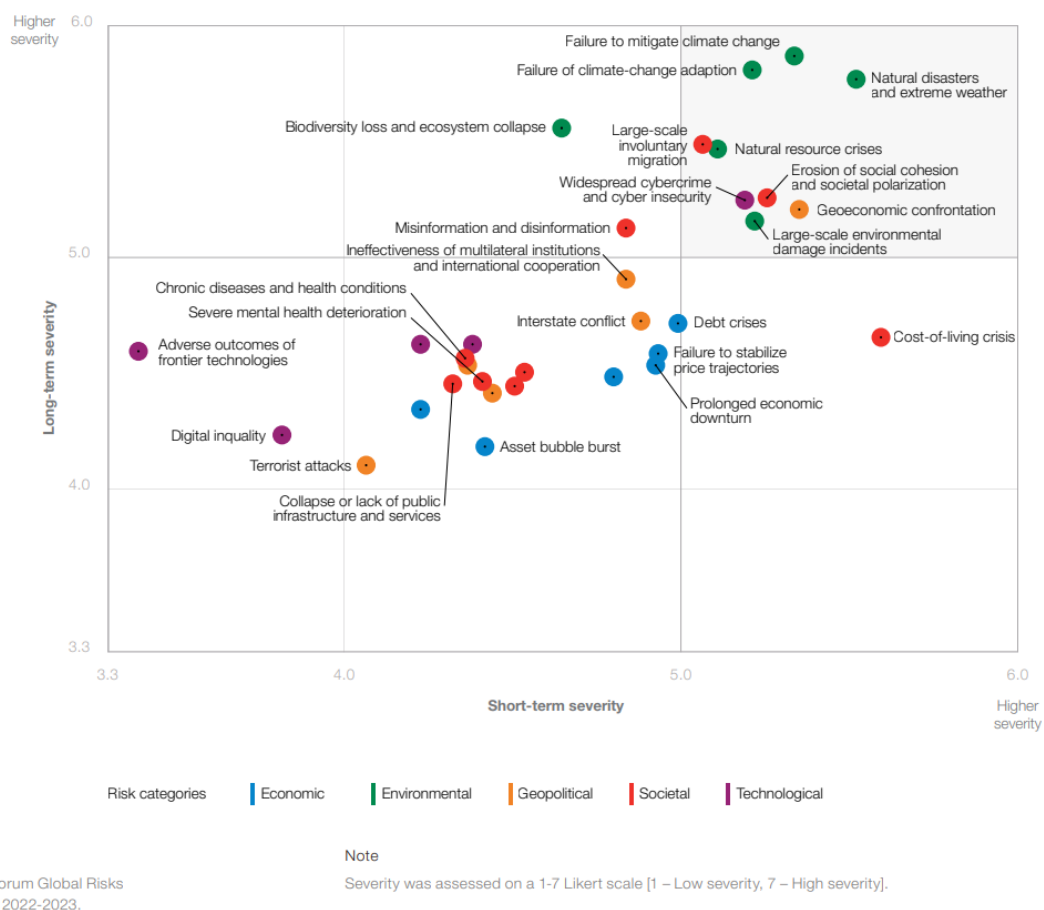


Image: Long-term/short-term severity chart with five risk categories (WEF, 2023)

The WEF Global Risks Report

The WEF Global Risks Report (WEF, 2023) presents a yearly outlook on the global risks facing the international community. The term 'global risk' is defined as the possibility of a phenomenon occurring by which global GDP,

population or natural resources would be negatively affected.

As opposed to other factors mentioned, debt crises are more concerned with the impact on economies and societies than on individuals; these crises,

nonetheless, certainly have the potential to have a negative effect on the welfare of individuals.

Sovereign debt

The concept of sovereign debt is summarised by Eaton and Fernandez (1995) as that incurred by governments. The authors use three facts to characterise sovereign debt: that governments have been able to borrow significant amounts at times, that much of what they borrow they repay, and that repayment is often complicated involving renegotiation and default.

Aguiar and Amador (2014) expand on this by mentioning that sovereign debt is often described

as non-contingent and contract-bound. Default — the failure of a government to meet a payment on time — has happened regularly throughout history.

Finishing this introduction, both the information from the WEF report and that regarding sovereign debt will be expanded upon and analysed in the next section to reach an understanding as to whether the risk of debt crises may hinder global efforts on sustainable development.

Analysis of risks

This section will analyse the WEF's interpretation of global debt distress, using arguments by Malthusian and neoclassical economists to discuss the severity level implied.

WEF Report

The prelude to the chapter explains that the threat of a sovereign debt crisis is looming as governments have provided fiscal support during the pandemic; in addition, global stagflation and historically high public debt levels are contributing to this crisis.

'The rising price of debt' mentions general government gross debt in advanced countries reaching 112% of GDP in 2022. Stagflation remains a large risk for many economies and the lingering impact of COVID-19 is still affecting basic inputs, meaning that a continued tightness in labour markets has the potential of worsening wage inflation.

'The new geopolitics of debt' begins by stating that, at present, the ratio of defaulted versus total global public debt remains very low; this may be partially reflective of growth in absolute public debt levels. Over 50 countries require debt relief, representing under 3% of the global economy yet 18% of the global population and 50% in extreme poverty. As the call for wealthier economies to intervene is growing, China has become one of the largest creditors; this has sparked fears of debt-trap diplomacy increasing pressure on developing countries.

'A looming investment shortfall' begins by providing examples of crises arising from sovereign debt default in relation to the 1980s 'lost decade' of development in Latin America and Sub-Saharan Africa, including currency crises, collapses in output, cost of living crises and rapid increases in poverty. The 41 countries which defaulted on their debts in the first half of the 1980s took, on average, eight years to reach pre-crisis GDP per capita. Even advanced economies will need to make trade-offs in a low-growth and low-investment economic era, as

social unrest and polarisation may influence expenditure prioritisation.

'Acting today' — the final section — serves to recognise potential sources of alleviation for this possible crisis. The private sector could be incentivised to participate in debt restructuring through a selection of tools, including the issue of bonds and value recovery instruments. Support for longer-term projects which can help crowd-in private capital, such as the IMF's Resilience and Sustainability Trust, is also of great importance.

Summarising these four sections, the biggest risks that can be drawn from them are threefold:

- Worsening inflation and possible post-pandemic stagflation;
- The possibility of a globally devastating impact of systemically important economies defaulting on debt; and
- A long recovery from default and no economy being safe from the necessity of trade-offs

Arguably the greatest risk drawn from this report is that of systemically important economies defaulting on their debts: in such a highly globalised world, one advanced country defaulting on its debt could easily spark a chain reaction of default, causing international economic fallout. This would create untold amounts of suffering as cost-of-living crises would spiral out of control. Additionally, government spending on critical state-funded institutions such as policing and education would be jeopardised, risking further breakdown of society — in both the short-term, due to a lack of law and order, but also in the long-term due to ineffective education leaving people unfit for the demands of the modern workplace. Furthermore, trust in major economic institutions such as the IMF would enter freefall, signalling an end to today's levels of global cooperation.

The prevailing question resulting from this risk analysis is whether unchecked population growth is a factor to blame for worsening debt outlooks.

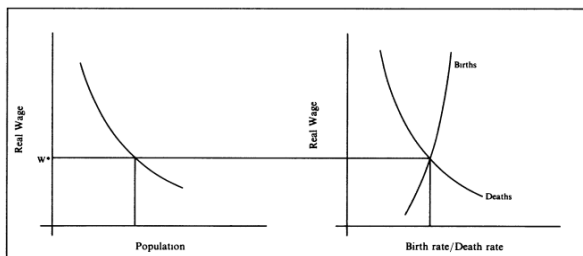
The next section of this analysis will determine whether the problem of human population growth, using Malthusian and Neoclassical arguments, is affecting the ability of governments to effectively manage public debt.

Economists' arguments

Malthusian arguments

The word 'Malthusian' is traced back to the works of Thomas Malthus, whose perspective on population growth is that resources are scarce in absolute terms and that, if left uncontrolled, population growth will grow exponentially (Meadows *et al.*, 1974).

Malthus' Theory of Population, written by D.R. Weir (1991) examines his essay, first published in 1798. The graph of Malthusian equilibrium is analysed, which shows three curves representing three functional relationships.



Malthusian Equilibrium (Weir, 1991, p. 402)

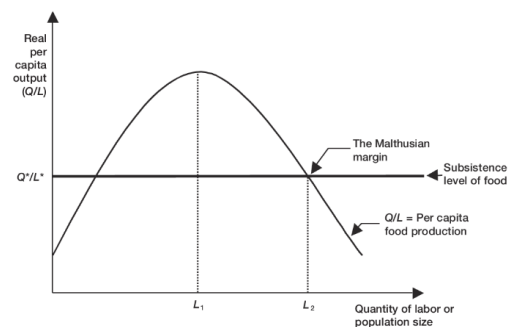
The graph on the left represents the standard of living produced by a population, showing diminishing returns to labour. The graph on the right describes demographic behaviour: as the standard of living falls, mortality, the 'positive check', rises, while fertility, the 'preventative check', falls. Equilibrium is reached at zero population growth.

Malthus envisaged two modes of action for the positive check: 'misery and vice' associated with declining wages, and sudden, short-lived mortality crises increasing in frequency as the standard of living falls.

Regarding the preventative check, Malthus believed fertility would remain nearly constant regardless of living standards. Instead of advocating for contraception — this being a misattribution to him — he advocated for delayed marriage as a check to population growth.

Below, the Malthusian growth model (Hussen, 2004, p.94) depicts an explanation of the limits on living standards, characterised by an association

of population growth and availability of necessities. If the population exceeds the Malthusian margin at point L_2 , any population beyond this point is ultimately prevented. This theory, however, has long been subject to criticism for being too simplistic in its explanation; firstly by overlooking the role of technology in reducing resource scarcity and secondly by being ecologically naive.



Malthusian growth model (Hussen, 2004, p.94)

Applying Malthusian theory to the need to take out additional debt, the latter graph could be applied, changing the subsistence level of food to that of basic services paid for through taxation. Not enough population would mean insufficient taxes collected for properly functioning public services; too much population would mean overstretching of services to meet an oversized population, requiring additional debt for financing this.

This line of thinking supports the argument that population growth is one of the factors to blame for a possible sovereign debt crisis. However, it also very much simplifies the argument into saying that too much population means too much spending; there is much more nuance to the situation than this model supports alone.

Neoclassical arguments

Breaking away from Malthusian thinking, many neoclassical economists are sceptical of such pessimistic prophecies (Rosenberg, 1973).

In response to Malthusian arguments, mainstream economists have provided pushback by saying that this line of thinking assumes that human self-destruction is inevitable, thereby underestimating our capability for self-preservation. B. Lomborg (2001) and J. L. Simon (1980) wrote on the issue.

Lomborg wrote that, contrary to the beliefs of Malthus, mankind's lot has actually vastly improved in practically every measurable indicator; despite *The Population Bomb* foretelling of mass starvation and death in the 1970s, agricultural production in the developing world actually increased by 52% per person.

Simon conducted mathematical analysis of the theory to prove his assertion that the population trap is a myth. The resultant findings showed that additional children induced by an increase in income did not consume the surplus. Furthermore, the long-run elasticity of fertility in relation to income being found to be negative in less developed countries is a fatal contradiction to the original version of the population trap.

Concluding the response to the Malthusian argument, it has been demonstrably proven that it is much too simplistic to be used to pin the blame of sovereign debt on a growing population; not enough nuance is captured to effectively tackle the issue and the orthodox model itself has been fatally contradicted by Simon's mathematical analysis proving that fertility works in a manner opposite to that espoused by Malthus.

Debt crisis and sustainable development

Regarding the UN's eighth goal (n.d.) — decent work and economic growth — of the negative influences on global economic recovery, those which align with the factors mentioned by the WEF include labour market challenges and rising

inflation. This shows that the WEF largely concurs with the UN on the issue.

With regard to inflation, the IMF (2023) reports that the global figure is expected to fall from 8.8% in 2022 to 6.6% in 2023 amid low global growth of an estimated 3.4%; this stagflation may be difficult to escape without damaging growth further. In advanced countries, the situation is no better; USInflationCalculator (n.d.) reports that inflation in the United States hit 6.5% in 2022 and, in the UK, hit 11.1% in the same year (House of Commons Library, 2023).

Regarding tight labour markets, unemployment in the UK hit 3.9% at the beginning of 2023, which has largely corrected itself to pre-pandemic levels (ONS, n.d.). In the United States, unemployment was at a similar level of 3.5%, down from a pandemic high of 14.7% in 2020 (YCharts, n.d.). This shows that, although the issue of tight labour markets may still be regionally present, the issue is not as severe as it once was.

Now that the root causes of a potential debt crisis have been established, suggestions can be presented for its amelioration, carried out in the following section.

Recommendations

With understanding of the root causes of global debt crises currently at risk of unfolding, some solutions can be presented to attempt to stop this issue now or prevent it in the future.

The Overseas Development Institute (ODI, n.d.) presents four potential solutions to the issue of a sovereign debt crisis: boosting alternatives to borrowing, managing borrowing and lending better, increasing accountability of borrowing and introducing better ways of managing shocks. A noteworthy point is that these are very much long-term solutions; for instance, telling a borrowing country to manage its finances better will not solve any issues. Of these solutions, alternatives to borrowing are the best over the

long-term if carried out to an appropriate extent to be worthwhile; the ODI states that many low-income countries could stand to improve their tax collection procedures, although this is easier said than done in many cases — often due to the nature of their economies and the level of education typically offered.

Overall, the ODI's recommendation of a long-term restructuring of taxation systems for developing countries is the best solution as it proposes the closest semblance to a manageable and realistic plan.

Conclusion

Overall, this report has shown that the WEF's report on global risks has been right in its categorisation of a possible debt crisis as a medium-severity issue; while it lacks the devastating and inescapable long-term effects of a climate crisis, it is clear that resting on this issue easily has the potential to light a spark and cause a global debt meltdown, which would leave untold misery and economic devastation in its wake due to the benefit to society of government-funded institutions and programs.

It should be noted, however, that the Malthusian take on the issue of population growth cannot be used as a scapegoat for a debt crisis — Lomborg (2001) and Simon (1980) proved this in their analyses of Malthusian theory — so it is necessary to view it through a lens of post-pandemic economic woes in an extremely interconnected modern world.

While the recommendation of taxation restructure offered may be helpful, it may leave the population of developing countries with a feeling that advanced nations have simply shifted responsibility onto them; however, any help to a greater extent risks economies becoming over-entangled in foreign affairs to an extent such as that of China, which has become one of the world's largest creditors. This, of course, is a very nuanced issue and so the situation may be liable to change in the near future; some attention must thus be kept on ensuring a crisis does not unfold within the decade.

Word count: 2328

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