

Spring 2025 Issue



# Penn Economics Almanac



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# EDITORS' NOTE

**Penn Economics Almanac** is an attempt to make economics accessible and interesting.

Economics might be confusing, but not because it needs to be—nor because you need a PhD to decipher the economy's impact on your day to day life. Economics is confusing because the language we use to talk about the economy is anything but inclusive. It's heavy in jargon and all too often the people who claim knowledge do their best to raise—rather than lower—the barrier to entry in economic discussions. As a result, a lot of the voices that should be heard don't feel comfortable enough speaking.

The Almanac is a forum for college students to write and for college students to read. Every semester, we'll publish pieces written by you: college students. In return, we hope you'll try reading something you might not have yesterday. The Almanac is not a forum for economics to be dumbed down. Rather, it's an opportunity to open up economic discussions to new voices, as we believe college students are more than capable of adding to discussions.

Our spring edition presents a diverse collection of articles examining both the micro and macro dimensions of economics in a rapidly changing world. You'll find an investigation into urban vitality and social cohesion—exploring why certain streets evoke a sense of safety, as discussed in “Behind the Streets.” There are pieces tackling broader societal imbalances, from “Unequal Burdens,” which reveals how climate disasters exacerbate economic inequality, to “On Sulfur and Kings,” which looks at the legacy of colonial-era institutions in Latin America's extractive economies. We also delve into pressing policy debates, including “The Debate on Taxing Unrealized Gains,” assessing the implications for equity and growth, and “2024 Fed Rate Cuts,” which unpacks how shifts in monetary policy affect everything from credit card debt to job creation. Finally, “Pandemic, Penury, and Payment” offers a sobering view of how Covid-19 has heightened sovereign debt risks, especially in developing countries. Our hope is that these articles and conversations inspire you to dive deeper into the economic questions shaping tomorrow's world.

**Mo Foroutan Nasab**  
**Brendan Warshauer**

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# Behind the Streets

Why do we feel safer on some streets than  
others?

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**O**n the Street  
In her 1961 book, *The Death and Life of Great American Cities*, Jane Jacobs states “If a city's streets are safe from barbarism and fear.” One can use their personal experiences in a city in order to reflect upon this statement. We often judge the safety of a city based off how we feel as we walk down the street. Are we leisurely strolling along, admiring the buildings and peering into shop windows or are we trying to make it off the street as quickly as possible? And what is it that helps us to subconsciously categorise whether an area is secure or not?

The heuristic “a busy street is a safe street” may come to mind. However, in Manhattan, one of the areas with the highest crime rates is the Midtown-South area, which encompasses Times Square—America’s most-visited tourist attraction—as well as Madison Square Garden and Grand Central Station. Clearly, just being well-populated is not enough to prevent disorder and crime. Critically, this heuristic assumes that there is a sense of responsibility that arises simply from having other people around, which is not always true in big cities, where there is often a sense of anonymity. Thus, it is generally down to the residents of the street to introduce social control, which then each member of the community feels a responsibility to uphold.

The specifications of social control in a neighbourhood depends entirely on its residents, however its structure is the same. There are some general standards that are ‘set’, usually implicitly, by the residents. The standards are communicated and upheld through collective surveillance and leadership by example, and this standard must be upheld continuously throughout the day (think, if a street isn’t safe at night, is it safe at all?). These conditions may be simple, but fulfilling them is most definitely not.

For one, we cannot force people to survey the street. Although observing the hustle and bustle of the city is a

a favoured pastime for many, very few have interest in watching an empty street. Here, we might reintroduce the importance of a well-used sidewalk; it should draw more observers to the street (from their windows, balconies, stoops etc.), and additionally, the users themselves provide another set of eyes. From this arises another question: how do we attract people to a street?

## Urban Vitality; or, the Life of Streets

We turn to the concept of urban vitality. This is a measurement of how lively an area is, and one can begin to conceptualise this by reflecting on the reasons why we might visit an area. Are there nice shops and cafes? Good restaurants and bars? Points of interest like this attract visitors who in turn, add to the vibrancy of the area. Having a mixture of amenities in an area will give people reasons to visit at all hours of the day, helping to maintain a frequent comings and goings. Businesses want to operate in areas with heavy footfall, leading to a synergistic relationship between urban vitality and safety.

Infrastructure also plays a key role when it comes to the vitality of an urban area, specifically when it comes to the sidewalk. The humble sidewalk may not be the first thing that comes to mind when we think of a neighbourhood, but their role has been discussed at length in urban studies. Their importance cannot be overstated: it is where we interact most with businesses, passers-by and is the binding material of the city.

The true purpose of the sidewalk is not only to facilitate foot traffic, but the quality of a sidewalk has important implications for the community, safety and economic prosperity of the streets which it borders. The most important benefit of having a good sidewalk is that the area becomes more walkable. A study from researchers at Boston University found that residents in highly walkable city neighbourhoods are 1.5 times more likely to get enough physical activity and 0.76 times less likely to be obese than those in areas with low walkability.

A larger variety of businesses leads to greater vitality, which creates a greater sense of safety, which attracts more investment and so forth. This cycle continues, and it becomes clear how the concepts discussed so far complement one another and benefit an urban environment. However, a key component of such a harmonic neighbourhood is a strong sense of community and belonging, and the remainder of this article will explore this issue in relation to previous discussions.

### **Society on the Streets**

Recall that to organize social control, standards must first be established and then upheld. Much of the discourse thus far has been surrounding how communities might uphold these standards, but little light has been shed on how they arise in the first place.

In order for there to be social control, residents must care about each other and the place they live. For example, if they did not care about one another, having eyes on the street would have much less meaning, as there is a slimmer chance of intervention in any illicit activities; people may simply turn a blind eye. Although this may sound slightly incredulous, theories such as the bystander effect can help to explain this idea. Moreover, if proprietors did not care about their street environment, then they simply would not bother to impose standards upon it. This is why neighbourhoods need social cohesion and integration.

Social cohesion refers to the extent of the relationships and solidarity amongst a community. Social cohesion has been shown to have positive effects on almost every facet of daily life. It can help ease financial stress through community support (i.e. neighbours looking after children to ease childcare costs) or through social capital (friend of a friend knows of a job), it has been shown to influence health habits (encouraged to get more exercise as everyone else is, quitting smoking as no one around you smokes) and improve mental health and reduce isolation. All of this comes together to create what one might call a sense of community, and it is from here where social controls may arise, as one of the overarching benefits of social cohesion is that it is a driver of wellbeing for the entire neighbourhood.

So how do we foster solid relationships within our communities? We must interact with one another, and where do most social interactions take place? The sidewalk. If you live in a walkable area, you might see the same people at the same time, every day and it is



likely that one day you may strike up a conversation. If the street is diverse, you will come across a host of different people of all ages, occupation, and races, but what everyone will have in common is the street. This can nurture a shared socio-cultural value from which relationships can stem. But if the sidewalks are poor and unwalkable, the frequency and diversity of interactions will decrease, making it difficult for connections to form. Thus, the role that sidewalks and walkability play in the formation of social controls and cohesion are easy to see.

Vitality must also be included in the discussion of social cohesion. Generally, a more vital area can be thought of as more diverse, as different people have different uses for the same space. In order to maintain heterogeneity, it is crucial to maintain vitality, so users of all purposes continue to return. Otherwise, a community risks becoming too homogenous. If certain groups of visitors stop coming, the businesses that they frequent may lose their clientele and be forced out. Vitality and diversity will start to decrease, which has ripple effects for safety and economic prosperity.

### Subtle Streets

Thus, one can see again how all of these factors come together in a delicate balancing act to build and maintain a cohesive, caring community, which is needed in order to install social control and standards, which then in turn amplify safety, vitality, walkability and economic prosperity.

This is certainly not a recipe for a ‘perfect’ neighbourhood, and there are nuances that must be considered when taking any policy action towards urban improvements. However, it is clear that having only one of the four elements this article has focused on is not enough for a community to have long term, sustainable growth and development, and in neighbourhoods where there is clear success in one area, there will also be success in others, although it may be slightly harder to see – though not impossible. As one walks through a particularly pleasant neighbourhood, one may now pause to consider what subtleties have helped cultivate the surrounding environment.

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# Unequal Burdens

## Climate Distributional Impacts

**T**he dream of owning a home is a cornerstone of economic security, a place where families build memories, accumulate wealth, and find refuge. But as the climate crisis

accelerates, this dream is increasingly under threat—from the wildfires that sweep through the American West to the relentless hurricanes battering coastal regions, natural disasters have become more frequent, more intense, and more unpredictable. The cozy sense of security associated with homeownership is starting to unravel, revealing a harsh reality: owning property in high-risk areas is no longer just a matter of location—it's becoming a gamble against nature. Moreover, these impacts are not evenly distributed—regions like coastal Asia, the Global South, and parts of Europe bear the brunt of the economic fallout, amplifying pre-existing inequalities.

New research sheds light on an alarming but perhaps underappreciated trend: the rising cost of insuring homes against natural disasters and its knock-on effects on property valuations. As insurers adjust their models to account for climate risks, premiums are skyrocketing, making it harder for families to protect their homes. And when insurance becomes unaffordable—or worse, unavailable—property values begin to erode, draining household wealth and destabilizing local economies. A study in *Nature*, finds that if the expected losses from increased flooding were considered, the value of American homes would fall by \$121 billion – \$ 237 billion.<sup>1</sup> According to the June 2024 Redfin Estimate, a measure of real estate value created by aggregating over 95 million U.S. residential properties, the total value of U.S. homes amounts to \$49.6 trillion, a record high (for reference, G.D.P. is approximately \$30 trillion).<sup>2</sup>

At the intersection of these forces lies a profound challenge. For the average homeowner, climate change isn't just an abstract concern discussed in policy papers; it's a tangible threat with the power to upend their most valuable asset. In this article, we will explore the complex web of interactions between rising insurance

costs, declining property values, and their regional disparities and differences.

What happens when the very foundation of economic stability—our homes—starts to crumble under the weight of climate change? This is the question that we must urgently address, not just for the families grappling with these realities today but for the generations hoping to own a piece of the future.

### Market Failure and Insurance Premiums

At the heart of our economic system lies a paradox: markets are supposed to allocate resources efficiently, yet they are unprepared to handle the creeping threat of climate change. The rapid increase in homeowners' insurance premiums in response to climate change is a glaring example of market failure. In a well-functioning insurance market, premiums should reflect the underlying risk of a property. However, climate change has introduced externalities that are not fully accounted for in traditional risk models. As the frequency and intensity of natural disasters increase, insurers face higher-than-expected losses, which they pass on to consumers in the form of rising premiums.

According to data from the Federal Reserve, the average American household holds approximately 60% of their net worth in home equity. This reliance on home equity is even more pronounced among lower-income households and minority groups. The U.S. Census Bureau reports that, in 2019, home equity and retirement accounts composed the majority (65.2%) of aggregate household wealth. Specifically, 34.1% of household wealth was held in retirement accounts, and home equity accounted for 28.5% of household wealth.<sup>3</sup> The disproportionate reliance on home equity among these groups means that increases in insurance premiums or declines in property values due to climate risks can have a more severe financial impact. For instance, a study by the Pew Research Center found that, in 2021, the median net worth of U.S. households overall stood at \$166,900, counting all assets.<sup>4</sup>

1. Gourevitch et al., "Unpriced Climate Risk and the Potential Consequences of Overvaluation in U.S. Housing Markets."

2. Worley and Zhao, "U.S. Housing Market Nears \$50 Trillion in Value as Number of Trillion-Dollar Metros Doubles."

3. Bennet et al., "2019 Data Show Baby Boomers Nearly 9 Times Wealthier than Millennials."

4. Kochhar and Moslimani, "The Assets Households Own and the Debts They Carry."

However, their median net worth without home equity included was only \$57,900. This indicates that home equity looms large in household wealth, and any threat to property values directly affects financial stability.

The National Bureau of Economic Research (NBER) study by Keys and Mulder (2024) using a novel dataset based on mortgage escrow payments sheds light on a market correction where insurance prices are adjusting to reflect new levels of risk.<sup>5</sup> Their study found that in the past three years alone, insurance premiums in disaster-prone areas have surged by over 60%. But why did it take so long for insurers to adjust their models? To some extent, the answer may lie in the tragedy of the horizon. As former Bank of England Governor Mark Carney emphasized, insurance companies, driven by quarterly earnings reports, are incentivized to focus on short-term profits. This myopic view prevents them from fully pricing in long-term climate risks – until disaster strikes. When insurers finally adjust their risk assessments, homeowners bear the brunt of this correction, often finding themselves priced out of coverage or facing non-renewal notices when they need protection the most.

The reinsurance market – especially the insurance for insurers – has also been severely impacted. According to Keys and Mulder, the rise in reinsurance prices accounted for over half of the observed increase in the relationship between premiums and risk. The elasticity of premiums with respect to climate risk has increased significantly, indicating that homeowners are bearing a growing share of the financial burden as disaster risks

intensify. As reinsurers adjust their pricing to reflect increased risks, primary insurers are forced to pass these costs down to homeowners. The result is a cost pass through mechanism that disproportionately affects middle- and lower-income homeowners who can least afford it.

### The Effect of Climate Risks on Property Valuations

The declining property values in regions affected by climate change can be analyzed through the framework of the capitalization theory. According to this, the value of a property reflects the present value of the expected future benefits, such as rental income or resale value. As climate risks escalate, the expected future benefits of owning properties in high-risk areas diminish, leading to a decrease in property valuations. Fairweather et al.’s (2024) field experiment in the U.S housing market found that simply informing buyers of flood risks led to a 20% drop in property values in affected areas.<sup>6</sup> This research shows that climate risks are becoming a significant factor in the discounting of future property cash flows, particularly in areas prone to flooding or wildfires. In Florida and Louisiana, properties in high-risk flood zones are sitting on the market longer, selling at discounts of up to 15%.

Their field experiment conveys how home investors respond to low cost yet salient “no news” information about emerging risks. By integrating flood risk information into its platform, Redfin was able to influence buyer behavior on a massive scale, leading to immediate changes in property values. Their experiment, which spanned three months and affected

### Areas facing the greatest risks saw the biggest surges in costs

AVERAGE ANNUAL PREMIUM

\$3,000

\$2,500

\$2,000

2014

2016

2018

2020

2022

Highest risk

Higher risk

Medium risk

Lower risk

Lowest risk

5. Keys and Mulder, “Property Insurance and Disaster Risk: New Evidence from Mortgage Escrow Data.”  
 6. Fairweather et al., “Expecting Climate Change: A Nationwide Field Experiment in the Housing Market.”

8,150 high flood risk properties valued at over \$5.3 billion, resulted in a collective price reduction of \$57 million for these properties. Conversely, 186,000 properties in low-risk areas saw a collective increase of \$100 million in value, suggesting that pinpoint climate risk information is not only causing price corrections in risky areas but also driving up demand for safer properties. This underscores the “new news hypothesis”: buyers were previously unaware of these risks, and access to clear, trusted information has now enabled them to adjust their valuations accordingly.

In Southeast Asia and the Caribbean, where disaster risks are even more severe, homeowners are facing even steeper insurance premium hikes due to cost pass-through from global reinsurance markets. These increased costs disproportionately affect lower-income households, exacerbating existing inequalities. The World Bank reports that in countries like Bangladesh, only 10% of households have access to affordable insurance coverage.

In cities like Mumbai, where real estate values have historically been resilient, climate risks are starting to catch up. Rising sea levels are not just a distant concern but an imminent threat, leading to capital flight and declining property values. The Economist estimates that by 2030, climate change could result in a \$25 trillion loss in global property values. The impact is even more severe in the Global South, where infrastructure is inadequate to withstand extreme weather.<sup>7</sup> The result is a downward spiral of property devaluation, poverty, and out-migration.

### **Conclusion: Rethinking Policy in an Age of Climate Uncertainty**

The ways in which people will adjust their actions in light of new climate-related information (“new news”) will play an increasingly crucial role in determining the societal consequences of carbon emissions (Kahn, 2020). While climate change is a global challenge, its economic impact is far from uniform. The costs of rising insurance premiums, falling property values, and increased disaster exposure are distributed unevenly across regions.

To address the gaps in insurance and property markets, innovative solutions like public-private partnerships (PPPs) and microinsurance schemes are essential. In the U.S., the National Flood Insurance Program (NFIP) administered by Federal Emergency Management Agency (FEMA) is a public-private partnership where

the government, as guarantor, bears the risk and oversees floodplain mapping while the private insurers handle administration. Japan, for example, has pioneered the use of PPSs to build resilient infrastructure that protects against natural disasters.<sup>8</sup> Through PPPs, governments attract private sector partners who can provide financing for infrastructure investment, management skills, and expertise to address the challenges of natural disasters. In Sendai City, PPPs are utilized not just for infrastructure development but also for disaster preparedness. By comparing public administration to a build-operate-transfer model (BOT), Sendai has found that involving private operators in infrastructure projects has led to better disaster management and reduction of administrative burden for the municipality.

Microinsurance has also shown promise in regions like Sub-Saharan Africa, where traditional insurance models fail to reach vulnerable populations. In Kenya, for example, Britam General Insurance and Habitat for Humanity International (HFHI) have partnered up to provide insurance to low-income households, and the impact is already being felt through the 69,000 low-income households that are already covered.<sup>9</sup> Their models scatters around scaling property microinsurance but also expanding flood insurance coverage by identifying high-risk areas and collaborating with local communities.

However, challenges remain. Migration patterns are shifting as families relocate to climate-resilient areas, altering demographic and economic landscapes. Additionally, political resistance to zoning reforms and infrastructure spending hinders progress. Policymakers must address these barriers to ensure equitable adaptation and minimize further displacement.

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# The Debate on Taxing Unrealized Gains

and what Trump's presidency could mean for this policy

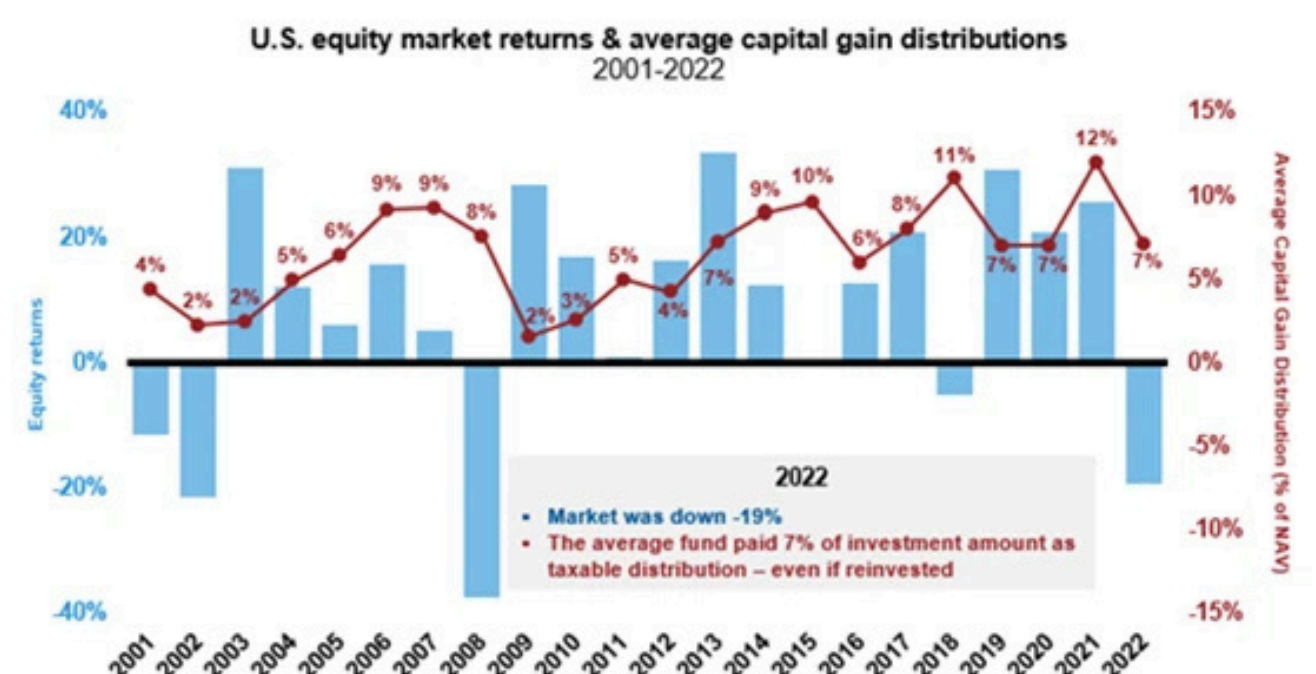
Taxes on unrealized capital gains had become one of the many focal points of the Biden-Harris presidential administration economic policy and came under scrutiny during the 2024 election season. Then-Vice President Harris campaigned on policy in the Biden administration's budget plan that would have levied taxes on unrealized capital gains. President Donald Trump, while not having explicitly focused on capital gains during his campaign, had been advocating for sweeping tax cuts for in areas from tips to overtime to Social Security benefits. Trump's policy is starkly different from that of what Harris campaigned on, so it is worth outlining these respective views as well as the consequences of the policies they have promised to enact. It is also worth focusing more on Trump's policy now that he has taken office.

We first define what unrealized capital gains are. Unrealized gains are profits on any investments or assets that have increased in their value, but have not yet been sold. In fact, they are often referred to as paper profits because they only exist on paper as they have not been sold. Thus, since no financial transactions have been made, they are not taxable under current law, as there is also no income reported. Under current law, unrealized gains are not reported to the IRS. Many have advocated<sup>1</sup> for a capital gains tax that would tax any gain in these investments even if no transactions have been made that are considered taxable under current law, arguing that asset appreciation should be considered income even if the income has not come in the form of a transaction or liquid cash. Long-term capital gains (held >1 year) are also taxed less than regular income, usually only at 0% or 15% (or 20% for the wealthiest Americans).

In the Biden-Harris 2025 budget, households with more than 100 million dollars in wealth must pay income taxes of 25 percent or more of their annual income, which includes a tax on unrealized capital gains from assets including stocks, bonds, or privately owned companies.<sup>3</sup> Thus, taxpayers owe taxes on capital gains

annually even if no transactions of the asset have occurred, so they are essentially prepayments of "future capital gains tax liability".<sup>3</sup> In her campaign for president, Vice President Harris embraced and touted these policies and tax increases, indicating she would have implemented them if she had won the election. This policy would come with many challenges, however. For example, it is difficult to value non-tradable assets such as savings bonds (savings bonds largely depend on the current interest rate, which is subject to change), complex derivatives, etc.<sup>23</sup> Additionally, some taxpayers may have paper gains but lack the liquid cash necessary to pay their tax bill on these capital gains, as these assets have not yet been sold, which can create difficulties in collection for the IRS.<sup>3</sup> Yet to meet these challenges, the Harris proposal allows for payment periods of nine and five years for those who may not have liquid cash to pay taxes, as well as eliminating prepayments for non-tradable assets that can be harder to value.<sup>3</sup> Still, many critics have also argued that these gains are simply on paper and should not be considered income until a transaction is made, so it is unfair to tax them preemptively at all. The value of the assets in question can either rise or fall at any point, so taxing them while they are still purely investments is essentially taxing something that critics say is not real money.

2022 capital gains distributions in context  
Annual returns and taxable distributions



Many critics also argue that these policies would be a marked departure from current tax law, asserting that unrealized gains have historically not been taxed. However, when it comes to how the middle class is

1. Steber, "What Are Unrealized Gains and What Is Unrealized Gains Tax."

2. Marr and Jacoby "Arguments Against Taxing Unrealized Capital Gains of Very Wealthy Fall Flat."

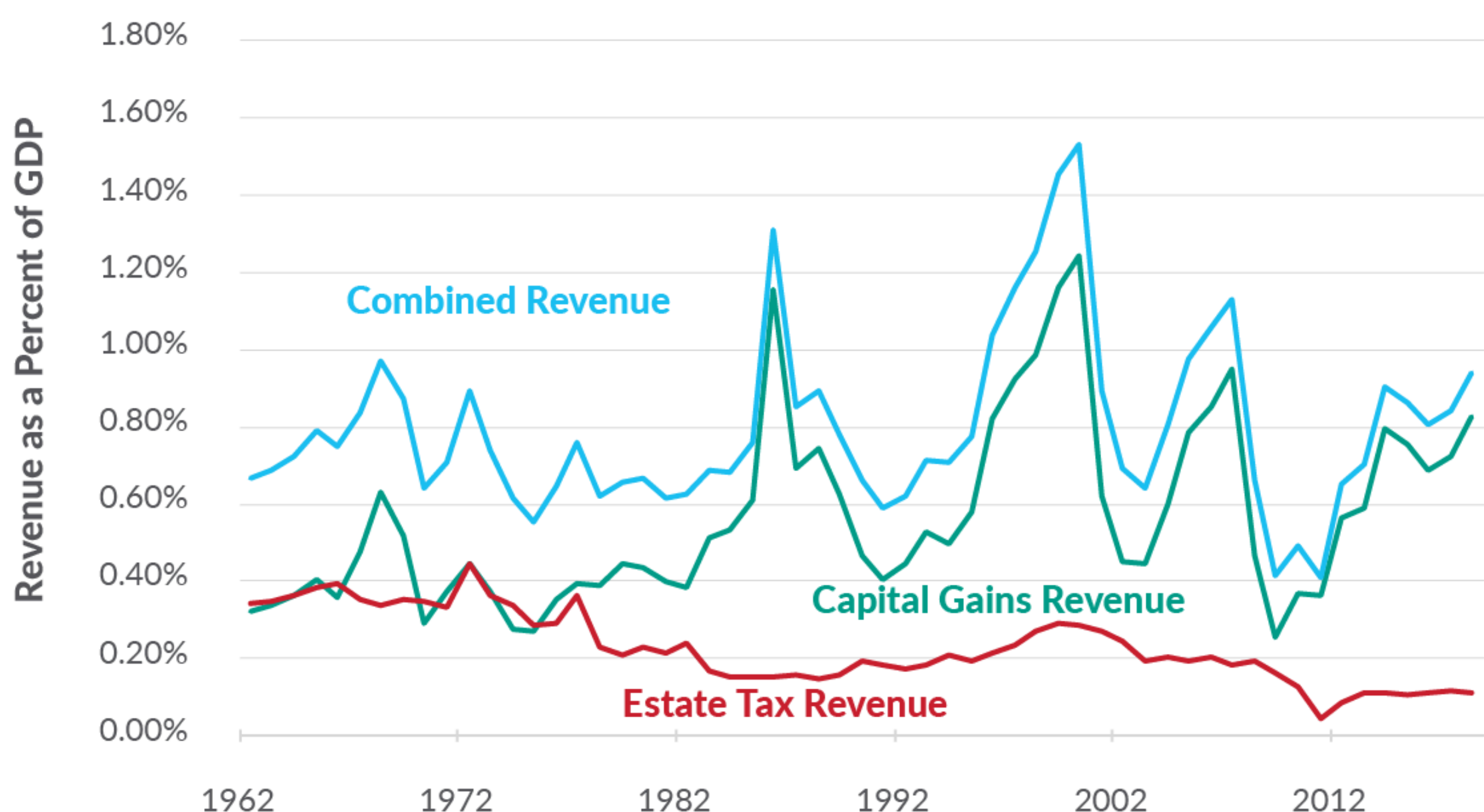
3. Dore, "Here's What Harris' Plan to Tax Unrealized Investment Gains Means for the Wealthiest Americans."

taxed, this is generally not true. For example, two assets, including contributions to 401(k) retirement plans and homes are taxed in a similar manner that unrealized capital gains would be.<sup>2</sup> Property taxes generally rise as the value of the home increases, so even though there is no transaction, there is an unrealized capital gain that is increasing their taxes.<sup>13</sup> This line of thinking is how the idea for a tax on unrealized capital gains came about in the first place. Many argue that the lack of taxes on this type of income benefits the wealthier, as they are more likely to have their wealth in market investments rather than liquid cash or other types of assets that the middle class are more likely to hold. Thus, not taxing these unrealized gains perpetuates income inequality, according to proponents of the policy. Additionally, there is a tax provision known as stepped-up basis. Essentially, when a person's investments increase in value, but they pass away, no tax is paid on the increase in value when their family inherits these investments, costing the federal government nearly \$42 billion in tax revenue in 2021, according to the Congressional Budget Office. This leads to wealthy people being incentivized to put a vast majority of their wealth in capital gains so that they can avoid paying taxes, especially when it

comes to generational wealth being passed down. Proponents of taxes on unrealized capital gains often use this to argue that wealthy people should pay their fair share as they often avoid these taxes when passing these assets to the next generation as in the status quo, the middle class pays taxes on unrealized gains. Very wealthy households are able to defer their gains and benefit immensely because the very top own about 70 percent of realized capital gains.<sup>2</sup> Unrealized capital gains are also owned mostly by the very wealthy, so they can defer these gains and not report them, escaping taxes. Thus, taxes on these unrealized capital gains could narrow income inequality as well as the ability of the very wealthy to avoid paying taxes on what is considered a majority of their wealth.<sup>13</sup> Furthermore, if the policy is enacted, these taxes could add more than \$500 billion in revenue to the current \$4.5 trillion the Treasury collects in tax revenue annually, which could play a significant role in chipping away at the soaring national debt.<sup>3</sup> It is worth noting, however, that capital gains taxes are a much more volatile source of federal revenue given how dependent they are on the state of the market, especially when compared to steadier sources like estate tax revenue.

## Capital Gains Tax Revenue Is a Volatile Revenue Source

Capital Gains and Estate Tax Revenue as a Share of GDP, 1962 to 2018



Source: Internal Revenue Service, Congressional Budget Office, Tax Foundation calculations

1. Steber, "What Are Unrealized Gains and What Is Unrealized Gains Tax."  
 2. Marr and Jacoby "Arguments Against Taxing Unrealized Capital Gains of Very Wealthy Fall Flat."  
 3. Dore, "Here's What Harris' Plan to Tax Unrealized Investment Gains Means for the Wealthiest Americans."

On the other hand, now-President Trump has not explicitly focused on capital gains or spoken about any policy related to this. However, it is assumed that were he to be elected president, he would resume the tax cuts for the wealthy that he had enacted in his first term. Proposals from Republican-aligned policy groups have pushed for the top bracket of long-term capital gains rates, paid generally by Americans making over \$500,000 annually, to be cut from 20% to 15%, its lowest in over 80 years. According to most economists from the Tax Foundation’s Center for Federal Tax policy, higher capital gains tax rates are most likely off the table now that Trump has been elected. The Trump administration has asserted that they will be pushing “swiftly” for new tax cuts now that Republicans control the legislative branch, reportedly hoping to slash “corporate rates and trillions of dollars of other cuts.” Thus, this means that all tax cuts are on the tables, and that Trump could decrease the capital gains tax and do so without congressional approval. Under Trump’s potential new policy, the investor’s cost and appreciation of their asset would be adjusted for inflation, which would significantly reduce the amount of long term gain that is taxable after sale. Because the vast majority of investments and capital gains are enjoyed by the wealthy, many argue that these taxes would disproportionately benefit the most well-of and thus exacerbate U.S. income inequality. Supporters counter that this policy serve to increase disposable income, lifting consumer spending and encouraging further investment, raising GDP and encouraging economy activity.

Overall, proponents of taxes on unrealized gains strongly assert that the policy change will end up

promoting equity in the tax structure when it comes to taxing investments as well as generating significantly more tax revenue. However, there still remain challenges in classifying some of these gains and taxing them. With President Trump back in office and Republicans in both chambers of Congress now presenting their tax plans, it is highly improbable that there will be any policy that increases capital gains taxes, let alone adds a tax on unrealized capital gains. With both the president and Congress eager to slash taxes, there is a more than fair chance that far from seeing an increase, the calculation for capital gains tax could be altered to reduce its effect.

**Author’s Note:**

This piece was written during the 2024 election season and served to contrast the policies between now-President Trump and then-candidate Harris.

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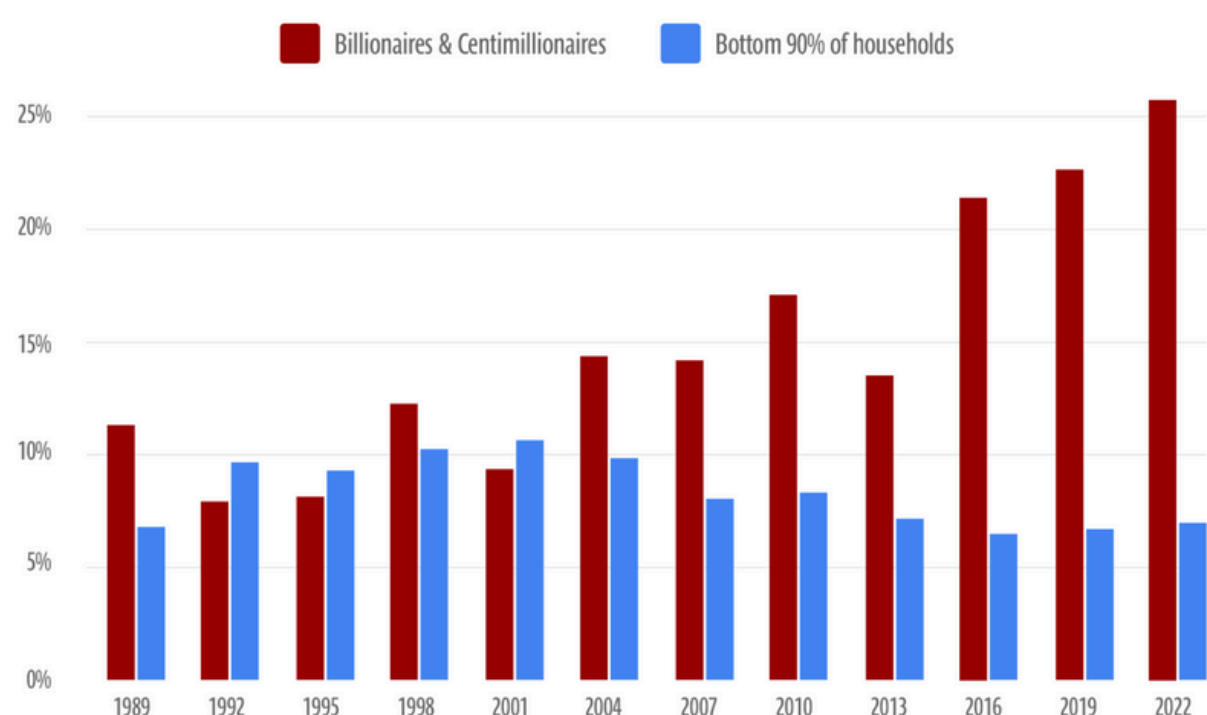
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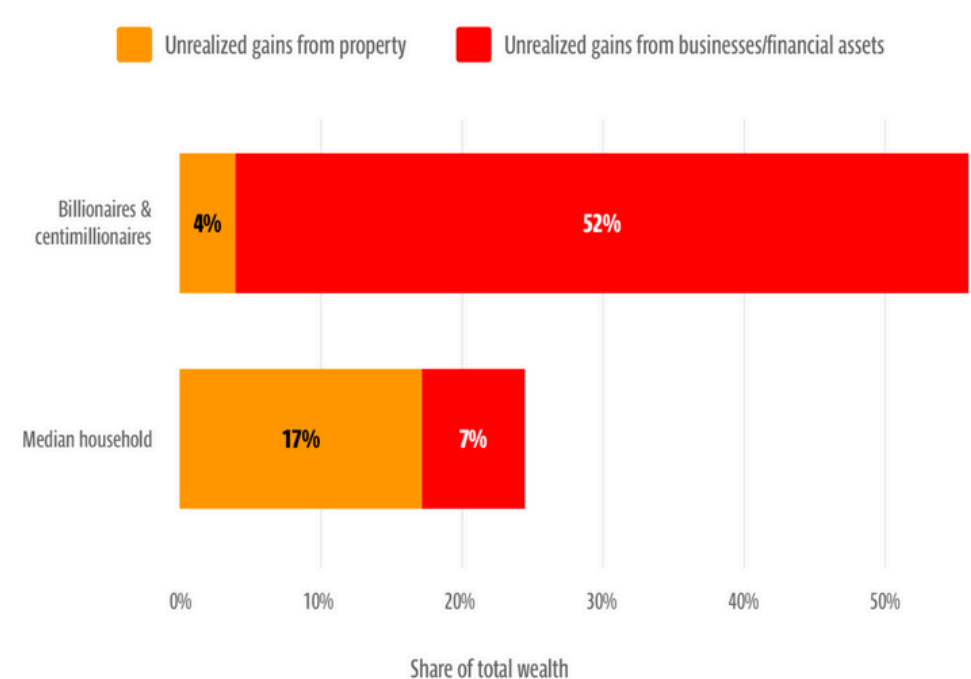
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Figure 5: THE SUPER-RICH’S SHARE OF THE NATION’S UNREALIZED GAINS IS REACHING NEW HEIGHTS



Source: [Americans for Tax Fairness](https://americansfortaxfairness.org/) (excludes value of primary residence)

Figure 4: WHILE FOR TYPICAL HOUSEHOLDS, MOST UNREALIZED GAINS ARE IN REAL ESTATE, FOR THE SUPER-RICH MOST UNREALIZED GAINS ARE FINANCIAL



Source: [Americans for Tax Fairness](https://americansfortaxfairness.org/)

3. Dore, “Here’s What Harris’ Plan to Tax Unrealized Investment Gains Means for the Wealthiest Americans.”

4. Taylor, “A Look at Donald Trump’s Tax Plans.”

5. Kiplinger, “What Are Trump’s Positions on Capital Gains Taxes?”

6. Dore, “Capital Gains Tax Hikes ‘Entirely off the Table’ under President-Elect Trump, Republican Congress, Economist Says.”

# On Sulfur and Kings

## The Challenge of Natural Resource Reform in Latin America



**E**conomic intuition suggests that natural resource endowments might propel economic growth and living standards in their host nations, yet in many nations resource wealth has led to conflict, corruption, and underdevelopment. Such a counterintuitive phenomenon has been the subject of extensive study under the case name of "the paradox of plenty". Although abundant natural resources can provide a solid foundation for economic prosperity, in many cases they have had the opposite effect. Countries rich in oil, gas, and minerals often showcase slower growth, weaker institutions, and sharper inequality compared to resource-poor nations.<sup>1</sup> Literature suggests that the presence of valuable natural resources tends to encourage "rent-seeking behavior" in host nations, characterized by political and economic elites who prioritize short-term gains over long-term development.<sup>1</sup> The battle for control over these resources usually leads to corruption, weakened institutions, and conflict, as several groups fight for wealth control. Such a phenomenon poses a threat to development in Latin America: a region heavily challenged by its economic and institutional conditions. I will study the historical origins of the economic structures governing natural resource extraction in Latin America: analyze its misdirected incentives, and failures to reform in order to underline the need for broad democratization and economic diversification at the heart of natural resource reform.

### Latin America's Colonial Institutional

The phantom of rent-seeking behavior signifies a particular threat to nations built over the foundation of weak institutions, where the incentives to reform the natural-resource extraction model for elites might perish to the possibility of costlessly overtaking rents. For this reason, many institutionalists seek to understand the origins of weak institutional in the Global South, a phenomenon whose reversion seems to be a major prerequisite to redirecting incentives toward effective developmental reform. Naturally, regions with a history of colonial subjugation seem particularly exposed to the harmful effects of natural resource endowments, as their institutions often stem from the ashes of the extractive colonial system.

Latest Nobel-laureate Daron Acemoglu argues that this is the special case of regions like sub-Saharan Africa and Equatorial South America: where high mortality for non-native settlers pushed systems of non-settler colonial rule, pushing for the establishment of a state foundation comprised of extractive institutions.<sup>2</sup> The prevalence of endemic diseases like malaria and yellow fever, made these areas a region of high mortality for European settlers, who in turn decided to establish non-settler extractive institutions in the region: building a system with little regard for welfare and nation-building, but rather concentrated in maximizing extraction volume and profit.<sup>2</sup> This situation was contrary to that of colonies in the North Atlantic, like the United States. These colonies posed environments of low settler mortality: pushing for the

1. Torvik, "The Political Economy of Reform in Resource-Rich Countries."

2. Acemoglu et al., "The Colonial Origins of Comparative Development: An Empirical Investigation."

creation of inclusive institutions built around a common welfare motive, seeking to benefit settlers and society through extraction.<sup>2</sup> Given this, colonized regions around the Equator were mostly built upon foundationally extractive institutions, leading to prominent examples of harmful resource abundance: ranging from Bolivia's natural gas to Ecuador's oil. Many of these colonized nations not only possess weak institutions unable to correctly manage growing rents, but are also conditioned by deeply entrenched racial and class inequities: turning corrosive societies into fertile soil for conflict and instability.

### **From Latifundismo's Geopolitical Subjugation to The Pink Tide**

Sitting on top of a history of political chaos, Latin America has suffered the burden of its extractive institutions made manifest through their political regimes. Sailing out of the independentist wars, the region was reborn in the form of agrarian feudal states—latifundios—subject to the rule of military strongmen—the caudillo.<sup>3</sup> Such a system cemented agrarian extractivism in its countryside—majority Indigenous, in cases like Peru—, while industrializing its capital cities, hosts of the old European economic castes.<sup>4</sup> Over time, caudillismo transfigured into the form of market economies reliant on trade with the United States—who openly influenced the decision-making of Latin America's economic elite, rendered political elite.<sup>5</sup> As natural resource discoveries surged, and trade reliance on new commodities increased, the Latin American countryside was soon to be abandoned for the exploration of more profitable industries<sup>5</sup>: widening racially marked social inequalities that grew evident to the eyes of a majority-rural population. The underlying social convulsion attached to a changing economic system fueled by commodity replacement, as well as the evident influence of foreign and domestic elite intervention in resource management, had turned Latin America into a canvas for social turmoil. Over the years, these divisions have made Latin American nations grow distant from the status quo, a division deepened by coups to leftist governments in the 20th century and the re-establishment of elite-backed governments.<sup>6</sup> The beginning of the 21st century witnessed the establishment of a wave of populist leftist movements in the region, often identitarian, though always fueled by the unaddressed class inequality of their nations. This wave, baptized as “The Pink Tide”, took control of natural-resource-dependent nations under the promise of effective and sovereign rent distribution for

these forgotten societies<sup>7</sup>. Leaders like Venezuela's Hugo Chávez and Ecuador's Rafael Correa were handed oil-dependent nations in the height of the oil price surges of 2008 and 2011. Similar to natural gas-dependent Bolivia: Venezuela and Ecuador enjoyed an abundant influx of fiscal revenue from sky-rocketing demand for commodities. Commodity prices, such as June 2008's \$140 oil barrel price<sup>8</sup>, allowed for sharp increases in public spending: targeting investment in social programs and poverty alleviation efforts.<sup>7</sup> Despite the increase in commodity prices resulting in a spending surge, Latin American governments have failed to diversify their economies. The region not only shows a 60% share of exports originating from natural resources but also a strong share of fiscal revenue depending directly on natural resources revenue: with the case of Venezuela, whose fiscal revenue depends by 96% on oil revenue.<sup>9</sup> <sup>10</sup> Such a commodity-dependent economy exposes the region to the volatility of commodity global markets. Thus, most of these governments have sought to correct societal inequalities through a model of rent distribution devoid of the productive change needed to emancipate the region from the whims of commodity markets: transferring the shackles of socioeconomic marginalization from economic elites to global markets.

### **Sovereign Wealth Funds and Solutions**

The establishment of Sovereign Wealth Funds (SWFs) in Latin America seems an evident necessity in the face of large commodity dependence. SWFs are state-owned investment funds often funded by revenue from commodity exports: such mechanisms usually target economic stabilization and diversification as an investment goal. However, Latin America is plagued by examples of SWFs' failure to diversify its economies. From Peru's Fiscal Stabilization Fund and Venezuela's Macroeconomic Stabilization Fund, to Colombia's Savings and Stabilization Fund: most SWFs established in Latin America have failed to diversify their economies and effectively stabilize their nations. These SWFs, rather than focusing on economic planning via diversification, target the creation of saving funds for government spending and macroeconomic stabilization during financial crises: mostly caused by commodity price declines.<sup>1</sup> The

1. Torvik, “The Political Economy of Reform in Resource-Rich Countries.”

2. Acemoglu et al., “The Colonial Origins of Comparative Development: An Empirical Investigation.”

3. Topik, “From Silver to Cocaine: Latin American Commodity Chains and the Building of the World Economy, 1500-2000.”

4. Barraclough, “The Legacy of Latin American Land Reform.”

5. Cardoso and Faletto, “Dependency and Development in Latin America.”

6. Tremlett, “Operation Condor: The Cold War Conspiracy That Terrorised South America.”

7. Burns, Nick. “Lessons from the First Pink Tide's Collapse.”

8. Rooney and Goldman “Oil Settles at Record above \$140 a Barrel.”

9. Margarita, “La Marea Rosa.”

10. Larraín, “Missed Opportunities: The Economic History of Latin America.”

design of most of these SWFs signifies a condemnation of their efficacy, with most of them relying on government control, the management of these SWFs is not only exposed to the threat of rent-seeking behavior but also reduces the transparency and civic bargaining that characterizes the successful model of citizen-managed SWFs of the Global North.

### 1. The Populist Challenge

It is evident how citizen-led diversification mechanisms are a necessity for natural resource reform in Latin America. However, a main collateral effect of the commodity-dependent welfare model restricts the effectiveness of change: political centralization. The introduction of checks and balances into state management of natural resources represents a priority when achieving transparency and efficient civic engagement in the management of rents.<sup>1</sup> However, institutionalists suggest that checks and balances represent a double-edged sword for unequal nations as they make it easier for economic elites to influence politics via non-electoral means. Such a visible control of economic elites over resource distribution incentivizes marginalized voters to support the dismantling of checks and balances on political power: opting to make popular political elites more powerful as long as it disempowers economic elites.<sup>1</sup> This has been the case of Latin America: traumatized by its economic elites, now cradled by a populist left. During The Pink Tide, Bolivia, Venezuela and Ecuador voted for constitutional reforms easing term limits—and in Venezuela’s case, abolishing them.<sup>11</sup> More recently, México gave a clear mandate for MORENA’s reforms to eliminate parliamentary proportional seats, and centralize several government agencies.<sup>12</sup> Past and present, deep social inequalities have fueled the centralization of institutions under the control of new political elites. The threat of economic elites’ control, via lobbying and private financing, results in a popular handover of resource wealth to the political establishment. Measures like strong restrictions against private funding on political campaigns, lobbying, and efficient models of citizen-managed public political funding are necessary to formulate natural resource reform protected from populism’s democratic backsliding. Otherwise, the political takeover of natural resources will not only obscure any attempt for diversification, but also the transparency required for efficient reforms.

### 2. The Enclave Challenge

Moreover, political control adds to a distinct problem of racially diverse resource-rich nations. Government reliance on the management of SWFs coupled with racially diverse societies and the prevalence of natural resource extraction in Indigenous areas fuels the creation of “enclave economies”. Enclave economies are, in the context of natural resource extraction, secured enclaves where most of the investment from resource extraction is concentrated with no benefit to the wider society.<sup>13</sup> According to James Ferguson, these enclaves bear the burden of resource extraction despite not perceiving any societal benefit other than economic investment solely directed to extraction processes.<sup>13</sup> The Indigenous inhabitants of the Latin American countryside —such as the communities on the Lithium Triangle, and the Yanacocha Gold Mines — are disproportionately affected by extraction processes that benefit urban populations and political elites at a higher level.<sup>14</sup> <sup>15</sup> Such communities are not only affected by pre-existing social marginalization, but are also hit by a lack of social investment, as well as the ecological and medical consequences of extraction processes. Given this, it is necessary to theorize reforms leading to the establishment of inclusive citizen-led institutions for the management and reinvestment of natural resource rents: taking into account the geographical, ethnic, historical, and socio-economic conditions unique to Latin America.

### 3. The Canadian Model

The Alberta Heritage Savings Trust Fund, although not keen on ethnic investment, represents an optimal policy model to generate tangible inequality reduction while cementing democratic institutions alongside checks and balances on political power. Established in 1976, The Heritage Fund seeks to establish savings, improve welfare, and diversify the economy of Alberta, which sits upon the largest oil reserves of Canada.<sup>1</sup> The fund aims at re-investing largely in Alberta, through investments in a set of publicly-owned companies. However, The Heritage Fund also provides investment to other provinces through preferential treatment loans with interest rates below market rates.<sup>1</sup> Nonetheless, The Heritage Fund effectively prevents the creation of an Enclave Economy by re-distributing a large portion of its revenue within the extraction province, while also stimulating the broader economy and infrastructure of Canada. Such a model seems to be attractive for Latin

1. Torvik, “The Political Economy of Reform in Resource-Rich Countries.”

11. Cubillos, “Chavez Wins Vote to Scrap Term Limits.”

12. Trejo, “Así Son Las 20 Reformas Que Envió AMLO al Congreso; Morena Buscará Aprobarlas Antes Del Fin de Su Sexenio.”

13. Ferguson, “Seeing like an Oil Company: Space, Security, and Global Capital in Neoliberal Africa.”

14. Janetsky et al., “Native Groups Sit on a Treasure Trove of Lithium. Now Mines Threaten Their Water, Culture and Wealth.”

15. *Common Dreams*, “How One Indigenous Woman Took on a Multinational Mining Corporation... And Won.”

American nations, offering possibilities to establish minimum quotas for the re-investment in the social development of extraction-enclave Indigenous areas, while focusing public investment in host provinces, as well as in the nationwide economy. It is important to also note how The Heritage Fund places a focus on investment in public companies, who could play a role in effective economic diversification. Furthermore, it is necessary to apply a keen interest in public companies in the context of post-colonial societies: as many of these nations' resource extraction industries have been built upon foreign investment models which have disproportionately benefited foreign companies to the detriment of national revenue. However, such considerations are to be made considering the centralization epidemic of many Latin American public companies, whose efficiency is constrained by high levels of government-intervention and a lack of citizen-led management. Therefore, these reforms must be coupled with increased autonomy of public companies, incentivizing technocratic civic management over political agendas.

Table 1: ECLAC's Primary Exports Analysis for Latin America and Caribbean (Data from UNCOMTRADE).

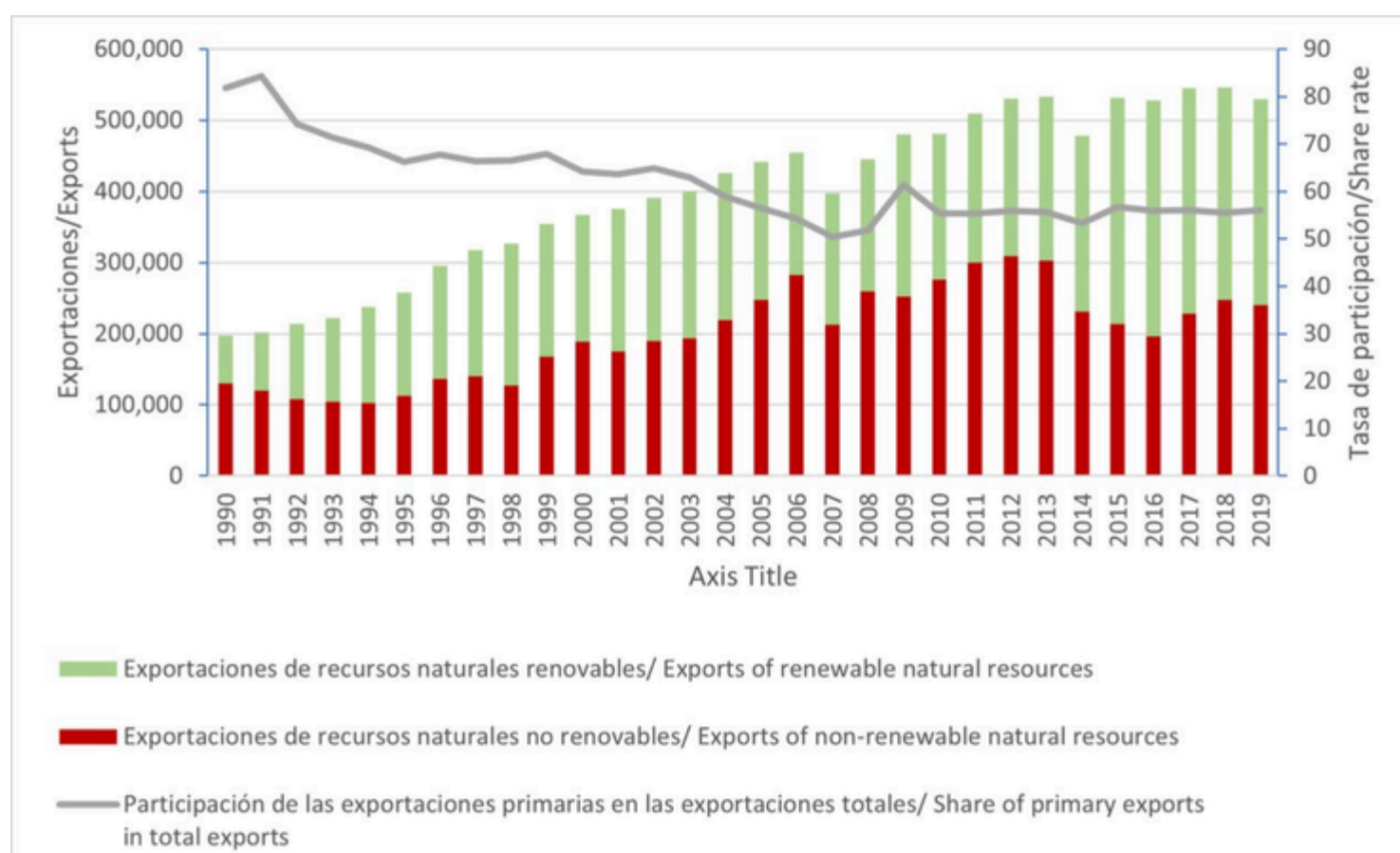
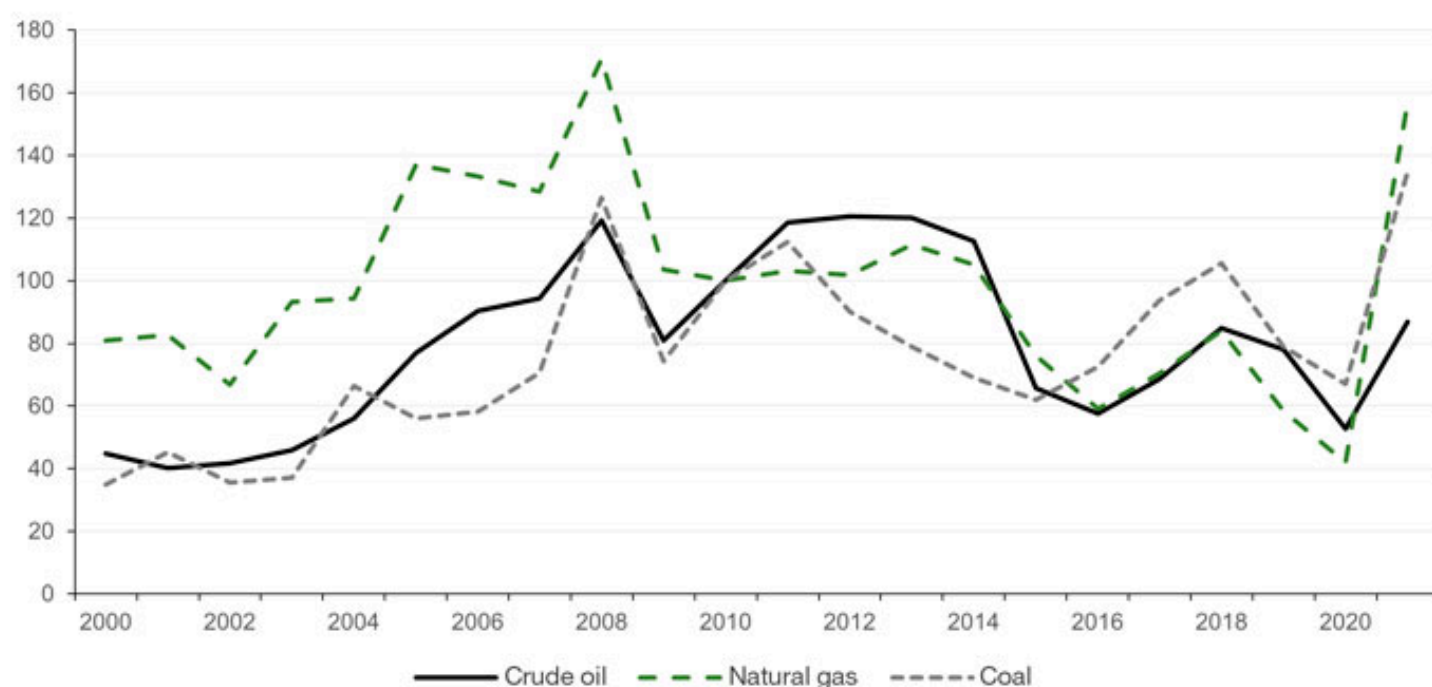


Table 2: Fossil-Fuel Price Indices 2000-2020 (Data from World Bank).



**Conclusion**

The unique conditions of Latin America call for unique solutions. In a region of colonialist institutions that have perpetuated race and class inequalities, we must seek to use rents in a way that fosters independence both from foreign investment and market volatility. We are called to remember that any reform devoid of an approach against social inequalities is ought to be ineffective. With a growing necessity for decentralized citizen-led rent management mechanisms, it is a priority to reform political institutions in a way that democratic backsliding is slashed via increased civic participation and regulated elite influence. It is only through deep democratic institutional reform that rents can be distributed in a way that maximizes economic security and social development: turning the page on extractivist institutionalism to chart a new path forward

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# 2024 Fed Rate Cuts

## The Ripple Effect: Balancing Growth and Inflation

Analyzing the Fed Rate Cut's Domestic Impact on Consumers, Business, Employment, and Investment

In September 2024, the Federal Reserve (Fed) took significant action by cutting interest rates by 50 basis points, marking the first rate reduction in four years, and further cutting it on November 7 by 0.25%. This move lowered the target interest rate to a range of 4.5% to 4.75%, aimed at supporting economic growth and stabilizing the labor market, which has shown signs of slowing<sup>1</sup>. These decisions reflect a shift in the Fed's priorities towards dealing with unemployment over inflation as Fed Chairman Jerome Powell stated the Fed was "encouraged" by the progress seen on inflation. As the unemployment rate rose from 3.7% in December 2023 to 4.2% by August 2024,<sup>2</sup> the Fed now views the risk of a weakening job market as a more pressing concern than inflation, which has shown progress toward stabilization.<sup>3</sup>

The Federal Reserve operates under a dual mandate, which directs it to promote two primary goals: maximum employment and stable prices (i.e., controlling inflation). This means the Fed aims to foster a labor market where everyone who wants to work can find a job, while also keeping inflation at a manageable level to ensure the purchasing power of money remains stable over time. However, low inflation and employment are counter-productive as more people working can boost demand for goods and services, potentially driving prices up. Therefore, the Fed must carefully balance these two macroeconomic goals to maintain overall economic stability.

Despite the overall consensus among the Federal Open Market Committee (FOMC)—the component of the Federal Reserve responsible for setting monetary policy, primarily through influencing interest rates and managing the money supply—there was internal debate about the extent of the rate cut. A rare dissenting vote, such as that of Michelle Bowman, expressed concerns that cutting rates too aggressively could prematurely signal victory over inflation.<sup>4</sup> Nevertheless, the Fed's

rationale for this bold move was driven by economic data signaling potential further softening in the labor market. The central bank's Summary of Economic Projections (SEP) "showed that the median FOMC participant is penciling in 50 basis points of further cuts across the remaining two meetings this year, followed by 100 basis points of cuts in 2025 and 50 basis points more in 2026 to a terminal rate of 2.9%,"<sup>5</sup>

As Chairman Jerome Powell indicated, the Fed remains encouraged by inflation's downward trend but is prepared for further cuts to ensure economic stability and stability in the job market.<sup>6</sup> This article dives into the impacts of the federal rate cut on domestic citizens of the U.S., discussing the impact of rate cuts on consumers, businesses, and inflation, the impact on employment and the job industry, and finally the impact on stock markets and investor behavior.

### Historical Federal Rates (2000 - 2024)



This chart shows the Federal Funds Effective Rate (the actual rate at which banks lend reserves to each other overnight compared to the target rate—which is a range set by the FOMC) from 2004 to 2024. The rate increased sharply between 2004 and 2007 as the Federal Reserve

1. Dwyer, "September 2024 Fed meeting: Fed cuts rates by half point to support economy"

2. Fitch Ratings, "Fed Rate Cuts Are Still Likely to Be Modest Overall in This Easing Cycle"

3. Dwyer, "September 2024 Fed meeting: Fed cuts rates by half point to support economy"

4. Ackerman, "Fed decision to go big on rate cut was not a slam dunk"

5. Dwyer, "September 2024 Fed meeting: Fed cuts rates by half point to support economy"

6. Pazzanese, "Consumers to see benefits of Fed rate cut, but how much and when are less clear"

ightedened monetary policy to curb inflation during an economic expansion. However, the 2008 financial crisis led to a rapid reduction to near-zero levels as the Fed sought to stimulate the economy and restore stability. Rates remained low for years, reflecting a slow recovery, before beginning to rise gradually in 2015 as the economy strengthened. At the onset of COVID-19 in early 2020, rates were slashed again to near zero to mitigate the economic fallout. Since then, rates have risen steadily as the Fed aimed to combat post-pandemic inflation, but this year, the rate was finally cut, signaling a pivot in monetary policy amid concerns about stabilizing the slowing labor market. This showcases how the rapid rise of rates from COVID-19 was highly unusual in comparison to previous years where the rate has been usually maintained at a low level, therefore cuts are now being utilized to return to the Federal Rate “norm”.

### **Impact on Consumers, Inflation, and the Overall Economic Outlook**

The Federal Reserve's decision to lower interest rates has a direct impact on various aspects of consumer finance. By reducing the cost of borrowing, the Fed aims to stimulate economic growth. When rates are low, consumers and businesses—“borrowers”—are more likely to take out loans for investments or large purchases, such as homes or cars, because the cost of financing becomes more affordable. For instance, adjustable-rate mortgages (ARMs) often see decreases in interest rates following a Fed rate cut, which can make homeownership more attainable for buyers. Similarly, credit cards with variable rates, which are often tied to the prime rate, also see lower interest charges, reducing the financial burden on consumers.<sup>8</sup>

Despite the benefits for borrowers, Fed rate cuts have downsides for savers. As interest rates drop, banks typically lower the interest they pay on savings accounts, certificates of deposit (CDs), and money market accounts.<sup>9</sup> This can reduce the income consumers earn on their savings, making it harder for individuals to grow their wealth through traditional savings vehicles. Over time, this could discourage saving and push consumers to seek higher returns in riskier investments, such as stocks or real estate.

Federal Reserve rate cuts also impact students, having both positive and negative impacts. Lower interest rates can reduce borrowing costs for students, making it cheaper to take out loans for tuition, textbooks, or

credit cards for day-to-day spending, such as food or transportation. However, a decrease in interest rates typically means lower returns on savings accounts, which could make it harder for students to grow their savings for future expenses.

From a broader economic perspective, while rate cuts are intended to spur growth, they can also have inflationary effects. When borrowing becomes cheaper, consumers and firms are more likely to spend, which can drive up demand for goods and services, potentially leading to higher prices. As demand increases, businesses may struggle to meet the higher level of consumption, particularly if production capacity is already stretched. This increased demand combined with limited supply can cause prices to rise, contributing to inflation. Additionally, lower borrowing costs may encourage businesses to invest in expansion or increase wages to attract workers, further adding to inflationary pressures. Furthermore, lower interest rates can weaken the currency as investors seek higher returns in other countries with higher rates, therefore supplying the US dollar into the market, depreciating the currency, and therefore raising import prices. This is particularly impactful in economies heavily reliant on imports for goods and raw materials. Rising import prices can push domestic inflation higher, making everyday goods more expensive for consumers.

Although inflation remains a concern, Powell claims that the current series of rate cuts is expected to result in only a slight increase in inflation over the next six to 12 months. The primary goal is to boost job creation and economic growth without allowing inflation to spiral out of control, striking a balance that supports long-term economic stability.<sup>10</sup>

### **Impact on Employment and Growth in the Job Industry**

The Federal Reserve's decision to lower interest rates has a profound ripple effect across the economy, particularly in the labor market. Lowering interest rates typically stimulates job growth by making borrowing cheaper for businesses, encouraging expansion, investment, and hiring across sectors. This boost in economic activity often creates new jobs, particularly in industries like construction, where lower mortgage rates drive demand.<sup>11</sup> Consumers also tend to spend more with lower borrowing costs, further fueling demand, therefore increasing derived demand for labor, and prompting businesses to hire.

7. FRED, “Federal Funds Effective Rate (FEDFUNDS).” Federal Reserve Bank of St. Louis, 2024.

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The recent revision of employment data showed that job growth between March 2023 and 2024 was slower than initially reported, with 818,000 fewer jobs created.<sup>12</sup> While the unemployment rate stands at 4.2%, tighter post-pandemic conditions have made private sector positions more competitive as there are now fewer job opportunities than there are unemployed laborers.<sup>13</sup> By cutting rates, the Fed aims to support job creation, reduce layoffs, and improve workers' bargaining power, potentially leading to higher wages as businesses compete to attract talent.<sup>14</sup>

Commodities also benefit from lower interest rates. Precious and base metals like copper stand to gain, as lower rates combined with a weaker dollar make these assets more attractive to investors, reducing the opportunity cost of holding metals and increasing demand from other countries using different currencies.<sup>15</sup> Additionally, when interest rates are lower, firms are more likely to borrow from banks to fund R&D programs and innovation and expand their capital and land factors of production. This would further increase the demand for base metals required for construction etc, therefore increasing the job opportunities available in the construction industry.

### Impact on Stock Markets and Investor Behaviour

This Fed cut had an immediate, albeit mixed, effect on U.S. equity markets. Initially, stock prices rose, and bond yields, especially short-term ones, dropped. However, by the end of the trading day, major indices such as the S&P 500, Dow Jones Industrial Average, and Nasdaq all posted small declines. Despite this, the broader expectation is that equities tend to perform well during rate-cutting cycles, particularly when the cuts are made outside of a recession. Historically, in 11 out of 12 previous cutting cycles, fixed-income investments outperformed cash, further encouraging investors to move their excess capital from cash holdings into higher-yielding investments.<sup>16</sup>

For individual investors, rate cuts also impact various financial products. Money market funds (MMFs), especially taxable ones, tend to adjust to rate cuts, so consumers can expect to see lower rates offered by these securities in the event of a rate cut leading to lower yields for investors. Lower rates typically boost stock markets by reducing borrowing costs for investors, allowing them to leverage margin accounts more efficiently. At the same time, bond prices can decline, especially for long-term bonds, which are more sensitive to interest rate movements.<sup>17</sup>

Finally, when the Fed cuts rates, interest rates generally fall across the broader financial market, including for U.S. dollar-denominated loans. Companies that rely on overseas funding (e.g., from international investors or global debt markets) may find it cheaper to borrow, as interest rates decrease globally in response to the Fed's actions. This is also furthered as a Fed rate cut typically weakens the U.S. dollar, as lower rates may reduce the attractiveness of investing in dollar-denominated assets to foreign investors. Companies that rely on overseas funding may benefit if they are borrowing in other currencies because the cost of servicing debt may decrease if the U.S. dollar depreciates relative to their borrowing currency.

### Conclusion

The Federal Reserve's September 2024 interest rate cut has sparked a wide-reaching ripple effect across multiple sectors domestically, benefitting certain consumers and businesses, stimulating the job market, and increasing employment. However, the full effects of these rate cuts remain to be seen, especially as they unfold in the context of ongoing inflation concerns and the potential need for further policy adjustments. The policy carries trade-offs, such as reduced savings returns and potential inflationary pressures, which the Fed must carefully monitor. Ultimately, the success of this rate cut will depend on its ability to strike a sustainable balancing act aimed at fostering sustainable growth and mitigating the risks of a weakening job market.

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# Pandemic, Penury, and Payment

## Sovereign Debt Distress After Covid-19

**B**ackground  
In September 2024, the International Monetary Fund (IMF) identified 69 countries as being at risk of or in debt

distress; with earlier assessments from private credit rating agencies, this number rises to 79. While distress for many—indeed, near all—of these countries far predates the Covid-19 pandemic and its economic fallout, that fallout has undoubtedly exacerbated their troubles.

The broad channels aggravating post-Covid debt distress have been (1): tremendous government spending on economic support and relief, exceeding \$9 trillion in 2020 alone and adding to high pre-existing debt piles, (2): a return of global inflation, reaching a median 8.7%, (3): tighter financial conditions and higher debt servicing costs amid global interest rate hikes, particularly for the poorest countries, and (4): the resulting foreign exchange implications of those hikes.

Naturally, this list is incomplete: the dramatic escalation of Russia's war in Ukraine in 2022; fluctuations in the prices of vital commodities like food and energy; and even climate change are other contributing global factors. And on the national level, one would be heedless to exclude years of corruption and economic mismanagement in Sri Lanka, Lebanon's 2019 political and liquidity crises, and Pakistan's 2022 floods and political unrest.

While each country must be considered in its specific context—and global debt burdens considered in the context of the past few decades—this article will examine chiefly those debt effects most attributable to the Covid-19 pandemic and its economic effects. It will also examine only sovereign, not private, debt.

### Debt Distress

A country in debt distress is one where the government is experiencing difficulty servicing its sovereign debt (that is, paying its own government-issued debt). A

default occurs when a government halts payments on its debt or otherwise declares it will do so. Distress is often a precursor to default, but can be resolved without default, often by a bailout or debt restructuring.

A common indicator of (or response to) distress is rising borrowing costs and, particularly, rising spreads. Debt investors (borrowers) require interest payments from debt issuers (lenders; here, sovereigns), and demand higher interest rates<sup>1</sup> when they believe the debt is riskier—this is the classic risk-return tradeoff. Private credit ratings agencies also rate sovereigns (government borrowers) on their creditworthiness, and their ratings can particularly influence major institutional investors. A country with a low enough credit rating may find itself virtually cut off from international capital markets.

Governments that run prolonged deficits (that is, that regularly spend more than they take in, requiring the issuance of debt to make up the difference), that set unfunded budget plans (pursue policies without clear funding beyond the issuance of more debt), that reach high or exceed maximum debt-to-GDP or deficit-to-GDP ratios, or that experience general political, economic, or civil or military turmoil, distress, or impasse are likely to see interest rates rise, even without issuing new debt.<sup>2</sup>

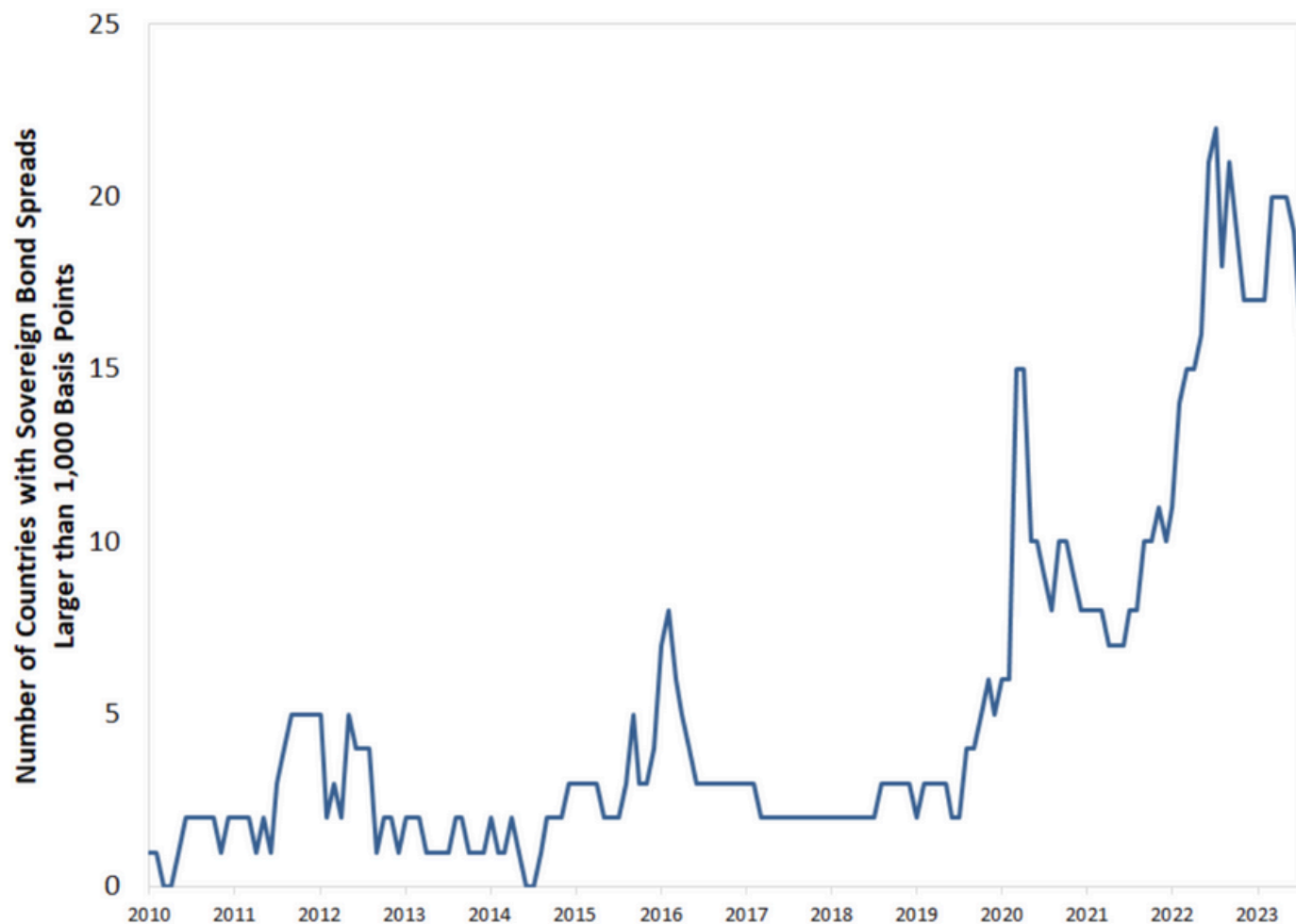
Beyond outright rises in interest rates, another key metric for distress is the spread, or difference, between a (potentially) distressed country's debt and that of a traditionally safe (and usually developed) country, such as the United States or Germany. A higher spread indicates investors demand higher interest from one country, likely because they view that country as riskier. Spreads are computed for bonds of similar

1. Equivalently, demand is lower for riskier bonds, which are thus purchased at lower prices. A lower price and an unchanged coupon (bond payment) mean the interest rate (the coupon divided by the price) is higher.

2. One may note the United States has experienced repeated budget standoffs and carries a high debt-to-GDP ratio of 123%. America's ability to remain the world's financial safe haven and a major borrower has been attributed by some to its "exorbitant privilege;" that is, its status as the monopoly supplier of the world's reserve currency, the United States dollar, in which commodities (which the US imports) and much government debt are denominated.

term, so a 10-year Lebanese sovereign bond would be compared to a 10-year US Treasury bond, not a 2-year or 5-year note. Higher (or, equivalently, “wider”) spreads are often used to measure distress:

**The Number of Countries in Debt Distress Rose Sharply during the COVID-19 Pandemic**

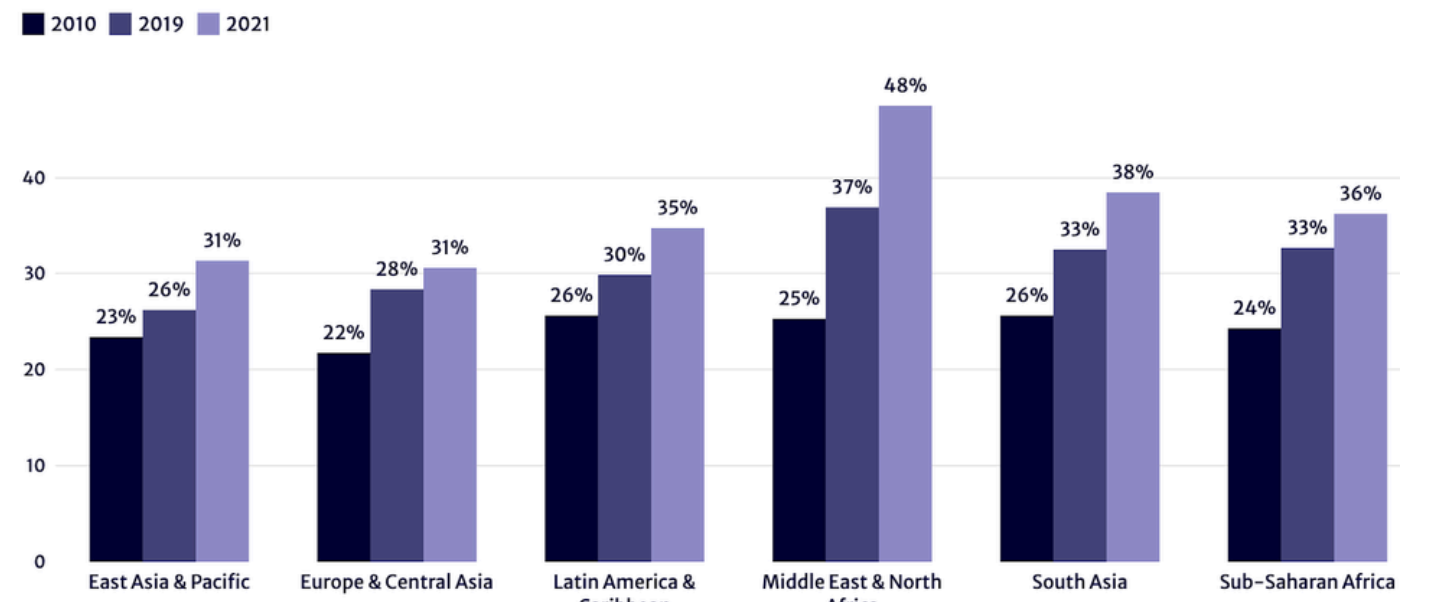


Note that spreads are often quoted in basis points, or hundredths of a percent. Thus, this graph depicts sovereigns with spreads greater than 10%, which is quite high and can indicate distress.

Debt distress is usually resolved with a bailout or debt restructuring, often in international fora. The European Union and IMF,<sup>3</sup> for instance, collaborated on financial rescue packages (bailouts) for Greece, Ireland, Portugal, and others during the European debt crisis of the 2010s. In 1995, the US organized an IMF-, G7-, and Bank of International Settlements (BIS)-supported bailout for Mexico.

Restructurings exchange outstanding debt for new debts or cash, altering or replacing distressed existing debt to ease the borrower’s path to repayment. Typically, restructurings include a haircut, or markdown, on the value of the debt. In 2003, Uruguay negotiated a 13% haircut, while in 2005, Argentina reached a 73% haircut, though these are extremes. Investors accept these haircuts to increase their expected repayment: a sovereign without a haircut may remain in default (and thus make no payments) for years, while a sovereign that negotiates a haircut may resume payments sooner (as its financial condition ideally recovers).

**Average External Public Debt Stock as a Percent of GDP in LICs and MICs**



External debt as a share of GDP has risen in low- and middle-income countries around the world since 2010, enjoying the now-reversing benefits of loose global monetary policy and economic openness.

Critically, most sovereign defaults occur on external debt, or debt issued to and owned by foreign states, companies, and individuals, rather than internal or domestic debt, held by an issuing government’s own citizens.<sup>4</sup> This is partly why debt restructurings can take years: they must be litigated across multiple legal systems and within the international system. Zambia, for instance, took nearly four years to reach an international bondholder vote through the G20’s Common Framework.<sup>5</sup> The southern African country had originally defaulted in 2020 after Covid shocks—including a collapse in the value of copper, which comprises 75% of its export revenues—pushed years of unsustainable borrowing over the edge.

**Covid Relief and Loaves of Bread**

As early as May 2020, governments allocated \$9 trillion, or just over 10% of world GDP, to pandemic economic relief, about evenly split between (1): direct budget support and (2): indirect relief loans, equity injections, guarantees, etc., though the vast majority (\$8 trillion) of spending was by the wealthy G20 group of developed countries.

Remaining expenditures were spread across low- and middle-income countries (LMICs), many with more limited fiscal space or heavy pre-existing debt loads (Zambia, as mentioned). Crisis-plagued Lebanon, where a quarter of residents are Syrian refugees and the social safety net has been strained by years of political and economic strife and regional conflict, defaulted in March 2020 on a \$1.2 billion USD bond, with Prime Minister Hassan Diab asking “[h]ow can [Lebanon]

3. This grouping of the European Commission, European Central Bank, and IMF is called the Troika, and sustained some criticism for being removed from democracy, though defenders argue national parliaments accepted its plans.  
 4. Erce, Malluci, and Picarelli (2022) found that internal debt defaults have recently overtaken external debt defaults.  
 5. The Common Framework incorporates both the wealthy Western Paris Club lenders group, traditionally dominant in international lending, as well as China, an emerging bilateral lender. Given the state of relations between China and the West, particularly the United States, this process was slow and included recriminations on both sides.

pay the creditors while there are people in the streets without the money to buy a loaf of bread?”

In Ghana, years of economic growth saw government spending (and borrowing) rise and imports of Western and Chinese consumer goods, paid for in US dollars, increase similarly. With Ghanians exchanging (selling) Ghanaian cedi for USD, the cedi depreciated and inflation rose. Over-ambitious debt-funded plans to build 111 hospitals, expand infrastructure, and raise the standard of living after the pandemic collided with Russia’s invasion of Ukraine. Hyperinflation set in, with interest payments rising to consume between 70% to 100% of government revenue. Ghana defaulted on most of its external debts in December 2022.

Faced with the cessation of basic services or defaulting on foreign debts, governments have predominantly—and not unreasonably—chosen the latter, if often reluctantly. International assistance programs, such as IMF bailouts, are also often unpopular for the foreign-dictated austerity—or cutbacks in government services, welfare, and social safety nets—they entail.

**Pre-Existing Debt Loads**

Yet these programs have become increasingly necessary: for a myriad of reasons beyond the scope of this article, public debt loads have surged since about 2010, especially among LMICs or developing countries:

By 2023, developing countries owed about \$3 trillion in sovereign debt, double 2010 levels, with about 60% owed to private creditors, who typically demand higher rates,<sup>6</sup> shorter maturities, and less generous restructurings. Private creditors also receive the majority of LMICs’ debt service payments, or about 68%. Most of these loans were taken out during the 2010s “easy money” era of low interest rates and economic openness, but have become more onerous given the slew of 2020s economic difficulties.

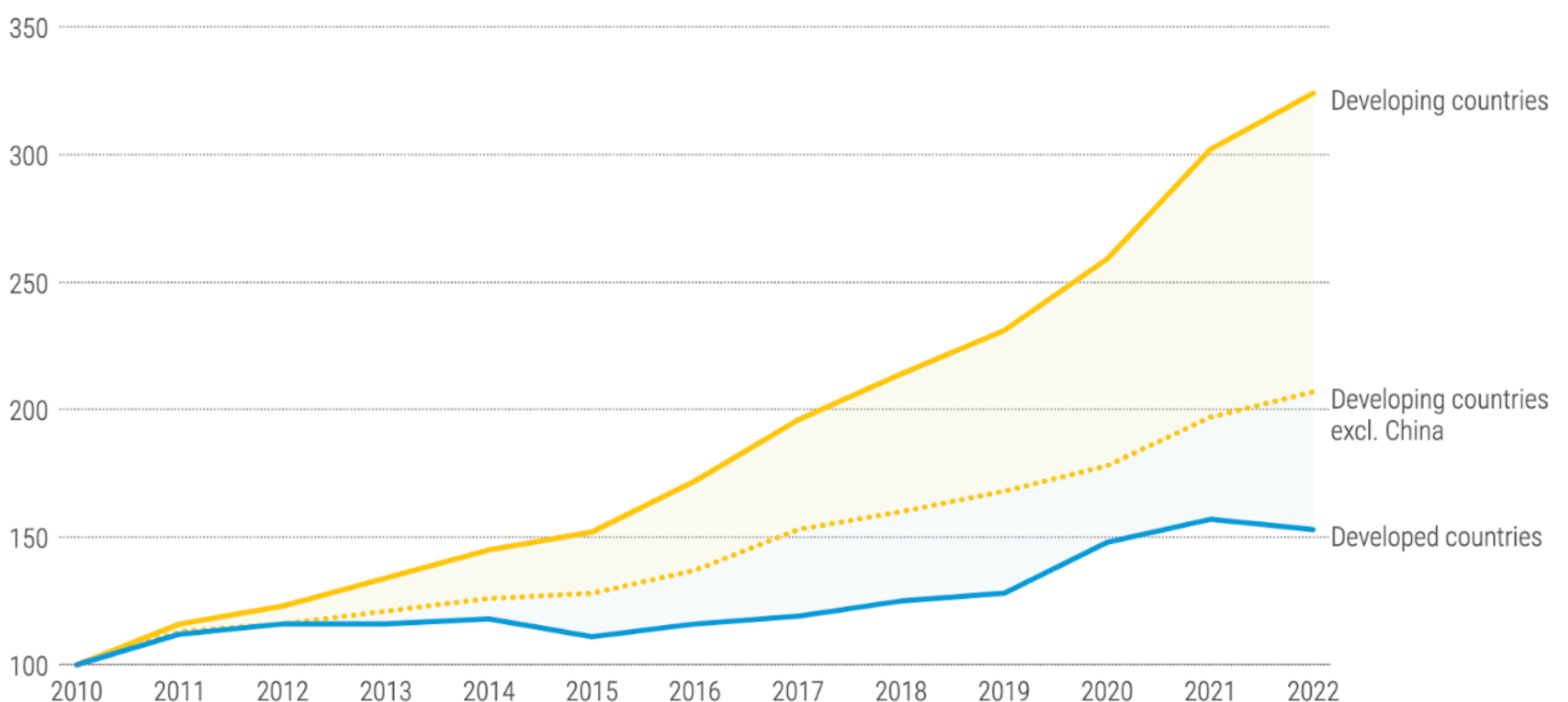
All this pre-existing debt means sovereign borrowers were already servicing interest payments when the pandemic hit, so any new spending was constrained by debt service or market reactions: “unfunded” (that is, debt-funded) tax cuts or spending, the Keynesian prescription for curing recessions, often incurs a market backlash if investors deem the measure unwise. Even developed countries are not immune: famously, British Prime Minister Liz Truss’ October 2022 mini-budget, which included £45 billion GBP of unfunded tax cuts, alarmed investors who feared it was fiscally irresponsible and inflationary. These investors sold off the pound sterling (devaluing the currency), sold off British government bonds (devaluing the bonds and thus raising yields or the government’s cost of debt), and sold off British stocks.

**Inflationary Environment**

Inflation, generally the rate of increase in the price of goods and services, has multiple causes. Perhaps the

**Public debt is growing faster in the developing world**

Index: Outstanding public debt in 2010 = 100



6. In addition to the profit motive, private creditors’ rates are often higher because international lenders like the IMF or World Bank offer “concessional financing,” or loans intentionally at below-market rates. Recently, some private lenders have also been offering concessional financing to socially- or environmentally-beneficial projects.

most “direct” Covid contribution is supply chain snarls (supply-side or cost-push inflation), and, arguably, increased demand for certain critical goods such as PPE (demand-side or demand-pull inflation). Early inflation was largely down to supply-side factors, such as supply chain restrictions and volatility and highs in commodity prices, chiefly energy (here, Russia’s war in Ukraine is an important contributor). The depreciation of an importer’s currency can also contribute to inflation, but is covered separately here.

Certainly, inflation reduces the real value of debt: inflation is broadly the decrease in purchasing power such that money now is worth more than money later (if the same loaf of bread is \$1 today and \$2 tomorrow, we can say the dollar’s value has halved). Thus, debt taken out today but paid back later is worth less, too: it is easier to pay off in the future, since if prices rise, government revenues—usually a proportion of income or prices—rise as well, all else equal. Nominal (non-inflation adjusted) GDP also rises while debt remains constant, so debt-to-GDP falls, lowering a key metric of debt distress.

The countervailing point is that high, sustained high, or volatile inflation is bad for consumers, businesses, investors, and the politicians they (usually) elect. For reasons given below, central banks and monetary authorities must stamp out inflation by raising interest rates, which naturally increases the interest payments paid on debt (the cost of debt). Thus, while inflation can devalue the real (inflation-adjusted) value of debt, it can also lead to higher interest rates that hike payments on that debt.

### Interest Rate Hikes

Once the economic fallout of pandemic restrictions became clear, central banks around the world lowered interest rates (in wealthy countries, this often meant bringing them to near-zero levels). This served to encourage more consumer and business spending, aiming to stimulate economic activity, since, under lower interest rates, saving (and thus not spending) money becomes less attractive while borrowing money (to spend on consumer goods or capital investment) becomes cheaper.

However, a stronger-than-expected economic recovery (and accompanying inflation) led to a reversal, with developed economies like the US and Eurozone hiking interest rates well above pre-Covid levels in an attempt to slow the overheating economy. These higher interest

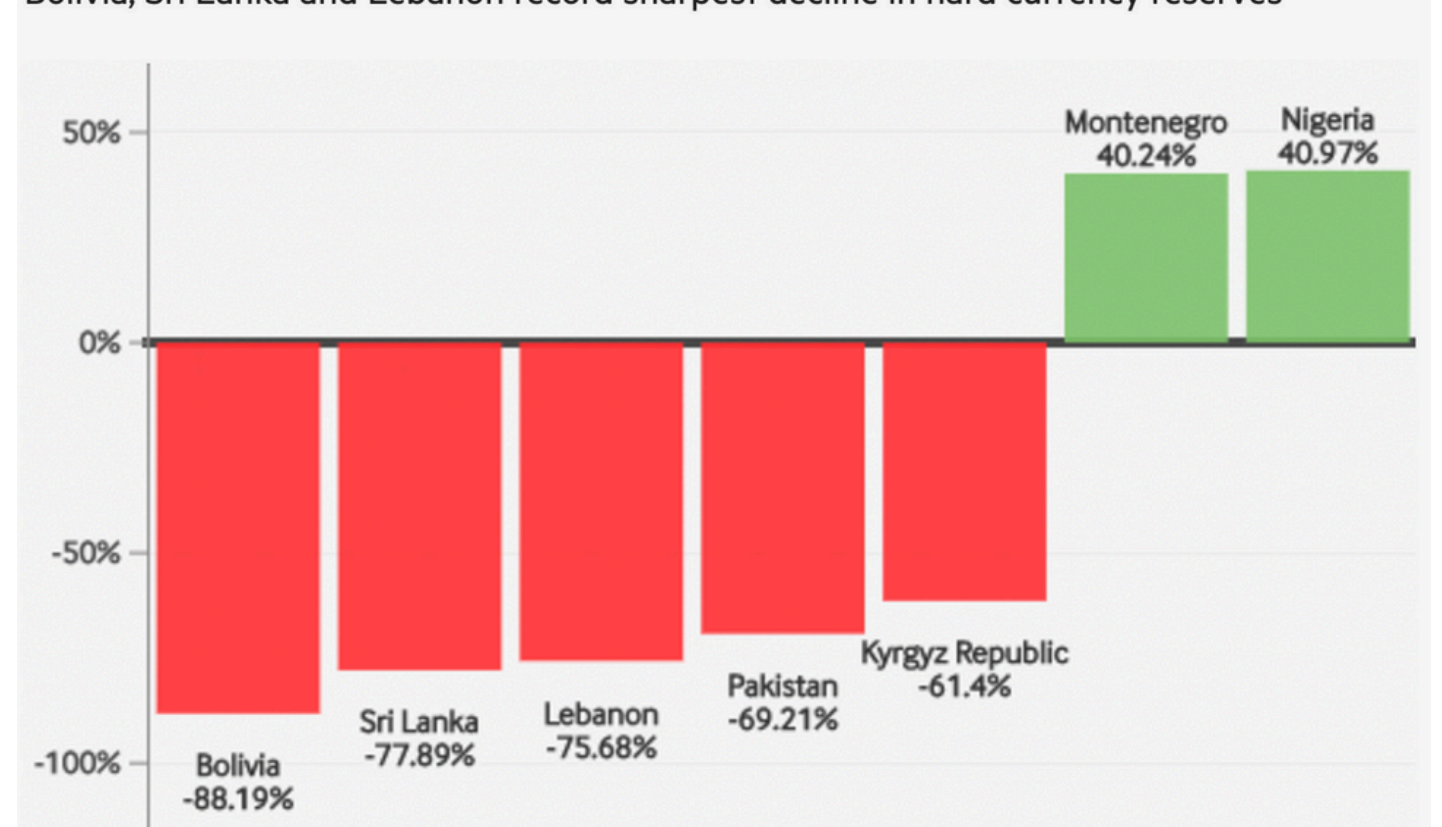
rates made developed economies, their assets, and their currencies more attractive to global investors, decreasing the appeal of riskier, emerging market and LMIC investments: a 7% return in the safe United States, for instance, may be more attractive than a 5% return in a riskier LMIC. Thus, a higher interest rate paid on US treasuries, considered a risk-free haven asset globally, can increase the interest rates investors demand from other countries, which are considered riskier than the wealthy United States.

### Foreign Exchange

Another challenge arises in currency. While internal debt is often denominated in the borrowing state’s local currency, external debt may be denominated in foreign currencies (these may be called Eurobonds, though they are not necessarily issued by European states or in euros). Especially among countries with unstable local currencies, Eurobonds are denominated in “hard” foreign currencies like the US dollar (USD), euro (EUR), or Japanese yen (JPY), which are generally considered safe by investors.

When US and other developed economies’ interest rates rose, authorities in emerging market economies faced two choices: defend their currency or allow it to depreciate against a hard currency. Defending their currency (that is, keeping its foreign exchange rate relative to the dollar, euro, yen, etc. stable) would have meant keeping rates high or hiking them higher, which would depress investment and consumption, threatening recession and increasing debt costs. The alternative method of defending a currency is for a central bank to buy (demand) it with other currencies by spending its (limited) foreign exchange reserves, or stores of foreign currency. Allowing the currency to depreciate (for instance, Nigeria allowing the naira to fall from 500 Naira equalling 1 USD to 700 Naira equalling 1 USD) would be the natural consequence of lower rates, but increase the relative costs of imports and foreign currency denominated debt.

Bolivia, Sri Lanka and Lebanon record sharpest decline in hard currency reserves



*Importers, who pay for many goods in foreign currencies, and countries whose domestic currencies are unstable often maintain higher foreign exchange reserves; higher interest rates in developed countries can draw down these reserves, as seen. Here, Montenegro's reserves rose on rebounding tourism and Nigeria's on the issuance of USD-denominated bonds, meaning it was loaned principal (by bond buyers) in USD.*

Most developing economies import much of their food and fuel, meaning a weaker currency ultimately hurts the general population (who spend a higher portion of their income on such necessities than the populations of wealthy countries)—the resulting popular discontent could also, beyond costing politicians their positions, contribute to broader social and political instability and thus capital flight, an exodus of capital or assets from a country investors fear is unstable (American rate hikes are particularly relevant here, as commodities like oil and food are often denominated in dollars). Disorder or protests can also trigger downgrades in a government's credit rating, restricting its ability to access international capital markets (investors, lenders, or “debt-buyers”).

A government whose bonds are downgraded from investment grade (low risk) to junk (high risk) status would likely see a quick sell-off (many institutional investors' rules prohibit them from holding non-investment grade securities), further pushing down the market value of their debt. Mathematically, a fall in bond prices means a rise in yields, or the relative cost of debt, further straining finances.

Finally, external debt must be paid in the currency in which it is denominated. While self-evident, this means a borrowing government must have enough foreign currency, which it typically acquires by export: exported goods are sold abroad, so foreigners buy the exporter's currency to pay. The reverse is true for imports, so a country with a trade surplus (one that exports more than it imports) should have a stronger currency and a country with a trade deficit (one that imports more than it exports) should have a weaker currency (in the real world, a myriad of other factors also influence relative currency valuations).

Thus, a country that exports too little or imports too much can run out of foreign exchange (forex) reserves (that is, its stock of foreign currency), meaning it is unable to pay its foreign-currency denominated debt. That country could use its local currency to buy the

foreign currency, but would likely do so at an increased rate. The effect is to increase the cost of debt: say 1 USD equals 20 Mexican pesos (MXN) and Mexico has a dollar-denominated \$50 USD Eurobond (worth 1,000 MXN). If the peso depreciates to 1 USD equalling 40 Mexican pesos, the price in pesos of that bond doubles to 2,000 MXN.

In Egypt, for instance, the Covid-19 pandemic slashed oil prices and collapsed tourism and shipping, cutting off the country's main forex sources (Egypt collects lucrative fees from the Suez Canal). Coupled with a longstanding reliance on fickle foreign investment to make up forex deficiencies, persistent ill-fated exchange rate interventions, and Russia's invasion of Ukraine (both countries collectively provide 85% of Egyptian wheat imports), the Egyptian pound lost two thirds of its value against the dollar and forex reserves fell to \$35 billion USD, enough to pay for just over 4 months of exports. This strained the government's ability to pay its foreign currency denominated external debts, which quadrupled from 2015, and necessitated a \$3 billion IMF loan in 2022, expanded to \$8 billion in 2024.

### **Political Effects**

When these risks are mismanaged—or neglected or exacerbated—a government can default, and its people suffer or revolt, peacefully or at the ballot box.

Sri Lanka, in the decade before the Covid-19 pandemic, recovered from a decades-long civil war through extensive public debt-financed infrastructure investments while government economic interventions favored domestic production of non-tradable goods (such as public services, real estate, and local commodities) that could not be exported and earn their exporters foreign currency.

Thus, as Sri Lanka was accumulating foreign debts denominated in foreign currencies, its government was undermining the exporting sectors that earned foreign currencies. In 2019, a fiscally devastating unfunded tax cut and budget deficit resolved by printing money led rating agencies to cut the country's credit score, virtually cutting it off from international capital markets.

It was in this context that the Covid-19 pandemic and recession hit: tourism, which employs or supports 14% of Sri Lanka's population and comprises about 3% of GDP, virtually collapsed. Foreign currency inflows from tourists fell from about \$4 billion USD in 2019 to just over \$500 million USD in 2021. Bucking potentially unpopular IMF intervention, the Sri

Lankan government embarked on a questionable forex and import restriction scheme, the most ill-fated component of which was a ban on agriculturally vital pesticide and fertilizer imports.

Farmer protests forced the government to rescind the ban by late 2021, after it had already caused a massive harvest failure. The country thus had to import nearly a majority of foodstuffs, further draining its limited foreign exchange reserves, which fell from \$7.6 billion USD in 2019 to a mere \$50 million USD in April 2022, enough to pay for less than a month of imports. Sri Lanka defaulted that month.

Severe shortages of food, fertilizer, gas, and fuel on the island nation<sup>7</sup> led to mass protests against the sitting government and politically influential Rajapaksa family, accused of persistent mismanagement. The cabinet and prime minister resigned, and, in July 2022, protesters stormed the presidential palace and President Gotabaya Rajapaksa fled to Singapore.



Sri Lanka is an extreme example, but demonstrative of the fact that the Covid-19 pandemic, while enormously disruptive, did not alone create the conditions for debt distress: rather, it was the final push to a beleaguered, mismanaged economy. Without years of debt-driven growth and an ill-conceived government response, Sri Lanka may well have weathered the pandemic's shock.

## Conclusion

Presently, 3.3 billion people live in countries that spend more on interest payments than on health or education. They may face a “lost decade” of underinvestment in workers, students, technologies, and institutions as debt service consumes otherwise-productive capital. 100 million people worldwide have been sent back to extreme poverty, and over a third of all countries in the world may default. The economic shock of the Covid-19 pandemic has been tremendous, and it has struck the poorest countries the hardest.

Yet the fault for their distress cannot be laid on the pandemic alone: the fallout of Russia's invasion of Ukraine, civil wars and regional conflicts, natural disasters, climate change, political deadlock, geopolitical rivalries, and outright errors in economic and fiscal statecraft going back years or decades have yoked the world's developing countries to a collective \$9 trillion in debt. The low-rate, debt-growing era of the 2010s deserves an examination of its own, as do the insufficiencies of the millennium debt jubilees, the emergence of China as a major bilateral creditor, and the possibilities of greater debt forgiveness now.

American and European readers may consider their countries to have largely tamed the inflationary aftermath of the Covid-19 pandemic, but as the world turns its eye to the impacts of the returned American president, it would do well to remember that over a third of its people and nations still face the threat of sovereign default.

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7. These were also exacerbated by Russia's invasion of Ukraine, which raised prices for food, fuel, and fertilizer.

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# OPEN SUBMISSION

Next edition, we will be introducing an open submission for writers interested in submitting their economics-related writing to the Penn Economics Almanac. Submissions could include op-eds, articles, interviews, letters to the editor, or other works in the range of ~1000-3000 words. Topics can range, so long as there is a significant tie-in to economics.

Not every piece submitted will be selected for publication, but we want to give a forum for those interested to share their voice. If your piece is selected for potential publication, we will reach out to you at the email you provide in order to move forward with the editing process. If you are interested, please fill out the submission survey available through the QR code below to submit your pieces:



**“It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a ‘dismal science.’ But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance.”**

**— Murray Rothbard**



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