AN ECONOMIC RESPONSE PACKAGE TO SPUR A TRULY GLOBAL RECOVERY

April 2021

COVID-19 is threatening to wipe out decades of economic progress and development gains. Strict lockdowns to control the spread of the virus coupled with dramatic declines in global trade, export earnings, and tourism have squeezed economies. The pandemic could end up costing the global economy more than $22 trillion by 2025 — roughly $10 billion a day — compared to pre-pandemic projected growth.[1]

The toll on lives and livelihoods is stark. COVID-19 could push up to 163 million people into extreme poverty around the world in 2021. This includes nearly 50 million people in sub-Saharan Africa, reversing the trends of the past two decades.[2] Equally concerning are the repercussions on human capital, which will be felt for years to come. Even before this crisis hit, a shocking 90% of 10-year-old children in low-income countries could not read and understand a simple text. This is the age when a child stops learning to read and starts reading to learn. Such learning poverty is bound to get worse: at the height of COVID-19, 1.6 billion children were pushed out of the classroom.[3]

The damage is particularly worrying in sub-Saharan Africa, which recorded its first recession in 25 years in 2020, with economic growth contracting by roughly 3%.[4] While growth for the region as a whole is forecast to rebound at a modest pace in 2021-2022, many countries — particularly those dependent on oil exports and tourism — will continue to struggle. With limited domestic resources and tools, the continent is experiencing a liquidity crisis. The World Bank and IMF estimate that Africa is facing external financing needs of about $1.2 trillion for 2020-2023; even with private capital inflows, the financing gap will be around $345 billion.[5]

One year into this global pandemic, a coordinated global response is yet to materialize. **ONE is calling for a robust economic response package for vulnerable countries, which includes:**

- ✔ A new allocation of $650 billion in Special Drawing Rights (SDRs), with a mechanism for wealthy countries to transfer a portion of their SDRs to the most vulnerable countries
- ✔ An extension of the G20's Debt Service Suspension Initiative (DSSI) at least to the end of 2021
- ✔ Comprehensive, fair, and transparent debt restructuring for countries with unsustainable debt burdens, which includes private debt

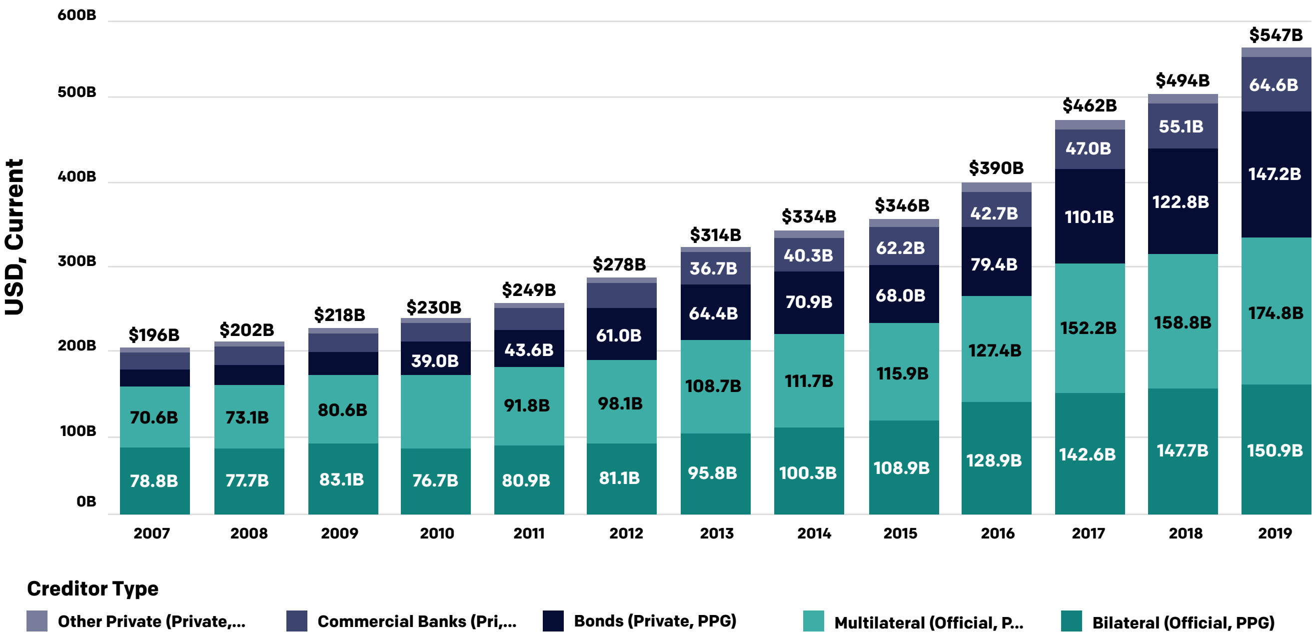
If these measures are adopted this year, Africa would gain a financing boost worth more than $42 billion.[6]

Trouble before the storm

Prior to the pandemic, many African countries were on unsteady footing as external flows declined and debt stocks rose. The COVID-19 crisis arrived at a time when foreign direct investment was already in decline, with the continent recording a 10% drop in inflows in 2019 to $45 billion.[7] In 2020, Africa saw a further decline of flows by 18%.[8] Official development assistance, another key source of external finance for Africa, also declined over the past two years.[9] Even remittances — a critical lifeline for millions — which had been growing steadily in sub-Saharan Africa in recent years, shrunk by 9% in 2020 and are predicted to fall by 6% in 2021.[10]

While external financing has been declining, debt stocks in Africa climbed to $547 billion in 2019 — double 2011 levels and driven mainly by increases in more expensive debt from private creditors, which in turn drove up servicing costs.[11] Over the same period, developing countries experienced a 125% increase in the amount of debt service paid, accounting for 12.4% of government revenue.[12] Social spending has suffered as a result, with 64 developing countries — half of which are in Africa — spending more on debt repayments than on healthcare.[13]

Figure 1: Africa's external debt stocks have been steadily rising over the past decade[14]

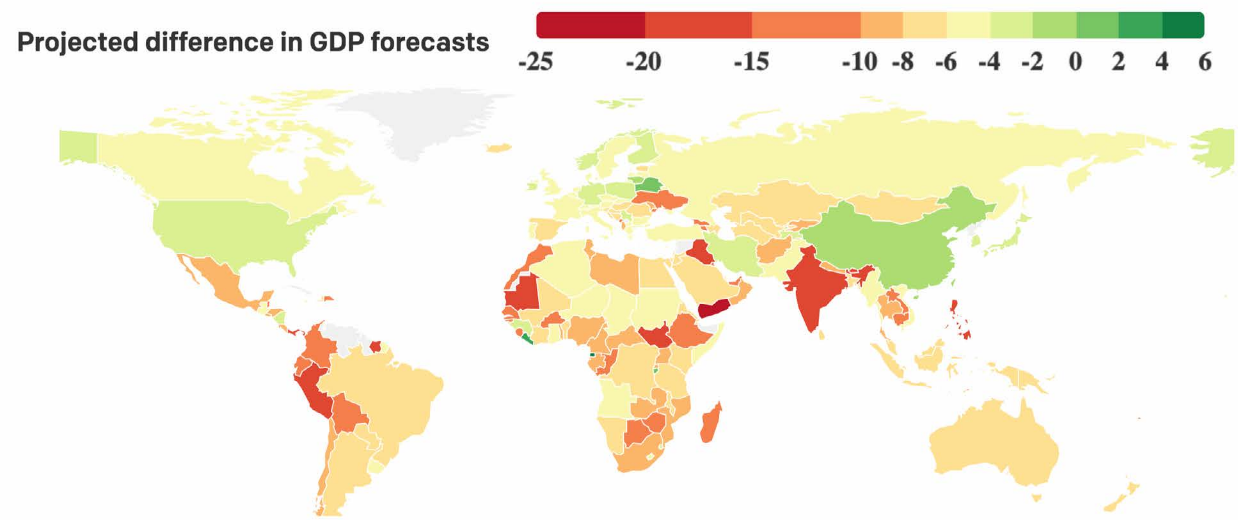


Source: World Bank, International Debt Statistics 2020

One pandemic, two standards

Response efforts and recovery prospects have been uneven across countries during the pandemic. Wealthy countries have ripped up the rulebook, defying previously held economic orthodoxy. While G20 countries have kept their economies afloat through stimulus packages worth nearly 20% of GDP, low-income countries don't have this firepower, spending less than 2% of GDP on recovery efforts.[15] These countries now face the prospect of a "long economic COVID" beset by uncertainty and massive financing needs.

Figure 2: Economic recovery will be slow and uneven for many countries[16]



Sources: Analysis by The ONE Campaign, GDP Projections: IMF - World Economic Outlook (WEO) Database • This chart uses data from the Fall 2019 and Fall 2020 WEO to assess how COVID-19 impacted GDP projections up to 2022.

Vaccine nationalism is threatening to further derail global recovery. The successful development of COVID-19 vaccines provides light at the end of the tunnel, which is shining bright for many wealthy countries, but is merely a flicker for the majority of low-income countries. Slower rollouts of vaccines in low-income countries will lead to a longer pandemic, with greater human suffering and more long-lasting economic damage.

For Africa, where countries aren't likely to reach widespread vaccination until 2023 at best, GDP losses are estimated to exceed -6% (compared to -2.5% in advanced economies).[17] Vaccine hoarding could cost the world up to $9.2 trillion in 2021 alone, with wealthy countries incurring up to almost half of this cost.[18] On the flip side, quick and concerted action to end the pandemic will benefit everyone and raise global income cumulatively by $9 trillion over 2020–2025, including around $4 trillion for advanced economies.[19]

An economic response package for vulnerable countries

Global leaders must gather the same ambition and urgency they have put into their national response to support a robust economic response package for vulnerable countries. Here are three crucial elements.

1. A new allocation of $650 billion in SDRs, coupled with a mechanism to transfer excess SDRs from wealthy countries, will go a long way to address liquidity needs and help spur recovery from COVID-19.

Special Drawing Rights are a type of international reserve asset issued by the IMF to all countries. SDRs are not cash in themselves, but can be exchanged for hard currency or used for payments to other central banks. A new SDR allocation would be a key countercyclical tool to provide financial support to developing and emerging economies.

The last general allocation of $250 billion in SDRs occurred in 2009 in response to the global financial crisis. While this represented just 3% of total global reserve assets at the time, the allocation increased reserves by over 19% for low-income countries and over 7% for emerging markets (excluding China and fuel exporters) and gave a boost to global markets.[20]

Countries are allocated SDRs in relation to their size in the global economy, so wealthy countries initially receive the bulk of the reserves. A new $650 billion SDR allocation would mean approximately $27 billion for DSSI-eligible countries.[21] While this is a small proportion of the total allocation, it would more than triple the SDR holdings of these countries (from approximately $10 billion now to $37 billion). African countries would receive $33 billion.

On March 23, the IMF Board signaled its support for a new $650 billion SDR allocation, a huge step forward. While there is still a formal process to go through in terms of the IMF presenting its proposals and having a formal vote, the path is now set for the allocation to become effective by the summer. This is step one.

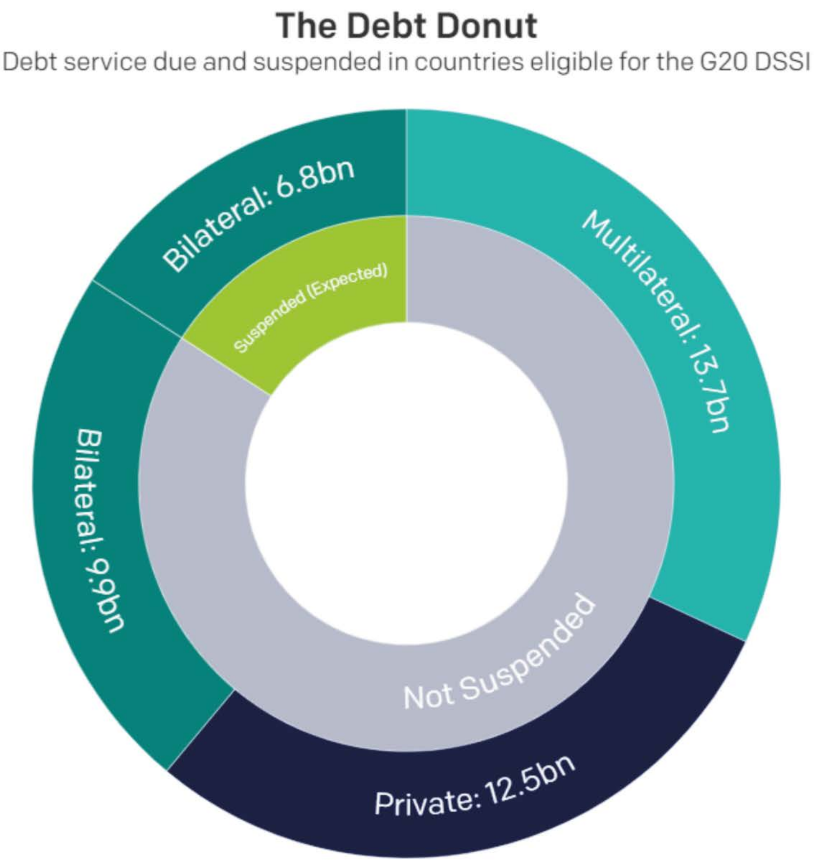
However, for a new allocation to have the biggest benefit to low-income countries, wealthy countries would need to agree to transfer some of their excess SDRs — that is step two. (G20 countries would receive approximately $443 billion in SDRs.) This could be done through a new trust fund created by the IMF to help developing countries respond to the pandemic and its aftershocks. This mechanism could provide these transferred SDRs to countries in need, in the form of highly concessional loans or grants. In return, receiving countries could commit to using the resources to address the direct and indirect consequences of the pandemic and to transparently record and publicly publish how the redistributed SDRs are spent.

2. An extension of the G20's Debt Service Suspension Initiative could save a total of $17 billion in bilateral debt repayments in 2021 alone.

In 2020, 45 countries signed up for the DSSI, resulting in $5.7 billion in debt payments deferred. Currently, the initiative has been extended until June 2021, which will pause $6.8 billion in debt service payments from participating countries. Extending the standstill until the end of 2021 could potentially save an additional $9.9 billion.[22] Eligible African countries' share of suspended debt payments would total $9 billion in 2021.

To date, one of the major limitations of the DSSI is that it has only covered bilateral debt — loans from G20 countries — which represents just one-third of external debt for DSSI-eligible countries. While multilateral and private creditors have been encouraged to participate in the initiative, they have so far been reluctant. If private creditors and multilateral creditors also suspended debt payments for 2021, up to $25 billion more could be saved for DSSI countries, freeing up crucial government resources for the pandemic response.

Figure 3: Extending the DSSI to all of 2021 would make a big difference.[23]



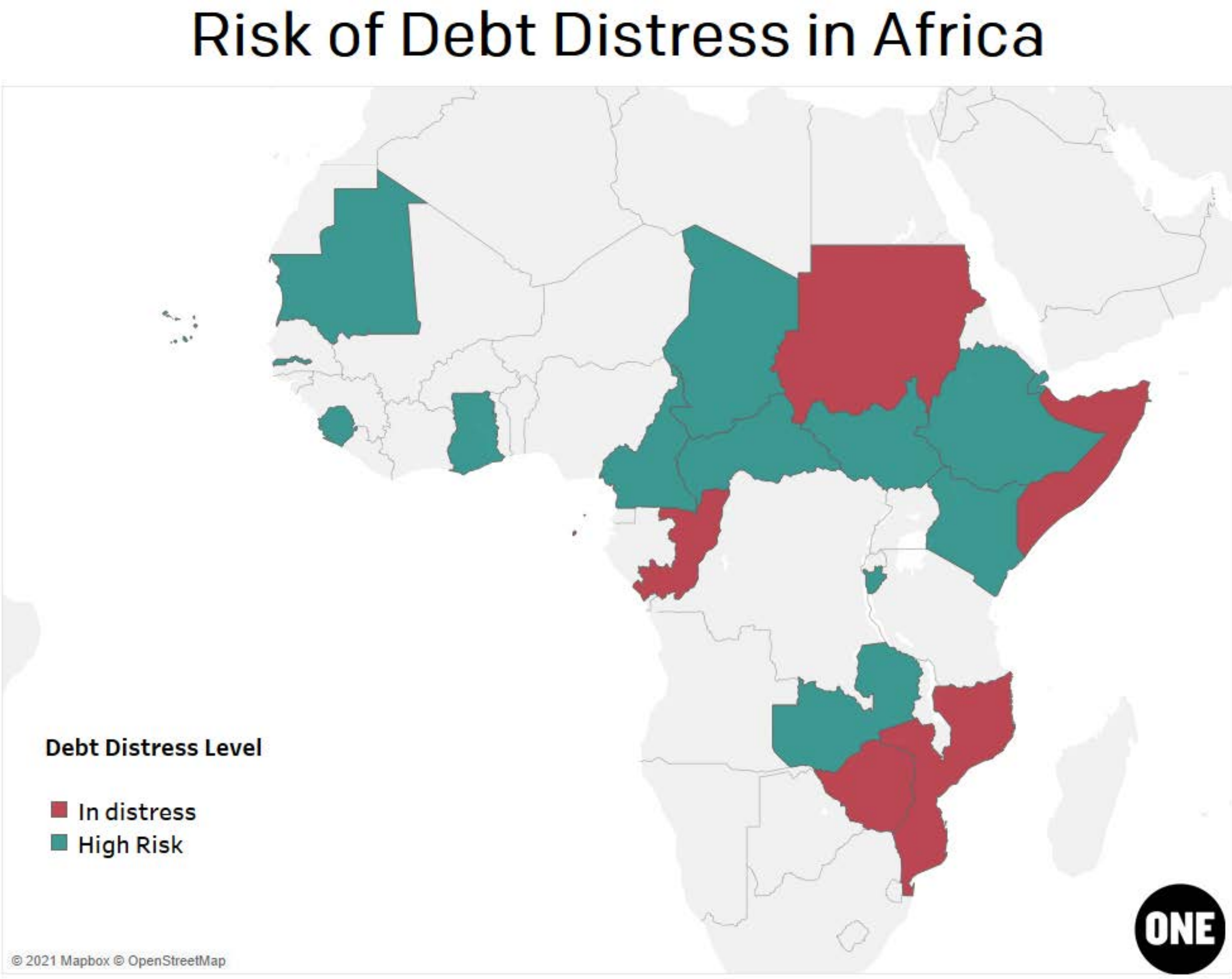
Moreover, many DSSI-eligible countries have not requested private debt relief due to the fear of credit rating downgrades, which could increase the cost of borrowing and limit future access to commercial markets.[24] This is not an unfounded fear. By October 2020, the ratings agency Fitch had downgraded seven African countries (out of 19 African countries with credit ratings) and put another seven on negative outlook.[25]

Multilateral creditors, such as the World Bank, also fear potential credit rating downgrades if they stop collecting debt service payments, as doing so would increase their borrowing costs and limit their ability to provide future concessional financing.[26]

3. **Comprehensive, fair, and transparent debt restructuring, which could include debt cancellation in some cases, is necessary to avoid a wave of defaults.**

Some countries need more than a standstill. Currently, over 30 DSSI-eligible countries — roughly two-thirds of which are in Africa — are either in debt distress or at high risk of it.[27] Debt distress can cause economic turmoil and make access to external finance harder and more expensive for extended periods of time. Debt restructuring involves agreeing new terms to loans to make them easier to pay, or in some cases even cancelling debt. Initiating this process before a country defaults has great advantages, reducing the economic fallout and cutting the time to reach an agreement from five years to just one.[28]

Figure 4: Nearly 20 African countries are in or at high risk of debt distress[29]



The G20's Common Framework for Debt Treatments beyond the DSSI is an important agreement for countries to coordinate, cooperate, and address unsustainable debt challenges. But, it does not go far enough. While multilateral and private sector creditors are encouraged to participate, there is no binding mechanism forcing them to restructure their part of the debt, meaning it will be much harder to reach a comprehensive agreement.

Ethiopia, Chad, and Zambia have already requested for their debt to be restructured through the

G20's Common Framework program. However, the prospect of credit rating downgrades remains a deterrent. The three major credit ratings agencies are punishing Ethiopia: Fitch and S&P have already downgraded the country, while Moody's has placed it on review for a downgrade after it announced its intent to take advantage of the program.[30]

Trust remains an issue. Absent full and equal participation of all creditors (particularly China and private creditors), there is a real concern that any relief received will be used to pay non-participating creditors. Successfully engaging all lenders in restructuring should be underpinned by a universal commitment to debt transparency from all creditors and debtors, requiring the sharing of the terms of agreements, which itself is an added hurdle. Drawn out debt negotiations and disorderly defaults could inflict more damage and further derail Africa's recovery.

URGENT ACTION IS NEEDED

During a pandemic, no one is safe until everyone is safe, and we can't move forward unless we all do it together. The IMF has warned that an incomplete global recovery will endanger the entire global financial system.[31] If all countries do not have access to vaccines or the liquidity needed to address COVID-19's impacts, this will affect even better performing countries through a prolonged global pandemic, disruptions to travel, supply chains, and global trade. A global economic response package will give vulnerable countries the fiscal space to respond to the pandemic, purchase vaccines and medical equipment, and get their economies back on track.

Endnotes

1 The latest IMF estimate is a cumulative economic output loss of $22 trillion over 2020-2025 relative to the pre-pandemic projected levels. https://blogs.imf.org/2021/01/26/a-race-between-vaccines-and-the-virus-as-recoveries-diverge/
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