IMF, World Bank Must Urgently Help to Finance Developing Countries

Anis Chowdhury
Western Sydney University
Australia

Jomo Kwame Sundaram
IDEAS
Malaysia

COVID-19 set back the uneven progress of recent decades, directly causing more than two million deaths. The slowdown, due to the pandemic and policy responses, pushed hundreds of millions more into poverty, hunger and worse, also deepening many inequalities.

Development Setbacks

The outlook for developing countries was grim, with output losses of 5.7 per cent in 2020. Compared to pre-pandemic trends, the expected 8.1 per cent loss by the end of 2021 would be much worse than in advanced countries, which dropped output by 4.7 per cent.

COVID-19 further set back progress towards the Sustainable Development Goals (SDGs). As progress was largely 'not on track' even before the pandemic, developing countries would need much support to mitigate the new setbacks, let alone get back on track.

The extremely poor, who are defined by the World Bank as those with an income under USD $1.90/day, increased by 119–124 million in 2020, and were expected to rise by another 143–163 million in 2021.

Fiscal Response Constrained

Global fiscal efforts of close to USD 14 trillion, plus low interest rates, liquidity injections and asset purchases by central banks, did help. Nonetheless, the world economy would lose over USD 22 trillion during 2020–2025, due to the pandemic.

Government responses were much influenced by access to finance. Developed countries accounted for four-fifths of total pandemic fiscal responses, costing USD 14 trillion. Rich countries deployed the equivalent of a fifth of national income for fiscal efforts.

Meanwhile, emerging-market economies spent only 5 per cent and low-income countries (LICs) a paltry 1.3 per cent by mid-2020. In 2020, increased spending, despite reduced revenue, raised the fiscal deficits of emerging-market as well as middle-income countries (MICs) to 10.3 per cent, and of LICs to 5.7 per cent.

Government revenue fell due to lower output, commodity prices and longstanding World Bank advice to cut taxes. Worse, these countries already faced heavy debt burdens and onerous borrowing costs. Meanwhile, private finance dropped by USD 700 billion in 2020.

Developing countries lost portfolio outflows of USD 103 billion in the first five months. Foreign direct investment (FDI) flows to emerging and developing countries also fell 30–45 per cent in 2020. Meanwhile, bilateral donors cut aid commitments by 36 per cent between 2019 and 2020.

The liquidity support, debt relief and finance available were woefully inadequate. These constrained LICs' fiscal efforts, with many even cutting spending, worsening medium-term recovery prospects!

Debt Burdens

In 2019, the International Monetary Fund (IMF) assessed that half the LICs were at high risk of, or already in, debt distress—more than double the 2013 share. Debt in LICs rose to 65 per cent of GDP in 2019, from 47 per cent in 2010.

Thus, LICs began the pandemic with more debt relative to government revenue, larger deficits and higher borrowing costs than high-income countries. And greater fiscal deficits of USD 2–3 trillion projected for 2021 implied more debt.

Debt composition became riskier with more commercial borrowing, particularly with foreign currency bond issues far outpacing other financing sources, especially official development assistance (ODA) and multilateral lending.

More than half of LIC government debt is non-concessional, worsening its implications. External debt maturity periods also decreased. Also, interest payments cost more than 12 per cent of government revenue in 2018, compared to under 7 per cent in 2010.

Riskier Financial Flows

Developing economies increasingly had to borrow on commercial terms in transnational financial markets as international public finance flows and access to concessional resources declined.

Low interest rates, due to unconventional monetary policies in developed countries, encouraged borrowing by developing countries, especially by upper MICs. But despite generally low interest rates internationally, external debt rates in LICs were rising.

Overall ODA flows—net of repayments of principal—from OECD countries fell in 2017 and 2018. Such flows have long fallen short of the financing needs of Agenda 2030 for the SDGs. Instead of giving 0.7 per cent of their national income as ODA to developing countries, as long promised, actual ODA disbursed by OECD countries has yet to reach even half this level.

Although total financial resource flows (ODA, FDI, remittances) to least-developed countries (LDCs) increased slightly, ODA remained well short of their needs, falling from 9.4 per cent of LDCs' GNI in 2003 to 4.3 per cent in 2018. Meanwhile, FDI to LDCs dropped from 4.1 per cent of their GNI in 2003 to 2.3 per cent in 2018.

There has also been a shift away from 'traditional' creditors, including multilateral financial institutions and rich-country Paris Club members. Some donor governments increasingly use aid to promote private business interests. 'Blended finance' is supposed to turn billions of aid dollars into trillions in development finance.

But the private finance actually mobilised has been modest, about USD 20 billion a year—well below the urgent spending needs of LICs and MICs and less than a quarter of ODA in 2017. Such changes have further reduced recipient-government policy discretion.

Inadequate Support

The 2020 IMF cancellation of USD 213.5 million in debt service payments due from twenty-five eligible LICs was welcome. But the G20 debt service suspension initiative (DSSI) was grossly inadequate, merely kicking the can down the road. It did not cancel any debt, with interest continuing to accrue during the all-too-brief suspension period.

The G20 initiative hardly addressed urgent needs, while private creditors refused to cooperate. Only meant for LICs, it did not address the problems that confronted MICs. Many MICs also faced huge debt, with upper MICs alone owing USD 2.0–2.3 trillion in 2020–2021.

World Bank President, David Malpass, expressed concerns that any change to normal debt servicing would negatively impact the Bank's standing in financial markets, where it issued bonds to finance loans to MICs.

The Bank Group made available USD 160 billion for the period April 2020 to June 2021, but moved too slowly with its Pandemic Emergency Financing Facility (PEF). By the time it paid out USD 196 million, the amount was deemed too small and contagion had spread.

Special Drawing Rights

Issuing USD 650 billion worth of new special drawing rights (SDRs) would augment the IMF's one trillion dollars lending capacity, which was already inadequate before the pandemic. But USD 650 billion in SDRs was only half the new SDR of the USD 1.37 trillion that *The Financial Times* considered necessary, given the scale of the problem.

To help, rich countries could have transferred unused SDRs to IMF special funds for LICs—such as the Poverty Reduction and Growth Trust (PRGT) and the Catastrophe Containment and Relief Trust (CCRT)—or for development finance.

Similar arrangements could have been made by the Bank. A World Bank version of the IMF's CCRT could ensure uninterrupted debt servicing while providing relief to countries in need. Investors in Bank bonds would appreciate the distinction.

Hence, issuing SDRs and making other institutional reforms at the Spring meetings in April 2020 could have enabled much more IMF and World Bank financial intermediation. This could have greatly helped to finance urgently needed pandemic relief, recovery and reforms in developing countries.

Originally published 29 March 2021

References

https://blogs.imf.org/2020/10/13/a-long-uneven-and-uncertain-ascent/

https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty-looking-back-2020-and-outlook-2021

https://www.imf.org/en/Publications/FM/Issues/2021/01/20/fiscal-monitor-update-january-2021

https://www.imf.org/en/Publications/WEO/Issues/2021/01/26/2021-world-economic-outlook-update

https://developmentfinance.un.org/sites/developmentfinance.un.org/files/FSDR_2021.pdf

https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020

https://www.imf.org/en/Publications/FM/Issues/2021/01/20/fiscal-monitor-update-january-2021

https://www.oecd-ilibrary.org/development/global-outlook-on-financing-for-sustainable-development-2021_e3c30a9a-en

http://www.oecd.org/coronavirus/policy-responses/oecd-investment-policy-responses-to-covid-19-4be0254d/

https://unctad.org/system/files/official-document/wir2020_en.pdf

https://devinit.org/resources/aid-data-2019-2020-analysis-trends-before-during-covid/#downloads

https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/02/05/The-Evolution-of-Public-Debt-Vulnerabilities-In-Lower-Income-Economies-49018

https://www.imf.org/external/pubs/ft/fandd/2020/06/pdf/COVID19-and-debt-in-developing-economies-kose.pdf

https://cdn.odi.org/media/documents/fiscalstimulus_covid_final.pdf

https://www.opendemocracy.net/en/oureconomy/combat-covid-19-developing-countries-need-be-granted-more-policy-space/

https://sdgpulse.unctad.org/debt-sustainability/

https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/02/05/The-Evolution-of-Public-Debt-Vulnerabilities-In-Lo

https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/02/05/The-Evolution-of-Public-Debt-Vulnerabilities-In-Lower-Income-Economies-49018

https://odi.org/en/insights/low-income-country-debt-three-key-trends/

https://www.oecd.org/dac/development-cooperation-report/Trends-and-insights-on-development-finance-2019.pdf

https://sustainabledevelopment.un.org/post2015/transformingourworld/publication

https://sdgpulse.unctad.org/financing-development/

https://sdgpulse.unctad.org/financing-development/

https://sdgpulse.unctad.org/financing-development/

https://odi.org/en/insights/low-income-country-debt-three-key-trends/

https://www.investopedia.com/terms/p/parisclub.asp

https://www.economist.com/finance-and-economics/2016/04/23/trending-blending

https://thedocs.worldbank.org/en/doc/622841485963735448-0270022017/original/

DC20150002EFinancingforDevelopment.pdf

https://www.economist.com/finance-and-economics/2020/08/13/blended-finance-is-struggling-to-take-off

https://www.oecd.org/dac/development-cooperation-report/Trends-and-insights-on-development-finance-2019.pdf

https://debtjustice.org.uk/press-release/reaction-to-215-million-of-debt-cancellation-by-imf

https://www.devex.com/news/g20-imf-deliver-on-debt-relief-but-more-is-needed-experts-say-97021

https://unctad.org/system/files/official-document/gdsinf2020d3_en.pdf

https://www.worldbank.org/en/news/speech/2020/05/28/world-bank-group-president-david-malpass-remarks-at-high-level-event-on-financing-for-development-in-the-era-of-covid-19-and-beyond

https://www.worldbank.org/en/news/factsheet/2020/05/11/debt-relief-and-covid-19-coronavirus

https://www.devex.com/news/opinion-now-is-not-the-time-for-the-world-bank-to-step-back-on-pandemic-financing-97837

https://www.worldbank.org/en/topic/pandemics/brief/fact-sheet-pandemic-emergency-financing-facility

https://www.ft.com/content/2691bfa2-799e-11ea-af44-daa3def9ae03

https://www.imf.org/en/About/Factsheets/IMF-Support-for-Low-Income-Countries

https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/49/Catastrophe-Containment-and-Relief-Trust

https://www.theglobalist.com/coronavirus-covid19-pandemic-debt-relief-imf-world-bank-sdrs-ccrt/