PUBLIC SERVICES INTERNATIONAL

The global union federation of workers in public services

CITIZENS FOR FINANCIAL JUSTICE

UNITED NATIONS UNCTAD

ENGLISH

BRIEF 1

1

Rentier capitalism and debt

PSI BRIEFING SERIES - DEBT AND WORKERS

INTRODUCTION

By Rosa Pavanelli,
General Secretary,
Public Services
International

Each year since 1970 an average of 8 countries have faced a sovereign debt crisis, with each one effecting neighbouring countries and trading partners. Sovereign debt issues will likely affect the vast majority of workers in the world at some point in their life.

When these crises hit public debt is often presented by journalists, politicians and business as the result of wasteful government spending, overpaid workers and welfare recipients like pensioners bleeding the country dry.

Yet more often than not, public debt is caused by governments bailing out reckless private speculation, politicians allowing the rich to dodge taxes, corruption and the gifting of unsustainable benefits to wealthy businesses.

In reality it is usually workers, pensioners and users of public services who bear the brunt of debt restructuring through austerity, labour market deregulation and privatisation, even when it is not them who created the problem.

In this series, PSI presents five related aspects of sovereign and public debt – and explains why workers must better understand this economic phenomenon that appears to be removed from day-to-day life, but has direct impact on economic and social conditions of workers.

Most importantly workers and their unions need to understand when they are being lied to or mislead so they can engage in real social dialogue and defend our interests.

To help do this our series on sovereign and public debt examines what happens when public spending leads to indebtedness, why indebtedness of the state is perceived to be a problem, what debt means for the sovereignty of the state and how this all impacts workers. The five parts to the series are:

1. Rentier capitalism and debt: why workers should be concerned
2. The Business of Debt: What workers and unions should look out for
3. Sovereign debt and default: Why it matters for workers
4. Debt distress and crisis: what happens when it hits?
5. Fixing a rigged system: fairer global debt rules

Proper public spending supports economic growth through investment in infrastructure, supporting an educated and healthy workforce, redistributing income to increase the spending power of poorer consumers, creating insurance against risks, providing direct support for industry (including through technological innovation), and increasing efficiency by taking on these functions.

Public spending also supports job creation, in both high income and developing countries: through direct employment of public service workers; indirect employment of workers,by contractors supplying outsourced goods and services; employment of workers on infrastructure projects; and extra demand and jobs from the spending of the wages of these workers and also of recipients of social security benefits. (For more information, see *Why We Need Public Spending*)

Ultimately, the enablers of crippling foreign debt lie in a global economic system deliberately created to allow powerful sections of our society to extract enormous wealth from our communities without taking responsibility for the risks they create.

Under such a rigged system it falls to workers to be vigilant and demand governments act responsibly to avoid such crisis. Where that does not occur, workers must ensure they are not punished for the reckless activity of others. When crisis hit, events move very quickly and if workers and their unions want to avoid being side-lined, they need to be informed about these issues in advance.

In the long term we must develop a better global system of sovereign debt work out like those endorsed by the UN but whose implementation has been blocked by a minority of rich creditor nations.

For all these reasons PSI is proud to be partnering with UNCTAD to produce this Series for unions and workers on sovereign debt.

Rosa Pavanelli
General Secretary
Public Services International

GLOSSARY

DOMESTIC DEBT - Domestic debt (also known as internal debt) is the part of the total government debt that is owed to lenders within the country.

SOVEREIGN DEBT – Refers to central government debt, typically issued as bonds denominated in a reserve currency, like the US dollar. It often refers to how much the country owes to outside creditors (non-domestic).

OFFICIAL CREDITORS - Official creditors are international organisations, governments and government agencies including official monetary institutions.

PRIVATE CREDITORS – Creditors that are not governments or public sector agencies, including private bondholders, private banks, other private financial institutions.

HOLDOUT CREDITORS - In a financial restructuring, when a country is in default or nears default, a restructuring offer may be made to creditors (government-bond holders), which typically involves a discounted pay-out. Holdout creditors refuse the restructuring terms, instead holding out for full - or at least improved - repayment of the original debt.

RENTIER - a person who lives on "rents" from property or securities, rather than productive profits.

RENTIER CAPITALISM - A system where large corporations gain significant amounts of profit as a consequence of the ownership and control of assets, rather than from innovative, entrepreneurial use of economic resources.

VULTURE FUNDS - Funds which purchase assets (bonds) which are in distress or default – such as sovereign bonds - at significantly discounted rates, and then go on to holdout for full face-value repayment, resulting in significant gains for the fund.

Rentier capitalism and debt

WHY WORKERS SHOULD BE CONCERNED

Multinational corporations are capturing an increasing share of the benefits of global economic growth in the 21st century, because of their undue influence and power resulting from market manipulation, tax avoidance and inequality.

Their ascendancy is creating a new form of rentier capitalism. This is a system where large corporations gain significant amounts of profit as a consequence of the ownership and control of assets, rather than from innovative, entrepreneurial use of economic resources.[1]

As a result, those who own financial, physical and intellectual property - the rentiers - get profits far beyond what they deserve. Rentiers are capturing the lion's share of wealth created, leaving workers with a declining participation in global prosperity.

WHAT IS A RENTIER?

A rentier is a term that is used to describe a person who can live off income from property or other assets, rather than current employment. For example, a landlord who owns a street of houses can live off the "rent" income.

When it is expanded to describe the capitalist system - as in rentier capitalism, it means corporations are similarly earning revenue from products or services that have been transformed into assets through copyright protection or through past investment. But in the case of corporations there is an underlying element of monopolisation and scale which may further capture revenue. For example, pharmaceutical companies claim intellectual property rights on drugs for decades after they are licenced, meaning they are sold at many times the production cost.

Payment systems and booking systems run by financial institutions and tech companies, and which have become essential to modern transacting, earn revenue for each transaction that far exceeds processing costs. Similarly, property companies have huge property portfolios, sometimes dominating significant parts of a geographical area and are able to impose high and growing rentals.

HOW DOES THIS AFFECT WORKERS?

As the benefits of the rentier economy flow towards the top multinational corporations, workers lose out. The relentless increase of corporate profits has been accompanied by a decline in the share of income going to workers. While workers' wages in advanced economies represented around 55% of total income in 1970, that participation has fallen to less than 40% in 2015.[2] The rise of multinational corporations has played a key role in this dynamic. UNCTAD estimates that nearly two thirds of the decline in the global labour income share between 1995 and 2015 resulted from the increase in the profits of the largest and most influential corporations.[3]

The degree of concentration and market power achieved by these firms has negatively impacted on the employment conditions of workers around the world. The international nature of their operations allows them to constantly use the threat of job reallocation, to move to countries with lower wages and regulations, to suppress wage claims by workers. In addition, multinational corporations tend to employ fewer people per dollar of revenue than smaller companies. As their share of economic activity increases, employment opportunities for workers decline. Coupled with low rates of economic growth, declining wages and employment opportunities leave workers receiving a declining share of a barely expanding pie.[4]

The forces of globalization have spectacularly failed to realize the promises some believed they held for women's rights: Where new transnational corporations have set up and created jobs for women - mostly in export processing industries and value chains – the majority of the jobs have been extremely precarious and among the worst paid and most exploitative. Globalization has instead maximized rentier profits from women.[5]

State deregulation and "enablement" of corporate activity by governments has facilitated the rise of rentier capitalism. The point is not whether states intervene or regulate, but how they regulate, as well as the extent to which their regulatory activities are captured by particular interests.[6] The state now needs to play a different role and regulate and intervene in the interests of ordinary citizens.

WORKERS SHARE IS SHRINKING

1975 - 55%

OF INCOME WENT TO WORKERS

2015 - 40%

OF INCOME WENT TO WORKERS

THE CONCENTRATION OF MULTINATIONAL CORPORATIONS

Multinational corporations have long been a staple of capitalism. In the not so distant past, a combination of strong government regulations and powerful labour unions kept their power in check.

However, decades of market deregulation across the world have shifted the scales in favour of multinational corporations.

DECADES OF MARKET DEREGULATION ACROSS THE WORLD HAVE SHIFTED THE SCALES IN FAVOUR OF MULTINATIONAL CORPORATIONS

The ensuing concentration of corporate power represents a political and economic threat to the global economy and its institutions. The share of profits from the innovative and entrepreneurial deployment of economic resources is declining. Instead, multinational corporations abuse their vast influence to rig the rules of the game in their favour and reap the benefits. In effect, globalization is an uneven playing field: only nine countries have governments that generate as much tax revenue as Walmart, the largest corporation by revenue in the world in 2015.[7] Multinational corporations deploy this power to protect their dominant positions, lower taxes and undermine labour bargaining power. This results in a weak global economy that struggles to achieve balanced and inclusive growth for the many.

The degree of concentration at the top of the global corporate order is breath-taking. Over the last decades, it has intensified in terms of revenues, profits and market capitalization (the total value of a company's outstanding shares).

FACT FILE:

THE WORLD'S BIGGEST CORPORATIONS ARE CASHING IN

- The revenues of the top 2,000 multinational corporations have almost tripled since 1995, from USD 12.8 trillion into USD 36.8 trillion in 2015.[8]
- The combined revenue of this group of corporations has been larger than global trade for each of the last 20 years.
- Within these top multinationals, firms from advanced economies account for 66% of total revenues.[9]
- The top 10% of firms now account for 80% of global corporate profits.[10]

These trends set the scene for a winner-takes-most environment, where multinational corporations rely on their ability to capture rents created elsewhere in the economy to cement their position at the top of the global economic order while squeezing workers, competitors and governments.

LOBBYING AND MULTINATIONAL CORPORATIONS

Multinational corporations rely on lobbying to capture rents and pull ahead of their competitors. Lobbying activities grant these firms privileged access to policy makers and allow them to secure favourable regulatory and tax treatment while undermining transparency and democratic accountability. Reductions in tax rates or introduction of loopholes in the tax code are a source of massive profits. In response, corporations are shifting their efforts from investment and innovation to lobbying and rent seeking.

LOBBYING FOR CORPORATE TAX CUTS (US EXAMPLE)

- In the US, each dollar firms spend on lobbying for tax breaks reaps returns in excess of 220 dollars.[11]
- For every dollar spent on lobbying by labour unions and public interest groups, large corporations spend 34 dollars.[12]
- This spending is part of a vicious circle, where "money is used to get political power and political power is used to make money."[13]
- Since 2000, political activity and lobbying have been the second most important factor in increasing corporate profitability.[14]

Regulatory capture through lobbying by multinational corporations is a pervasive element of international economic treaties, such as trade or investment agreements. Multinational corporations have played a central role in shaping these agreements in a way that has allowed them to capture a growing share of global profits. The growing number of trade agreements between advanced and developing economies has increased the power of corporations against governments and labour.

These agreements allow corporations to re-organize global production chains to maximize profits, while skirting taxes and regulations. A good example are the provisions on Intellectual Property Rights (IPR) included in trade agreements. In the case of pharmaceutical companies, such as Novartis or Pfizer, IPR provisions allow them to protect patents on medication for extended periods of time and far beyond what is economically reasonable. Pharmaceutical companies are able to capture monopoly rents and deter the entrance of new competitors. In many instances, corporations use IPR provisions to block attempts by developing countries to produce affordable medication of strategic importance to public health.

As a result of these practices, multinational corporations have emerged as the undisputed winners of globalization: the top 1% of exporting firms account for over 50% of country export revenues in many developed countries.[15]

TAXING MULTINATIONALS

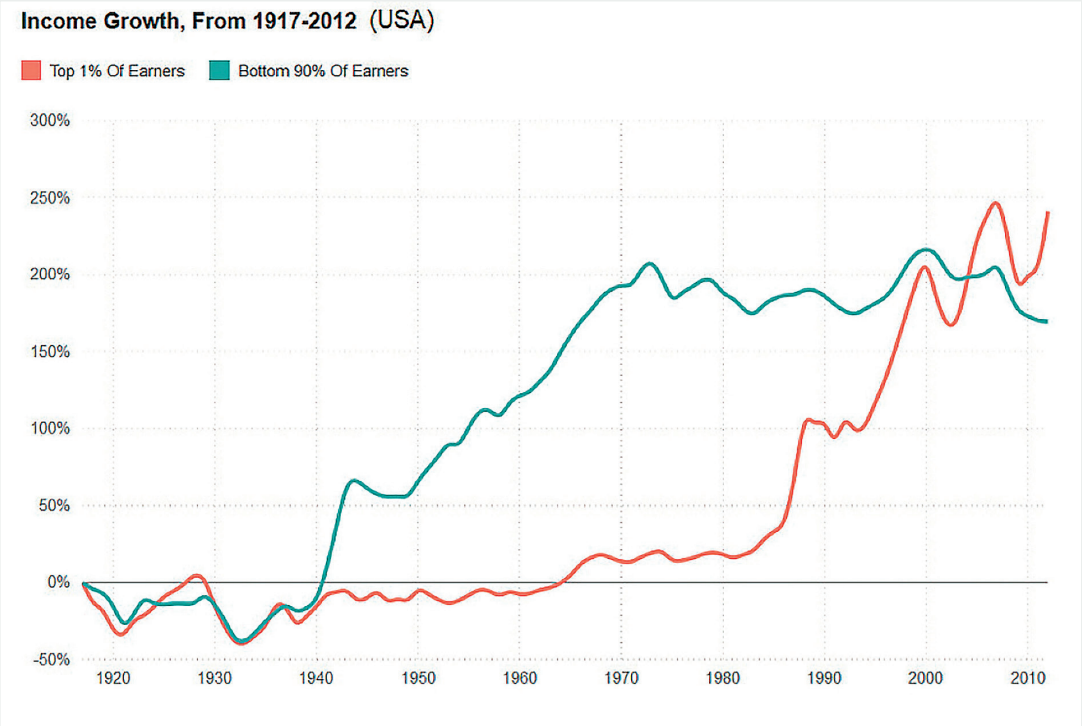
The influence of multinational corporations extends to government budgets. While government expenditures on basic social programmes for unemployment, pensions and health have been systematically reduced in most advanced economies and in some developing countries, the global average corporate tax rate has fallen by more than half, from 49% to 24%.[16]

Even with this massive tax windfall, multinational corporations use aggressive tax planning schemes to further reduce their tax obligations across the world. These tax schemes take advantage of provisions included in trade and investment treaties. Corporations use them to ensure that their subsidiaries in different countries are treated as independent companies. This allows corporations to set up internal trading and pricing schemes designed to shift profits from subsidiaries to low tax jurisdictions.

ROTTEN APPLES

- Companies like Apple have used this system to reduce tax liabilities on a massive scale.
- Over the last decade Apples European tax scheme allowed it to shift over USD 120 billion from world revenues into Ireland.[17]
- Secret agreements with the Irish government allowed Apple to pay an effective tax rate of less than 1%.
- This meant an estimated loss of tax revenue for EU Countries of over USD 14.5 billion.[18]
- If this tax were collected, it would be enough to pay the annual salaries of over 300,000 nurses in Ireland

At a global scale, the impact of profit shifting and tax avoidance on public revenues is even larger. Multinational corporations shifted at least USD $600 billion in corporate profits to tax havens in 2015. As a result, governments around the world lost around 10% of their tax revenues.[19]



Source: World Bank Top Incomes Database

ENRICHMENT OF A FEW

Corporations actively lobby for the privatization of public assets. Under the pretence of private sector efficiency, a drive for large scale privatizations has taken place over the last three decades across the globe. Many of these privatizations turned into highly effective vehicles to boost corporate monopoly rents. In some cases, privatizations involved the transfer of liabilities and undervaluation of assets to attract private investors. In other cases, lack of regulations allowed recently privatized firms to retain and grow monopoly power.

Suppression of competition and high fees translate into exorbitant rents for their owners at the expense of the provision of public services for the population. An analysis of the evolution of wealth of billionaires shows that privatizations and political connections are the most important factor in accounting for billionaire wealth in emerging markets between 2001 and 2014. It is estimated that these two factors account for 30% of the growth in the wealth of billionaires in emerging markets.[20]

The spoils from these schemes are distributed between CEOs and shareholders.

Multinational corporations use an increasing amount of resources to boost the returns of shareholders at the expense of productive investment. Companies deliver massive profits to shareholders through dividend payments and stock buybacks (where a corporation buys its own stock to artificially increase its price). Over the last decade and a half, dividends absorbed 37% of corporate profits in the US. On top of this, companies in the US spent an additional USD 2.4 trillion to finance stock buybacks. equivalent to 54% of corporate profits. This diverts income which could otherwise be used to reinvest in hiring new workers, building new infrastructure or developing better products.

The scale of purchases has given a manipulative boost to stock prices to the benefit of shareholders. Taken together, dividends and stock buybacks represented 91% of corporate profits in the US between 2004 and 2014.[22]

RENTIER CAPITALISM AND DEBT

But what does debt have to do with rentier capitalism? Ideally, bankers and financiers would use their powers to pump productive credit into the economy: to help ensure full employment, efficient use of resources and socially desired growth. Keynes described credit as “the pavement along which production travels; and the bankers, if they knew their duty, would provide the transport facilities to just the extent that is required in order that the productive powers of the community can be employed to full capacity.”[23]

But if they are more interested in making a quick buck, they use credit and debt instruments as just another financial asset to play with.

Debt - of countries, businesses and households - has increasingly become a tradable asset in international markets. Private and institutional investors increase their rentier incomes by speculating on the future value of these assets and by exploiting the lack of international regulation for sovereign debt restructurings to hold entire countries to ransom for full repayment of the nominal value of debt, bought at large discounts.

These actors are often described as Vulture Funds: private creditors who litigate against governments for full repayment of nominal debt bought cheaply. This often comes after governments have had to socialize private debt, incurred by local businesses and households.

In 1965 the average US worker worked for twenty years to earn what the average CEO made in one year. By 2019, the average worker would have to work for 339 years to earn what the average CEO makes in a year.[21]

Increasingly, the role of credit is no longer funnelled towards productive investment and public services which create jobs, incomes and help the debt pay for itself.

Instead, it fuels financial speculation and becomes indispensable to households deprived of sufficient income from jobs. This leads to ballooning private debt- often accompanied by growing public debt. This can create crises where governments have little choice but to bail out large private corporations, including banks and other financial and non-financial institutions, to avoid systemic bankruptcies and a full-blown economic crisis.

As will be expanded on in more detail in subsequent briefs of this series, this destructive and wasteful use of credit/debit to boost short-term rentier income is depriving ordinary people of jobs and salaries and driving them deeper into household debt.

Debt isn't just another trick in the toolbox of get-rich-quick bankers: it is the heart of the entire rentier economy.

UNIONS TAKE ACTION - ARGENTINA

When the Macri-led Argentinian government set out to undermine labour rights at the behest of the IMF, a united trade union response managed to avoid the worst.

Argentina's past experience with IMF conditions showed they exacerbated poverty, hurt the most vulnerable and undermined quality and quantity of work, wages, pensions and rights. They led to a fall in public investment and a significant increase on public services costs. They also led to capital flight, currency devaluation undermining real wages, inflation, a fall in imports, unemployment and business closures.

PSI affiliates in Argentina, almost all of which are members of the General Confederation of Labour (CGT), actively participated in the opposition to IMF reforms. They organised media campaigns, held meetings with IMF delegates, organised two general strikes and many other mobilisations. The Union movement also organised in coordination with some other important economic sectors including small and medium sized businesses who would also suffer from the IMF conditions.

Because of strong union action, the worst labour reforms were stopped in the National Congress. In some cases, the movement won salary increases and a one-off bonus to cushion the effects of inflation. Layoffs in the public sector were halted through collective bargaining mechanisms. The prices of some basic food products and public services were also frozen.

In the middle of the debt crisis, there were primary elections - political mobilisation by unions led to a bad result for the neoliberal governing parties. The case of Argentina shows that the worst outcomes of debt crisis can be opposed with strong organising by unions.

WHAT ROLE DO UNIONS HAVE?

1. Labour unions must fully exert their role as a countervailing power to global multinational corporations. This requires developing an effective voice and active participation in key policy discussions at the national and international level, so that economic democracy is strengthened.

2. Unions must demand that the private banking sector, including its shadowy elements, are made transparent and subjected to democratic public control. The power to create credit must be made to serve public interests, and used to expand and improve public services, rather than fuel a casino economy.

3. Unions must stand against corporate lobbying on labour, social, financial and environmental rules, which has helped create massive deregulation and fuel instability.

4. Unions must work together with governments to both defend and update the multilateral regulatory framework established in the post-war period. This requires a revision of the status-quo on trade and investment treatments.

5. Unions must fight for measures that tackle large-scale rent-seeking activities by global multinational corporations, such as profit-shifting, collusion and abusive business practices including exploitative and precarious jobs for women and the vulnerable. Addressing these challenges will be central towards establishing a more inclusive global economy in future.[24]

6. Unions must demand that governments cooperate to make the financial reporting of Multinational Corporations (MNCs) transparent and ensure they pay their fair share of tax. Workers lose out when MNCs shift profits to tax havens because these profits are hidden from the workers and are not available to pay wage rises or fund public services, often fuelling further privatization.

7. Unions must demand governments support initiatives to rewrite the rigged global debt workout rules which force unnecessary austerity on millions of workers each year in order to preserve the profits of global finance.

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PUBLIC SERVICES
INTERNATIONAL
The global union federation of workers in public services

45 AVENUE VOLTAIRE, BP 9
01211 FERNEY-VOLTAIRE CEDEX
FRANCE

TEL: +33 4 50 40 64 64
E-MAIL: PSI@WORLD-PSI.ORG
WWW.PUBLICSERVICES.INTERNATIONAL

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CITIZENS FOR FINANCIAL JUSTICE

UNITED NATIONS UNCTAD

ENGLISH

BRIEF 2

2

The Business of Debt:

WHAT WORKERS AND UNIONS SHOULD LOOK OUT FOR

PSI BRIEFING SERIES - DEBT AND WORKERS

The Business of Debt

WHAT WORKERS AND UNIONS SHOULD LOOK OUT FOR

DEBT & CRISIS

- Since 1970, 390 financial crises have taken place around the world: equivalent to 8 crises per year[1]
- Global debt levels have increased from USD 80 trillion in 1999 to USD 170 trillion in 2008.
- When the 2008 Global Financial Crisis hit, global debt was almost three times global GDP[2]
- More than 40 million people lost their jobs as a result of the GFC[3]

Debt build ups and crises are an endemic feature of modern globalized capitalism. Their frequency and impact have increased in recent years.

The economic and social consequences of these crises continue today. With rising unemployment comes rising inequality. In Europe there is less work, reduced overall working time, less overtime, rising job insecurity, less choice for workers, wage freezes and wage cuts.[4]

When crises happen, workers pay the price. For this reason, workers need to identify the causes and warning signs of a debt build-up and crisis - and fight against them.

While individual country debt build-ups have their own characteristics, they tend to share a common set of elements. Crises are often preceded by periods of financial deregulation. They involve increases in international capital flows, and increasing debt levels over a short period of time.

FINANCIAL DEREGULATION:

A PRECURSOR TO DEBT BUILD-UPS

Financial institutions have been re-shaping government and international regulations in their favour since the 1970's, after decades of financial stability following WWII. Things started to change after the collapse of the so-called Bretton Woods system in 1973. This system of global economic governance was a concerted effort by leading economies to ensure peace and productive growth by promoting international trade, foreign direct investment and helping countries to bridge liquidity problems, while reining in short-term, speculative international capital flows. The role of governments in the economy shifted from a focus on structural controls and stability to market-friendly approaches to self-regulation and allowing banks to expand their involvement in a range of risky financial activities.[5]

There were at least three major consequences of this process:

Financial institutions assets and power have grown like never before. In advanced economies, the assets of banks as a share of GDP more than doubled since 1990, now representing more than 200% of GDP. In emerging economies, bank assets as a share of GDP tend to exceed 100%.[6]

International capital flows have grown as controls on capital have been eliminated. Gross capital flows increased from 5% of world GDP in 1990 to over 20% in 2007. During this period, cross border capital flows rose three times faster than world trade flows.[7]

Global debt levels have increased dramatically. Global debt stocks rose from only USD$ 16 trillion in 1980 to USD$ 152 million at the onset of the global financial crisis and have since risen again to an eye-watering USD$ 213 trillion, or three times global output. Much of this extraordinary increase in global debt levels has been driven by the accumulation of private debt, fuelling financial speculation rather than productive investment, and explaining much of the growing recurrence of debt build-ups and crises[8].

VOLATILE INTERNATIONAL CAPITAL FLOWS: FUELLING DEBT BUILD-UPS

A key warning sign for crises is a sudden increase in international capital flows. These create several problems for countries:

- The size of global financial markets means even minor shifts in capital flows can dwarf the capacity of individual countries to respond

For example, global gross capital flows reached USD 4.3 trillion in 2016.[9] The power imbalance between global markets and countries is made worse by deregulation, as it allows large investors and corporations to overwhelm domestic institutions, such as governments and labour unions. To put this in context a 5% shift in global capital flows would be bigger than the combined stock market value of the smallest 55 countries.[10]

- Large capital inflows distort asset prices and economic activity

When capital flows into a country it often results in an expansion of domestic credit that can drive asset prices higher and fuel financial speculation. Under these circumstances borrowing no longer finances productive investments: instead, speculation in the real estate and stock markets accounts for most of the financial activity. This dynamic explains the link between capital flows, debt build-ups and crisis: countries receiving large capital inflows are four times more likely to experience a crisis.[11]

- Deregulation has led to an increase in the volatility of international capital flows

Without controls, capital can flow in and out of countries rapidly. This leaves countries in a vulnerable position. As international investors take flight - for reasons that might not be even related to the country itself - the system falters, asset prices drop, and borrowers struggle to service their debts. Depending on the severity of the bubble, a country can experience a combination of debt, currency and banking crisis. This dynamic was at play in Ireland and Spain in 2010, and more recently in Turkey and Argentina in 2018.

DEBT BUILD-UPS AND THEIR RISKS

When used appropriately, debt can be a key tool to deliver productive investment and jobs. However, a debt build-up, in the context of financial deregulation and strong capital flows, can create significant problems including speculative investments, bubbles and crisis. Dangerous debt build-ups have a recognizable set of characteristics: they occur at a fast pace during a short period of time and often involve credit in foreign currencies. They are especially risky when they involve borrowing for consumption and real estate speculation.

Rapid accumulation of debt is a sign of future problems. Financial deregulation often leads to falling credit standards. In this context, both borrowers and lenders take increasing risks and speculative bets. As safety margins decline, the economy becomes vulnerable to a crisis. This dynamic makes credit booms a reliable indicator of trouble. The evidence is overwhelming: of 43 countries where the credit-to-GDP ratio increased by more than 30% over 5 years, only five didn't end up in a crisis.[12]

Borrowing in foreign currency increases the risks of a debt build-up. Accumulation of debt in a foreign currency is usually a consequence of large international capital inflows. These reduce the costs of borrowing in a foreign currency such as US dollars or Euros. Both public and private sectors respond by increasing their external borrowing. This creates a dangerous situation: while their incomes are still in local currency, their debts are in a foreign currency. Ability to repay now depends on access to foreign exchange, over which national authorities have no control. An external shock restricts access to foreign currency can quickly plunge countries into crisis. This is why large volumes of foreign-currency debt is one of the most common explanations of debt crisis over the last 30 years.[13]

As discussed in Brief I of this series, productive investment financed through debt does not usually represent a threat. Investment in activities such as manufacturing or infrastructure provides individuals or countries with income. This can be re-invested, saved or used to service debts. But the risks increase substantially when debt finances consumption and speculative investments. Most recent episodes of crises involved a period of rising household debt, often incurred as a result of wage stagnation.[14] With rising housing prices and cutbacks to the welfare safety net, workers increasingly rely on credit to maintain their living standards. The financial system preys on their situation, creating unsustainable debt. Increasingly, research is showing that as household debt increases, economic growth decreases.[15]

UNIONS TAKE ACTION - CHAD

In 2014 the Chadian government accepted a significant oil-backed loan from Glencore - a mining corporations - in part, to avoid IMF Loan Conditionality. Within months, the price of crude had dropped by over half and the costs of maintaining the debt have cost the country over half its oil profits, forcing the government to go back to the IMF to seek assistance.

On top of this, tax avoidance and evasion have placed huge strains on the country's revenues, intensifying the debt crisis. In 2016 the government claimed an oil consortium led by Exxonmobil owed the country over $800 million in unpaid royalties.

Dr Grieve Chelwa, of the University of Cape Town, highlights how creditors such as Glencore stand to benefit from this form of commodity-backed loans: "A lender faces limited risks whereas the bulk of the risks are carried by the borrower. If the price of a major commodity falls, the principal amount of the loan remains largely unaffected and the borrower is expected to pay back the loan in full. Default is highly unlikely: the IMF and other multilateral entities usually put together "rescue" packages (not free, of course)."

Meanwhile, Chad's public sector workers such as nurses and teachers ended faced salary cuts of up to 40%. PSI affiliates led a General Strike which avoided the worst of the austerity measures and ensured workers received their unpaid salaries. Journalists joined the protests, holding a media blackout to protest against intimidation.

The Chadian labour movement have sought support from unions in France, which still holds sway over its former colony. French Unions addressed a letter to Presidents Emmanuel Macron and Idriss Deby, urging social dialogue. "We call on Christine Lagarde, the IMF and the French and Chadian Governments to work to end the brutal austerity in Chad. Development cannot exist without strong public services, and the workers who make them happen," said Laurent Berger, General Secretary of the influential French CFDT union.

The protests helped stop the worst cuts and reforms, and won public sector workers months of back pay which had been withheld from them. Adjoujiu Gueme - leader of the Federation of Public Service Workers of Chad, says the struggle will still continue:

"Why do we face imposed austerity when we know our country is rich in resources? We recognize the corruption of many of our leaders: but the real corruption is systemic."

QUICK CHECKLIST FOR DEBT BUILD-UP RISKS

1. Has the government introduced legislation to deregulate finance in recent times?
2. Has the country received large volumes of international capital flows over a short period of time?
3. Are prices of houses and stocks going up in value?
4. Is debt, either public or private, accumulating at a fast pace?
5. Is most of the new debt denominated in a foreign currency?

If the answer to most of these questions is yes, workers need to argue for changes to avoid the crisis and organize and prepare for the possibility of a financial crisis. This involves several elements:

1. Identify and monitor the most economically vulnerable sectors of the economy, as they are the most likely to be affected by a debt crisis, and publicly highlight their vulnerable conditions and build coalitions with interest groups who would be detrimentally affected.

2. Develop an agenda of political and social priorities to protect workers' rights in the event of a crisis.

3. Advocate for the unwinding of the conditions that have created the risk, highlight the vested interests responsible for the build-up and warn that workers will not be responsible for the consequences if the warnings are ignored.

4. Identify potential alliances with other unions, both at the domestic and international level, and civil society organizations to create a solid front against the effects of the crisis.

Effective protection of workers' rights in the context of a crisis requires the presence of strong unions that can effectively serve as countervailing power to the interests of finance and multinational corporations. Therefore, the process of building support for unions must be an on-going priority.

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The global union federation of workers in public services

45 AVENUE VOLTAIRE, BP 9
01211 FERNEY-VOLTAIRE CEDEX
FRANCE

TEL: +33 4 50 40 64 64
E-MAIL: PSI@WORLD-PSI.ORG
WWW.PUBLICSERVICES.INTERNATIONAL

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3

BRIEF 3

Sovereign debt and default:

WHY IT MATTERS FOR WORKERS

PSI BRIEFING SERIES - DEBT AND WORKERS

Sovereign debt may feel far-removed from the concerns of workers. As voters, they rarely have a say on governance of national debt. But, as was revealed by the Greek crisis, when a country is insolvent, it is the voice of the financial markets which decides economic and employment outcomes, rather than the voice of workers.[1]

Sovereign (or external) debt is issued by a national government to foreigners be they private investors, other governments or international organisations. This gives the state funds to spend in the short term, but an obligation to pay back investors (with interest) in the long term.

Sovereign debt and default

WHY IT MATTERS FOR WORKERS

Traditionally, sovereign debt is seen as risk-free for investors as governments can employ different measures to guarantee repayment, including increasing taxes or print money. But in practice, governments do default on external debt, leading to debt restructuring (often under harsh terms) and even the imposition of austerity measures by external creditors such as the IMF and World Bank.

WORKERS SUFFER WHEN DEBT IS UNSUSTAINABLE

The costs of sovereign default are profound. Countries suffer a blow to their growth: on average GDP shrinks by 3 to 5 percent for the first few years and the negative effect on growth can last up to 10 years. If a banking crisis occurs at the same time, GDP can collapse by as much as 10%.[2] Simultaneously, governments are forced into austerity as taxes drop and access to foreign financial markets either stops abruptly or becomes a lot more costly. Austerity then exacerbates these problems as public sector jobs and welfare payments such as pensions are cut, labour markets are deregulated, and infrastructure spending is cancelled or delayed supressing demand further.

Countries try to avoid default (although this is not entirely in their hands) as the default can lead to destruction of wealth, a drop in national income, and dislocation for those who cannot insure against such risks: usually workers and the poor. Orthodox solutions have traditionally visited misery on those unable to protect themselves and are least to blame. Financial speculators tend to accrue the benefits while the loses are often paid for from public budgets, especially when the debt crisis is an outcome of private credit-led speculative financial flows.[3] This means that it is the workers – tax-payers – who must tighten their belts (wage cuts or worse) until the debt is ultimately repaid or reduced.

As individuals, we have some independence over what we earn and spend. To reduce our personal debt, we can cut down on our spending – and our income is unaffected as it is dependent on a much larger economy. But for an economy as a whole, if individuals, businesses and the government cut their spending, then total income falls. At a national level, total spending and total income are equal, as whatever is earned must have been spent by someone else. Government expenditure provides income for others in the economy. Public spending includes wages and salaries, demand for the goods and services from private businesses in the economy, as well as investment into infrastructure spending like electricity, water, sanitation, roads, etc. But if the government increases saving and reduces spending then the income of businesses and individuals is compromised.

Austerity usually involves immediate and sharp cuts to government spending as part of a negotiated bailout. This often includes a consolidation period, where the country is given extra time to repay. All kinds of social spending may be cut, pensions may be reduced and there may be an off loading of state assets through fire-sale privatizations. The impact of these cuts falls hardest on those whose livelihoods depend on state expenditure: workers in the public service and those who rely on public services, particularly low paid workers and women. Since women are more likely to be employed in the public sector (in education and healthcare) and rely disproportionately on public services, austerity effects women more, increasing their financial insecurity, and exacerbating the gender employment and the wage gap.[4] Austerity often results in the unravelling of social cohesion– crowded schools and declining public services may be seized upon by right-wingers as the fault of migrants – when in reality it is budgetary cuts approved by complacent politicians that are to blame.

A recent and drastic example of imposed austerity is the ongoing crisis in Greece that began in 2010.

Debt crisis and enforced austerity have helped fuel the far right – such as the Golden Dawn in Greece seen here

CASE STUDY

NEVER TO BE REPEATED THE DISASTROUS BAILOUT OF GREEK CREDITORS

Over the last decade, Greece has experienced the worst debt and economic crisis in modern economic history. That this happened to a member of the European Union demonstrates that no country is immune and that the orthodox solutions of the west do not work. Since the beginning of the crisis, Greek GDP shrank by 27.7%. By comparison, the crises in East Asia and Argentina in the late 1990s and early 2000s shrank the GDP in those economies by 12.5% and 19.5%, respectively. However, unlike any other case during peace-time, the Greek economy has failed to show any signs of recovery a full decade after the crisis. The devastation to the economy and the severe social costs present a clear argument to never let international authorities subject any country to the same punishment.

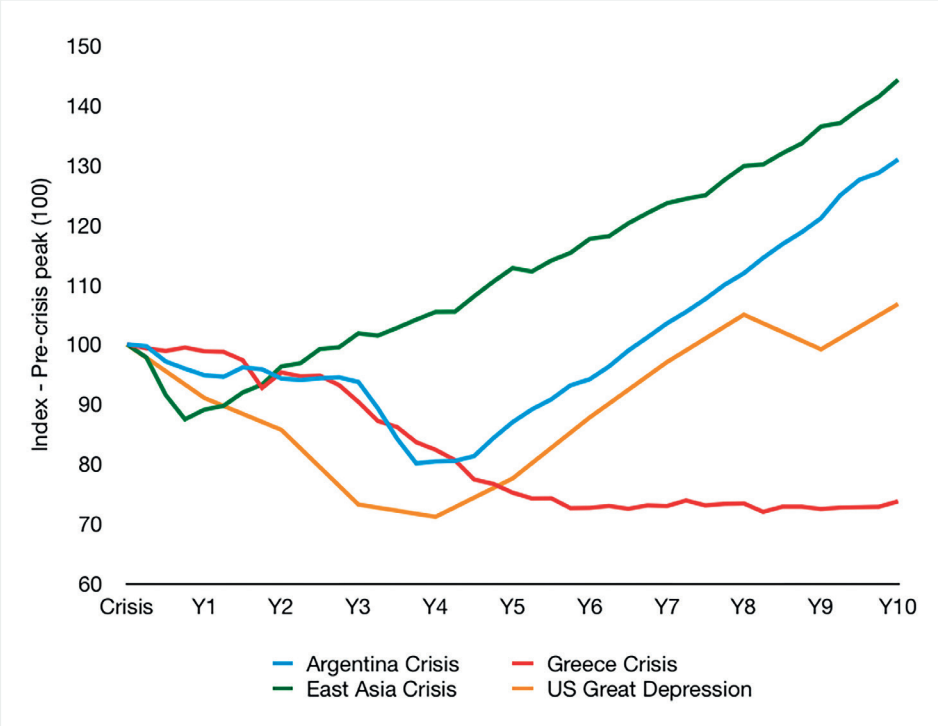
The key factor behind the depth and length of the crisis was the decision by EU authorities to fully bailout the private creditors of Greece (mostly European banks), so that the losses of the crisis were transferred from banks and other private holders of Greek public debt to public creditors such as governments and international institutions. This has meant that the debt burden of the country has continued to increase at the same time that austerity measures have been imposed in an unrelenting manner. Together, these measures caused a sharp and prolonged deterioration in the living standards of the Greek population.

EVOLUTION OF REAL GDP DURING AN ECONOMIC CRISIS

INDEX – PRE-CRISIS GDP PEAK (100)

The Greek crisis that started in 2009 stands out as the worst economic crisis in modern economic history.

Source: Thomson Reuters, Maddison GDP data set.[5] Note: Argentina crisis (Q2 1998 – Q2 2008); Greece crisis (Q2 2007-Q2 2017); East Asia crisis (average index for Thailand, Indonesia and South Korea) (Q3 1997- Q3 2007); US Great Depression (1929-1939)



A decade after their respective crises, East Asia (1997) and Argentina (2000/01), had managed to grow their economies substantially above the pre-crisis levels. Even the US after The Great Depression, where GDP collapsed by 28,8%, recovered to its pre-crisis peak faster than Greece.

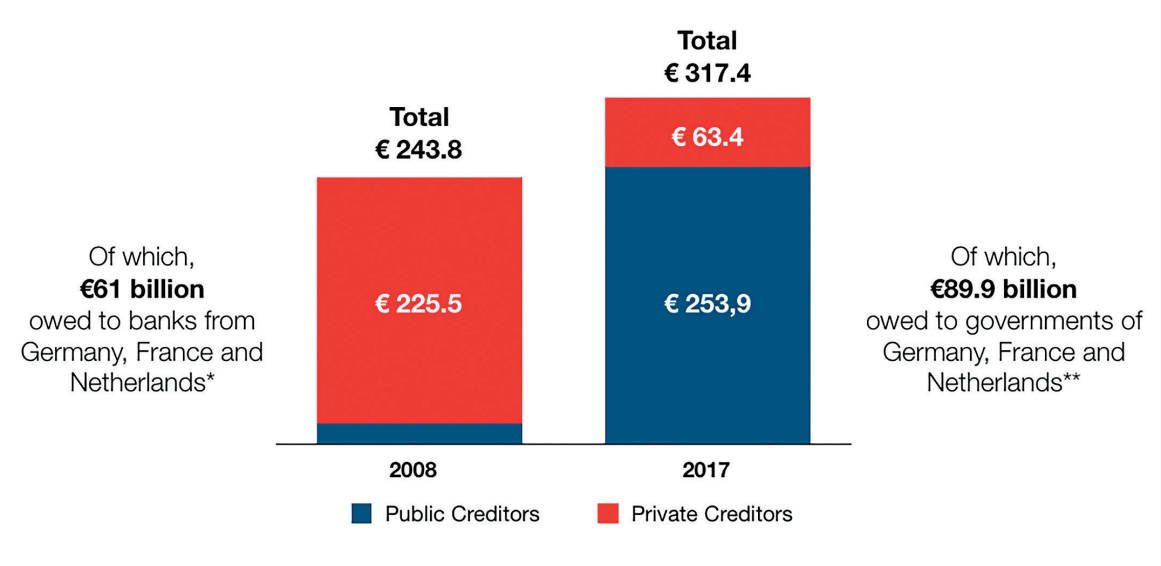
In 2008, before the crisis began, the public debt of Greece stood at €243 billion.[6] Over 90% of this public debt was held by private investors - over 70% by foreign investors. German, French and Dutch banks had an exposure of €61 billion (over a quarter of the total).

As the aftershocks of the GFC hit Europe, borrowing costs for Greece increased substantially and Greek debt became unsustainable. Faced with this situation, Greek and EU authorities could have chosen to restructure the debt of the country. In this scenario, the debt burden of the country would have been reduced by imposing some losses on private creditors (who played their part in creating the unsustainable debt). Instead, the so-called Troika of the EU Commission, the ECB and the IMF, coordinated the biggest international financial rescue for private investors in history: official creditors lent Greece a total of €288.7 billion between 2010 and 2018.[7]

GREECE, GENERAL GOVERNMENT DEBT BY CREDITOR 2008-2017

(BILLIONS OF EUROS)

The Greek bailout increased the debt of the country while it transferred the credit exposure from private banks to governments across Europe.



Source: Arslanalp, S. and Tsuda, T., (2014), BIS (2018)[8] WSJ (2018)[9] ., ECB (2018)[10]
**BIS data. Exposure to official sector of Greece by banks on an ultimate risk basis.*
*** Includes GLF, ESM and EFSF loans. National shares using ECB capital key.*

The rescue operation allowed the repayment of private creditors in full, protecting them from losses, while shifting exposure to Greek debt onto official institutions. The share of Greek public debt owned by official international creditors (composed of EU governments and institutions and the IMF) increased substantially from 7% of the total in 2008 to 80% in 2017. Private international investors took the bailout money and fled: during the same period, their share of Greek public debt fell from 70% to 7% of the total.

While private creditors cashed-in, the population of Greece suffered. As part of the austerity program imposed on Greece to free resources to pay creditors, government expenditures fell by 30% between 2008 and 2017.[11] Expenditure on health services decreased by 45%. Expenditure on education and social protection fell by 18% and 13% during the same period.

In addition, the government embarked on an aggressive program of privatizations. Since 2010, a total of 38 privatizations were completed, in many cases at fire-sale prices, raising a total of €4.7 billion.[12]

The impact of these measures on the Greek population cannot be overstated. Unemployment peaked at 27.5%, while youth unemployment reached 59.9%. The percentage of Greek people living below the poverty line increased from 16.3% in 2010 to 42.2% in 2015.[13]

During this same period, the number of homeless people quadrupled while the number of suicides doubled.[14]

While some viewed the rescue program as a success, given that private creditors came away unscathed, it was an outright failure in terms of ensuring the recovery of the Greek economy, the sustainability of its debt and the wellbeing of its people.

Instead of decreasing the country's debt, the program actually increased it by almost a third. This failure in now recognized by one its main coordinators, the IMF, who acknowledge that Greece will continue to face substantial challenges to ensure the sustainability of its public debt in the medium term. After a decade of crisis and decimation of the living conditions of the population, the IMF now argues in favour of debt relief to ensure recovery and debt sustainability for Greece.[15]

As it stands, however, there is no common approach to debt restructuring which would prevent such an outcome being repeated. What is clearly needed is international commitment to sound principles on sovereign debt restructuring, such as those adopted by the UN General Assembly in 2015, but still not made effective by nation states.

HOW DO GOVERNMENTS FUND DEFICIT SPENDING?

Governments use income (mostly tax revenue) to fund their expenditure priorities. These can range from investment in infrastructure to supporting an educated and healthy workforce and providing vital public sector workforce.

Importantly, governments also spend to maintain social cohesion and equity, providing safety nets for families, the unemployed, disabled and the elderly.

Depending on their public spending priorities and the state of the economy, public spending can exceed tax income resulting in deficit spending and accumulation of government debt.

Public debt can be held by:

- nationals of the country, which is known as domestic debt
- foreigners, in which case it is termed sovereign debt.

To fund this public budgetary shortfall, governments may increase public debt by issuing bonds (a form of debt) or seeking loans - both from domestic and foreign sources. Governments must consider all the relative costs, risks and benefits of undertaking foreign and domestic debt obligations.

While interest rates payable on foreign loans may be lower than domestic loans, foreign loans have to be repaid in a foreign currency and so if the value of the foreign currency appreciates, or the domestic currency falls, over the repayment period the benefits of a lower interest rate might be wiped out.

The value of many currencies has been depreciating against the US dollar since 2008, which raises the nominal values of sovereign bonds when issued in dollars. A frequently cited example is Ghana, whose government issued a 10-year eurobond with the nominal value of $750m in 2007 at a coupon rate of 8,5%. At the time, the Ghanaian cedi was nearly at parity (one to one) to the dollar, but the cedi value collapsed against the dollar in the 10 -year period , so that Ghana effectively repaid 4.5 times more than the face value of the original bond.

Governments must consider all the relative costs, risks and benefits of undertaking foreign and domestic debt obligations.

WHEN IS SOVEREIGN DEBT UNSUSTAINABLE?

While it is relatively easy to tell when a household or corporation is solvent (by assessing whether net liabilities are greater than net assets), for countries it depends on their ability to generate budget surpluses to repay debt. Judging public debt sustainability means looking at economic activity (present and future) as well as external factors over which governments have little control – like commodity prices.

Debt sustainability is based on many judgments about the future. By the end of WWII, Britain shouldered debt of up to 250% of GDP (as it had the previous century after the Napoleonic wars): yet no threat of default loomed.[16] Japanese debt to GDP has exceeded 200% of GDP for years, but is relatively stable as 90% of it is held by domestic investors. There is no absolute level at which debt to GDP becomes unsustainable – it depends on future growth projections, productivity and external trading conditions, amongst others.

Austerity can be enforced by external creditors, but also by conservative politicians using deficit hysteria to restrict spending on public services. Today, over two-thirds of countries around the world are implementing austerity: contracting their public purses and limiting rather than expanding their fiscal space.

Many governments have been unable to service their external debt obligations and had to seek terms for debt restructuring. If investors consider a country to be high risk, they ask for a higher return on the debt. Since servicing sovereign debt involves payment in foreign currency, this means that as debt grows, more foreign income earned through exports must be used to service the debt. This adds to the cost of borrowing and to a country's deficit and debt level.

WHAT UNDERMINES GOVERNMENTS ABILITY TO SERVICE THEIR DEBT?

In an ideal world, the boost to the economy that results from deficit spending should result in higher economic activity that leads to higher tax revenues and ensures that debt incurred by the government can be serviced. But things don't always go as planned.

A state may need to service the debt before the public spending that created the debt generates revenue, or their currency could devalue relative to the currency in which they must make repayments, or commodity prices slump, or there is a natural disaster such as a drought or a hurricane.

Similarly, debt-servicing may become difficult or impossible when corporate debt becomes socialized as firms or state-owned enterprises fail. Speculative credit flowing into countries - often chasing higher returns than in their domestic markets – can mean higher risks, if not immediately then often in the medium term. What begins as private debt can transform into a sovereign debt crisis.

Sometimes governments' actions undermine their ability to service their debt – such as when they provide tax and other incentives to MNCs to attract them to invest. Offering tax breaks or holidays rarely puts countries in an advantageous position and contributes to a race to the bottom. This also undermines fiscal justice as it provides foreign companies with advantages that undermine local businesses (who do not have the same special treatment) and erodes the ability of governments to mobilize domestic resources for much needed social and economic expenditure.

Similarly, both developing and developed countries have undertaken public-private sector partnerships (PPPs) which allow governments to shift debt off the public balance sheet - for a time. For example, a 20 year PPP with a private healthcare company to build and run a hospital will avoid a debt on the governments accounts but will cost the government a high fixed fee every year that is usually greater than the debt and thus a bigger burden on the public finances. Yet by using the PPP model, politicians can push the costs on to future governments and generations while appearing to balance their books in the short term. Obscure and often secret exit clauses can make leaving such deals even more expensive and can trap future governments wanting to renegotiate or leave poor deals.

WHAT CAN HELP ENSURE DEBT SUSTAINABILITY?

Policies that increase GDP growth - and slow the growth of debt - must be implemented simultaneously.[17] To grow faster, a substantial and sustained increase in public and private investment is needed - aimed at growing productivity and incomes to benefit workers and provide opportunities for those stuck in low wage jobs. At the same time, states need to find ways to re-balance the tax system - increasing domestic revenue by ending special tax incentives and reversing tax cuts for the wealthy and corporations. In particular, they need to ensure that corporations pay their share and they need to clamp down on illicit flows that undermine the ability to ensure tax justice. Policymakers need to find ways to raise the shares of labour income as this leads to the positive effect of higher wages on consumption and investment.

WHAT CAN UNIONS DO?

Unions must:

1. Develop a well-informed voice. This means public and private sector workers need to be informed and aware of their country's debt and challenge the concept of a "balanced budget" (i.e. no deficit) as being a universally "Good Thing".

2. Resist the bailouts and arbitrary socialization of losses arising from crisis caused by unregulated or underregulated private banks and corporations.

3. Lobby for much stronger public control over the creation of credit, debt and the expansion of a state-owned or state-controlled banking system that services the financing of productive investment, public services and higher wages.

4. Challenge austerity and demonstrate its disastrous effects on jobs, wages and disproportionately negative impact on women.

5. Demand that social and economic impact assessments are made of austerity measures before the decision to implement, and demand that debt audits are undertaken to clearly ascertain who was responsible for the build-up of the unsustainable debt.

6. At the international level, labour unions must unite and work together with governments to restore the authority of the state and citizens against powerful international financial creditors.

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45 AVENUE VOLTAIRE, BP 9
01211 FERNEY-VOLTAIRE CEDEX
FRANCE

TEL: +33 4 50 40 64 64
E-MAIL: PSI@WORLD-PSI.ORG
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BRIEF 4

4

Debt distress and crisis

WHAT HAPPENS WHEN IT HITS?

PSI BRIEFING SERIES - DEBT AND WORKERS

Debt distress and crisis

WHAT HAPPENS WHEN IT HITS?

DEBT-TO-GDP: NOT A MAGIC NUMBER[1]

2015 UKRAINE
DEBT = 80% OF GDP
SOUGHT AN IMF BAILOUT

2018 PAKISTAN
DEBT = 70% OF GDP
SOUGHT AN IMF BAILOUT

2018 USA
DEBT = 100% OF GDP
NO CRISIS (YET)

Debt distress occurs when a country's debt-levels and other internal and external factors put it in danger of not meeting its debt obligations. This could result from an ecological disaster, interest rate hikes in other countries, currency depreciation, changes in commodity prices etc.

The first sign is when a country can no longer get a low interest rate from lenders, as investors begin to fear a potential default.

When this happened to Iceland in 2008 and Greece in 2010, both countries were thrown into crisis. But is this inevitable, and what can be done about it?

FROM DEBT SUSTAINABILITY TO DEBT DISTRESS

Being in a position of debt distress - or a debt crisis - is linked to the perceptions of global investors about debt sustainability. As mentioned in Part II of this series, there is no absolute level at which debt to GDP becomes unsustainable – it depends on a range of variables such as future growth projections, productivity and external trading conditions.

Although the US has the highest debt-to-GDP ratio, and its highest since 1946, there is no indication that this is an unsustainable level of debt.

Pakistan currently has little capacity to generate export earnings, and only low reserves of foreign currency – so the country is deemed fragile by investors with a high risk of default, and finds it difficult to attract reasonably priced external financing.

The US, by contrast, is in a unique position because the US dollar is the dominant international reserve currency: a status referred to by one French president (V. Giscard d'Estaing) as "an exorbitant privilege."

What this means is that:

- Overseas institutions and individuals (including governments and banks) who hold US currency are essentially providing the US with an interest-free loan
- The US can raise capital more cheaply since there will always be large purchases of US Treasury Bills (securities) by foreign governments, institutions and companies.
- There is little risk that current national indebtedness will lead to a crisis in the US.

It's clear that not all countries are equal.

As market confidence in a country's debt sustainability falls, lenders start to worry and typically demand higher yields to offset their (perceived) risk. The higher the required yields, the more it costs the country to refinance its sovereign debt. This can prevent a country from rolling over debt and lead to crisis and default.

Outflows – often experienced in the form of sudden capital flight – are a signal for a lack of market confidence. It is market sentiment – rather than real economic indicators - which drives this capital flight.[2]

What this means is governments are at the mercy of the (often self-fulfilling) fears of global financial markets. On top of this, foreign governments are seldom neutral: instead they act to protect investors and banks from their countries from exposure to losses, as was the case in the response to the Greece crisis.

COLLATERAL DAMAGE: FOR THE ECONOMY AND FOR WORKERS

When a country indicates debt-distress (by missing repayments, declaring a standstill on its debt, or seeking bailout from the IMF or others) it often results in an economic crash.

The consequent slump in growth can negate years of positive growth. This was the case for developing countries in the 1980s (such as Mexico, Brazil, Venezuela and Argentina)[3] and for Italy and Greece since the Global Financial Crisis[4].

This can lead to reduced trade, falling foreign direct investment and slowed growth for local business. Confidence in the domestic economy is massively undermined, resulting in job losses, wage freezes and economic and social disruption. As discussed in Part III this series – the vulnerable sectors of the economy are likely to suffer most.

DOUBLE WHAMMY

Working out how (and whether) the debt will be repaid involves the governments of both debtor and creditor countries, private investors and multilateral institutions. The voice of workers is rarely heard in these negotiations, although they bear many of the real costs of economic collapse. This is not new, but it has become more extreme.[5] But the question underlying the negotiations at the time of debt distress or crisis is: who pays the cost of the debt workout?

After Royal Bank of Scotland's risky investment decisions brought it to the edge of bankruptcy, the British taxpayer dished out over £40 billion to bail the bank out.

In theory, the consequences of the loan's risk should be distributed among the parties according to the risks accepted as part of the transaction. Thus, in addition to the risks borne by the debtor country:

- Part of the cost should be borne by the shareholders of financial institutions – be they banks or hedge funds.
- Some costs might be borne by the taxpayers of creditor countries, as their banks record losses, lower profits, and subsequently lower tax revenue.

The harsh reality is that the burden of debt is largely borne by workers in the debtor countries. The growing power of financial markets and exposure to private investors has led to the increasing use of legal action. What this means is creditors can sue states to pursue debt repayments via domestic courts, often in the creditor's country.

In the 1980s and 1990s, less than 10% of defaults were accompanied by litigation - but since the mid-2000s, 50% of defaults have led to legal action.[6]

Litigation is now seen by some creditors as a way to get a huge (predatory) benefit from debt. And because governments are afraid of the high costs of long court cases, they are settling earlier rather than waiting for punitive court outcomes.[7]

The lack of certainty and fairness in the global debt workout system has created a new market actor - vulture funds - who buy distressed debt cheaply with the sole intention of profiting from the unfortunate situation by manipulating the current flawed rules (see box below).

From the perspective of economic sustainability, pushing the bulk of the burden of sovereign debt onto the debtor country is like putting a person in prison until they repay their debts. It is punitive but it helps nobody.

If a business goes bankrupt, the investor takes a haircut in terms of capital repaid.[8] Bankruptcy laws for business and individuals have evolved this way because punishing debtors with prison was counterproductive – a prisoner cannot repay their debts.

Countries in economic free-fall also have no chance of repaying their debts, either. The workers of the debtor country suffer twice – as the economy is plunged into negative growth - and as the government tries to find the means to repay the debt by cutting services, safety nets and jobs. This is like putting the debtor's family in prison and is not just unhelpful - it is manifestly unjust.

Private creditors are exploiting a system that protects them from risks they would have to bear in any normal transaction.

WHAT ARE "VULTURE" FUNDS?

Some financiers now buy government debt that has defaulted or is at risk of default on the secondary market (at a discount) explicitly so they can sue for full repayment. The "Holdout creditors" can impede debt renegotiations and immiserate debtor states. Hedge funds account for more than two-thirds of all sovereign debt lawsuits in the last two decades.

Because there is no coherent international framework for working out sovereign debt disputes, countries face real challenges in resisting the punitive actions of these Vulture Funds, who can seek to impede debt renegotiations and punish debtor states.

These funds often buy the debt after the majority of original creditors have reached a settlement with the defaulting country. They then sue for the face value of the bonds, plus interest, arrears and litigation costs. One such creditor received a

392% return on the original face of the bond, resulting in profits of up to 2,000%.[9]

This creates a moral hazard, encouraging creditors to avoid settling or renegotiating, knowing they will have more power and reap high returns if they 'hold-out.' These litigations threaten debt sustainability, financial stability and jeopardize sustainable development. They are also unjust: imprudent lending is just as important for sovereign debt crises as imprudent borrowing. Yet the burden tends to fall disproportionately on the debtor side.

For example, after years of battles with creditors following a major crisis, Argentina paid four vulture funds 1-2% of its GDP to avoid being barred from international capital markets.

Some countries have now adopted national legislation to restrict the ability of Vulture Funds to prey on countries which have undergone international debt relief initiatives. These include the Belgian legislation against vulture funds and the UK Debt Relief (Developing Countries) Act 2010.

But in the absence of universal adoption of such laws, countries remain vulnerable to litigation in foreign courts.

UNIONS TAKE ACTION - ICELAND

Iceland might be a small nation but the 2009 crash of its banking sector was one of the largest ever of its kind. For a small community this could have been disastrous. But Iceland recovered much sooner and stronger than feared.

The idea of fair distribution and social cohesion preached for decades by the labour movement played a key role in steering this recovery, says Ögmundur Jónasson - a former head of the Confederation of State and Municipal Employees of Iceland and PSI Executive Board Member. At the time of the crisis, Jónasson was Iceland's Minister of Health and had a frontline perspective on the country's debt crisis.

He explains:

"Iceland, like other Nordic countries, developed a tripartite system of social dialogue between organized labour, the state and municipalities and the employers' associations. This tradition of dialogue had certainly been impaired with the advance of neoliberalism but the tradition was still there and when it became clear that Iceland was on the brink of bankruptcy all these partners knew that there was a need for dialogue and cooperation."

As the country's banking sector crashed, largely as a result of irresponsible investments on the international money markets, the IMF became increasingly politically involved.

"The IMF had a bad reputation in labour circles. As Minister of Health I had several meetings with representatives of the IMF who pushed for public spending cuts - but never do I recall them asking about how the health system was faring. We managed to negotiate a compromise, involving the social partners, where taxes were increased for the better off while alleviated for the lower paid. This gave the state and municipalities increased revenue and the need for cuts was somewhat reduced."

The IMF was made aware from the outset that any harsh proposals- including privatisations, widespread cuts and lay-offs – would not be tolerated in a society where labour unions were to be reckoned with. This in turn strengthened the government's negotiating position.

"The IMF's working method is in direct contradiction with the concept of social dialogue. That method taught us we would never get out of the crisis if we did not listen to the grassroots. I have often described our dealing with the crisis by drawing attention to a well known saying in Iceland: When in danger on a boat hit by heavy seas, everybody must take to the oars – together and in unison. But of course there is a precondition: We must be on the same boat."

Despite claims that opposing the traditional IMF formula would lead the country deeper into crisis, by raising taxes, letting the banks go bust and protecting the public sector, Iceland recovered quicker than any one predicted - thanks in no small part to the general understanding that social cohesion and participation was needed if Iceland was to get out of the crisis. These are of course the long-term fruits of labour union struggle.

NOT TOWING THE LINE

When a country is hit by crisis it leads to substantial pressure from official creditors to reduce expenditure and impose austerity measures. This means government priorities are focused on restructuring debt and dealing with short-term liquidity problems, rather than long-term strategic needs of the country.

But it doesn't have to be this way.

For example, during the East Asian crisis many countries initially followed the IMF, which recommended fiscal austerity and raised interest rates.

This had a negative impact on the three largest countries of the region – Thailand, Malaysia and South Korea: GDP collapsed by 12,5%.

These countries decided to stop towing the IMF line and adopted a range of measures to stimulate their economies. Within a period of three to five years, East Asia had largely recovered its pre-crisis levels of growth through a mixture of increased expenditure by government, incentives for domestic demand such as housing loans and the use of controls to stem capital flight along with agreements with international lenders to roll-over short term debt.[10]

This suggests when countries experience a crisis, careful analysis and policy design (rather than a one-size-fits-all approach) can enable a country to avoid the worst. IMF conditionality – where governments have to implement policies such as austerity to receive bailout loans - has had disastrous effects. While they might help bring down inflation and balance budgets in the short term, they have never led to sustained economic growth.[11] Moreover, they almost always deepen inequality, and undermine long-term economic development.

Despite being economically discredited, these terms continue to be imposed because they serve the creditor interests of major banks and the high-income countries that fund (and therefore control voting rights on the board of) the IMF.

In fact, leaked IMF documents show how the IMF's own economists observed how, in the case of Greece, austerity made matters worse and viewed the action as politically motivated.

The documents describe how "debt restructuring would have been better for Greece although this was not acceptable to the euro partners. A delayed debt restructuring also provided a window for private creditors to reduce exposures and shift debt into official hands." The provision of funds by official creditors to ensure repayment of loans to international banks undermines due diligence and lender responsibility by such banks.[12]

Of course, it is easier for large, growing economies like South Korea to resist pressure from the IMF. Smaller, developing countries typically have much less policy space and political clout. This underlines the urgent need for a more balanced debt restructuring framework to be adopted by the international community (see Brief 5).

WHAT CAN WORKERS DO DURING A DEBT CRISIS?

One of the best protections for workers during a debt crisis is to have been highlighting the causes of the crisis in its build up and warning against them. While the debt build-up takes years, the crisis usually emerges quickly and if unions have not been engaged in the public debate early then they are often side-lined when the crisis hits.

When a debt crisis does hit unions and workers in **debtor** nations need to stand together to ensure that:

1. The government understands that the socialization of bank losses to workers is not acceptable.

2. Debt audits are undertaken and evaluated before austerity measures are implemented, so that an understanding of what, and who, caused the crisis informs the response and that the government is not able to scapegoat vulnerable sectors of society.

3. Based on the audit, there should be a more equitable sharing of the risk of the debt by all parties.

4. The public sector and the benefits system continue to protect those in the most vulnerable situations during the downturn.

5. Measures are put in place to ensure that cuts that cannot be resisted in terms of services, workers and employment conditions are not permanent and are able to be re-instated once the economy recovers.

Unions and workers in **creditor** nations also need to play their role in ensuring that financial capitalism is not the only winner. They need to:

1. Publicly explain the reasons for the debt default (as per the debt audits) so that false accounts of public sector waste and benefits do not take hold in the population of the creditor country.

2. Highlight the human cost to workers in the creditor country that was not of their making and publicise the unfairness and tragedy.

3. Highlight that the best way for creditors to get their money in the medium term is for Creditors to adhere to the economic rationale that the debtor nation needs to be able to grow to service and repay its debt.

4. Fight for legislation that bans vulture funds and predatory lending.

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PUBLIC SERVICES
INTERNATIONAL
The global union federation of workers in public services

45 AVENUE VOLTAIRE, BP 9
01211 FERNEY-VOLTAIRE CEDEX
FRANCE

TEL: +33 4 50 40 64 64
E-MAIL: PSI@WORLD-PSI.ORG
WWW.PUBLICSERVICES.INTERNATIONAL

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5

Fixing a rigged system

FAIRER GLOBAL DEBT RULES

BRIEF 5

PSI BRIEFING SERIES - DEBT AND WORKERS

Fixing a rigged system:

FAIRER GLOBAL DEBT RULES

There are very limited global rules to govern how creditors and debtors should behave when crisis hit and how they come to agreement on sovereign debt issues. The rules which do exist are fragmented, ad hoc and malleable: a patchwork of contractual clauses, global forums, and initiatives.[1] Attempts to set up uniform legal or regulatory frameworks and address the unbalanced allocation of risks and rewards between creditors and debtors have failed.

There are a number of factors which are keeping the current system rigged:

1. **Sovereign countries that are unable to service their debt cannot seek bankruptcy protection to restructure or delay payments, in the same way that a failing business can.**

2. **IMF intervention typically seeks to protect international banks and other creditors, often providing loans to the distressed country to help ensure creditors are paid in full.**

There is an urgent need for a new global debt system that provides more policy space to countries in debt distress, so that macroeconomic measures can be taken to restore stability.

3. **There is no evaluation of the motives, rights and responsibilities of the borrower or lender.** Instead, creditors rely on getting their money back from IMF loan or the use of litigation and arbitration to obtain settlements which often exceed their initial exposure.

4. **Trade and investment deals restrict governments' ability to respond by reducing policy and regulatory space.** International investment agreements (IIA), regional and bilateral investment treaties (BITs) and treaties with investment provisions (TIPS) strengthen creditor/investor rights and make sovereign debt restructuring more difficult and costly. Creditors have argued that policies like capital controls, bank deposit guarantees and nationalization of banks breach trade agreement clauses such as national treatment, most favoured nation and fair and equitable treatment.[2]

5. **When courts rule on sovereign debt matters, the sanctity of "the contract" prevails over the public interest.** This automatically puts workers in debtor countries at a disadvantage.

6. **In this uncertain environment, vulnerable countries enter once again into a phase where the repayment of debt takes precedence over strategies for industrialization and development,** locking them into a cycle of stalled development, inability to grow sustainably, more debt, premature repayment of the debt and so on.

There is an urgent need for a new global debt system that provides more policy space to countries in debt distress, so that macroeconomic measures can be taken to restore stability.

THE CONSEQUENCES OF FAILURE

There is no coherent international scheme for working out debt or a formal bankruptcy mechanism. There are many types of government liabilities which are not systematically handled under the existing arrangements. In times of crisis, debtor countries are essentially working with pieces of an incomplete puzzle, making them ill equipped to prevent or promptly resolve debt crises when they arise. This creates a number of negative economic consequences:

1. **UNNECESSARY DELAYS.** The absence of a defined international framework for solving crises contributes to uncertainty and restricts countries from resolving debt difficulties when they arise. Debtor governments are often reluctant to openly admit solvency problems for fear that it will trigger capital outflows, financial distress and economic crisis. Private creditors have little incentive to acknowledge a solvency crisis, which might entail reducing the value of their repayments. This means that interventions are often characterized as "too little, too late" and debt renegotiations fall short of restoring a country's debt sustainability (this is particularly the case for low income countries).

2. **ECONOMIC AND HUMAN COSTS.** Prolonging the period before negotiations on solvency ahead of a sovereign default may result in ballooning costs that reduce both the ability and willingness of a country to pay. If countries are compelled to impose austerity, they can lose development gains. Such policies make it more difficult for countries to get out of debt distress, return to strong and inclusive growth and pursue a sustainable development path.

3. **CREDITOR HOLD OUTS.** Many creditors actively resist debt restructuring. If debt is to be cancelled or reduced, it requires a coordination mechanism that forces all creditors to accept some nominal losses. Without this, each individual creditor is incentivized to hold out while other creditors cancel parts of their claims. Coordination problems and the possibility of free riding are particularly serious in the case of bonded debt and are exacerbated by the presence of vulture creditors.[3]

4. **COSTLY RENEGOTIATION.** Countries might agree to a deal to restructure or delay debt but as the time for repayment draws closer, they often face pressure by changing economic realities to renegotiate a new deal. Each time this happens, creditors seek larger long-term rewards, often with longer repayment terms. For example, Mozambique recently renegotiated a USD 760 billion loan. This loan was considered by many locals and international commentators as illegal in the first place, as it was undertaken without appropriate parliamentary approval. The original repayment terms were for USD 1.1 trillion between 2014 to 2020. Now Mozambique must pay back USD 2.2 trillion between 2014 and 2033.[4]

HOW DOES THIS IMPACT WORKERS?

The problems for workers of a sovereign debt crisis are outlined in previous briefs. However the lack of balanced and certain rules defined in advance create further problems. During the period leading up to default, governments may take (or be pushed into) measures such as cutting pensions and public sector wages, privatization, postponing investments and pushing banks to hold larger shares of sovereign debt in order to try to avoid default.[5]

Anti-debt protestors in the Philippines

During restructuring, the lack of interim financing or liquidity can make it difficult for government to function. This can amplify the crisis and further reduce the ability to pay for social programs, provide trade subsidies or stimulate the economy through other measures. In the years following default countries often undergo declines to GDP, trade, foreign direct investment, private credit and foreign credit to domestic firms.

THE LONDON AGREEMENT A FORGOTTEN EXAMPLE OF THE WAY FORWARD

The 1953 London Agreement between the Federal Republic of Germany (FRG) and its creditors was a major factor contributing to the country's so-called "post-war economic miracle." The agreement stands in sharp contrast to the harsh reparations imposed on Germany after the First World War which set the stage for WWII.

Substantial debt cancellation for West Germany ranked high in the Western Allies' priorities for post-war reconstruction: as a means to ensure future economic and political stability and integration into the emerging bloc of anti-Soviet Cold War allies. The response was also informed by the post WW1 experience where austerity created economic pain that radicalised German politics and contributed to the rise of fascism. Beyond these political considerations, the economic logic underlying the agreement was the complete opposite of the austerity policies which characterize contemporary approaches to debt restructuring. The London Agreement included the following:

1. **Limited debt servicing costs, dependent on Germany running a trade surplus:** The ceiling for the debt servicing costs was set at a maximum of 3% of total export revenues in any year. Repayment could be postponed if there was no trade surplus. In other words, in years where a trade deficit was experienced, Germany was not required to take on new borrowing to service existing loans.

2. **Built-in incentive for creditor nations to import German goods.** Creditor countries bought exports from the debtor Germany themselves so they would later get their money back, thereby laying the foundations of Germany's powerful export sector and fostering its so-called "economic miracle

3. **Interest rates capped and repayment in local currency.** Interest rates for debt ranged from 0 and 3 percent, much lower than countries face today. Importantly, debt could be repaid in Deutsche Mark rather than in a creditor currency.

4. **The agreement was comprehensive and coordinated and there was no space to opt out.** All creditors were treated equally and the possibility of any creditor engaging in individual negotiations was ruled out.

5. **Renegotiations were allowed for.** An explicit option to renegotiate on the basis of Germany's economic prospects was allowed for, with the clear understanding that the growth of the debtor economy was essential to enable it to service and repay the debt.

These types of measures are the equivalent of releasing an inmate from debt-prison prison and offering them a job, rather than forcing them to languish in jail until death.

The current reality is debtor countries:

- regularly have debt service obligations well above 10% of their export revenue
- pay market interest rates well above 5% per annum,
- are obliged to repay in US dollars
- face holdouts from individual creditors seeking special (predatory) deals

The London Agreement provides a useful model for debtor countries to aspire to: one that would help ensure fairness, growth and ultimately increase the likelihood of repayment for creditors too.

WHY IS A SOLUTION SO HARD TO FIND?

Countries and responsible creditors would benefit tremendously from a fair, transparent, predictable and timely resolution of crises when they arise.

So why have rules to help ensure this happens still not been developed?

In 2003, an internal proposal for an international bankruptcy procedure for sovereign debt was roundly rejected by IMF Board members. This is, in part, because major power inside the IMF lies with creditor countries who are the funds major contributors.

But at the UN, the voices excluded from IMF decision-making, including many of the countries forced through painful debt restructuring procedures, have a stronger voice.

In 2015, the UN General Assembly adopted a resolution on "Basic Principles on Sovereign Debt Restructuring Processes."[6] This set out a number of so-called soft-law legal principles – including sovereignty, good faith, transparency, impartiality, equitable treatment, legitimacy, and sustainability – that should guide sovereign debt restructuring processes. Such principles are not legally binding but provide a normative guide that creditors and debtors should follow in the interest of equitable, fair and effective sovereign debt restructuring. This was an important step forward.

"THE CLASH OF INTERESTS BETWEEN CREDITOR AND DEBTOR COUNTRIES REMAINS"

But little has happened since then to promote the implementation of these "basic principles," despite deepening concerns about imminent sovereign debt crises, global economic fragility and threats to long-term debt sustainability, primarily in developing countries.

The reason is clear: the clash of interests between creditor and debtor countries remains.[7]

Most creditor countries are hostile to the idea of fully-fledged international bankruptcy procedure. They are wary of relinquishing their existing power as

creditors to neutral international bodies or institutions. They are backed by well-funded lobbyists from major banks and institutions, operating out of Wall Street and The City of London.

Debtor countries, on the other hand, have a strong interest in an international legal framework that balances creditor and debtor interests while preserving long-term growth and development prospects. Although they are more numerous than creditor countries, they are also smaller and less powerful and face difficulties in organizing collectively. In other words, they face the same issues workers face when trying to organize and challenge the power of management and the influence of corporations over government.

This shows the importance for workers in creditor and debtor countries to strengthen their links of solidarity and fight for equitable, effective and timely debt governance while opposing toxic austerity programs.

WHAT CAN WORKERS DO TO IMPROVE DEBT GOVERNANCE?

Unions and workers in both debtor and creditor nations must fight for the implementation of the 2015 UN resolution on "Basic Principles for Sovereign Debt Restructuring Processes" and build the argument for an international debt work-out mechanism that:

1. Enacts legislation against vulture funds and predatory lending activity.

2. Establishes a framework where the Principles of sovereignty, legitimacy, impartiality, transparency, good faith and sustainability guide the behaviour of lenders and borrowers (such as the UNCTAD Principles Promoting Responsible Sovereign Lending and Borrowing).[8]

3. Like the London agreement in the box above, acknowledge that creditor nations have a responsibility to buy the exports of debtor nations and make debt servicing costs sensitive to economic performance, so that debtor nations may benefit from growth to help service and repay debt.

4. Avoids the socialization of debt losses on to workers.

UNIONS TAKE ACTION - GREECE

For Yiorgos Archontopoulos, a water worker in Thessaloniki, his job is about bringing life to community. But in the wake of the Greek Debt Crisis, the Thessaloniki Water Service along with dozens of other state-run services were marked out by the Troika for privatisation, with major French multinational Suez taking a keen interest.

Yirogos refused to accept that the financial recklessness of certain special interests and speculative creditors should put his job – and his community's water supply – at risk. As head of PSI affiliate EYATH Workers' Union, he helped organise a full-front resistance to the fire-sale.

First, he partnered with the Citizens group "Save Greek Water" – an existing network of Greek activists ready to join the fight.

His union made direct links with groups and unions in Germany – a key creditor country putting weight on Greece to privatise. They helped raise the issue at the national level and build international solidarity.

Next he enlisted PSI's help, with dozens of union journalists from around the world coming to Thessaloniki for a special workshop to help get the message out and build pressure against both Suez, and within the creditor nations, leading to key media coverage. This network helped support and transmit the message of a General Strike by Greek Unions against austerity.

Unions across Greece helped lead a court-case against water privatisation – and obtained a key ruling from the Greek Supreme Court [ruling the sale unconstitutional](https://neoskosmos.com/en/23600/athens-water-utility-to-remain-public/).

Finally, his union organised a city-wide referendum on water privatisation – when the Central Government attempted to stop them by banning them from carrying out voting within government premises, they set up outside voting stations out the front of the buildings. 98% of voters said no to privatisation, sending a formidable message to government and creditors.

Yiorgos' union deployed a wide range of strategies – including the use of media, courts, community activism and international solidarity, to help stave off one of the most pernicious effects the Debt Crisis. Their victory shows that resistance is possible.

To learn more about their story, check out PSI's short documentary: Something In The Water.

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45 AVENUE VOLTAIRE, BP 9
01211 FERNEY-VOLTAIRE CEDEX
FRANCE

TEL: +33 4 50 40 64 64
E-MAIL: PSI@WORLD-PSI.ORG
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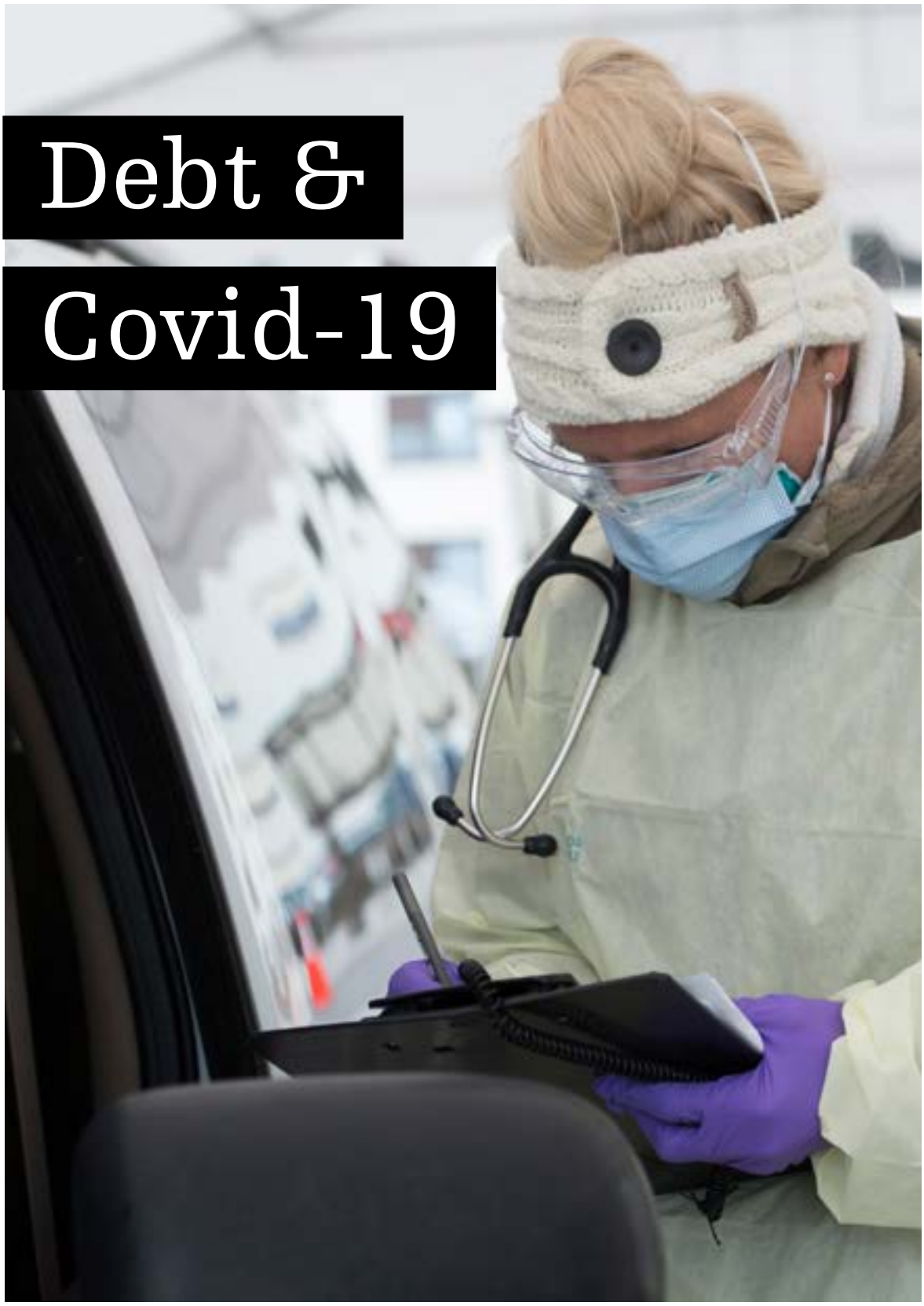
PSI BRIEFING SERIES - DEBT AND WORKERS SPECIAL BRIEF

Debt & Covid-19



SIX THINGS WORKERS & UNIONS MUST KNOW

COVID-19 AND DEBT ISSUES

"To safeguard workers and our public services, unions must understand these issues"

This Special brief has been adapted by PSI from a piece originally produced by Eurodad and our other partners in the Citizens for Financial Justice Coalition (C4FJ)

In responding to the Covid-19 pandemic, governments around the world are embarking on essential spending programs to support the public health response. The impact this has on debt levels will become a key issue for workers and unions in developing and developed countries.

PSI has worked with the United Nations Conference on Trade and Development to produce a five-part series on debt to ensure workers and unions understand the threats which debt issues can pose to workers and public services.

This Special brief is designed to answer some of the specific questions for unions in the developing and developed world about debt in times of COVID.

1) WHAT ARE THE RISKS TO DEVELOPING COUNTRIES OF THE COVID CRISIS?

Firstly, the health care systems in most of these countries are vulnerable and lack the required medical equipment (such as ventilators and intensive care units) to deal with a pandemic. According to the International Labour Organisation, large parts of the population in many low-income countries (LICs) lack access to essential health services due to a shortage of health workers, particularly in rural and remote areas. Years of increasing debt payments, austerity measures and private-sector involvement, promoted through World Bank assessments and IMF loan conditionalities, have had a negative impact on the health sector in many countries. Consequently, governments in the global south have been left particularly underprepared to deal with the public health crisis unleashed by the pandemic. Healthcare services will need to be scaled up substantially to tackle national Covid-19 outbreaks.

Secondly, the crisis is already having a devastating economic impact. According to the IMF, the global economy is set to experience the worst crisis since the Great Depression in the 1930s. This will reverberate around the world. The resulting recession in LICs will reduce economic growth from 5.4 percent in 2019 to just 0.4 percent in 2020. Commodity prices and exports have already dropped due to the global Covid-19 crisis, contributing to the 'largest ever capital outflow ever recorded' from developing countries. As a result, government revenues are falling and debt payments will increase, due to local currency devaluation and increased borrowing costs for global south governments. All this at a time, in which countries need to expand healthcare and social protection to respond to the crisis. Developing countries that were already facing heightened debt vulnerabilities and rising debt costs prior to the outbreak, have been left with practically no fiscal space to increase expenditures without incurring more debt, unless the international community provides adequate grant support.

Finally, the combination of health care vulnerabilities and economic impacts caused by the crisis have left developing countries in a precarious situation. Along with additional resources to tackle the health catastrophe and to deal with the economic losses, there is an urgent need to support those living in extreme poverty, to ensure food security or protect workers in the informal sector who have lost their livelihoods due to extended lockdown measures.

PSI, the International Union of Food workers (IUF) and our allies have highlighted the fragility of the current global food system and called on the G20 Agricultural Ministers to provide an urgent and coherent global policy response to food security that prioritises people's vital needs and not the profits of large food companies. Countries in the global south need all the external support they can get to tackle Covid-19 and the consequent economic and social crises, otherwise up to half a billion more people could be pushed into poverty. An initial estimate by Eurodad shows that low-income countries will require up to US$ 93.8 billion in external emergency financing to do so. In late March, UNCTAD called for a US$ 2.5 trillion crisis package for all developing countries (including low- and middle-income countries).

2) WHY CAN'T ADVANCED ECONOMIES SIMPLY PROVIDE COUNTRIES WITH THE NEEDED RESOURCES?

In an ideal world, this would be the right response. Unfortunately, advanced economies have a disappointing track record regarding support to the global south. In 1970, the UN set an official target for Official Development Aid (ODA) of 0.7% of Gross National Income (GNI) to be transferred from donor countries to developing countries. UNCTAD has estimated that, over the last decade, US$ 2 trillion would have reached developing countries had donor countries fulfilled their ODA commitments. However, the target has never been met. The crisis is likely to put further pressures on scarce ODA resources. As donor countries deal with the fallout of the pandemic on their domestic budgets, ODA is expected to drop, as it has in recent years.

3) IN THAT CASE, WHAT IS BEING DONE TO HELP DEVELOPING COUNTRIES FACE THIS CRISIS?

The international response so far rests on two main pillars: financial support in the form of loans (i) and a suspension of debt payments (ii).

- i. The IMF and the World Bank are responsible for the provision of most of the emergency response lending. These two multilateral institutions have already made a total of US$ 114 billion available for countries to borrow and the IMF can further increase its lending capacity to US$ 972 billion if needed. So far, more than 100 countries loans in order to tackle the crisis.

- ii. In Mid-April 2020, The IMF approved debt service cancellation for 25 countries for six months and the G20 has announced an agreement to provide a suspension of debt principal and interest payments due between 1 May and 31 December 2020 by the poorest developing countries to bilateral government lenders. The agreement potentially covers 77 countries – those classified by the UN as Least Developed Countries, and so-called IDA countries (countries that are eligible to borrow from the World Bank's International Development Association). All eligible payments are postponed and countries would then have 3-4 years to repay. The G20 also has the possibility to extend the suspension period, following review in the course of 2020.

No debt relief has yet been gravnted on loans from the World Bank or other Multilateral Development Banks, or debt owed to private creditors, so countries will still need to make these payments in 2020.

4) WHAT ARE THE PROBLEMS WITH THIS TYPE OF RESPONSE?

The current response simply kicks the can down the road. It completely fails to address the problems developing countries are facing. Not only do the loan financing and suspension of debt payments measures being discussed cover a fraction of the current financing requirements in the global south, especially in LICs, but they also create additional problems down the road, which could fuel a devastating long-term debt crisis.

- Loan financing to deal with the impact of Covid-19 is the equivalent of rearranging deck chairs on the Titanic. LICs were already struggling with debt burdens before the crisis. According to the IMF, 34 countries were at high risk of debt distress or already in default in 2019. Furthermore, middle-income countries such as Argentina, Lebanon, Ecuador and others, had already defaulted on some debt payments prior to the current Covid-19 crisis. If all the emergency financing is provided in the form of loans, public debt in those countries borrowing to tackle the crisis, will increase by at least 14.2 percentage points of GDP. Financing the Covid-19 response through loans swaps an immediate humanitarian crisis with a longer-term, yet equally devastating, debt crisis.

- The agreement by the IMF to grant debt relief to 25 countries provides just US$ 215 million over the next six months. This will be financed through the Catastrophe Containment and Relief Trust (CCRT), designed to cover scheduled IMF repayments from beneficiary countries, and which currently only has US$500 million in available resources. As Eurodad has assessed, while the provision of debt relief by the IMF is a step in the right direction, it is not without its problems as without additional funding, the capacity to provide further relief to these countries beyond October 2020, or expand the coverage to all 76 International Development Association countries, is extremely limited. Furthermore, given the large amount owed to the IMF by these countries – equivalent to eight times the debt relief they just received– the initiative has to be interpreted as a symbolic gesture to place additional pressure on G20 countries to agree on bilateral debt relief and mobilise additional ODA.

The suspension of debt service payments proposed by the G20 does not mean cancellation of debt service, but a postponement of the payments after 2021 (a one-year grace period and repayment period of 3 years). Even though the step taken by the G20 is significant and will support the immediate Covid-19 response with around US$12 billion worth of debt payments suspended, the breathing space it provides countries may be short-lived.

By agreeing only to postpone payments, debt crisis risks are being stored up for later. Furthermore, the suspension will be done on a basis to ensure the deferred payments will be adjusted at the time of repayment, to ensure creditors face no losses on the value of the delayed payments (this is referred to as net present value neutral or NPV-neutral). The upshot is that this costs creditors nothing, and borrowing countries simply have bigger repayments when the suspension period ends, and may need to borrow more to be able to repay.

The G20 agreement does not strictly apply to creditors other than bilateral government lenders, but it calls on multilateral development banks (including the World Bank) to explore the possibilities for debt service suspension for a limited period of time and for private creditors to participate in the initiative on comparable terms. However, no measures have been put in place to compel or enforce participation by these creditors. LICs are projected to pay US$ 9.8 billion to these two groups of creditors in 2020. As a result, the resources freed by suspending official bilateral debt payments may end up being used to pay other creditors, and private creditors in particular, rather than supporting the emergency response. We can expect that developing countries will be dealing with the impacts of the Covid-19 crisis on their economies for many years to come, so without full cancellation from all creditors, the G20 action currently pushes debt crisis risks further down the road.

5) BUT IF THE CURRENT RESPONSE IS WRONG, WHAT ALTERNATIVES ARE AVAILABLE?

PSI is supporting the widespread global call for a debt jubilee to tackle the Covid-19 crisis. The proposal is very simple:

- The cancellation of all external debt payments due in 2020 and 2021. This must cover all external creditors, both official and private, and all debt service charges for 2020 and 2021 on a permanent basis. Unlike the recently announced IMF initiative, this cancellation would cover all LICs and could potentially increase healthcare spending for Covid-19 by 119%. Support for middle-income countries experiencing at risk of a humanitarian crisis should follow suit.

- The provision of emergency financing, which does not create additional debt. In addition to encouraging donor countries to meet their ODA commitments, we support a creative use of financing arrangements by the IMF and the World Bank to provide large-scale grant financing.

In order to prevent any lender, especially vulture funds, suing governments for stopping debt payments in 2020 and 2021, key jurisdictions, such as the UK and New York should pass legislation to protect developing countries.

Debt payment cancellations and additional finance should not be tied to beneficiary countries undertaking economic policy reforms promoting privatisation, deregulation, labour market reform and trade liberalisation: countries' needs for relief and emergency finance are a result of a pandemic and resulting global economic downturn and not due to economic mismanagement.

6) WHAT ABOUT THE LONGER TERM? CAN WE DO ANYTHING NOW TO HELP AVOID A SIMILAR SITUATION IN FUTURE?

PSI and our allies are also calling for long-term solutions to debt crises. Many countries were in debt crisis before the Covid-19 crisis began and many more will emerge from this crisis with even higher unsustainable debts. The scale of the social and human cost of the pandemic demonstrates the need for a reformed approach to how debt sustainability is assessed (principally by the IMF) that moves beyond a narrow focus on repayment capacity to one that considers human rights, public service needs (in particular health), gender, climate, and other Agenda 2030 needs at its core.

Moreover, urgent actions in response to the crisis, such as immediate cancellation of debt payments, should be linked to a more comprehensive and long-term approach to debt crisis resolution, including the creation through the United Nations of a multilateral debt workout mechanism that would allow a more efficient, systematic, comprehensive, enforceable and equitable debt restructuring.

Urgent reform to the international corporate tax system is also necessary. PSI has long argued for unitary taxation to ensure corporations pay tax in the country where the economic activity takes place, an end to tax havens and better tax transparency.

Now, in the context of COVID-19, we also need urgent taxes on wealth, especially the very wealthy and corporations who have dodged tax, contributing to the underfunding of vital public healthcare systems now struggling to deal with the COVID crisis.

The digital and tech companies' business models have meant they are both the most profitable global companies but also those who are able to pay almost no tax. These massive multinationals are also the companies that are making increased profits during the confinement period whilst local, small and medium enterprises are struggling. Countries should introduce digital sales taxes immediately to raise the revenue urgently needed to fight COIVD and avoid further debt crisis.

PUBLIC SERVICES
INTERNATIONAL

45 AVENUE VOLTAIRE, BP 9
01211 FERNEY-VOLTAIRE
CEDEX, FRANCE

TEL: +33 4 50 40 64 64
E-MAIL: PSI@WORLD-PSI.ORG

WWW.WORLD-PSI.ORG