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CITIZENS FOR FINANCIAL JUSTICE

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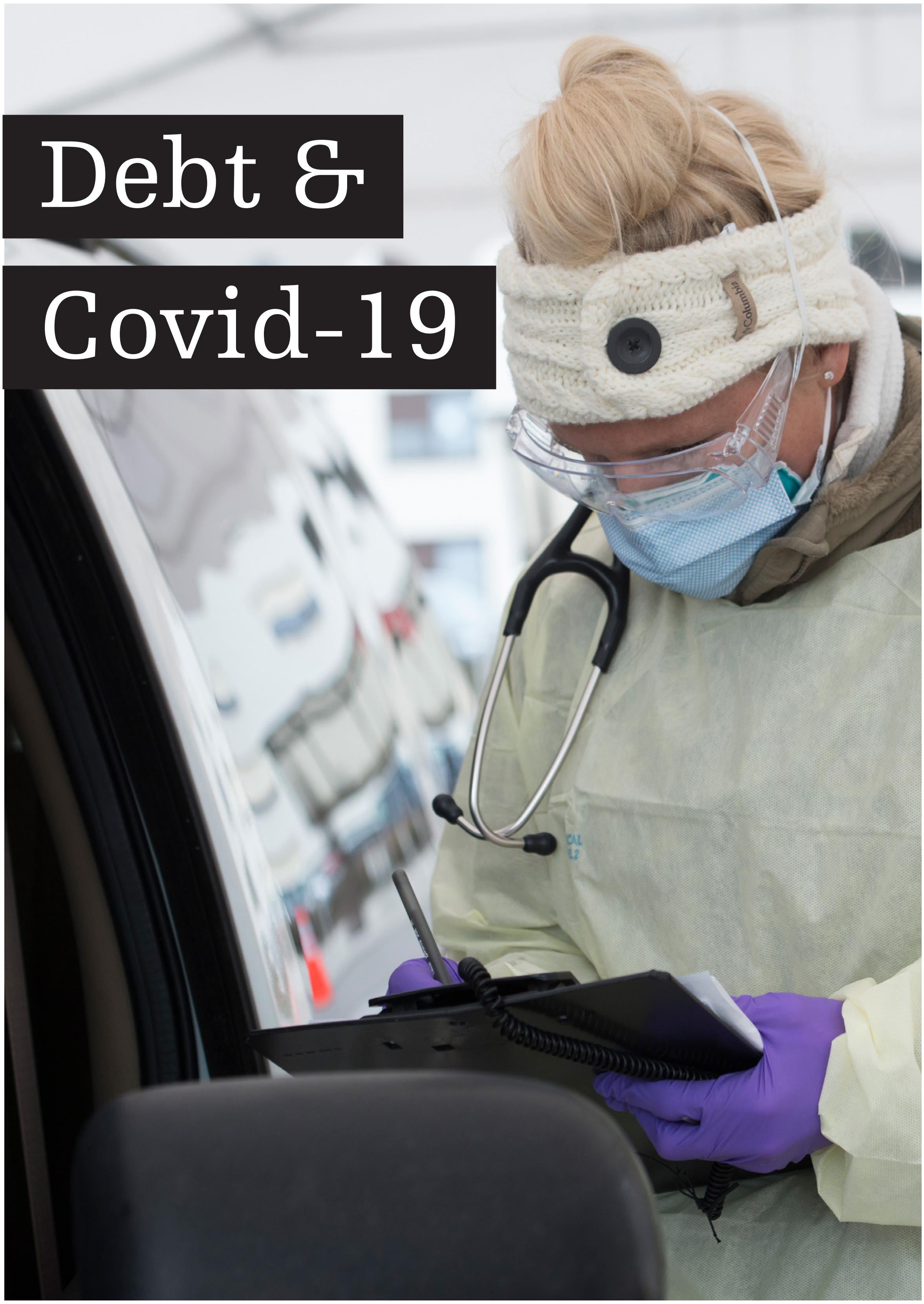
PSI BRIEFING SERIES - DEBT AND WORKERS SPECIAL BRIEF

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 an additional 130 million could be pushed towards starvation, and 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.

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