DEVELOPING ECONOMIES IN A TIME OF PANDEMIC

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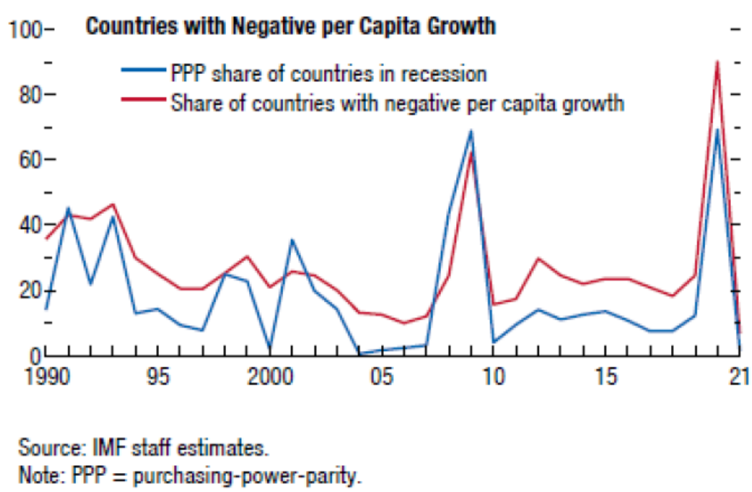
> "The dramatic [global] economic slowdown already underway…will do damage [to developing economies] at levels that are hard to forecast and grim to contemplate."
> *New York Times editorial, April 14, 2020, citing a survey by the International Crisis Group*

We are in a global crisis that has spread to all corners of the world, bringing death and impoverishing people in rich and poor countries. In what follows, we sketch the dimensions of the economic crisis (others will address the pandemic per se) and report on cross-border policy measures taken thus far to ameliorate the situation. An additional note is needed to propose additional policy measures that should be taken in the short run and in coming years.

Output and labor income in 2020

IMF published its latest estimates of global output this week, which it expects will contract 3.0% in 2020, with most of the decline in the developed countries (6.1% on average). This is the sharpest global contraction since the Great Depression. The pain is widespread, as over 170 countries are expected to see a fall in per capita income (90% of its 189 member countries; 80% in outright contraction [figure 1]).

Figure 1.



Source: IMF, *World Economic Outlook*, April 2020.

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Measured unemployment for the year as a whole is expected to be higher everywhere, but it is skyrocketing in the United States from 3.7% to 10.4%. Unemployment in developing countries is also rising, particularly in a number of large economies that already have high unemployment rates, e.g., in Brazil from 11.9% to 14.7%; in Turkey from 13.7% to 17.2%; in Iran from 13.6% to 16.3%; in South Africa from 28.7% to 35.3%.

The International Labor Organization reminds us, however, that formal unemployment does not reflect the situation of many workers in most developing countries where much work takes place in the informal economy. ILO thus instead studies the overall loss of labor income due to reduced wages and hours worked, which they estimated in March for the world as a whole to range from $860 billion to $3.4 trillion in 2020 [table 1]. ILO also estimated that instead of the number of working poor around the world declining by 14 million, which was expected pre-Covid-19 crisis, the number may decline by only 5 million or rise by as much as 21 million people.[2] In a subsequent estimate, ILO expressed concerns that one might summarize as saying that "optimistic" scenarios seem increasingly unlikely.

Table 1: Estimated decline in labour income and increase in extreme and moderate working poverty (<$US 3.20 per day, PPP), 2020

Income group	Low	Mid	High
Labour income (US$ billion)	-860	-1,720	-3,440
Extreme and moderate working poverty (millions)			
World	8.8	20.1	35.0
Low income	1.2	2.9	5.0
Lower-middle income	3.7	8.5	14.8
Upper-middle income	3.6	8.3	14.5

Note: *Working poverty estimates pertain to an absolute poverty threshold (below US$3.20 at PPP) for 138 low- and middle-income countries. This analysis excludes potential impacts on working poverty in high-income countries.*

Source: ILO, 18 March 2020.

Prospects for 2021

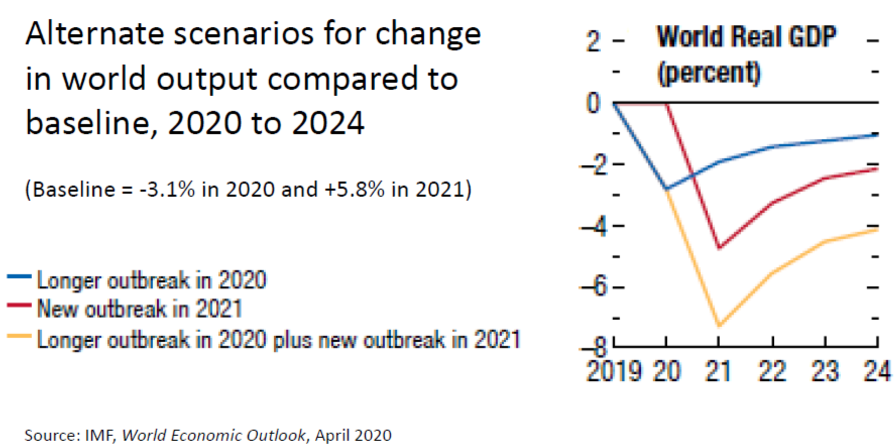
While IMF calls its estimate a "baseline" projection for 2020, it acknowledges that it assumes that the pandemic "fades" in the second half of the year, restoring consumer and investor confidence, returning people to work, limiting company bankruptcies and containing strains in the financial sector. On this basis, the Fund projects global growth recovery in 2021 of 5.8%. Developing economies are projected to grow 6.6% on the whole

[2] ILO defines the working poor as having an income below $3.20 per day and includes 138 low and middle-income countries in its analysis (national currency data converted to purchasing parity dollars).

in 2021, with the largest increases in China and India.

However, the IMF warns that there is “extreme uncertainty” about this projection. If the pandemic lasts 50% longer than in the baseline, with corresponding negative impacts on financial conditions, global output would be expected to contract 6% instead of 3% in 2020 and grow about 4% in 2021 instead of almost 6% [figure 2]. If the baseline assumptions were correct for 2020, but the pandemic returned in 2021, global output would grow by only 1% in 2021; and if the pandemic lasted longer in 2020 and returned in 2021, global output would contract in 2021 as well as in 2020. IMF does not explain whether it expects its alternative scenarios to be probable. They should be read as a warning.

Figure 2.

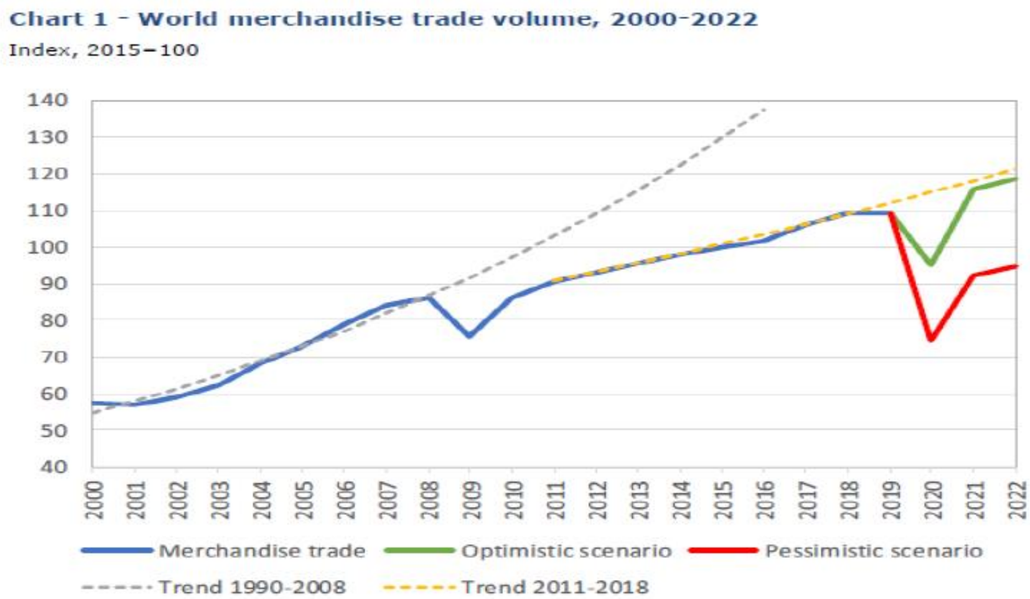


International trade

It may be appreciated that just as forecasts of economic activity into 2021 are not reliable, so too would the forecasts of other major economic variables not be reliable. Let us thus focus on how things are evolving this year. IMF expects the volume of world trade in goods and services to shrink 11.0% this year, after growing only 0.9% last year. The World Trade Organization thinks a range of outcomes are possible, each a worse decline than IMF’s projection. WTO estimates that merchandize trade (a narrower category than IMF uses) will decline this year by from 13% to 32%. Moreover, trade recovery when it comes will continue to be disappointing compared to the trend pre-financial crisis [figure 3]; i.e., the era of robust growth of world trade on which especially Asian developing countries based their remarkable economic growth ended with the global financial crisis. Thus, even in the optimistic recovery scenario, world trade will not soon regain its historic dynamism.

The collapse in world trade this year is understandable, what with the Covid-19 lockdown reducing supplies of intermediate goods needed to maintain production in distinct stages of global value chains in different countries, on top of which Covid-19 caused a sharp overall drop in demand as people had to “shelter in place” and worry how to survive their loss of income. This has not only been devastating to the tourism and travel industries, but also to international commodity prices, notably petroleum. IMF estimates that the average price of crude oil will have fallen 42.0% in 2020, after a fall of 10.2% last year. And, that estimate is embodied in its "baseline" (i.e., optimistic) scenario. The immediate impact of the crisis showed itself for oil and other commodities in just three weeks, from January 17 to February 7, 2020 [figure 4.].

Figure 3.

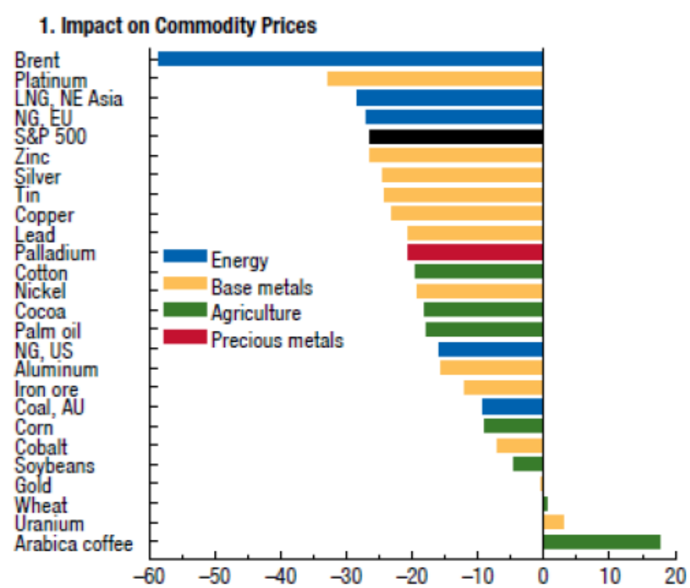


Source: WTO Secretariat. 8 April 2020.

Figure 4.

Coronavirus Shock

Percentage change in international prices of selected commodities between 17 January and 7 February 2020.



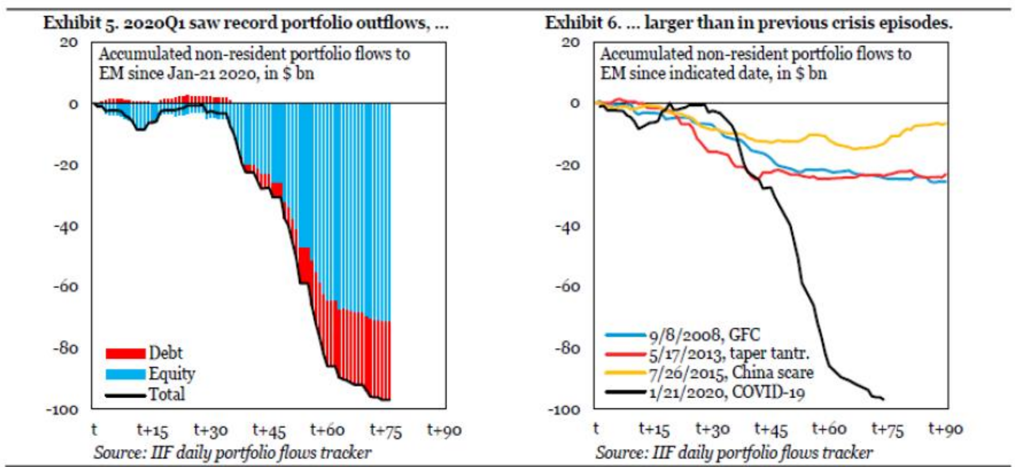
Source: IMF, *World Economic Outlook*, April 2020.

International finance and debt

While the trade shock for commodity exporters was sharp enough, the sudden capital flight from emerging economies was all the more dramatic. From January 21 until April 3, non-resident equity investors and lenders sold almost $100 billion on a net basis of their holdings of the stocks and bonds issued in the 25 largest emerging economies, most of it in March [figure 5]. This "flight to quality" by international investors made even the 2008/9 global financial crisis pale by comparison.

Figure 5.

Investors flee emerging economies, first quarter 2020



Source: Institute of International Finance, *Capital Flows Report, April 9, 2020.*

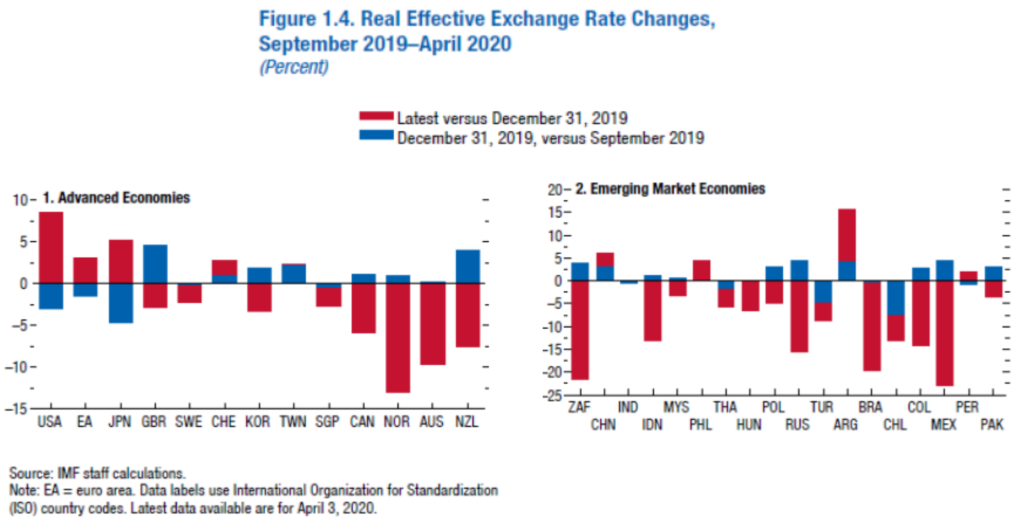
You will not be surprised to hear that the foreign portfolio investors, along with other non-residents and residents with movable money, then took substantial funds out of these countries, prompting telling declines in currency exchange rates [figure 6]. When exchange rates fall, not only do the domestic currency costs of imports rise, but financial payments that have to be made in foreign currency rise, including servicing the external sovereign debt of the affected countries. For countries already carrying heavy debt burdens, this can cause a dilemma in the face of the need to spend fiscal resources to fight Covid-19.

A number of developing countries are thus confronting heavier foreign debt-servicing obligations. Argentina is in a class by itself, as the Covid-19 crisis only compounded Argentina's existing debt stress, leading IMF to acknowledge it required debt restructuring. On April 6, Argentina delayed defaulting on $70 billion in foreign currency denominated bonds issued under foreign law. It gave itself a degree of breathing room by postponing until 2021 debt servicing falling due on other foreign currency bonds which it had issued under domestic law whose repayment terms it could legally amend.[3] This bought time to negotiate a comprehensive debt restructuring agreement (and a proposal to

[3] Argentina had been scheduled to pay $32 billion in interest and principal on its foreign debt in the remainder of this year, mostly on the local-law bonds.

creditors was made yesterday).[4]

Figure 6.



Source: IMF, *World Economic Outlook*, April 2020 [N.B., Argentina wrong; REER fell 4% Sept-Dec; fell 8% Dec-Apr, Banco Central].

Lower income countries have faced a particular debt challenge, as some of them had borrowed heavily on commercial terms by issuing bonds on international markets in recent years. The buyers of those bonds accepted the risk of non-payment from these "frontier" markets because global interest rates had fallen to unprecedented lows and the "risk premium" on these bonds increased the interest rates they could charge. But the risk was real and sixteen lower-income countries had already fallen into default by 2019, while another 28 were assessed by IMF and the World Bank as at high risk of default [figure 7]. As may be seen in the figure, the lower income countries had borrowed more heavily from private sources in 2017 and 2018. Those sources are unlikely to want to lend again now that the borrowing needs of these countries are greatest, let alone roll over maturing bonds with new ones in the next few years unless the world economy and thus the growth prospects of these economies show new dynamism. In short, they will need to negotiate reduced debt obligations.

International policy measures

Both trade and financial policies that impact developing countries need to be noted here. The trade policy side is uniformly disappointing while there have been some positive developments on international financial cooperation and debt.

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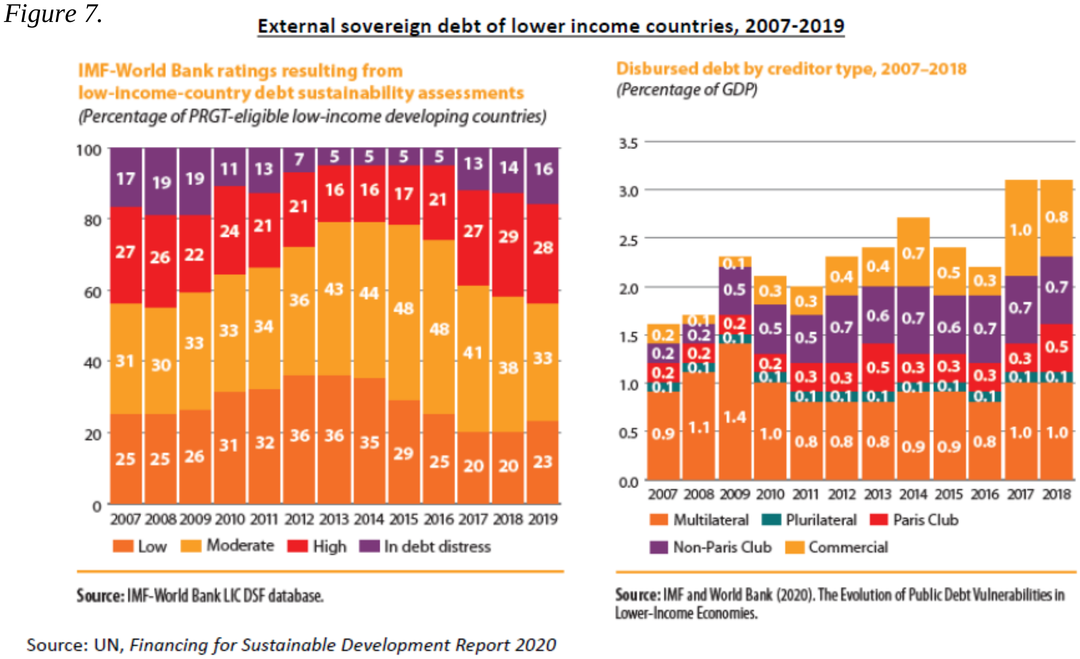
[4] In addition, Argentina currently owes IMF $43.6 billion, which cannot be restructured, although Argentina and IMF can agree to a new adjustment program which IMF would support with a new loan, essentially refinancing the outstanding obligation.

Figure 7.



Trade policy

In the absence of a globally coordinated attack on Covid-19, each nation seeks to maximize its own access to medically necessary supplies. Indeed, 54 countries have imposed 46 Covid-related export curbs since the beginning of the year, 33 of them in the first three weeks of March alone.[5] On the other hand, on March 25, a group of seven countries, led by Singapore and New Zealand, signed a pledge to remove any barriers to trade in essential goods, especially medical supplies.[6] While many developing countries produce some of what is needed to fight Covid-19, they generally do not produce the most technologically sophisticated equipment, in particular, ventilators. This situation requires some global political oversight.

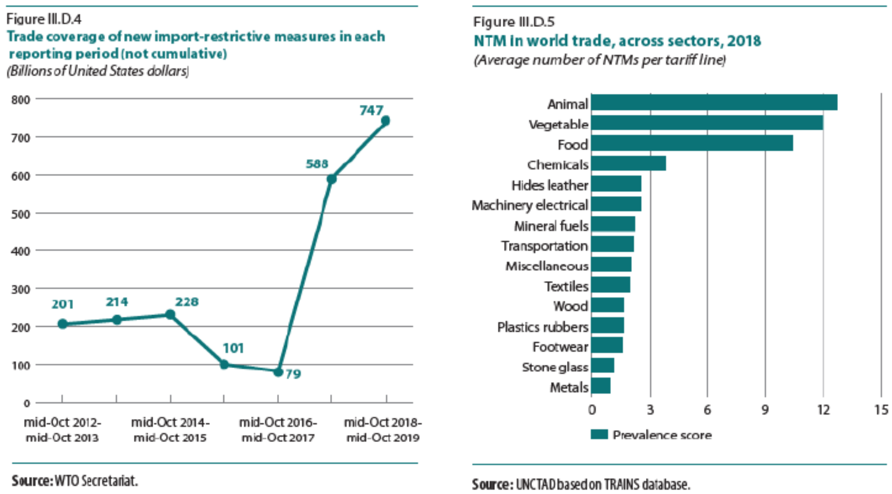
This nationalist scramble for pandemic-related materials is a simple extension of the "mercantilist" policy trend in recent years [figure 8]. The trade-restricting measures included tariff increases, import or export bans, quantitative measures, stricter customs procedures, import taxes and export duties. Non-tariff restrictions in this mix include sanitary and phytosanitary (plant health) measures, which can be fully warranted or an excuse to limit imports that compete with local production. They especially impact agricultural exports in the Asia and the Pacific, Middle East and North African regions. The solution, naturally, is to help exporters meet the legitimate safety standards required by import-restricting countries and to remove the restrictions that merely serve to protect

[5] In addition, many countries have eased import restrictions or duties on pandemic-related goods. WTO compiles announcements of pandemic-related restrictive and liberalizing trade-policy changes at https://www.wto.org/english/tratop_e/covid19_e/trade_related_goods_measure_e.htm (currently updated as of April 14).

[6] Australia, Brunei, Canada, Chile, Myanmar, New Zealand and Singapore.

high-cost farmers in developed countries.

Figure 8. Not so free trade anymore, 2012-2019



Source: UN, *Financing for Sustainable Development Report 2020.*

The Group of 20 finance ministers and central bank governors, meeting virtually on April 15, offered scant prospect of rewinding the approach to trade policy of some member countries even in light of the pandemic, saying,

> *We agree that emergency trade measures designed to tackle COVID-19, if deemed necessary, must be targeted, proportionate, transparent and temporary, and that they do not create* ***unnecessary*** *barriers to trade or disruption to global supply chains, and are consistent with WTO rules. We are actively working to ensure the continued flow of vital medical supplies and equipment* [emphasis added].

Financial assistance

Only governments and their central banks can address the financial challenge of the pandemic. Central banks need to support their banks and financial markets when the vast majority of borrowers suddenly can no longer make their payments falling due or need credit on an emergency basis. The biggest danger is that the financial system freezes up and businesses and individuals can no longer make or receive payments. To prevent this from happening, central banks will flood their banks and sometimes their financial markets with money, at least in domestic currency, to increase lending, increase prices of securities and boost investor confidence. In addition, governments will need to spend more not only on public health but also to help meet at least some of the public's need for replacement income as jobs disappear and businesses suddenly face bankruptcy. At the same time, government revenues are plummeting, as income and value-added or sales tax collections shrink, along with government revenues from mining and commodity exports.

The governments of the major economies responded to the 2008 global financial crisis and several climate and public health emergencies in part by setting up a variety of special official financial support instruments.[7] Some of these instruments are being used again, including lines of credit in US dollars that the US Federal Reserve System offered in March to major developed and developing country central banks.[8] In addition, the IMF had created emergency lending facilities that promised to extend credit quickly to developing countries with no "conditionality" (except the promise to repay) in case of crises not of their own making. IMF has recently lent $4.6 billion using the special facilities (one making interest-free loans to low-income countries and the other lending on standard terms) or it added to the loans already extended to a total of 17 countries (as of April 15).[9] In addition, on April 9, the IMF Executive Board doubled the total amount of funds that can be borrowed from these two facilities from $50 billion to $100 billion, a decision it will review in six months. Then, on April 15 IMF created a new Short-term Liquidity Line of credit for countries judged to have "very strong policies and fundamentals," which will allow them to quickly borrow from the Fund without "conditionality" up to 145% of their quota (the normal limit when negotiating a regular IMF loan with conditionality).

While IMF and central bank cooperation provides general fiscal and monetary resources to developing countries, the international development banks provide more targeted financing. The World Bank, in particular, has set up a Fast Track Covid-19 Facility for quickly approving pandemic-related loans. On April 2, the Bank's Executive Board approved such loans to 25 countries totaling $1.9 billion for Covid-19 response, including hiring more medical staff, purchasing supplies, engaging in contact tracing, and building domestic health systems. An additional 40 countries are said to be in the pipeline for these loans which could total $160 billion over 15 months. In addition, the International Finance Corporation, the World Bank's private sector lending arm, is providing $8 billion in loans to domestic partner financial institutions in developing countries to boost trade finance, working capital and medium-term credits, such as to address disruptions in supply chains.[10] The main regional development banks have also announced expanded lending programs in their respective regions[11] and, like the World Bank, are also reallocating funds from existing longer term investment projects to Covid-19 campaigns.

[7] An inventory of these instruments was compiled by the UN's Inter-Agency Task Force on Financing for Development in 2018.
[8] Australia, Brazil, Denmark, Canada, Euro area, Japan, Republic of Korea, Mexico, New Zealand, Singapore, Sweden, Norway, Switzerland, and the United Kingdom.
[9] Albania, Burkina Faso, Chad, El Salvador, Gabon, The Gambia, Ghana, Kosovo, Kyrgyz Republic, Republic of Madagascar, Niger, Republic of North Macedonia, Panama, Rwanda, Senegal, Togo, and Tunisia.
[10] In addition, the Bank's Multilateral Investment Guaranty Agency is offering fast-track decisions on $6.5 billion in political risk insurance and other incentives to private investors and private-sector lenders for pandemic-related investments and purchases in developing countries.
[11] The UN reported pandemic response packages of the European Investment Bank (€40 billion), Asian Development Bank ($6.5 billion), Inter-American Development Bank ($2 billion) and Islamic Development Bank ($730 million). After the release of the UN report, the African Development Bank announced a $10 billion response facility. The UN also reported that the World Health Organization (WHO) estimated that it needed $675.5 million to combat COVID-19, but by mid-March 2020, had received only $103.4 million, plus two grants from small international funds, totaling under $25 million.

Debt relief

While these loans provide much needed financial resources to help countries combat the economic and health dimensions of the pandemic, all of these funds, including those provided at zero or very low interest rates, are loans that have to be repaid. As noted, many developing countries were already facing a difficult debt situation and the additional debt burden from these operations will need to be handled or if not possible, the debt burden will have to be relieved. While that entails post-crisis negotiation between the indebted country and its creditors, some steps have been taken to lessen the debt-servicing burden at least of low-income countries during the depths of the crisis this year.

IMF, in particular, had earlier created a facility to free low-income countries from their debt-servicing obligations on loans from IMF when they are struck by disasters. That facility (the Catastrophe Containment and Relief Trust) provides grants, funded by donor governments, to impacted countries to cover their debt-servicing obligations to the Fund. On April 15, the Fund's Executive Board approved $213.4 million in grants for 25 countries to cover the next six months of principal and interest payments.[12] As another four countries are expected to qualify soon and as the coverage ends in six months, the IMF Board and Management are seeking additional contributions to the Trust. In the global scheme of things, this is a modest effort, but it establishes a principle that countries, at least the poorest, should have their debt servicing *canceled* during extraordinarily harmful events and their aftermath.

On April 15, the Group of 20 finance ministers and central bank governors offered low-income countries a far more limited package of relief but applying to a larger amount of debt. In this case, the relief would be on interest and principal payments owed to member governments of the G20 (principally on export credits and to a lesser degree official development assistance loans) that are scheduled to be paid between May 1 and December 31, 2020. The offer is to suspend interest and principal payments but not to forgive them. The unpaid amounts would be added to existing debt servicing obligations (plus interest for the period of delay) starting in 2022 and payable over the following 3 years. If conditions warrant, the moratorium period can be extended.

Reuters reported that the Saudi finance minister said the agreement can free up $20 billion for fighting the pandemic. A French finance ministry official was cited claiming it could reduce official debt servicing by $12 billion and that $8 billion in private debt could be rolled over or refinanced. While the latter would be a new departure in private finance of sovereigns, it remains to be seen if it happens. Another concern is that middle-income countries are excluded from the arrangement and many are indeed facing severe debt difficulties (e.g., Lebanon, Ecuador, Argentina, Venezuela).

By way of conclusion

The global extent of the Covid-19 disease and its economic consequences are proof, as if any were needed, that the world has become a single social and economic space.

[12] Afghanistan, Benin, Burkina Faso, Central African Republic, Chad, Comoros, Congo, D.R., The Gambia, Guinea, Guinea-Bissau, Haiti, Liberia, Madagascar, Malawi, Mali, Mozambique, Nepal, Niger, Rwanda, São Tomé and Príncipe, Sierra Leone, Solomon Islands, Tajikistan, Togo, and Yemen.

And yet all policy to address the crisis is made by national governments—or sub-national government entities when the national government is slow to act. National governments more or less coordinate their policies and the efforts of the more able countries to assist the countries with less capacity are similarly more or less coordinated (supplemented by philanthropy). This is the usual practice since the end of the Second World War, but this time government leaders have been slow to cooperate and have not always acted to positive effect. This will not do in the current crisis and is not sustainable in future crises. Ameliorating the crisis requires that States act together.

Despite the encouraging steps taken this week, at least on the official finance and debt agenda, more is needed in the short run and systematic reform, rather than temporary crisis management, is warranted so the world is better prepared for the next crisis. That, however, may need to await a rebirth of multilateralism. The experience in the current crisis should be all the evidence needed to make that process politically palatable. The challenge is to make that argument so it is heard and absorbed.