Financing for development in the era of COVID-19 and beyond

Priorities of Latin America and the Caribbean in relation to the financing for development global policy agenda

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Economic and social impact

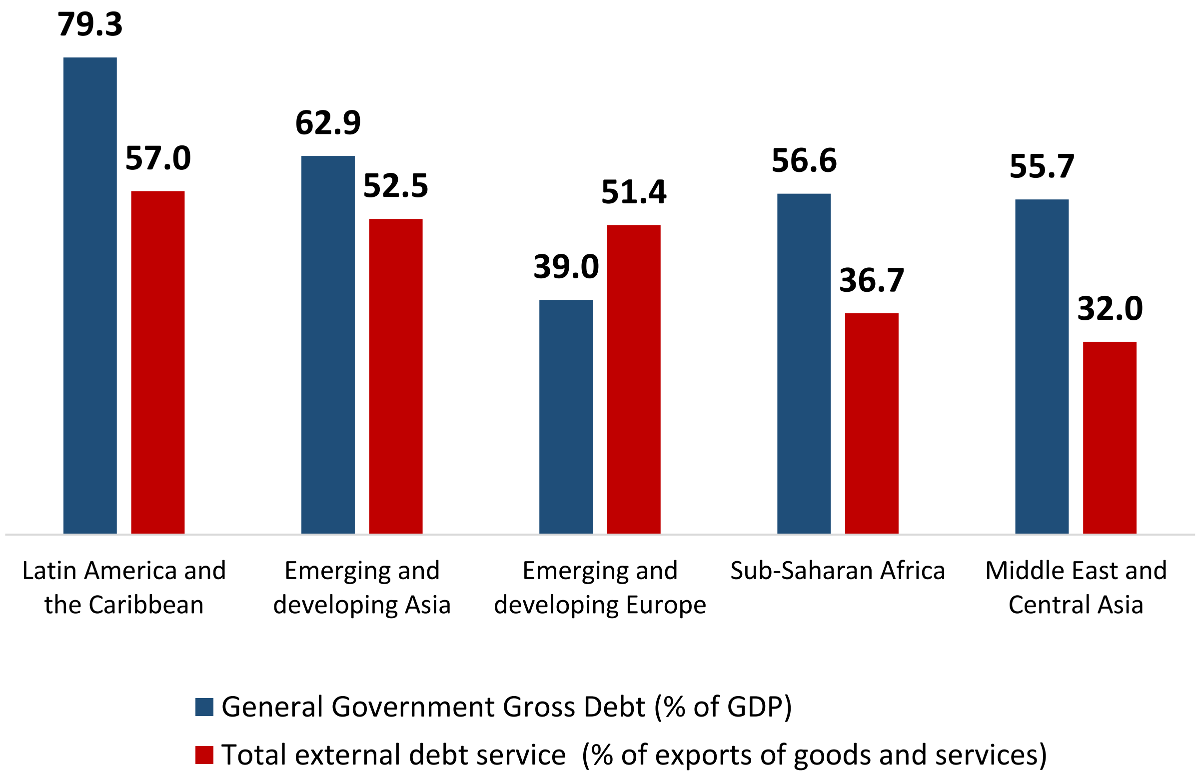
LAC IS THE DEVELOPING REGION HARDEST HIT BY COVID-19, EXACERBATING DEBT BURDENS AND PAYMENT IMBALANCES (SMALLER ECONOMIES)

- LAC represent 8,4% of world population but registered 28,7% of global fatalities due to COVID-19
- Sharpest economic contraction in 120 years: -7.7% in 2020; exports fell roughly 13%, and more than 2.7 million firms (mostly SMEs) shut down.
- 40 million households without an Internet connection
- Unemployment rate: 10.7% (44,1 million people)
- Steep decline in labour participation
- 209 million in poverty and 78 million in extreme poverty (33.7% and 12,5% of total population)

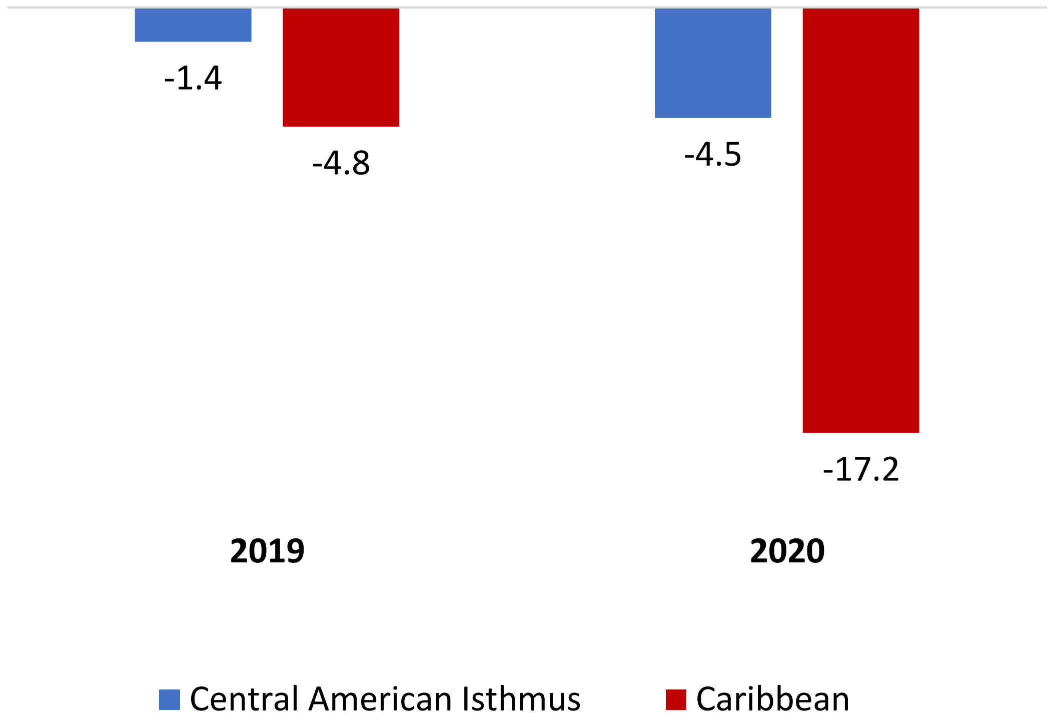
- Latin America and the Caribbean is the most indebted region in the developing world (79% of GDP)
- The region with the highest external debt service relative to exports of goods and services (57%)
- The external deficit in the Caribbean will expand from (4.5% to 17% of regional GDP)

COVID-19 CRISIS WILL SIGNIFICANTLY WIDEN LAC'S FINANCING GAP: INCREASE IN EXTERNAL DEBT AND WORSENING OF THE BALANCE OF PAYMENTS POSITION ESPECIALLY FOR THE SMALLER ECONOMIES OF THE REGION

Developing regions: selected debt indicators, 2020 (Percentages)



Current account as percentage of GDP for the Central American Isthmus and the Caribbean 2019-2020



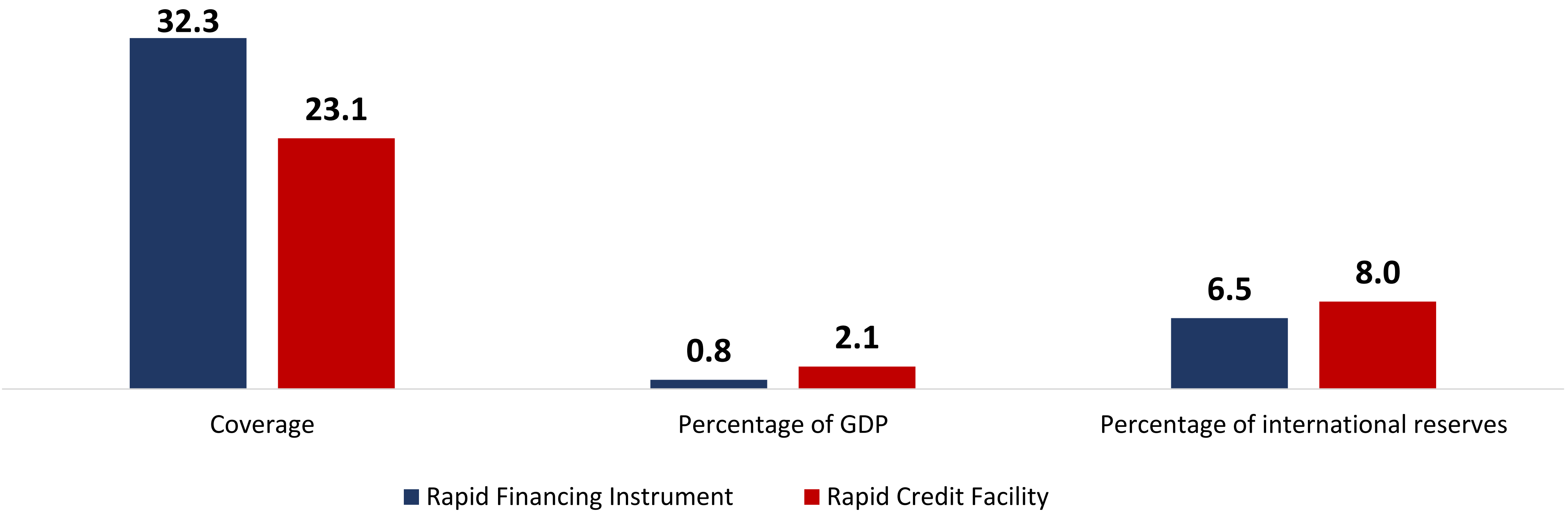
Source: On the basis of the IMF (2021)

INTERNATIONAL FINANCIAL INSTITUTIONS NEED TO SCALE UP THE AVAILABILITY OF LIQUIDITY TO MEET THE FINANCING NEEDS OF LAC

- IMF Lending is provided through financial instruments with limited or no conditionality in order to improve its flexibility and response capacity to confront the effects of the pandemic.
- The instruments that cover most of countries' financing needs are available to a small subset of countries.
- Most instruments cover only between 23.1% and 32.3% of countries' financing needs for 2020.
- Besides IMF emergency lending facilities, countries have three other alternatives to access funding:
  - Apply for an IMF standard programme with the associated conditionalities
  - Tap into the international bond market
  - Request loans from multilateral development banks

FOR THE MAJORITY OF LAC ECONOMIES, THE EMERGENCY FINANCING LINES COVER ONLY A SMALL PART OF COUNTRIES' FINANCING GAP

Latin America and the Caribbean (selected economies):
financing gap coverage provided by the Rapid Financing Instrument and the Rapid Credit Facility, 2020
(Percentages of total financing needs, GDP and of international reserves)



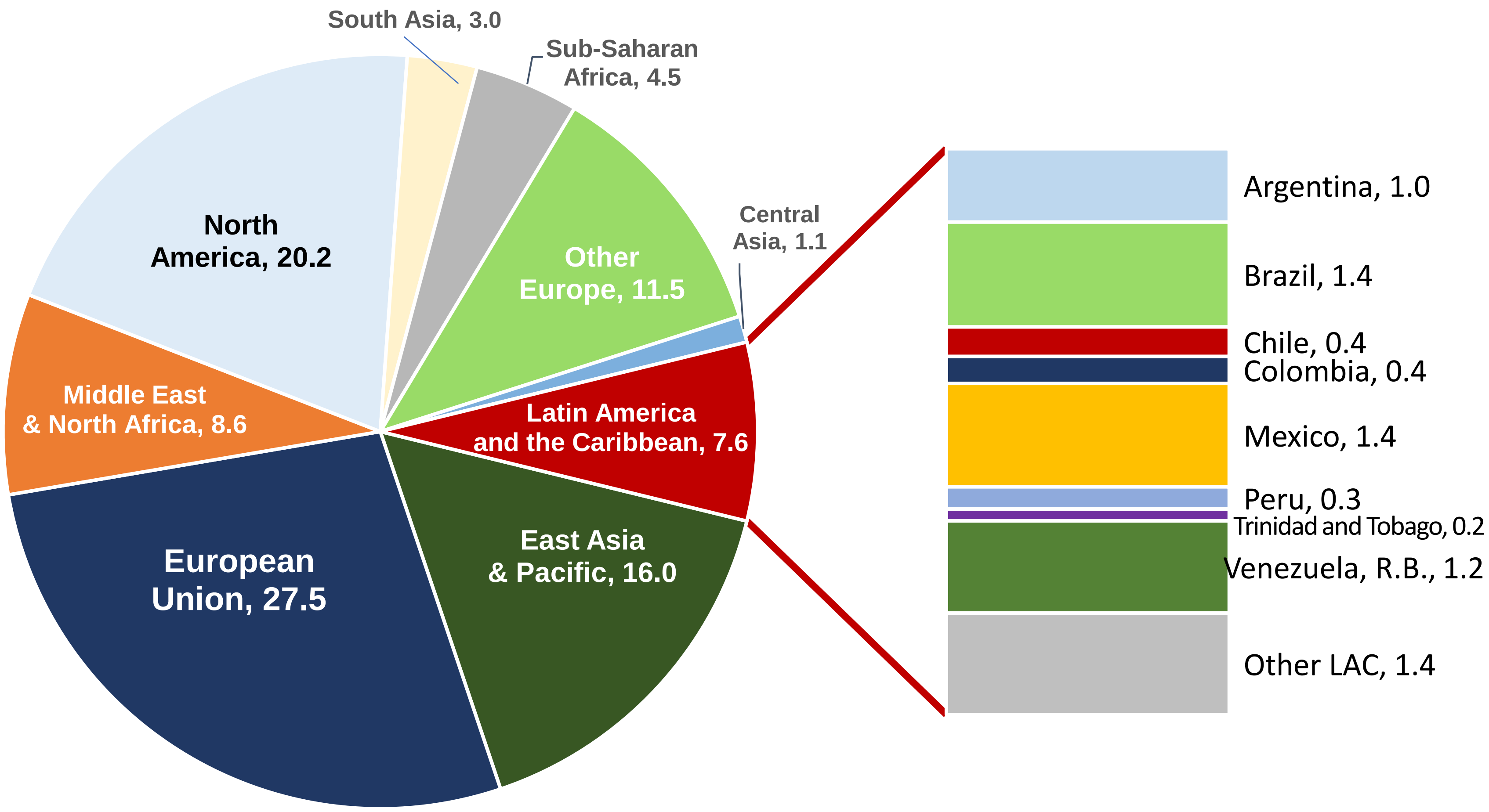
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of information provided by the International Monetary Fund (IMF) and official data, 2020.
Note: The figures are estimates are based on a series of IMF reports on the countries of Latin America and the Caribbean that requested emergency funding through RFI or RCF during 2020, including the Bahamas, Costa Rica, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Haiti, Jamaica, Panama, Paraguay, Plurinational State of Bolivia, Saint Lucia and Saint Vincent and the Grenadines.

ECLAC PROPOSES FIVE POLICY ACTIONS TO ADDRESS THE LIQUIDITY NEEDS AND DEBT CHALLENGES OF LAC COUNTRIES AND TO SET THE STAGE FOR BUILDING FORWARD BETTER

1. Expand and redistribute liquidity from developed to developing countries.
2. Strengthen regional cooperation by improving the lending and response capacity of regional/subregional/national financing institutions and the linkages between them.
3. Institutional reform of the multilateral debt architecture.
4. Expand the toolbox of innovative instruments to improve debt repayment capacity and avoid debt distress.
5. Liquidity and strategies to reduce the debt must be part of a financing for development strategy to build forward better.

FIRST POLICY ACTION: EXPAND AND REDISTRIBUTE LIQUIDITY FROM DEVELOPED TO DEVELOPING COUNTRIES

Allocation of Special Drawing Rights by Region, December 2020



- A new allocation of SDRs would increase countries’ liquidity without generating any additional debt
- Developing economies would be allocated roughly 40% of a new issue of SDRs and the rest would go to developed countries

Source: Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of IMF (2021)

SPECIAL DRAWING RIGHTS: ISSUEANCE AND REALLOCATION

- The region could receive 7.6% of a new allocation of 500 billions SDRs amounting to US$56 billion dollars in additional international reserves for Latin American and Caribbean economies. It would benefit several economies including highly indebted ones.
  - South America (Argentina and Ecuador)
  - Central America (Costa Rica, El Salvador and Nicaragua)
  - Caribbean (Belize and Suriname)
- New SDR allocation should be complemented with a reallocation of existing SDRs to middle income countries in LAC.
  - The pooling of SDRs would be a more effective way of dealing with the liquidity needs of our countries than bilateral voluntary transfers.
  - A reallocation of SDRs would strengthen the financial capacity of Regional Financial Arrangements (RFAs) and other regional financial institutions (regional development banks) including the creation of a new trust fund.

MULTILATERAL FUNDS LIKE THE FUND TO ALLEVIATE COVID-19 ECONOMICS (FACE) CAN ALSO REDISTRIBUTE LIQUIDITY FROM DEVELOPED TO DEVELOPING ECONOMIES

FOUR MAIN FEATURES

1. **The fund is of modest size**
   - US$ 516 billion dollars (3% of GDP of low and middle-income countries which is equal to roughly US17 trillion dollars)
   - This is equivalent to the funding that multilateral development banks could provide in an emergency
2. **Concessional lending regardless the income level of countries**
   - Terms of 50 years, 5 years of grace and a rate of zero (or near zero) percent interest.
3. **Absence of conditionality**
   - The concessional loans are free of fiscal, monetary or structural conditionalities.
   - Requirements for good governance, and a steady fight against corruption from countries.
4. **Spending of FACE funds should be aligned with the 2030 Agenda**

SECOND POLICY ACTION: IMPROVE LEVEL AND RESPONSE CAPACITY OF REGIONAL, SUBREGIONAL AND NATIONAL FINANCING INSTITUTIONS

- By increasing levels of **capitalization** and adopting **more flexible criteria** for lending.
- Development banks could use its available capital more effectively by **reducing its equity-to-loan ratios** to a level commensurate to that of commercial banks.
- Regional and subregional development banks (including CABEI, CAF, CDB and IDB) have committed US$ 20 billion dollars to LAC countries to respond to the Pandemic.
  - **CABEI** increased its authorized capital by 40% (US$ 2 billion) in April 2020
  - The **IDB** has submitted a capital increase that would enable annual lending to grow from $12 billion to nearly $20 billion.
- Foster more cooperation & coordination between regional/subregional and national development banks: national development banks as key players in the provision of finance committing the equivalent of US$ 93 billion in financial support.

THIRD POLICY ACTION:
INSTITUTIONAL REFORM OF THE MULTILATERAL DEBT ARCHITECTURE

External debt, public and publicly guaranteed by country groupings
(Millions of $US and as percentage of the total)

Country groupings	Millions of $US	As % of total
Low and middle income	2,923,874	100%
Low income	118,111	4.0%
Lower middle income (excluding India)	1,021,506	34.9%
Upper middle income (excluding China)	1,784,258	61.0%
Middle income (excluding China and India)	2,805,763	96.0%

Source: World Bank (2020)

The **rise in debt in MICs** can be a major stumbling block to an effective response to the urgency of the pandemic

- MICs represent 75% of the world's population, 62% of people living in poverty and roughly 30% of world aggregate demand
- MICs account for 96% of developing country debt (excluding China and India). Debt distress and potential default in MICs can reverberate throughout financial markets.

THE DSSI TO REDUCE DEBT BURDENS MUST BE DEEPENED AND EXPANDED TO RESPOND TO THE CURRENT CIRCUMSTANCES ESPECIALLY THOSE OF MIDDLE-INCOME COUNTRIES

Dominica, Grenada, Saint Lucia and all countries worldwide participating in the Debt Service Suspension Initiative: debt service by creditor type, 2020

(Percentages of the total)

Type of creditor	All participating countries	Caribbean countries participating in the DSSI		
		Dominica	Grenada	Saint Lucia
Private lenders	**25.5**	**18.0**	**25.0**	**1.0**
Official multilateral	30.1	49.0	58.0	74.0
Official bilateral	44.4	25.0	17.0	25.0
Non-official	…	8.0	0.0	…

Source: World Bank and European Network on Debt and Development (EURODAD) (2020).

- The DSSI must include MICs
  - Only three countries from LAC participate: Dominica, Grenada and Saint Lucia
- The private sector and multilateral institutions must also be included in the initiative
  - These account for more than 50% of total debt service of all participating countries and more than 70% on average for Dominica, Grenada and St. Lucia
- The time frame of DSSI must be extended beyond June-2021

DEBT RELIEF INITIATIVES REQUIRE CHANGES IN THE INTERNATIONAL DEBT ARCHITECTURE

- A multilateral sovereign-debt restructuring mechanism is needed to deal with obligations owed to private creditors.
- A sovereign multilateral restructuring mechanism goes hand in hand with the creation of a multilateral credit rating agency which could lessen the conflict of interest between private and public objectives.
  - The existence of risk evaluation by private credit rating agencies implies transferring the regulatory authority from the government (which is normally entrusted with this task) to the private sector.
  - Thirteen countries of LAC witnessed credit downgradings during the pandemics
  - Credit downgrades can create significant problems since credit rating agencies do not have a mandate to provide information or evaluate credit risk in the interests of public objectives, but rather to maximize profits and shareholder value (Gavras, 2012).

A DEBT REDUCTION STRATEGY MUST AVOID A ONE-SIZE-FITS-ALL APPROACH AND CONSIDER THE HETEROGENEITY OF DEBT PROFILES AND DEBT VULNERABILITY

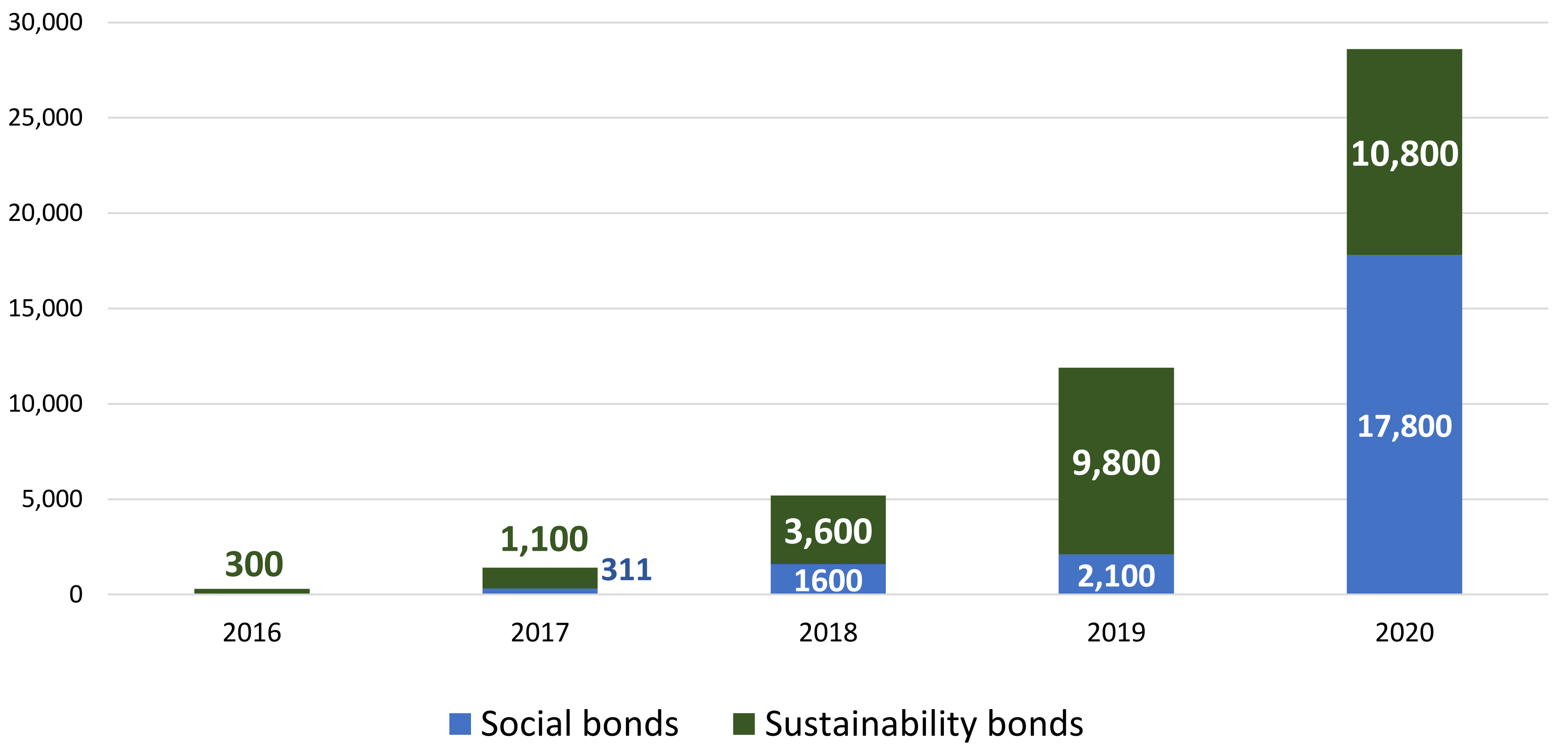
- Highly indebted economies: with short-term debt profiles and economies that face a high debt service burden should benefit from **official debt relief and/or standstills**.
- **Debt haircuts** along with **new innovative financing** debt mechanisms are required when debt accumulation is a structural feature of economies as is the case of Caribbean countries.
- Countries with greater fiscal space or that have a more solid fiscal/macroeconomic situation (such as for example Chile, Colombia and Peru) according to international standards can access the international financial markets to fund their debt.

FOURTH POLICY ACTION: EXPAND THE TOOLBOX OF INNOVATIVE INSTRUMENTS

- Hurricane clauses should become a permanent feature of debt relief initiatives for countries recurrently exposed to natural hazards, such as those of the Caribbean.
  - Hurricane clauses enables deferral of principal and interest debt service payments or the possibility of fast-tracking debt restructuring operations, in the event of a hurricane (or other insured natural disaster).
  - Grenada (2013-2015) provides an example for the use of hurricane clauses in debt restructuring.
- The experience with hurricane bonds underscores the need to link repayment capacity to the performance of the economy.
  - Income-linked bonds tie debt repayment to the capacity of a country to repay.
  - Considers the importance of the external sector, including exports, imports and terms-of-trade.
  - It reduces the burden of the debt when the economy is in a slow growth period, which is normally accompanied by reduced government revenue.

BUILDING FORWARD BETTER CAN BE FACILITATED BY THE GROWING INTEREST IN SOCIAL AND SUSTAINABLE BONDS ISSUED BY EMERGING MARKET ECONOMIES

Social and sustainable bond issues in emerging market economies, 2016–2020
(Millions of dollars)



- From 2016 to 2020 show that social bond issuances have increased from US$ 0 to US$ 17 billion and sustainable bond issuances from US$ 300 million.
- Within the Latin American and Caribbean region, Chile and Mexico are of two of the countries that have taken advantage of the existing investor sentiment to issue sustainability-linked bonds to US$ 10.9 billion.

Source: Mutua (2021)

FIFTH POLICY ACTION: LIQUIDITY AND DEBT RELIEF MEASURES MUST BE PART OF A FINANCING FOR DEVELOPMENT STRATEGY TO BUILD FORWARD BETTER

- Short and long-run must be integrated in order to **reshape the development model** towards productive transformation with sustainability and equality.
- **Recovery** efforts must target resilience-building.
- The international community can support **building forward better**:
  - ✓ Remove barriers to environmental technology access, fostering innovations through the expansion of compulsory licensing practices in developing countries.
  - ✓ Put forth a new global development declaration (along the lines of the Doha Declaration) for intellectual property rights and climate change.
  - ✓ Develop a voluntary environmental patent pool and enforce climate finance commitments to help developing countries, as envisaged in the Paris Agreement.
  - ✓ Creation of employment and job programmes linked to the development of the green economy.

DEVELOPMENT BANKS CAN SIGNIFICANTLY CONTRIBUTE TO THE RECOVERY BY SHIFTING THEIR LENDING PRIORITIES TOWARDS MEDIUM- AND LONGER-TERM DEVELOPMENT GOALS

- Increased financing should be accompanied by changes in the composition of lending portfolios.
- Mandates of development banks should require channeling a significant percentage of portfolio loans to green investment and climate-change-related projects.
- Articulating a coherent strategy for the development banking system towards green finance requires the support of multilateral development banks towards subregional and national development banks in order to access low-cost funding, long-term capital, and technical capacity to access funds and design projects.

AT THE SUBREGIONAL LEVEL, RESILIENCE-BUILDING CAN BE IMPLEMENTED THROUGH INITIATIVES SUCH AS THE CARIBBEAN RESILIENCE FUND

- The Caribbean Resilience Fund (CRF) will function to attract large-scale, low-cost finance to address investment in green sectors, debt reduction through debt-for-climate-adaptation swaps, and support investment in resilience-building projects.
- It would use its funds to finance green industrial policy initiatives, infrastructure, and resilience-building in general, which in Caribbean SIDS, as in other parts of the Latin American and Caribbean region, should be a crucial component for recovery efforts and an opportunity for diversification and job creation.
- Apart from attracting concessional and other sources of financing, the CRF would be financed through a debt reduction representing 12.2% of total public debt of the Caribbean SIDS, amounting to only US$ 7 billion.

THE ONLY WAY TO RESPOND TO THE URGENCY AND MEDIUM-TERM CHALLENGES OF A SYSTEMIC CRISIS, SUCH AS COVID-19, IS THROUGH COLLECTIVE ACTION AND SOLIDARITY

- COVID-19 represents an opportunity to reach wide social and political consensus to implement ambitious reforms in order to engage in a sustainable and egalitarian process to build forward.

- The countries in the region must also do their part
  - The countries can increase their policy space by eradicating tax avoidance and tax evasion, and by placing the weight of taxation on direct taxation, property and wealth taxes.
  - They can also reorient public expenditure towards employment creation and transformative and environmentally sustainable activities.
  - Public expenditure should prioritize public investment, basic income, universal social protection, support for small and medium-sized firms (SMEs), digital inclusion and the development of green technologies.