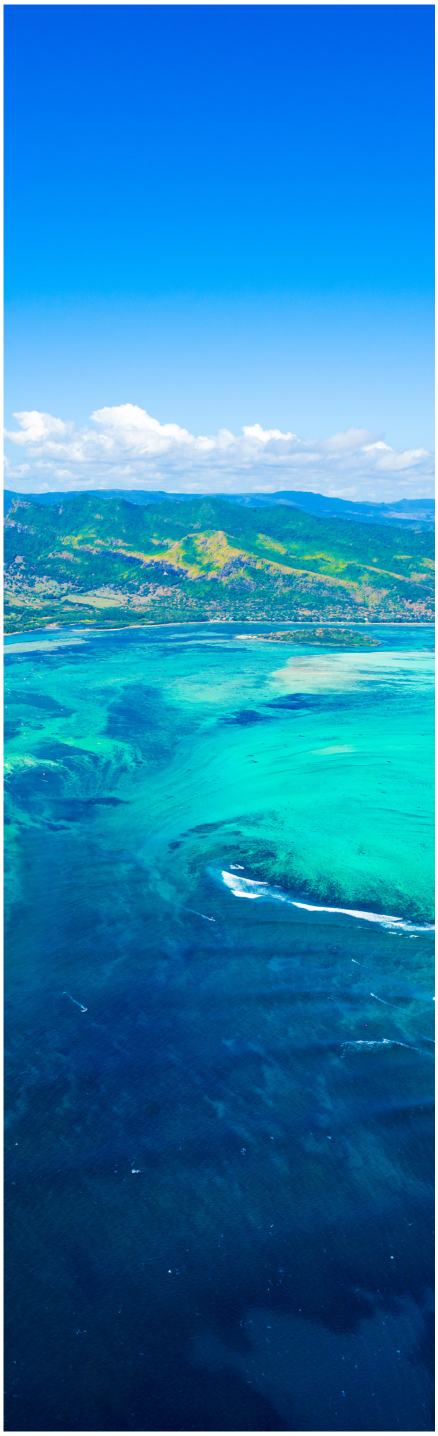
BUILDING FORWARD TOGETHER



FINANCING A SUSTAINABLE RECOVERY FOR THE FUTURE OF ALL

United Nations
Economic Commission for Africa

DECADE OF ACTION

Executive Summary

The economic damage to developing economies triggered by COVID-19 can be transformed: from a threat to global growth, into an accelerator of global prosperity. Rapid financial support, developed and deployed in concert between developing countries and the major players of the global economy, public and private, will reinject growth momentum into economies which were among the world's fastest growing prior to the pandemic. Emerging and developing economies, excluding China, already account for nearly 40% of global output; restarting these economies will be important for the recovery in the developed world. A prolonged funding gap will impose lasting scars on the labour markets, social cohesion and businesses of all emerging markets and jeopardise our shared global goals.

Africa's growing economy and society will be a major part of the future of global economic growth. The potential of its growing and young population, as well as the investment and productivity opportunities in its developing free trade area, communications and digitalization drive, its biodiversity, global carbon sinks, and renewable energy potential, are all at the leading edge of a sustainable world economy. Making the continent ***a global powerhouse of the future*** is the vision of Agenda 2063 and the task for the Sustainable Development Goals (SDGs) in Africa for 2030.

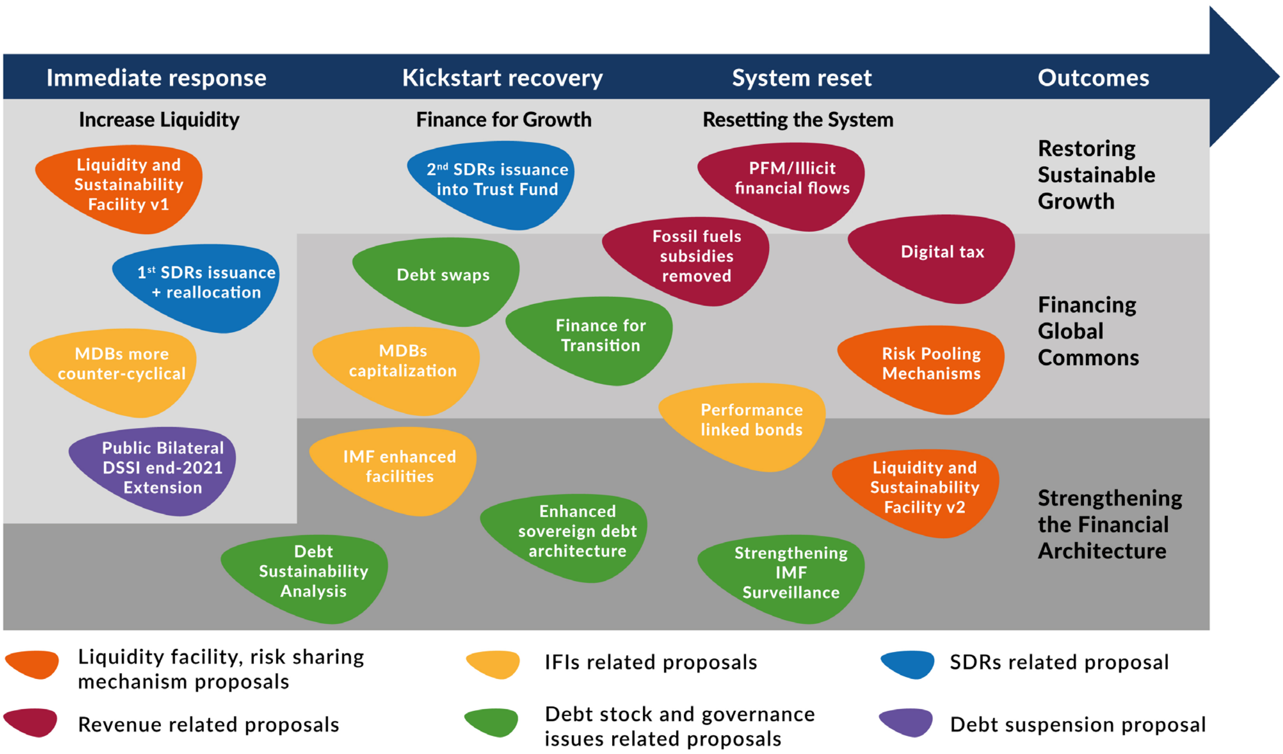
Yet progress towards that vision is threatened by a liquidity crisis, driven by the exogenous factor that is COVID-19. African governments have already taken all the steps they can afford, spending between 1-7% of their GDP on domestic stimulus packages. The relative success of African states in dealing with the pandemic is itself a positive sign. However inflows of capital, remittances and income are falling across the board, and economic activity is inhibited by the pandemic. Countries entered the crisis at different economic starting points, and some were already teetering on the verge of insolvency. Now even the strongest economies will struggle to survive a persistent liquidity crunch, driven by successive waves of the pandemic across the world. Africa's resilience will break if global policy makers remain indifferent or timid in their response. This is a shared responsibility.

Global growth won't be restored and sustained if so many countries are shut out from accessing the same financial tools for response and recovery as the world's wealthiest economies enjoy. The latter have deployed over $13 trillion dollars, whilst less than 1% of this amount has been made available for emerging economies and less than $100 billion for Africa. As a result, the African response has been less aggressive and the economic impact will be deeper- jeopardizing a high quality economic recovery[1]. As well as responding to the immediate threat, measures to deliver longer-term finance to attain development goals will make the recovery more sustainable.

Greater action now is needed to orchestrate a synchronized global recovery. Financial safety nets and countercyclical measures must be shared. Past experience, such as Latin America's lost decade in the 80s/90s, shows that it is far cheaper for the global economy to **act swiftly, restore liquidity and enable growth, than to try to manage a disorderly solvency crisis**. This will stop further economic damage, fight COVID-19 and prevent more people sliding back into poverty, ensuring that the 2020s will still be the decade of delivery, not of dithering or disaster. The good news is we have many of the required tools – they just need to be used.

This paper proposes a three pronged **road-map of precise, feasible actions in the current response phase of the crisis which set up strategic actions in subsequent recovery and reset phases. No one set of solutions will fit all cases**. However these are immediate actions that can and must be taken by developing and developed economies, by the public and private sector together, to restore liquidity, handle insolvency, and build the foundations for recovery, continuing the process of rebooting the system and delivering on Agenda 2063 and the SDGs.

The shapes show the sequencing of the options across the different phases, building on those proposed in the first one.



Within the next 3-6 months, the global community can provide significant liquidity, of up to $500 billion, through four **immediate response** measures:

1. An immediate extension of the Debt Suspension Service Initiative (DSSI) until end 2021, possibly end 2022. Official sector bilateral external debt service to International Development Association (IDA) countries is $15.9 billion in 2021 alone

2. Issuance of a first round of Special Drawing Rights (SDRs), with some reallocation of existing SDRs ($150 billion for all frontier economies to ensure access to Foreign Exchange markets and support National Development Banks and the private sector)

3. Setting up a Liquidity and Sustainability Facility (LSF), to lower borrowing costs by ensuring that short-term debt obligations can be met ($50 billion, which could be leveraged to $250 billion)

4. Increased lending by Multilateral Development Banks (MDBs), using their existing balance sheets, by relaxing risk management policy guidelines ($100 billion additional lending to Africa).

At the same time, the global community can fine-tune a strategy to deliver the options outlined under the later stages of this roadmap to ensure that the full suite of measures delivers for all citizens in a sustainable way. These must be online by mid- to late-2021 through 2023 – an additional $1 trillion of total financing, needed to reset economies:

- **Kickstart recovery:** MDBs capitalization and IDA replenishment; further SDR issuance; development of the LSF to facilitate market development by reducing volatility and increasing market depth; and further evolution of debt instruments – providing up to $500 billion over time.

- **System reset:** SDG linked bonds; fiscal measures, including building on the Base Erosion and Profit Shifting (BEPS) initiative; strengthening public financial management and civic scrutiny; developing a more orderly approach to debt – raising another $500 billion over the medium-term.

These urgent items can be actioned over key moments in the 2020 and 2021 global economy diary:

- The 2020 G20 Finance Ministers extraordinary summit and Heads of State Summit

- Setting the G7 and G20 agendas for 2021, working with the UK and Italian Presidencies

- Bilateral engagement with the USA to unblock SDRs and other multilateral actions

- The African Union Summit in February 2021

- The G7 Sherpa, ministerial, and Heads of State Summits over the first half of 2021

- The G20 Sherpa, Finance Minsiters, and Heads of State Summits throughout 2021

- IMF and World Bank (WB) Spring meeting in April 2021

- The summit in May 2021 on financing of African countries' economies, organized by France

- Central Bank summits throughout 2021.

A commitment to this approach will allow the international community to finance the recovery, support the reboot of the financial and economic system in emerging and frontier markets, and ensure that Africa, specifically, is back on the path to 2030, giving a brighter future to those who would otherwise have been left behind.

Introduction

This paper explores the options for increasing fiscal space for emerging and frontier economies as a response to the crisis. It has a particular focus on Africa. Swift action not only supports developing countries but sets the global economy on a more sustainable, long-term growth footing.

The COVID-19 economic crisis undermines prospects for global growth by damaging fast-growing developing economies. This will be a multi-year crisis. Countries will not reach their 2019 output levels for many years[2]. Over 100 million people could fall back into extreme poverty[3].

These countries face a liquidity crisis. They have been hit hard by the economic crisis, despite varying levels of success in containing the pandemic. The risk is exacerbated by their more limited financial resources. African countries have seen incomes and capital inflows collapse. Some face reduced or onerous and prohibitive access to international capital markets, or have limited or shallow domestic markets. Sub-Saharan Africa's COVID-19-related fiscal support has amounted to 3% of GDP, about 25% of the proportion disbursed by developed countries[4]. In addition a small number of countries do face deeper solvency issues, which will need to be resolved.

An urgent, effective response to this liquidity crisis in African and developing economies worldwide, matters for the world economy. This multi-year crisis requires sustained actions to set countries onto a pathway to build forward better – not just a short-term fix[5]. By 2040 Africa will have the largest workforce in the world and will be a major place for investment. 40% of the world's youth workforce will be African. Taking effective action now will avoid the long-term loss of economic capacity that would follow a protracted crisis. The world would be supporting the ongoing development of new markets and the new workshop of the world, an engine of creativity and youthful energy.

This paper shows how to deliver the financial support that is needed to enable countries to build back better, using the recovery plans of their choosing, but leveraged together in order to accelerate our collective recovery.

The World Needs Immediate, Bold Action

All developing economies have been affected by the pandemic and the economic shock[6]. Many have weathered the first round of economic shocks well. However, they have used much of their available fiscal space[7]. COVID-19 will leave Sub-Saharan Africa's GDP in 2021 at 14% below the levels implied by its pre-crisis trend[8].

Governments are exhausting their resources as scarce public funds are needed for the health response to combat the pandemic [9]. Lower domestic investment (public and private) is stunting current growth and reducing spending on necessary infrastructure. Foreign Direct Investments (FDI), vital to diversification, are expected to contract between 25%-40% in 2020[10,11]. Remittances are projected to fall by 7% year-on-year[12]. Bilateral assistance from leading donors[13] such as Australia and the UK[14] is under threat. Many countries have significant debt: of the 73 countries eligible for the G20's Debt Service Suspension Initiative, 43 will spend more on debt service than healthcare in 2020[15]. This leaves them dangerously exposed to a prolonged crisis and in some cases to natural disasters – domestic disaster reserve funds in the Caribbean especially have been depleted.

At this time, traditional mechanisms for increasing fiscal space, such as cutting spending or increasing taxes, are entirely inadequate.

Advanced economies can issue debt at record low interest rates. Italy, with a debt to GDP ratio for example of over 155%, still can access markets at 0.2% for a 5 year bond. In contrast emerging and developing economies continue to face volatile, expensive and pro-cyclical funding markets. This is a systemic issue which goes beyond pre-existing conditions and speaks to the structure of the markets. And although some countries entered the crisis with high existing debt/GDP levels, COVID-19 is independent of, and does not respect, previous good macroeconomic management. Instead, African governments' access to markets is diminishing, and in some cases closed off. All five of the Sub-Saharan African countries scheduled to issue Eurobonds between March and June 2020 pulled their offerings[16], and only two African countries have gone to the markets so far this year, Morocco and Egypt, compared to nine this time last year. All of this is increasing costs of capital and debt, and access to debt markets is not correlated with needs.

Sub-Saharan Africa's external financing requirements in 2020-23 are about $900 billion, with the source of $130 to $400 billion of this still unclear[17]. Market analysts now suggests nearly 40% of emerging and frontier-market sovereign external debt is at risk of default over the coming twelve months[18].

In effect emerging and developing economies are trapped in a 'vicious cyle', where they need to choose between meeting their debt repayments or supporting their healthcare systems, whilst spending on areas such as education, poverty reduction, long-term growth, and climate resilience is threatened. This unsolvable dilemma creates a long-term risk of economic collapse for the world.

Acting fast and effectively now the global community can address this liquidity problem, and can support and finance the recovery in developing economies. Doing so will not just address a current crisis but will support the long-term growth of the global economy.

By contrast, failure to take decisive action now, or doing too little too late,[19] risks losing the opportunity of trading with a dynamic and rapidly growing continent, while increasing the risks of conflict[20], human suffering and migrant flows. Latin America's lost decade in the 1980s/90s shows that, where debt has become unsustainable, delaying action carries long-term costs[21]. Acting swiftly to provide additional liquidity to meet near-term spending needs for economies who had good fundamentals prior to the crisis is an economic imperative as well as a moral one, even as we work to restructure insolvent economies.

Without significant infusions of liquidity and long-term finance for development, particularly in the energy sector, the continent may will be unable to deliver its 2063 vision[22], to optimize the benefits of the Africa Continental Free Trade Area and achieve its prospects for a green development pathway.

Thankfully, there are concrete actions that African countries and the international community can take together to address this.

From Response, to Recovery and Re-set

This roadmap sets out the path the world economy must take, if it is to travel from crisis to success. It is a general guide, because there is no there is no 'one size fits all' solution for supporting countries. Rapid action to finance the journey needs to address the heterogeneity of countries' starting situations and of their experiences of the crisis. It must also provide a package of solutions that evolves over time as the crisis itself evolves. The multi-year nature of the crisis means that countries will require a different menu of options, including long-term finance for development, as they move towards recovery.

The options in the roadmap synthesise existing proposals[23]. They show the strategic critical path, both to deliver short term liquidity to countries, handle insolvency where necessary, and to lay the foundations for future action.

A Strategic Response that Evolves with the Crisis

This crisis will continue to come in waves, as countries see cases of COVID-19 increase and decrease. However dealing with the crisis, along with the measures needed to unlock funding, will broadly require three interlocking phases, as set out in figure below.

The focus in the immediate, response stage must be to give confidence to markets, and to each country's businesses, workers and entrepreneurs, that the current liquidity crisis will not trigger a generalized solvency crisis, knocking down those

The disks show the sequencing of the options across the different phases, building on those proposed in the first phase.