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G20 test of trust: coming together to narrow the pandemic divide

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Theme

Political failure to tackle the pandemic divide will aggravate the dangerously divergent paths between the advanced economies and China, and many emerging markets and developing economies.

Summary

The G20 is the premier forum for international economic cooperation and a vehicle for strengthening multilateralism, designed to take more ambitious and concerted action to address global economic challenges. It is also now a forum to manage geopolitical tensions between heterogeneous countries (such as the US, China and Russia) by relying on the presence of other countries to apply peer pressure for a common global leadership, instead of competing to divide it.

As at many times of crisis, the G20 has certainly stepped in once again during the COVID-19 pandemic. But whether it will be able to keep up the momentum throughout the recovery phase remains to be seen.

A major concern in 2021 will be addressing the widening gap between the advanced economies and China, with widespread access to vaccines and the financial power to support their economies through the COVID-19 crisis, and many emerging markets and developing economies that are falling behind.

Analysis

Italy's G20 Presidency will culminate in the Leaders' Summit on 30-31 October in Rome. Its agenda is built around three pillars, namely People, Planet and Prosperity. The EU supports Italy's priorities –the fight against COVID-19, pandemic preparedness, economic recovery, climate change, digital taxation and trade– and wants to sustain the renewed global momentum, notably since the change in the US Administration.

The Rome Summit will be another decisive moment for the future of the G20 and its place in global governance. G20 leaders should live up to expectations by sending a robust message of unity to tackle the much broader challenges to be faced by moving beyond the pandemic, including narrowing the pandemic divide by closing gaps in the access to vaccines, securing finance for the most vulnerable countries and ensuring inclusive development –accelerating the transition to a greener, digital and more inclusive world–. As a member of the G20, the EU is ready to play its part.

The global economic outlook

Global economic recovery is gaining momentum, but it is likely to be uneven. Back in July the IMF projected that the global economy would grow by 6% in 2021 and 4.9% in 2022. Compared with its April outlook, the IMF has left its global growth forecast unchanged for 2021, but economic prospects have diverged even further across countries. The outlook for the advanced economies has improved while that for emerging markets and developing economies has deteriorated, especially for emerging Asia.

The G20 did the right thing with unprecedented policy responses, providing US$16 trillion in fiscal action and a massive liquidity injection by central banks. Without these synchronised measures the global recession in 2020 could have been far worse. Macroeconomic policy support should continue until recovery is firmly anchored, while premature withdrawal should be avoided.

However, there remains a high degree of uncertainty in this uneven global recovery: new COVID variants; diverse speeds of vaccination; potential shifts in financial conditions; and the varied ability of countries to sustain policy support.

Clearly, there is the dangerous prospect of divergent recoveries, driven by pandemic developments and differences in the pace of vaccine rollout and policy support. The political and socio-economic implications of this divergence may prove to be serious.

Looking ahead, the financial stability of emerging markets in particular could be at risk from a tightening of financial conditions and capital outflows. In aggravation, many developing countries are reeling under mounting debt, with some of the poorest countries already at high risk of debt distress. The crisis may result in the devastating loss of many development gains that took decades to achieve.

This 'divergence risk' might also constrain growth prospects in advanced economies and increase migration, forced displacement, institutional fragility, social unrest and geopolitical tensions. The already visible effects of global warming will likely make these repercussions even worse.

COVID-19 has been a powerful test for international solidarity and our capacity to demonstrate genuine multilateralism. After a shaky start, things are improving. However, we have much more to do, including improving our warning systems and preparedness for handling future crises.

Fighting a global pandemic, dealing with climate change and reducing inequalities are all key to the sustainability of growth and can only be tackled by countries working together, looking beyond their own borders.

Priorities for G20 action

The pre-existing inequalities before COVID-19 have been aggravated. The pandemic has starkly revealed the divide between a few countries with advanced vaccination efforts and a scope for crisis-response spending and those lagging behind. The crisis has exposed low-income countries' specific vulnerabilities, given their inequitable access to vaccines, existing challenges such as climate change adaptation and their limited policy space. G20 collective action is urgently needed to address these growing gaps.

The first priority is access to vaccines, diagnostics and therapeutics. Right now, vaccination is the most important policy. IMF data highlights the undoubtedly disparate vaccination rollout: roughly 40% of the population in advanced economies has been fully inoculated against the virus, in contrast with 11% in emerging market economies and only 1% in low-income countries.

IMF research shows that faster vaccination can result in a higher global GDP of US$9 trillion by 2025, enabling over US$1 trillion in additional tax revenues. But this window is closing fast since most vaccines must be administered in two doses: at current vaccination rates it will take two years to vaccinate 80% of the world's population.

There is an urgent need for more equitable access to vaccination, especially in the countries that are left behind, and to accelerate the vaccine roll-out globally. The IMF, World Bank, WHO, WTO, in close cooperation with ACT-A (Access to COVID-19 Tools-Accelerator),[1] have established a task force to help achieve the goal of covering at least 40% of the population in every country by the end of 2021 and 60% by mid-2022, alongside ensuring adequate diagnostics and therapeutics at a price of US$50 billion.

Although all emerging market and developing economies are likely to gain 60% coverage (thanks to a combination of COVAX[2] orders, regional arrangements like the African Vaccine Acquisition Trust –AVAT–[3] and bilateral agreements), most deliveries will take place at the end of 2021 or in 2022. It is of paramount importance to support further financing of ACT-A and COVAX, and to encourage vaccine donations from countries with surplus doses. The WHO has even urged advanced economies to reconsider plans to vaccinate children and instead donate doses, after inoculating their priority populations, to the COVAX scheme that shares them with poorer countries. Also, it is crucial for vaccine manufacturers to prioritise deliveries to low and lower middle-income countries as well as to remove export restrictions on vaccines and raw materials.

As announced at the Global Health Summit in March, the EU will donate 100 million doses of vaccines to low- and middle-income countries until the end of the year and will provide €1 billion in support to Africa to step up local production capacity. Moreover, the EU has been working with European industrial partners –BioNTech-Pfizer, Moderna and Johnson & Johnson– to make available 1.3 billion doses of vaccines in 2021 to low-income countries at production cost and to middle-income countries at low cost. Moreover, more than 1 billion doses are committed for 2022.

To further speed-up global vaccine delivery, another option on the table is a temporary patent waiver in response to the pandemic. In October 2020 India and South Africa,

[1] https://www.who.int/initiatives/act-accelerator/about.

[2] COVAX is the vaccine pillar of the Access to COVID-19 Tools-Accelerator, https://www.who.int/initiatives/act-accelerator/covax.

[3] AVAT is part of the African Union's COVID-19 Vaccines Development and Access Strategy, https://africacdc.org/african-vaccine-acquisition-trust-avat/.

backed by many developing countries, proposed a temporary waiver of intellectual property rights on COVID-19 vaccines as well as diagnostics, therapeutics and medical devices, which met divided opinion. The WTO talks over the proposed waiver are ongoing, with no tangible signs of progress at this point.

Secondly, climate action. There is no vaccine for global warming. Science and technology may prove to be part of the solution, but there is no substitute for cutting CO2 emissions more rapidly. The EU's pledge to become climate neutral by 2050 is a minimum. More important is the EU proposal for a legally-binding commitment to cut emissions by 55% before 2030. Real action, right now.

Achieving climate neutrality will imply a profound transformation of economies. There is no contradiction between growth and climate action. Europe's 'decoupling' between 1990 and 2020 saw emissions fall by 25% while it grew by 60%.

As with other deep transformations of an economy, climate action may entail major social adjustments. Workers need to be retrained and the jobs of the green revolution must be seized. The EU will pay particular attention to this just transition in rolling out its 'Next Generation' Recovery Plan: each Member State will undertake reforms and investments to address fragile social groups or regions that fall behind. Over 30% of the EU's recovery plan will be spent on fighting climate change.

Focusing on green recovery opens up opportunities for growth and jobs. But poorer countries are less well equipped to 'build back better'. According to the IMF, low-income countries need US$450 billion over five years to fight the pandemic, preserve buffers and regain their pre-pandemic convergence paths.

That brings us to the third priority: creating policy space. Advanced economies will maintain fiscal support, with US$4.6 trillion of announced pandemic-related measures for 2021 and beyond, whereas in emerging and developing economies most measures will end in 2021. The scope for policy responses in low-income countries was considerably restricted due to a lack of fiscal space, elevated debt levels, limited access to financing and little room for monetary policy support. Ensuring access to international liquidity must be a priority for those countries that are walking a fiscal tightrope between meeting essential health and social spending needs and more broadly providing adequate support and preserving financial stability.

This is why the EU strongly supported the G20/Paris Club Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond DSSI. The Common Framework should become, over time, the standard process for all debt restructuring cases, including those of middle-income countries. The EU also pushed for a new general allocation of IMF Special Drawing Rights, which will ease financing constraints and help low-income countries to better manage the difficult policy trade-offs they face.

Failing to provide a global safety net as the COVID-19 crisis persists, particularly in the developing world, might have devastating economic and political repercussions, threatening to poison international economic relations for years to come.

Supporting low-income developing countries: G20 Debt Relief Initiatives

Many countries entered the pandemic with elevated debt levels: one-half of the world's 76 lower-income economies were at high risk of or already in debt distress.

Since 2010 over-borrowing has led to a significant debt rise, including non-concessional debt, in low-income countries. A combination of factors has led to a wave of excessive debt, including the rapid growth of new official lenders, such as China and private sector creditors, and low-interest rates in global financial markets. In addition, countries have had to spend much more on health and on providing relief to households and businesses to cushion the economic and social impacts of the COVID-19 crisis. Higher overall expenditures raise the risk of some countries entering into debt distress.

Debt distress is a painful process and can set back a country's development for many years. Clearly, we need further steps to cover financing needs and proactively prevent countries from falling into debt default. The COVID-19 crisis may have otherwise led to another 'lost decade' in development, as in the 1980s, had we not acted urgently.

The EU has been a strong promoter of multilateral initiatives on debt relief, notably in the G20 framework. In addition, the EU contributed €183 million to provide relief to 29 low-income countries for debt service owed to the IMF under the Catastrophe and Containment Relief Trust (CCRT), which is funded by other countries' contributions or donations, thereby making the EU the largest contributor.

The EU has strongly supported the G20/Paris Club Debt Service Suspension Initiative (DSSI)[4] for low-income countries. The DSSI is a deferment of debt service owed to official bilateral creditors aimed at providing eligible countries with liquidity support for COVID-19 crisis response, a modest temporary relief to their public finances. Half of the 73 eligible countries are African. The DSSI was a significant achievement for multilateralism, bringing together for the first-time traditional lenders and emerging non-Paris creditors, in particular China. It has also contributed to enhancing debt transparency –a high priority for accurately assessing debt sustainability–. In April 2021 the G20 Finance Ministers and Central Bank Governors agreed to a final extension of the DSSI until December 2021. So far 45 eligible countries have applied to benefit from the first six-month extension of the DSSI (from January to June 2021) amounting to an estimated US$4.6 billion of debt service deferred in the first half of 2021.

In October 2020, given the scale of the COVID-19 crisis and the deteriorating outlook in many low-income countries, the G20/Paris Club agreed on a Common Framework for debt treatment[5] for countries with unsustainable debt. This was another important precedent, based on the Paris Club's principles and bringing on board G20 official bilateral creditors in a coordinated manner, especially China –the main bilateral creditor of many low-income countries–. Such an approach addresses solvency challenges with a long-term perspective and ensures a fairer burden sharing. Here, the participation of private-sector creditors is crucial to providing treatment on terms at least as favourable

[4] Term Sheet_ G20 Debt Service Suspension Initiative.

[5] Common Framework for debt treatments beyond DSSI.

as those provided by official creditors, in line with the principle of comparability of treatment.

The Common Framework adopts a case-by-case approach when considering debt treatment, which should be complemented by reforms ensuring public debt sustainability in the future and consistent with the parameters of an Upper-Credit Tranche (UCT) of an IMF-supported programme. Following a request from an eligible debtor country, a Creditor Committee is set up to negotiate a Memorandum of Understanding between the debtor country and its creditors. The IMF and the World Bank Group support negotiations, including through their debt sustainability analysis. First on the list are Chad, Ethiopia and Zambia, which requested debt treatment under the Common Framework. As politics cannot be set aside, the situation in Ethiopia is closely monitored since the conflict broke out in the Tigray.

G20 debt relief initiatives have laid the groundwork for improving multilateral coordination in sovereign debt resolution. The success of the Common Framework will rest on making it fully and rapidly operational, which depends on the degree of creditor coordination in practice. In April 2021 the first Creditor Committee meeting for debt treatment for Chad took place and since then good progress has been made. Now, the G20 should move ahead with other countries, like Ethiopia, to ensure the credibility of the Common Framework.

IMF Special Drawing Rights

In April the G20 agreed to call on the IMF to make a comprehensive proposal for a new general allocation of Special Drawing Rights [6] (SDRs), while exploring options for member countries to voluntarily channel a share of their allocated SDRs to the benefit of vulnerable countries. On 2 August the IMF Board of Governors approved the largest-ever allocation of SDRs, equivalent to US$650 billion, that became effective on 23 August. This will boost confidence in global recovery, as did the previous SDR allocation in 2009 in response to the global financial crisis.

In a general allocation, the IMF distributes SDRs to member countries based on their IMF quota shares -reflecting their relative economic weight in the global economy-. The IMF estimates that more than 42% will go to emerging markets and developing countries, including some 3.3% to low-income countries. This SDR allocation will supplement global reserves while providing scope for necessary fiscal expenditure to exit the pandemic and facilitate more sustainable recoveries. At the G7 Summit in June, leaders expressed their willingness to further boost this support through voluntary channelling SDRs and/or budget loans to reach a total global ambition of US$100 billion for the most vulnerable countries. At the July G20 Finance Ministers and Central Bank Governors Meeting, several emerging market economies requested also considering middle-income countries as vulnerable countries, given the poverty increase triggered by the pandemic.

[6] IMF Special Drawing Rights (SDRs) are an interest-bearing international reserve asset. Members can trade SDRs for freely usable currencies held by other IMF member countries. If a member trades SDRs for freely usable currencies, its SDR holdings decrease and its foreign exchange reserves increase. This causes holdings to fall below allocations. When this occurs, the country pays an interest rate to the IMF.

Many options for re-channelling SDRs have been floating around, but the IMF would like to focus on those with the most potential. Focus is important, as re-allocating SDRs towards the most vulnerable countries is a complex technical issue. During the current crisis, members with strong external positions have used part of their already existing SDR holdings to contribute to financing low-income countries by lending to the Poverty Reduction and Growth Trust. Furthermore, the IMF is exploring with its membership a new facility –the Resilience and Sustainability Trust– directed at supporting emerging markets and developing economies to tackle climate change and build resilient economies.

However, an SDR allocation is not a catch-all solution. Meeting the financing needs of low-income countries requires a multipronged response to help them prevent long-term scarring from the pandemic. This approach would need to combine structural reforms in low-income countries with other sources of financial support, along with debt restructuring where needed. Supporting low-income countries overcoming the COVID-19 crisis and accelerating income convergence call for substantial international support, including grants and concessional loans provided by bilateral donors and multilateral institutions. In addition, a bold domestic reform agenda requires structural measures to strengthen governance institutions, improve revenue collection and spending efficiency, and the business environment to catalyse private sector financing, particularly on green and digital infrastructures.

Conclusion

As the IMF has warned, recovery from the pandemic will only be achieved if the virus is defeated globally. Meanwhile, politics have become more nationalistic and less cooperative in many parts of the world. Even before the COVID-19 crisis, there was a growing perception that the gains from globalisation were unevenly distributed, and public trust in governments, international institutions and forums, including the G20, was fading. Nationalism and political rivalries have significantly limited the global response to the COVID-19 pandemic.

Today, political failure to tackle the pandemic divide will aggravate the dangerously divergent paths between the advanced economies and China, and many emerging markets and developing economies. The world could emerge as a more fractured place, where poverty, inequality, social unrest and geopolitical tensions can grow. Fragile states will drift further apart, creating conditions ripe for conflict and mass displacement.

Closing the pandemic divide is, therefore, not just the right thing to do, it is also the key to strengthening global prospects and the world's resilience against future pandemics and crises.

The G20 has a major role to play by delivering an ambitious package of concrete measures to boost a sustainable, resilient and inclusive global recovery at the Rome Leaders' Summit in October. This is the moment of truth.

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