

Background Briefing CSO - EU SCIMF Meeting¹

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In these unprecedented times, we call on the EU member states and the IMF to support policy measures that rise to the occasion. The IMF should align its loans and policy advice to its current rhetoric of a greener, just and fairer recovery. IMF's policies ought to be consistent with the commitments made by its member governments, with international human rights law, Agenda 2030, the Beijing Declaration and Platform for Action, and the Paris Climate Agreement. In contrast, implementation of tried and failed prescriptions of fiscal consolidation, structural adjustment and austerity would represent a mistake of historical proportions. These would lead to a new [lost decade](#) for developing countries. We call on the EU member states and the IMF to implement the recommendations below to ensure we avoid such an outcome.

1. IMF lending

1.1 Scale of IMF lending and programmes

The response of the IMF has been insufficient in the context of the magnitude of the crisis. Failure to provide timely assistance to countries in financial and debt distress is hampering their ability to adequately respond to the public health, social and economic challenges posed by the pandemic.

Since March 2020, the IMF has approved a total of [US\\$ 101.5 billion](#) in financial assistance to 81 countries. However, only [US\\$ 39.8 billion](#) have been disbursed so far. Most of the lending capacity of the IMF, estimated at US\$ 1 trillion, remains idle.

This dynamic is concerning given the impact of the crisis on the Gross Financing Needs (GFN) of developing countries. For 80 countries² that have received IMF financial assistance in 2020, GFN are projected to increase from [9.1 to 13.5 per cent of GDP](#) between 2019 and 2020. Failure to meet this growing financing gap has forced countries that have received IMF financial assistance to implement off-setting expenditure in order to finance their Covid-19 emergency response. Forty countries have implemented expenditure cuts equivalent to [2.6 per cent of GDP](#) in 2020. For countries eligible to participate in the G20 Debt Service Suspension Initiative (DSSI) these expenditure cuts have caused a reduction in development spending and education of [1.6 and 0.1 per cent of GDP](#), respectively, in 2020. These expenditure cuts will have substantial long-term effects on the development prospects of these countries. They are both economically and morally wrong.

EU member states must encourage the IMF to adopt a bolder approach in its response to the crisis. First, the IMF should **expand the debt cancellation initiative under the Catastrophe Containment and Relief Trust (CCRT)**. Debt payments cancellation should be extended to all G20 DSSI eligible countries. Financing for this [initiative](#) can be obtained through a combination of gold sales by the IMF and an issuance of Special Drawing Rights (SDRs) (see section 1.3). Second, the IMF should **extend the increase of the access limits to the Rapid Credit Facility (RCF) and the**

¹ This background briefing represents a collective effort of over 15 civil society organizations coordinated by Eurodad. Comments or questions: dmunevar@eurodad.org

²The IMF Executive Board approved financial assistance to Dominica on April 28, 2020. However, as of October 2020, the IMF has not published a staff report for this program.

Rapid Financing Instrument (RFI) until the end of 2021. This will ensure countries can access financing as needed as the impact of the pandemic extends into 2021. Third, EU member states should **provide additional support to the Poverty Reduction and Growth Trust (PRGT).** This will allow vulnerable countries at high risk of debt distress to continue to rely on access to financing on concessional terms. Support to the PRGT should be structured so as not to compromise direct Official Development Assistance (ODA) provided to developing countries. Fourth, the IMF should **explore the possibility of a new credit facility** that can provide long term access on concessional terms to countries struggling to finance their response to the pandemic, regardless of income levels. The credit line could have a [300 per cent quota limit](#) and would involve identical criteria for access and approval than those of the RFI and RFC, including a strict assessment of debt sustainability (see section 2.2).

1.2 Concerns on IMF program design

IMF programs approved in the context of the pandemic will lead to an unprecedented and synchronised exercise of fiscal consolidation. The scale, speed and reach of the planned adjustment raises serious concerns regarding its impact on country and global growth prospects. Furthermore, failure to include considerations regarding equality, gender, climate and development finance needs will exacerbate the long-term negative impact of fiscal adjustments.

A review of IMF programmes of financial assistance approved since March 2020, shows an **excessive emphasis on premature fiscal consolidation in developing countries.** This is a direct result of the insufficient support provided by the international community. Out of 81 countries that have received IMF financial support, 72 are expected to begin a process of fiscal consolidation as early as 2021. These measures will extend to all countries by 2023. Between 2021 and 2023, this set of countries will implement austerity measures worth on average [3.8 per cent of GDP](#).

IMF staff research shows that front-loaded fiscal consolidations in [credit constrained environments](#) which rely on [expenditure cuts](#) have a negative impact on growth. IMF program design in the aftermath of the Covid-19 pandemic does not even take its own recommendations into account. Thus, even by the IMF's own criteria for fiscal adjustment design, the programs approved in recent months represent a policy blunder. Almost all programs rely on [optimistic growth projections](#), front loaded adjustments and rely mostly on expenditure cuts. Furthermore, they do not measure contributions made to the economy including unpaid care and domestic work. There is no evidence the IMF has taken into consideration the systemic effects of synchronized fiscal consolidation across countries.

In addition, programs approved in recent months fail to take into account [relevant policy elements](#) with direct consequences for the protection and satisfaction of human rights:

- **Revenue measures across programs rely excessively on indirect tax increases which will have a negative impact on gender and income inequality.** Out of 59 countries with an IMF financial assistance program, 39 show an increase in indirect taxes between 2019 and 2023. This goes against the recommendations on taxation set forth by the IMF in its latest [Fiscal Monitor](#).

- For 46 countries for which data is available, public expenditures will decline from [25.7 to 23 percent of GDP](#) between 2020 and 2030. **Public expenditures in 2030 are projected to stabilise at below pre-crisis levels.** [Reduction of public expenditures](#) at this scale will severely hamper the capacity of States to provide basic [public services](#) and social safety nets. This dynamic will disproportionately affect women. Additional unpaid care, health and educational burdens will largely fall on the shoulders of women across the Global South. This will cause an irreparable setback in the accomplishment of the gender equality goals set in Agenda 2030 and the Beijing Platform for Action.
- **IMF programs fail to take into account [development and climate](#) considerations.** Out of 80 IMF country reports, the Sustainable Development Goals (SDGs) are mentioned a total of ten times in seven reports. The issue of climate change receives slightly more attention. Climate change and events are mentioned a total of 87 times within twenty country reports.

EU countries must without any further delay ensure a review by the IMF of its approach to short-term fiscal consolidation. Policy frameworks must be designed to ensure countries have the time and space to set sustainable and responsible financing strategies through progressive revenue generation, tackling tax avoidance, evasion and illicit financial flows, as well as through debt cancellation and restructuring. Given the large number of countries under an IMF program, **the IMF needs to develop a systematic review of spillover effects between programs.** This ought to include relevant policy dimensions such as fiscal impulses, balance of payment dynamics and debt sustainability. Going forward, IMF programs need to include considerations of **the impact of adjustment policies on human rights, equality, gender, climate and the SDGs.**

1.3 Special Drawing Rights (SDRs)

To address developing countries' urgent funding needs the IMF managing director and numerous experts, including many current and former heads of state and finance ministers, have called for [a major issuance of SDRs](#). This would allow countries to boost their international reserves and avert [potential financial collapse](#). It would also give them access to otherwise scarce foreign exchange, thereby allowing them to fund imports and cover debt payments.

Until now, opposition from the US and India has blocked this possibility. EU member states and the IMF should work together with the new US administration to expedite the issuance of [US\\$ 1 trillion](#) SDRs. This would provide developing countries with an additional [US\\$ 330 billion](#) in fresh resources. SDRs allocated to EU member states could be allocated to a special trust fund destined to finance debt cancellation through the CCRT and support concessional lending through the PRGT.

Regardless of the outcome of such an initiative, EU member states should work together with the IMF in developing mechanisms to deploy unused SDRs. Large scale mobilization of SDRs through a trust fund to on-lend resources could support a new IMF credit line as described in section 1.1.

2. Debt issues

2.1 International Financial Architecture (IFA) reform - Private Sector Involvement (PSI) in debt treatments

A key challenge faced by the G20 DSSI and the recently announced “Common Framework for Debt Treatments Beyond the DSSI” relates to PSI. The DSSI encouraged the private sector to participate on a voluntary basis in the initiative. [To date](#), private creditors have not participated in the DSSI. At least three DSSI participating countries are so far known to have asked private creditors to participate in the DSSI. Refusal to participate by both private creditors and creditors with hybrid features from China has undermined the implementation of the [DSSI](#) and this risks derailing any prospective debt relief to be offered under the [Common Framework](#). **Moreover it delegitimizes the DSSI, as official creditors are effectively bailing out private investors.**

The proposals put forward by the IMF in its recent report on [IFA reform](#) to tackle this problem are insufficient. Given the nature and methodology of the Paris Club, an agreement to involve China is [unlikely to work](#). Difficulties to establish comparability of treatment between private creditors and creditors with hybrid features from China will obstruct debt relief and restructuring operations. In addition, while there have been improvements in the implementation of Collective Action Clauses (CACs), significant [coverage gaps](#) remain. These are susceptible to be taken advantage of by both types of creditors to delay the successful completion of debt restructuring.

The IMF [acknowledges](#) that this reform agenda might not be enough to address a systemic sovereign debt crisis and additional tools could be required. **EU member states should encourage the IMF to adopt a proactive approach to private sector participation.** This can be achieved through the following:

- First, **active use of the Exceptional Access Lending (EAL) guidelines for countries identified to be at high risk of debt distress**, or have debts sustainable but not with high probability or unsustainable. **For programs with financing requirements above 300 per cent of the country IMF quota, the IMF can make access to its financing [conditional](#) on PSI.** Since the reform of the EAL policy in 2016, the IMF has not made use of this mechanism. As a number of countries are expected to transition from emergency financing into full IMF programs, the IMF is in a position to incentivize PSI through the EAL provisions.
- Second, deployment of [Article VIII, Section 2 \(b\)](#) of the IMF Articles of Agreement. The article in question allows the IMF **to impose a debt standstill through the temporary suspension of enforceability of debt contracts in domestic courts of more than 189 IMF member countries, including the US and the UK.** Debtor countries acting in good faith under an IMF programme would be protected from aggressive litigation strategies from holdout creditors in numerous jurisdictions, including the US and the UK. A standstill under Article VIII would ensure that private creditors receive uniform treatment and ensure intercreditor equality.
- Third, **actively engage with the United Nations and member states on the establishment of a [multilateral debt workout mechanism](#) for an orderly, fair, transparent and durable sovereign debt crisis resolution.** Only a multilateral approach that includes the priorities and

concerns of developing countries can hope to succeed in tackling the magnitude of the current crisis.

2.2 IMF debt sustainability

Debt Sustainability Assessments (DSAs) will soon take center stage in policy responses to address debt vulnerabilities. Debt burdens in developing countries have increased substantially as a result of the crisis. At least [thirty countries](#) that have received IMF financial support in 2020 are projected to pay an additional amount equivalent to their 2020 Covid-19 packages to their creditors as increased debt service by 2023. Despite the worsening outlook, the IMF DSAs characterise debt dynamics as “sustainable” in 76 out of 80 countries that have received financing in 2020. In most cases, sustainability is premised on the capacity of countries to deliver on “[steep and sustained](#)” fiscal consolidation over the coming years. These measures will only deepen the crisis for hundreds of millions of people across the globe as the access and quality of public services decrease alongside public expenditures. This decrease will explicitly shift care, education and health burdens onto the shoulders of women’s unpaid labour.

The current DSA methodology has a blind spot by not considering the opportunities of investing in increasing resilience to external shocks, which are at the moment considered expenditures rather than investments. In addition, it is building up systemic risks by favouring capital intensive technologies which risk obsolescence, particularly in the power generation sector. Furthermore, the DSA methodology works at cross purposes with the multilateral development agenda as it fails to account for development financing requirements. This methodology is grounded in the assessment of the commitment of governments to adjust domestic resource use to levels compatible with meeting creditor claims. Debt is sustainable as long as the country is able to meet these claims without incurring a large policy adjustment, even at the expense of resource mobilisation towards their development. Thus, without additional financial support and substantial debt relief, attempts to stabilize debt levels will result in **countries having to abandon the active pursuit of the 2030 Agenda, their international human rights obligations, the Beijing Declaration and the commitments of the Paris Agreement on Climate Change**. This is reflected in the long-term evolution of expenditures (see section 1.3). The conscious abandonment of any of these commitments is an unacceptable policy failure that may trigger a widespread humanitarian crisis and further gender inequality.

Against this background, post Covid-19 debt relief needs cannot be assessed under this framework. **EU member states should request a review of the DSA methodology. DSA’s must explicitly incorporate countries’ long-term financing needs to pursue the SDGs, climate transition and adaptation goals, human rights and gender equality commitments.** Debt sustainability consistent with the SDGs and human rights can be achieved through an ambitious process of debt relief, including extensive debt cancellation and progressive resource mobilization.