# Development Matters

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# Significant but insufficient progress in financial support for developing countries

13 April 202113 April 2021 New social contract Debt, Financing

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Recent events and particularly last week's meeting of the Bretton Woods institutions have generated significant advances in international financial co-operation (https://www.g20.org/wp-content/uploads/2021/04/Communique-Second-G20-Finance-Ministers-and-Central-Bank-Governors-Meeting-7-April-2021.pdf), particularly in support of developing countries. The latter is crucial, as a large number of low and middle-income countries continue to be severely affected by the COVID-19 crisis while the economic recovery underway is very uneven, as underscored by the IMF in its World Economic Outlook (https://www.imf.org/en/Publications/WEO).

The first good news was the agreement to issue $650 billion dollars in Special Drawing Rights (SDRs), the IMF's global reserve asset. Close to two-fifths of the new SDRs would engross the reserves of developing countries. It remains to be agreed (https://www.reuters.com/article/us-imf-sdr-breakingviews-idUSKBN2BU1ZM) how the unused SDRs, particularly from developed countries and China, would be lent or donated to special funds to support low-income countries, and there is no agreement on how they could also be used to support middle-income countries.

The second good news was the endorsement by the US of a global effective minimum tax in the context of the negotiations taking place in the OECD Inclusive Framework on BEPS (Base Erosion and Profit Shifting). There is still a need to agree on what the tax rate would be and the criteria for determining the tax base: whether sales, as the US has suggested, as well as other criteria, particularly resource use and employment that would benefit developing countries, as the Independent Commission for the Reform of International Corporate Taxation (ICRICT) (https://www.icrict.com/) has suggested.

Another important advance was in debt relief initiatives for low-income countries: the extension through December of the Debt Service Suspension Initiative (DSSI) and the G20's Common Framework for Debt Treatments. It remains to be seen to what extent the private sector creditors would participate in these processes. On the other hand, the Catastrophe Containment and Relief Trust, which provides grants to particularly hard hit low-income countries, to pay debt service to the IMF, was extended until October 15.

The major missing element in this agenda was the support for middle-income countries, as the Group of 24 developing countries in the Bretton Woods institutions also called for (https://www.g24.org/wp-content/uploads/2021/04/G-24-Communiqu%C3%A9-Final-Spring-Meetings-2021.pdf). This is, of course, essential, because close to two-thirds of the world's poor live in these countries, and many of them have been severely affected by the COVID-19 crisis.

Notably, and in contrast to the 2009 decision by the G20 to capitalise all Multilateral Development Banks, there has been no call to do so in either 2020 or 2021. The only decision adopted was advancing the 20th replenishment of the World Bank's International Development Association (IDA), benefiting low-income countries. As pointed out, although middle-income countries directly benefit from the issuance of SDRs, there is no agreement on how the unused SDRs could be channelled to funds that would support them.

There was also no decision to reform the IMF's access limits and surcharge policy, which is another major request of the G24. The surcharges increase the cost of financing when the loans exceed a certain proportion of a country's quota or when loans have been outstanding for more than a certain period. These surcharges affect in particular middle-income countries, and as the G24 argued, following the views of other analysts (https://www.ft.com/content/cc82f5bf-36c6-454f-b7f0-a4a18576ff2bee), they should be suspended to support the recovery of middle-income countries, and hopefully permanently eliminated.

It should be added that the IMF credit lines that were more broadly used by developing countries last year were the emergency credit lines –the Rapid Credit Facility and the Rapid Financing Instrument. Although theses credit lines are small (a maximum of one country's quota), they had two basic advantages: rapid approval and no conditionality. For these reasons, the IMF should double these credit facilities in 2021.

Additional multilateral financing for middle-income countries is essential for two additional reasons. The first is the risk that international private sector financing for these countries would decline due to the rise in US interest rates, and in any case, many of them have no access to that financing. This includes the group of countries that already face or risk a debt crisis, an issue that was at the centre of IMF Managing Director statements last week. But no action has been suggested, either, to support middle income countries' sovereign debt restructuring.

It should be finally added that, beyond crisis management, the discussion on long-term frameworks for some of these issues should also be in the agenda. This includes the SDRs (https://www.project-syndicate.org/commentary/new-sdr-allocation-calls-for-two-reforms-by-jose-antonio-ocampo-2021-03?barrier=accesspaylog), which remain one of the most underutilised instruments of international co-operation. The most important is to eliminate the dual IMF accounting (regular and SDR accounts). If the two accounts are consolidated, unused SDRs could be considered as deposits by countries in the Fund, which the institution can use to finance its programmes.

The way they are allocated should also be subject to discussion, as the G24 has argued. This could imply increasing the share of low and middle-income countries in the allocation, as these countries have a larger demand for foreign exchange reserve and are therefore the most important users of SDRs.

Also, sovereign debt issues should be managed in the short term with an ad hoc mechanism, perhaps similar to the Brady Initiative used after the Latin American debt crisis, which provided guarantee for the bonds issued in the debt restructuring processes. However, beyond the short-term solutions, the design of a longer-term institutional mechanism to facilitate sovereign debt restructuring should be in the agenda, going beyond the Collective Action Clauses agreed after previous crises.

Major advances have been made on international financial co-operation, and the US' change of the position on these issues under the Biden Administration is most welcome. But much more remains to be done, particularly to support middle-income countries, which have been largely ignored in the initiatives launched in recent weeks.