POLICY CENTER FOR THE NEW SOUTH
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COVID-19 & Developing Countries—the Road to Recovery

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About the Policy for the New South

The Policy Center for the New South (PCNS) is a Moroccan think tank aiming to contribute to the improvement of economic and social public policies that challenge Morocco and the rest of Africa as integral parts of the global South.

The PCNS pleads for an open, accountable and enterprising "new South" that defines its own narratives and mental maps around the Mediterranean and South Atlantic basins, as part of a forward-looking relationship with the rest of the world. Through its analytical endeavours, the think tank aims to support the development of public policies in Africa and to give the floor to experts from the South. This stance is focused on dialogue and partnership, and aims to cultivate African expertise and excellence needed for the accurate analysis of African and global challenges and the suggestion of appropriate solutions.

As such, the PCNS brings together researchers, publishes their work and capitalizes on a network of renowned partners, representative of different regions of the world. The PCNS hosts a series of gatherings of different formats and scales throughout the year, the most important being the annual international conferences "The Atlantic Dialogues" and "African Peace and Security Annual Conference" (APSACO).

Finally, the think tank is developing a community of young leaders through the Atlantic Dialogues Emerging Leaders program (ADEL) a space for cooperation and networking between a new generation of decision-makers from the government, business and civil society sectors. Through this initiative, which already counts more than 300 members, the Policy Center for the New South contributes to intergenerational dialogue and the emergence of tomorrow's leaders.

Abstract

COVID-19 has ravaged nearly every country in the world, with the globalization of recent decades intensifying its spread. As of mid-2021, the world had spent $16.5 trillion—18% of global GDP—to fight the disease. And that amount does not even include the most important losses such as deaths, mental health effects, restrictions on human freedom, and other nonmonetary suffering. Nearly 90% of this spending was by developed economies, with the rest by emerging market and developing economies. As a result, developed countries are on their way to taming the pandemic. But at just $12.5 billion, or less than 0.0001% of the total, coronavirus-related spending by low-income countries amounts to virtually nothing.

This book shows that low- and middle-income countries still have a long way to go to control COVID. To survive the pandemic and restore economic growth, these countries must increase fiscal spending to vaccinate against and treat COVID-19 over the next two years. Because their ability to do so depends on individual country's circumstances, the book examines the fiscal space of selected low- and lower-middle-income countries and finds that most are not in a position to increase fiscal spending without jeopardizing debt solvency and sustainability. Thus, this book concludes that developing countries must bite the bullet and be willing to risk further debt stress to emerge from the crisis. The international community must be willing to accept these exceptional conditions and adopt measures to ease the pain and suffering of the developing world. The book also recommends policies for dealing with the long-term growth issues of developing countries.

Executive Summary

COVID-19 has hit the world economy hard, with global GDP falling more than 3.5% in 2020. The pandemic has inflicted widespread human misery and economic damages since it emerged from Wuhan, China in late 2019. By November 2021, more than 250 million people had been infected worldwide and over 5 million had died. Though the number of new infections has declined in recent months, the rapid spread of variants of the virus has rekindled fears about the reimposition of lockdowns and other measures to contain it.

Unlike previous global crises, COVID-19 spared no country. Both the developed and developing worlds suffered severe harm, creating a self-reinforcing contraction in global demand for goods and services. The more open a country's trade system, the greater the impact on its balance of payments and the deeper the effect on the national economy. Yet, COVID-19's effects on developing countries have been more severe, deepening inequality between the two worlds.

The pandemic arrived when trade tensions were mounting between China and the United States, and the developing world was facing a new wave of debt. Between January 2020 and June 2021 global spending to curb the virus was about $16.5 trillion (18% of world GDP)—which does not even include the most important losses such as deaths, mental health effects, restrictions on human freedom, and other nonmonetary suffering. Nearly 90% of this amount ($14.5 trillion) was spent by developed economies; the rest by emerging market and developing economies (simply referred to as developing countries in this summary). Low-income countries spent just $12.5 billion, or less than 0.0001% of the total. COVID-19 has had especially devastating impacts on vulnerable groups including women, young people, poor people, and informal sector workers.

Developed countries are projected to see GDP growth of 5.4% in 2021 and 4.0% in 2022, while developing countries are expected to grow 4.4% and 4.2%. But these forecasts assume that annual investment in 2020–22 will exceed that in 2019, especially in China. Excluding China, developing countries will face lower investment and growth. In particular, underlying these growth assumptions is the hope that COVID-19 vaccinations of the global population will be sufficient by the end of 2022 to achieve herd immunity before economic activity fully resumes. As of mid-2021, this hope remains optimistic given halting progress on vaccinations (35% for the world and less than 5% for Africa), emerging variants of the virus, and new waves of infections around the globe.

The countries hit hardest by the pandemic are those that have relied on tourism, services, or commodities for income. Unemployment, already high before COVID-19, worsened—particularly among women and young people—lowering per capita incomes and raising poverty and inequality. Both supply and demand factors have caused the sharp contraction in GDP. On the supply side, the contraction was mainly driven by a sharp decline in the services sector due to the collapse of tourism, reflecting strains on transportation due to closed roads, railroads, airports, ports, and border crossings. On the demand side, consumption and investment have fallen.

COVID-19 caught the world off guard. Emergency measures to save lives included closing borders and introducing lockdowns, quarantines, and stay-at-home orders. To maintain livelihoods, conventional and unconventional policies were developed to support businesses and workers during lockdowns and help them prepare for recovery when lockdowns were lifted. These included fiscal and monetary measures to support healthcare systems, income relief for businesses and households, and liquidity injections to stimulate economies.

All developing countries face a more daunting paradox of choices than before. On the one hand, they need to borrow continuously to manage the lingering pandemic and support their nascent economic recoveries. On the other hand, they face rising debt service costs while their exports slump and their weak economic growth has diminished creditors' confidence. Given the constrained space for budgetary maneuvering, the resulting fiscal deficits are increasingly being financed by central banks through direct advances and holding of more short-term treasury bills and long-term bonds. The fiscal burden on these banks is aggravated by the easing of monetary policies and injections of liquidity.

Until COVID-19 is controlled, near-term prospects for the recovery of developing countries are clouded with risks and uncertainties. Among the greatest likely challenges are the spread of new variants, limited access to or delays in the distribution of vaccines, restoration of supply (especially through global supply chains), and weaknesses in the recovery of consumer and business confidence causing protracted depression of domestic and external demand.

Developing Countries Have Limited Fiscal Space to Respond

Because the pandemic hits both the supply and demand sides of economies, its effects are far more serious than a typical economic shock. On the supply side, lockdowns and quarantines reduce labor supply and firm capacity utilization, while disruptions to global supply chains undermine the provision of inputs—causing shortages and rising costs. On the demand side, the loss of income causes consumption and investment to drop. Workers in services such as tourism and hospitality are hit hardest, and informal workers suffer the most due to the need for close contact with customers. Low-income households fare worst due to limited access to healthcare and financial resources. Commodity exporters and tourism-dependent economies are also vulnerable.

Two types of fiscal measures are being used to support households and businesses during COVID-19. The first are above-the-line policies that directly raise budget deficits, such as cash transfers to low-income households, temporary enhancements of unemployment benefits, and wage subsidies or paid sick and family leave for workers who stay home to care for their children during school closures. These policies also include temporary government cashflow assistance or tax relief for people and firms affected by COVID-19. The second type are liquidity measures that do not directly affect budget deficits. For example, to help firms with liquidity, governments provide cashflow support in the form of loans, umbrella guarantees, and other support. These measures do not show up in budgets immediately but involve contingent liabilities outside budget revenue and spending.

Between January 2020 and June 2021 the world spent over $16.5 trillion on fiscal actions related to COVID-19, about $10.4 trillion of which was above-the-line spending (additional spending and forgone revenue) and $6.1 trillion for government loans, guarantees, and capital injections. Again, these COVID costs did not include the most important losses such as deaths, mental health effects, restrictions on human freedom, and other nonmonetary components. The size of financial support has varied by country depending on income level, political willingness, and the extent of the pandemic. Combined, global public debt has approached 98% of GDP. For developed countries the increase in fiscal deficits comes from both higher spending and declining revenue. For developing countries, the increase mainly reflects a collapse in fiscal revenue.

About 88% of this fiscal spending was incurred by the 57 high-income countries. For these economies, half the above-the-line support was devoted to protecting jobs and supporting household incomes. High-income countries spent 14% of GDP on average on COVID-19. Italy led in spending as a share of GDP (more than 46%), though the United States spent the most—nearly $6 trillion.

Low-income countries spent just $12.5 billion to cope with COVID-19, compared with $14.5 trillion by high-income countries, $1.5 trillion by upper-middle-income countries, and $408 billion by lower-middle-income countries. In developing countries as a whole, the most support went to public works and employment protection, though there has been substantial variation in the fiscal measures taken.

In response to the pandemic, and to varying degrees, all developing countries have mobilized resources to boost health spending, provide emergency funds for affected workers and companies in strategic sectors, adopt temporary tax reliefs and holidays, and provide government guarantees for loans from banks or central banks for strategic sectors.

Developing countries face difficult choices between increasing spending to fight the disease and protecting people during a time of fiscal constraints due to lower domestic revenue and external inflows. As a result, in addition to more accommodative monetary policy, countries have had to borrow more—domestically and externally.

Among developing countries, low-income countries face a particularly difficult situation. Faced with contractions in output, drops in commodity prices, and rising debt burdens, these countries could not afford the needed fiscal support, resulting in higher poverty and malnutrition. Many resorted to cutting capital spending, which will make it harder to grow after the pandemic.

In short, the budgetary needs to cope with COVID-19 in developing countries remain large, especially given emerging variants of the virus. In addition to vaccine and treatment budgets, governments are expected to continue to provide social protection—especially cash transfers to vulnerable populations. These needs will pose massive challenges to countries under tight financial constraints, especially those at risk of debt distress.

Thus, the fiscal outlook for developing countries is not promising. Risks are intertwined and reinforcing. The main sources include:

- Protracted economic downturns, such as further lockdowns, delays in vaccine access and availability, and new waves of infections caused by new variants.
- Tighter financing conditions, including rising international interest rates.
- Realization of contingent liabilities, as a significant part of global financial support has been through loans or guarantees, equity injections, and other quasi-fiscal operations.

Other risks include volatile commodity prices and rising social discontent caused partly by mental stress due to lockdowns.

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COVID-19 has ravaged nearly every country, with the globalization of recent decades intensifying its spread. As of mid-2021, the world had spent $16.5 trillion—18% of global GDP—to fight the disease. And that amount does not even include the most important losses such as deaths, mental health effects, restrictions on human freedom, and other nonmonetary suffering. Nearly 90% of this spending was by developed economies, with the rest by emerging market and developing economies. As a result, developed countries are on their way to taming the pandemic. But at just $12.5 billion, coronavirus-related spending by low-income countries amounts to virtually nothing. This book shows that low- and middle-income countries still have a long way to go to control COVID. To survive the pandemic and restore economic growth, these countries must increase fiscal spending to vaccinate against and treat COVID-19 over the next two years. Because their ability to do so depends on individual country circumstances, the book examines the fiscal space of selected low- and lower-middle-income countries and finds that most are not in a position to increase fiscal spending without jeopardizing debt solvency and sustainability. Thus the conclusion is that developing countries must bite the bullet and be willing to risk further debt stress to emerge from the crisis. The international community must be willing to accept these exceptional conditions and adopt measures to ease the pain and suffering of the developing world. The book also recommends policies for dealing with the long-term growth issues of developing countries.

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