Post COVID and Labourmarkets: The need for reforming the International Financial and Fiscal System

Rolph van der Hoeven
ISS-EUR, The Hague
UN-CDP

ETUC Re-Think Seminar
Lyon and Virtual
6 September 2022

Partly based on: R. van der Hoeven and R. Vos, (2022) 'Reforming the International Financial and Fiscal System for better COVID-19 and Post-Pandemic Crisis Responsiveness', Chapter 2 in Papyrakis, E. (ed.), *COVID19 and International Development,* Springer

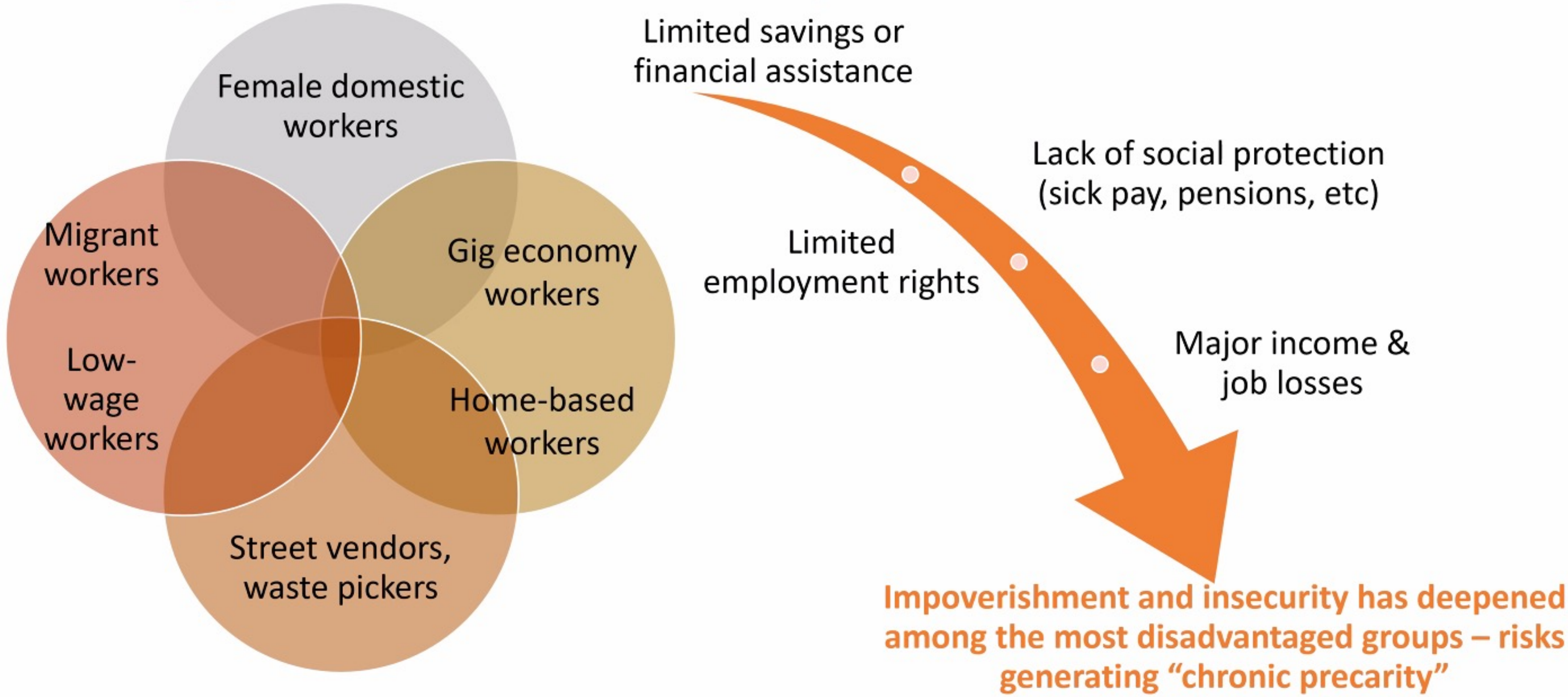
- The global economic crisis provoked by the COVID-19 pandemic disproportionally hurt low income workers in developing countries, through increasing poverty, food insecurity, and income inequality.

- Richer nations cushioned their economies from the worst impacts with unprecedented massive fiscal and financial support programmes. These were however unequally distributed and failed to cushion negative effects on low income workers, leading to greater inequality.

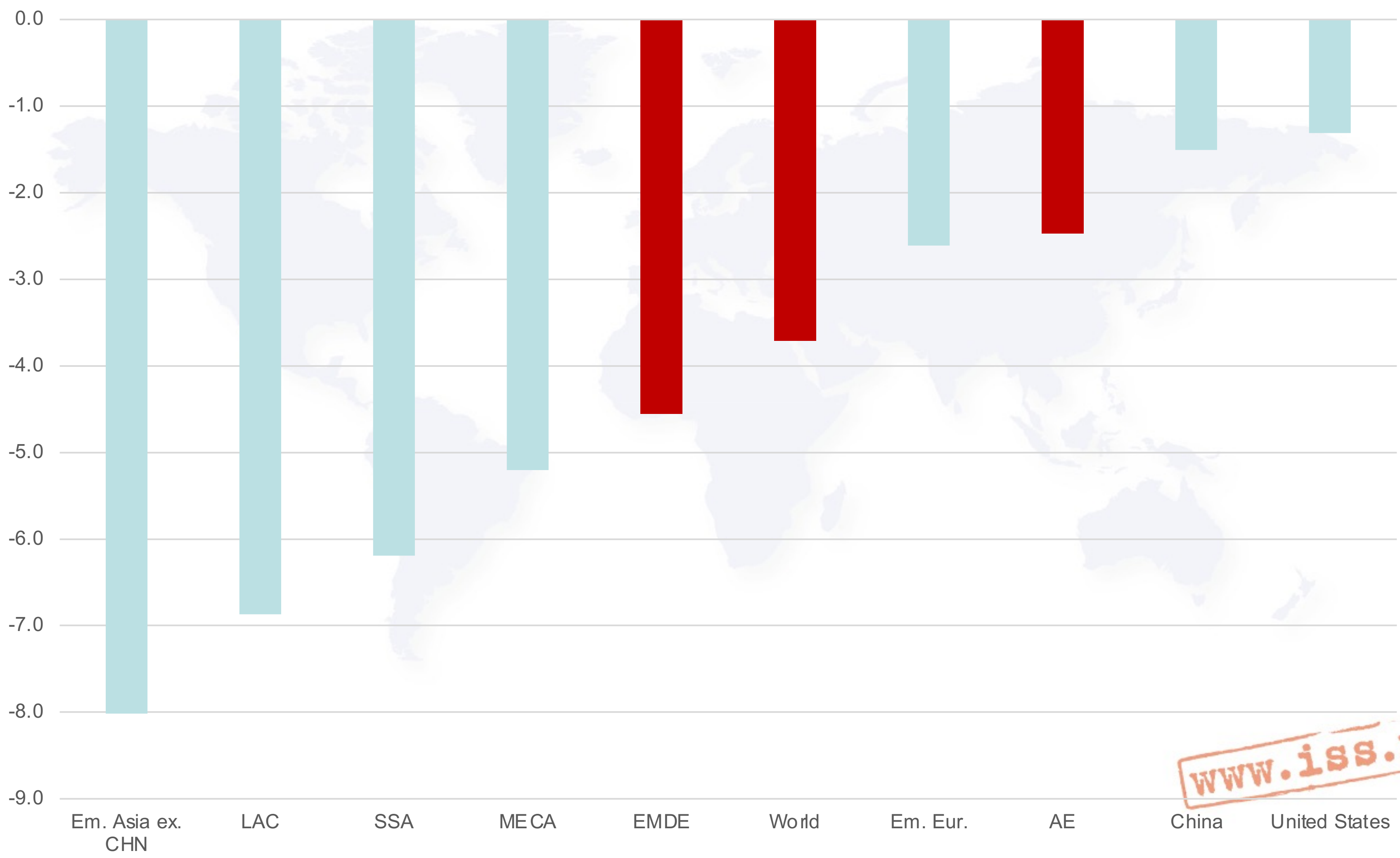
- Developing countries lacked such capacity and received feeble multilateral contingency financing, symptomizing the fundamental flaws in the international financial and fiscal system (IFFS).

International Institute of Social Studies

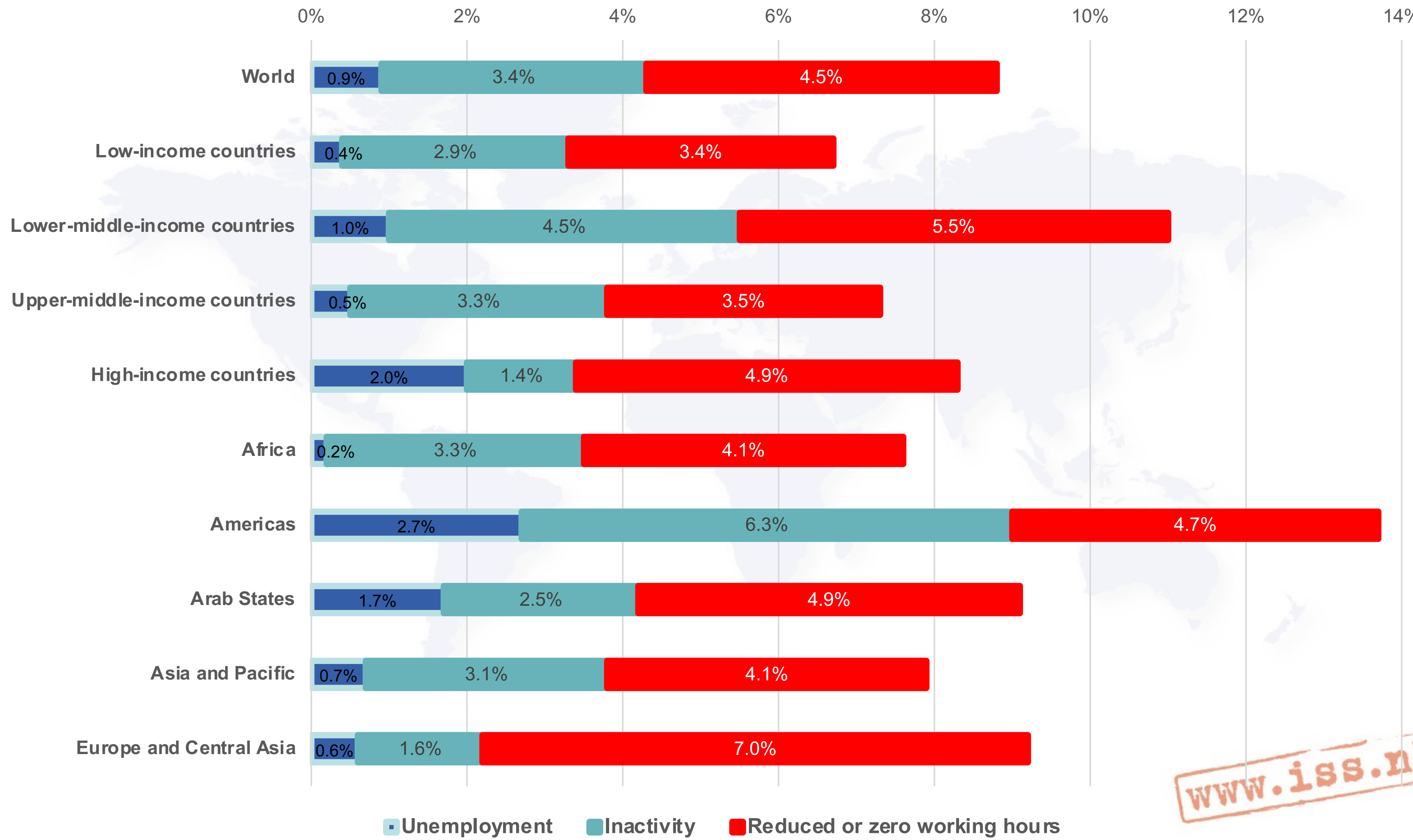
The global Covid-19 pandemic has reinforced and aggravated these inequalities



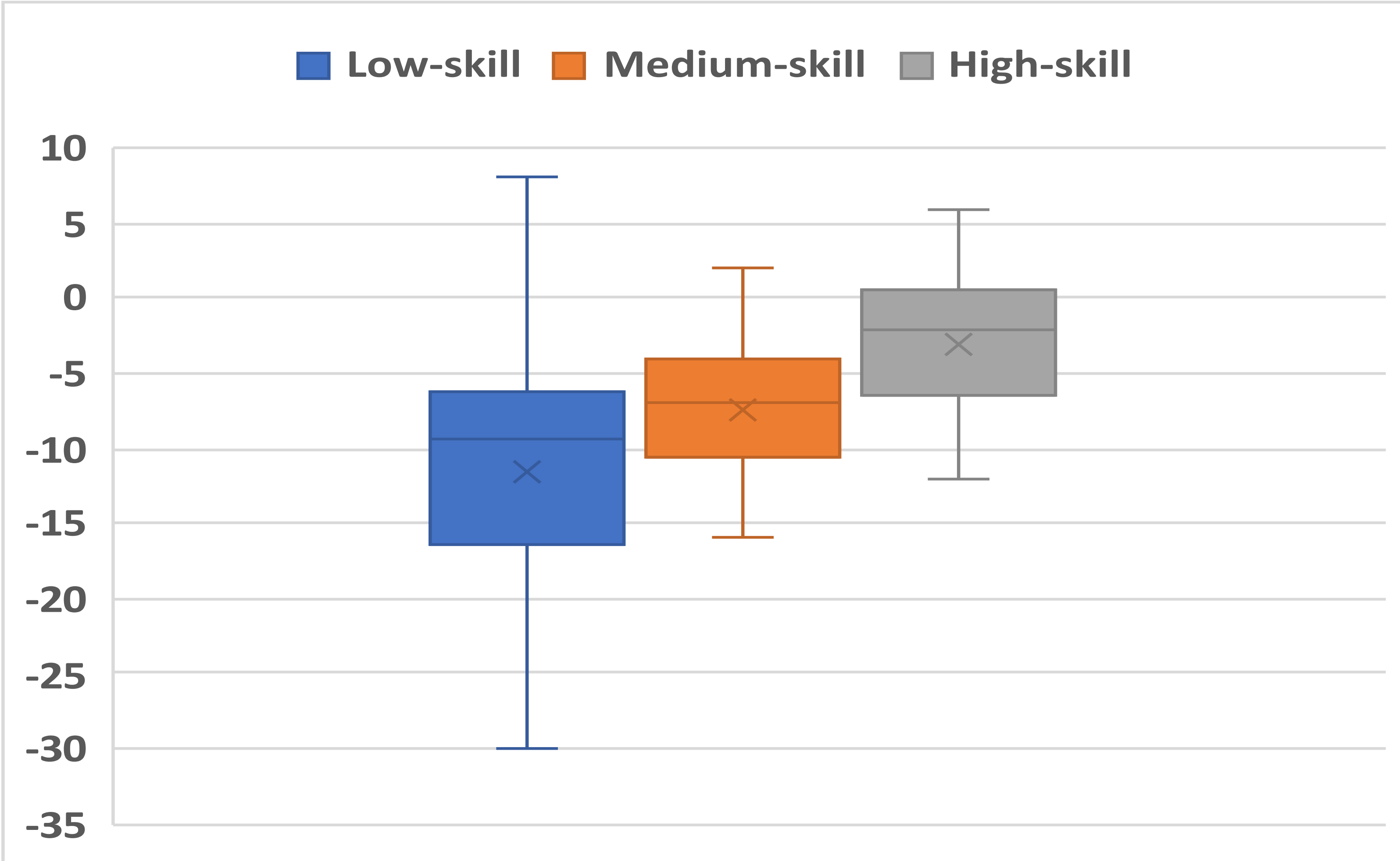
GDP losses (January 2022) relative to pre-COVID output levels (percentage change)



Decomposition of working-hour losses into changes in unemployment, inactivity and reduced working hours (averages for the world and by income group and region in 2020, percentage change)



Year-on-year country-level changes in employment, by skill level, 2021 (percentage change)



Several analyses have used simplistic approaches calculating the projected impact of the global recession on average per capita incomes to estimate poverty impacts, (e.g. studies by the World Bank in Mahler et al., 2020 and World Bank, 2020b; and that of UNU-WIDER by Sumner et al., 2020).

A major drawback of this approach is that it assumes that the *crisis has had no impact on within-country income distribution and, consequently, that workers across sectors and type of activity were all affected to the same degree.*

COVID 19 : Patterns of Food Consumption

The income and price changes associated with the recession and supply disruptions caused by pandemic are furthermore likely to have resulted in substantial changes in patterns of food consumption, with adverse nutritional consequences.

These will induce shifts in demand away from nutrient-dense foods, such as fruits and vegetables, dairy products and meats, and towards calorie-rich basic staple foods, such as rice, maize and other basic grains, raising concerns about dietary quality and likely increase in micronutrient deficiencies.

The dietary shift is (on average) similar in both developed and developing regions.

The United Nations Secretary-General stated recently (8 June 2022):

there is no answer to the cost-of-living crisis without an answer to the finance crisis

Flaws in the International Fiscal and Financial System

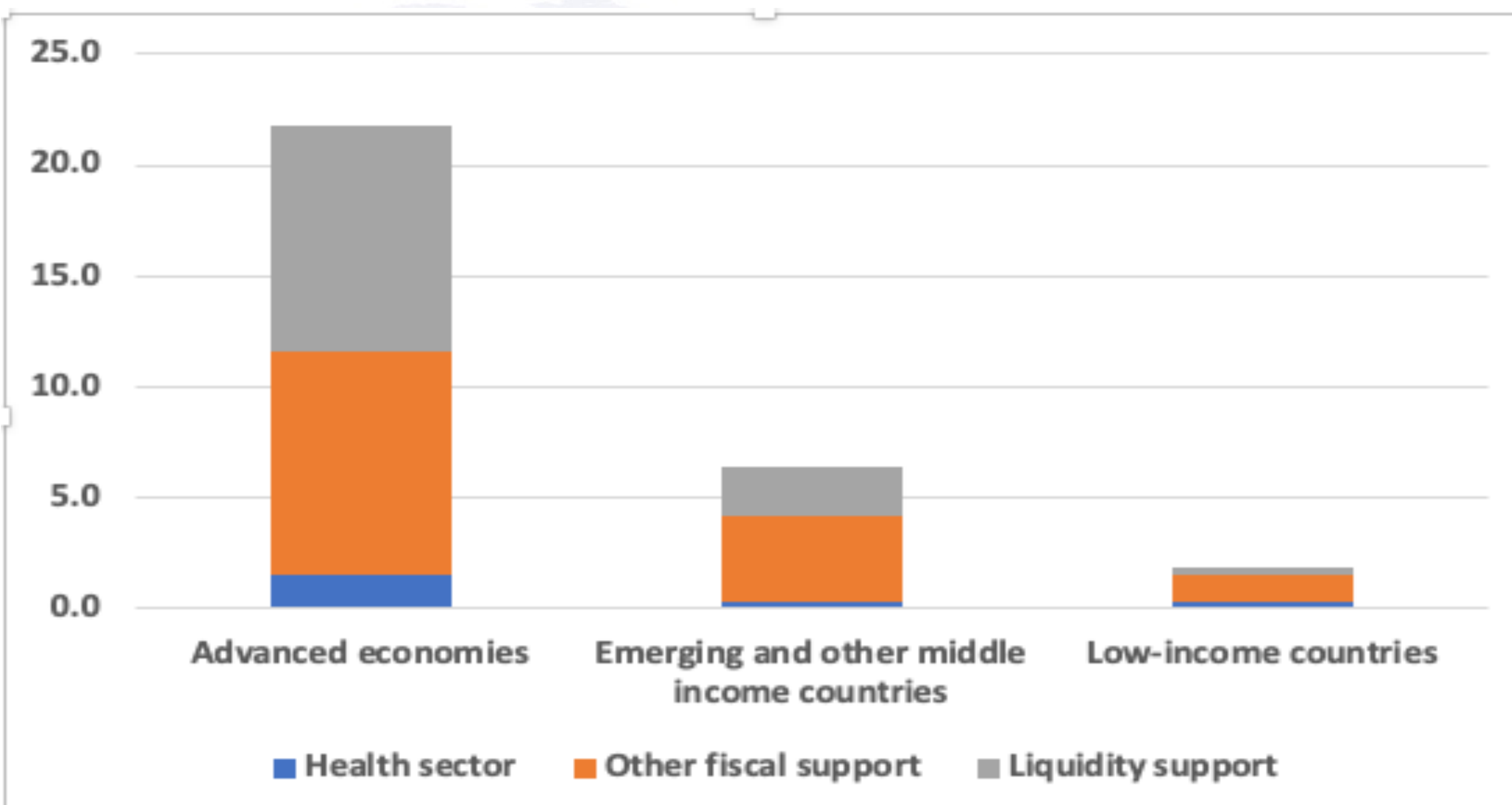
The global economic crisis provoked by the COVID-19 pandemic has painfully revealed the fundamental flaws in the international financial and fiscal system (IFFS).

While advanced countries could engage in massive fiscal and monetary support measures, low- and middle-income countries lacked such capacities and were hit disproportionally. During the first year of the pandemic (2020), advanced countries provided fiscal stimuli to the tune of 12.5 percent of Gross Domestic Product (GDP) on average.

This was *three times more* in relative terms than the stimulus in emerging and other middle-income countries, and *almost 10 times more* than governments in low-income countries could provide.

This divergence in government support mimicked the inequality in vaccine roll-out.

Fiscal and monetary support in response to COVID-19 per January 2021 (% of GDP)



A Non-Functioning IFFS

Lacking sufficient domestic resources to support their economies to pay for health costs and to stimulate their economies, developing countries needed to look for outside resources.

This proved difficult for many developing countries for several reasons:

A Non-Functioning IFFS

- After a period of falling external debt levels supported by the Highly Indebted Poor Country (HIPC) initiative during the 2000s, external debt burdens of many low-income developing countries surged again during the 2010s.

- Developing countries also faced an outflow of capital to developed countries and were hit by the appreciation of the dollar (and depreciation of their own currencies)

- The additional resources that were made available have come with conditions that in fact made these less effective as a response to the impacts of the pandemic.

Reforms making the IFFS fit for purpose in achieving the SDGs and combatting the outfall of the COVID19 Pandemic should include:

- An equitable international tax coordination mechanism;
- A multilaterally backed sovereign debt workout mechanism;
- Overhauling policy conditionality associated with development finance;
- Increasing Special Drawing Rights *to be leveraged for development finance.*

1. Establish credible mechanisms for international tax coordination.

Such mechanisms would include, among other things:

- an internationally agreed, uniform corporate tax rate of approximately 25% to stop tax base erosion. This tax rate would hinder multinational companies shifting their profits to tax havens.
- Improved tax coordination should further include mandated publication of data on offshore wealth holdings. This would enable all jurisdictions to adopt effective progressive wealth taxes and facilitate the monitoring of income taxes effectively paid by the super wealthy.

After years of deliberations, the G20 indeed agreed to a proposal for uniform corporate tax treatment in 2021. Unfortunately, at 15%, the rate is still significantly lower than proposed, thereby falling short of making a more significant impact on boosting tax revenues and on limiting profit-shifting behaviour.

2. Establish a multilaterally backed sovereign debt workout mechanism

- Although existing mechanisms to renegotiate sovereign debts with private creditors have improved over the years, they are still far from adequate.
- This is due to the multiplicity of debt contracts, some of which are not subject to collective action clauses. These collective action clauses are perceived as preventing more drastic action in cases of crises; without them bonds could potentially lose a great amount of their value.
- A global institutional mechanism to renegotiate sovereign debts should, therefore, be put in place as soon as possible.
- To this day, sovereign debt solvency problems continue to be solved in an ad-hoc fashion, at little favourable terms to debt-distressed countries.
- Moreover, they are accompanied by policy conditionality. This leads to unnecessary hardship in affected countries.

3. Reform of policy conditionality attached to International Monetary Fund (IMF) contingency financing

- While the IMF has recognized the need for enhanced public spending by developing country governments, including those facing debt distress, in practice, however, it continues providing pro-cyclical policy advice.

- This means that the IMF asks for fiscal restraint, rather than deficit spending when economies are in recession.

4. More truly international liquidity by increasing Special Drawing Rights (SDRs) and making these available to developing countries

- As an important step in this direction, the IMF approved the issuance of US $650 billion in new SDRs in June 2021.

- However, no agreement has yet been reached regarding how these additional SDRs should be allocated to developing countries, and how they can leverage additional investment to foster sustainable development.

- Had such reforms been in place already, the pandemic response would have provided a fairer level playing field for emerging and developing countries. This would have mitigated the pandemic's worst economic consequences.

None of these reforms should be seen as acts of charity. They are necessary to facilitate a global economic recovery that is both sustainable and equitable.

As in past crises, government leaders have acted with a ‘me first’ attitude, as has been blatantly clear in the roll-out of vaccination programs.

Some countries perceived this as a return to protectionism. This form of protectionism was evident in the unprecedented fiscal responses of high-income countries to protect the livelihoods of their own citizens, but which woefully disregarded the fate of people in low-income countries.

The governments of those countries did not have the means to protect the livelihoods of their citizens to the same extent.

Beggar-thy-neighbour policy responses, however, will affect global prosperity in the long term, and will make achieving the Sustainable Development Goals in 2030 elusive.