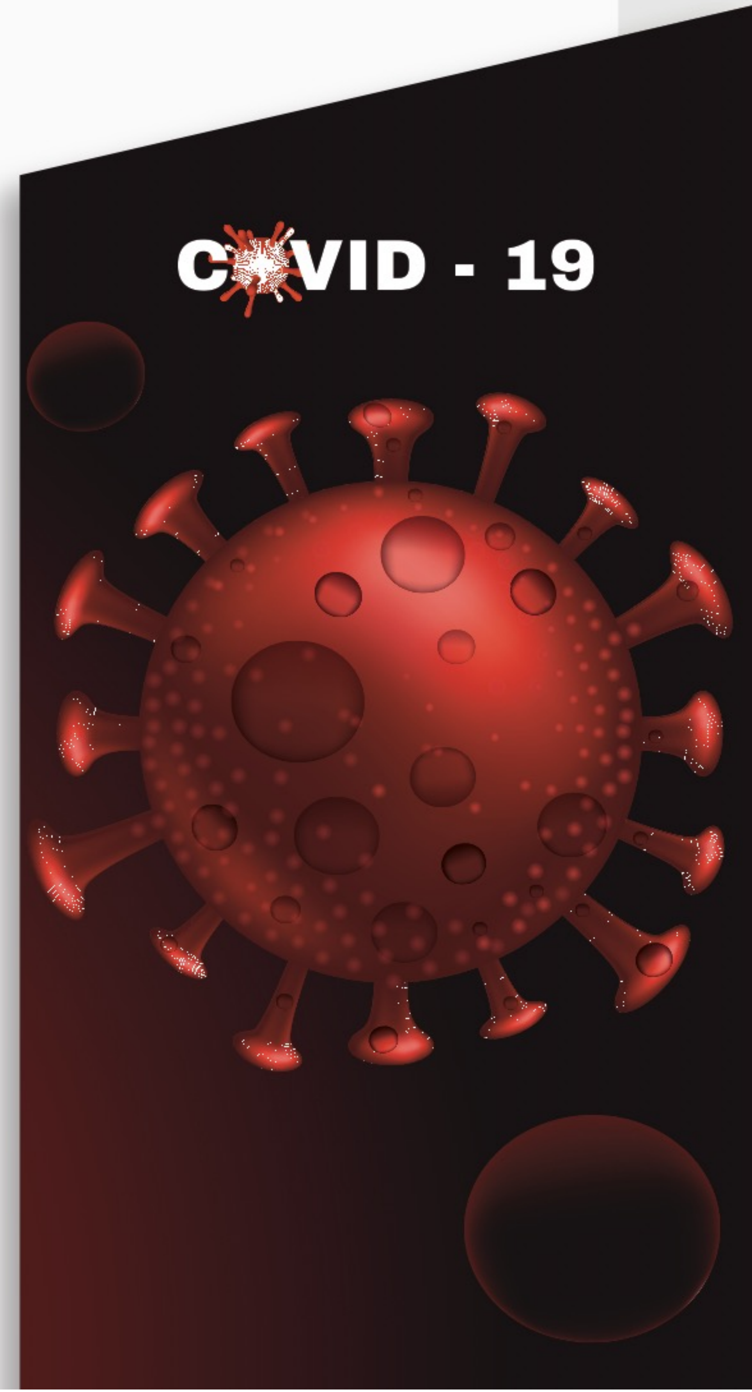
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
UNCTAD

TRADE AND DEVELOPMENT REPORT UPDATE

South-South Cooperation at the time of COVID-19:

Building Solidarity Among Developing countries

MAY 2020



UNITED NATIONS
UNCTAD

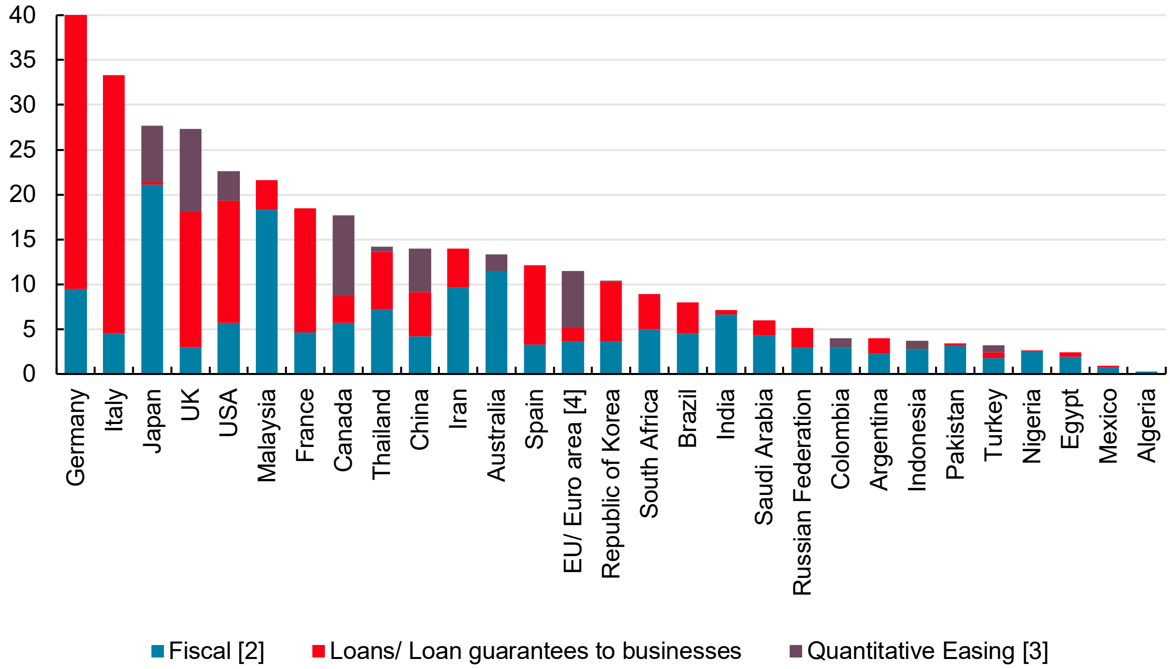
1. North-South Divergence in the fight against the COVID-19 crisis

The world economy is reeling from the Covid-19 pandemic and most governments have no choice but to lock down social and economic activity – a decision that comes at the cost of a global recession. Global output is estimated to contract by at least 3 per cent, with up to half the global workforce at the risk of losing their jobs and billions of people, especially in the South, pushed back into poverty and hunger (UNCTAD, 2020a; IMF, 2020; ILO, 2020).

While developed countries are providing trillions of dollars in relief, support and bailouts, developing countries are more constrained on the fiscal, monetary and external payments fronts making it difficult for many of them to respond to the multiple shocks triggered by the crisis (UNCTAD, 2020b). Nevertheless, some larger developing countries have provided immediate relief through financial bailouts and income support.

In China, the first country affected by the outbreak, an estimated RMB 13 trillion (over the 10 per cent of the GDP) of fiscal measures and financing plans have been announced. Right after the outbreak, Brazil's government announced emergency measures to inject nearly 575 billion reais (106 USD billion) into the economy to soften the blow from the coronavirus pandemic, while India's overall disbursement to date amounts to around 9 per cent of its GDP. In most other developing economies, however, the allocated funds are minimal. Figure 1 illustrates this huge variance in the volume of resources employed to respond to the pandemic by comparing the magnitude of the policy stimulus in 28 countries operating at different levels of development.

Figure 1 **COVID-19 rescue measures as a percentage of GDP in different countries**



Source: UNCTAD estimates[1].

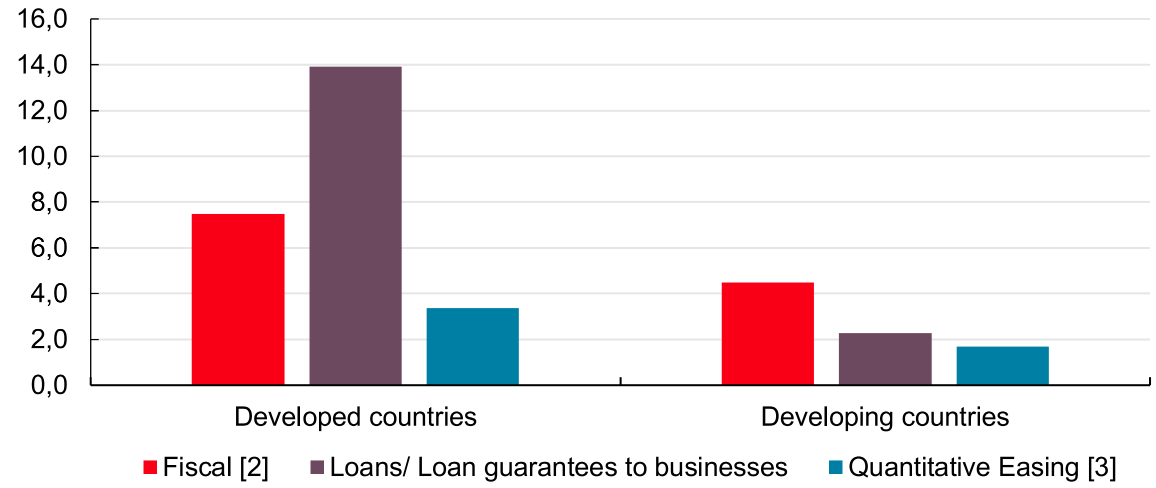
Note: [1] As of May 25th 2020. [2] Short-term deferral measures, i.e. tax payments deferred from one quarter or month to the next, are not included. [3] Estimate of additional asset purchases by Central Bank in response to the Coronavirus outbreak. In the case of China, the figure includes also and other monetary stimulus measures such as reductions in lending facility rate and lowered banks' Required Reserve Ratio. [4] As % of EU-27 GDP.

The asymmetry in mobilising public resources emerges even more clearly in Figure 2, which compares the average magnitude of the policy stimulus in selected developed and developing economies.[2] The figure shows that developed economies have so far committed on average almost 30 per cent of their GDPs to fight the pandemic, while the average size of relief packages in developing countries does not even reach 5 per cent (as of May 25th 2020). The figure also highlights the existence of significant differences in the composition of these packages – while, in advanced economies, over forty per cent of the total resources are employed to facilitate access to credit for firms operating in the non-financial sector, this component is much lower in the developing economies. This can put at risk many small and medium-sized enterprises which operate in the non-financial sectors in these countries.

[1] Methodological note: Fiscal estimates are based on fiscal spending and tax stimulus measures announced by relevant government authorities in reaction to COVID-19 outbreak. Loans/loan guarantees to businesses estimates are based on loan/loan guarantee programs announced by relevant government authorities in reaction to COVID-19 outbreak. Quantitative Easing estimates were calculated on the basis of asset-purchase programs announced by central bank authorities in reaction to COVID-19 outbreak. When provided, the magnitude of the stimulus measures is based on the official estimates from the relevant government authorities. Otherwise, magnitudes are estimated based on UNCTAD's calculations.

[2] The countries included in the sample are: Algeria, Argentina, Australia, Brazil, Canada, China, Colombia, Egypt, France, Germany, India, Indonesia, Iran, Italy, Japan, the Republic of Korea, Malaysia, Mexico, Nigeria, Pakistan, the Russian Federation, Saudi Arabia, South Africa, Spain, Thailand, Turkey, UK, USA.

Figure 2 **COVID-19 rescue measures as a percentage of GDP in different groups of countries**



Source: UNCTAD estimates.
Note: [1] As of May 25th 2020. [2] Short-term deferral measures, i.e. tax payments deferred from one quarter or month to the next, are not included. [3] Estimate of additional asset purchases by Central Bank in response to the Coronavirus outbreak.

Overall, this crisis is serving as an important reminder of the significant differences in the underlying economic conditions of developed and developing countries which determine their respective vulnerabilities to external shocks and capacity to respond. In particular, the much higher levels of informality, the lack of diversity in the formal economy and the heavy reliance on external markets and sources of finance, all of which are, moreover, closely interlinked, not only make developing countries much more exposed to the adverse economic impacts of the pandemic but also put them in a weaker position to respond with active policy measures.

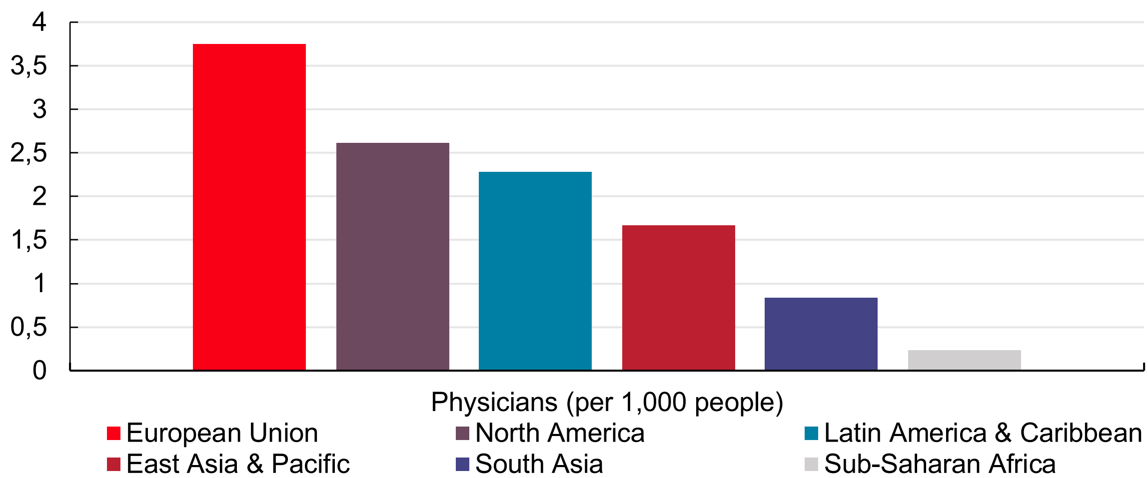
2. The South is more vulnerable and will take more time to recover from the COVID-19

The crisis is demonstrating, once again, that having in place state institutions and agencies for rapid response matters a great deal. Administrative capacity has over decades in many developing countries been hollowed out by repeated adjustment programs which are designed to downsize the public sector, erode the regulatory capacities of the state and generally extend the reach of markets and private firms into the public realm. At the same time, a weakened fiscal base in most developing countries has not only acted as a direct constraint on government spending but also restricted the room for a more active monetary response, given that the effectiveness and legitimacy of the Central Bank to manage credit expansion also depends on reliable fiscal revenues. As a result, developing countries have in recent years become more and more dependent on external private finance as a source of resource mobilization.

After the global financial crisis, a growing number of developing countries were able to raise finance in the international capital markets as foreign investors sought out higher yielding financial instruments and were willing to assume more of the risk from doing so. The resulting piling up of debt, much of it in dollars or other reserve currencies, but also including increased foreign ownership of domestic debt instruments, is now posing a huge obstacle to effective crisis responses and sustained recoveries in many of these countries. Moreover, and while the current global recession is likely to cause an impact in developing countries harder than the global financial crisis, for reasons discussed in previous reports (UNCTAD, 2020b), the recovery is likely to be slower and more protracted.

Least developed countries are the most exposed to Covid-19 because of their higher capacity constraints in providing even the basic health facilities, due in part to the large percentage of government revenues absorbed by debt servicing. General government health expenditure in low- and middle-income countries amounts to only 3 per cent of GDP and in the group of least developed countries (LDCs) just 1 per cent, against 10 per cent in high-income countries. While the European Union has four physicians per 1000 people, low- and middle-income countries have one physician per 1000 people and low-income countries have one physician per 2000 people (Figure 3). Developing countries are especially exposed to the Covid-19 outbreak given their limited ICU capacity. In China and India, for example, the number of critical care beds per 100,000 people stands at just 3.6 and 2.3 respectively, compared with 29.2 registered in Germany.

Figure 3 **Number of Physicians per 1,000 people**



Source: World Development Indicators, World Bank.

Beyond the threat to health services, in the absence of effective international support, developing countries will inevitably suffer lasting economic damage from the pandemic, including lower rates of capital formation, persistent debt stress, trade disruption, etc., all of which will severely constrain their recovery as well as halting progress towards meeting the 2030 Agenda. If the downside risks identified in the IMF's forecasts push global growth below 3 per cent this year and the anticipated rebound in 2021 fails to materialize – both plausible outcomes – the recession that will ripple across the South could turn in to a more prolonged depression and in some regions another lost decade.

3. International Responses have been inadequate for recovery of the South

Given their limited room to respond to a major shock, developing countries, at all levels, will need massive international support to avoid the worst-case economic and health scenarios. However, the response to date has been wholly inadequate (UNCTAD, 2020a, b). The G20 has agreed to suspend official debt service payments for the poorest countries until the end of the year, the IMF has cancelled $215m of debt payments due over a six month period for some of its poorest members and has expanded credit lines for crisis-hit countries and the World Bank has put together a crisis response package of over $160 billion to be disbursed over the next 15 months. There has also been a series of parallel initiatives undertaken by the regional development banks, albeit on a smaller scale (AfDB, 2020; ADB, 2020). However, not only have these emergency packages fallen well short of what might be expected given the scale of the challenges posed by the Covid-19 crisis, but also have lacked effective coordination which further dissipates their impact.

There is undoubtedly much greater room for bolder and more comprehensive action. First and foremost, due to the tightening finance constraint caused by the current shock, the southern countries particularly need external financial support to help mitigate the economic and social damage they are enduring. UNCTAD (2020a,b) has laid out a menu of possible options for the international financial system involving the scaling up of liquidity provision (through a massive injection of Special Drawing Rights by the IMF) and long-term financing (through grants and concessional lending by the World Bank and increased ODA flows) as well as substantial debt relief. The three regionally based multilateral development banks (MDBs), which have a high equity-to-loan ratio, also have considerable headroom to scale up lending without hurting their triple-A ratings with the international credit rating agencies. Indeed, some calculations point to additional lending capacity by these MDBs of over $340 billion, equivalent to almost 150 per cent their current loan levels (Humphrey, 2020).

Second, while the packages announced so far have rightly focused on strengthening national health systems, and to a lesser extent helping smaller businesses, much more needs to be done to effectively protect countries' productive capacities, employment, and inter-sectoral linkages within and across borders and enhance social protection systems. At the national level, effectively using fiscal tools (including subsidies) and strengthening public institutions to help guide recovery and expand fiscal space would be important but needs to be accompanied by strategic trade and industrial policy measures where south-south cooperation has a crucial role to play through sharing lessons and expertise. And at the regional and international levels, south-south cooperation could facilitate the scaling-up of available finance, for the better integration of developing countries into the existing trading system, as well as supporting new regional/global value chains and forging more coordinated positions in trade negotiations for preserving adequate policy space.

4. South-South Solidarity essential for a sustainable recovery in the South

The Covid-19 shock has not only exposed the fragile health systems and economic vulnerabilities of the South but has also revealed the lack of a strong vision that unites developing countries, at all levels, around a shared international agenda. Since the outbreak of the pandemic, although cooperation and coordination among the advanced economies themselves has been disappointing, the leading G20 members have organized a series of meetings and dialogues to discuss their actions. However, among developing countries, only some general statements (from G77 and the BRICS countries) have emerged affirming the fight against Covid-19, without any systematic and concrete action plans.

Given the urgency of multiples challenges, it is essential that the Southern countries build a strategic partnership and take coordinated actions without further delay. Going beyond the immediate relief packages, there is a need to have in place a plan for recovery and resilience in the South. Any such initiative cannot substitute for effective multilateral action to ease the pressure on developing countries and drive a resilient recovery for all countries. But the multilateral system is currently weak and rudderless and cooperation measures within the South should not only be reactive and palliative in nature but designed to promote reform of the wider multilateral system.

With this in mind, cooperation should be designed around three basic principles: scaling-up resources; enhancing policy space; and building resilience. Accordingly, a solidarity plan could come in the form of enhanced south-south financial cooperation encompassing initiatives covering mechanisms for both short- and long-term finance; joint action by developing countries for reviving trade and industry; and strengthened south-south cooperation for mitigating the health and food crises.

4.1. Scaling up South-South Finance

Most developing countries do not have large national development banks with access to significant funding at short notice (be it from markets or in the form of treasury transfers) to support emergency programs on a scale required to protect a country's productive capacity, jobs and the most vulnerable[3]. Given that the multinational and regional development banks thus far have launched narrowly focused financing packages, the two newly created southern banks, plus the Islamic Development Bank (IsDB), could have a significant role to play.

All three banks have already announced programmes in response to the crisis. The Asian Infrastructure Investment Bank (AIIB) is making available up to $10 billion to help member states to alleviate health pressures and is planning to scale up investment in social infrastructure, as well as boosting liquidity and budgetary support, the latter in partnership with other MDBs. The BRICS New Development Bank (NDB) has approved a $1 billion emergency loan to help Chinese provinces to cover public health expenditures including the purchase of health supplies and the construction of hospitals[4] and is negotiating allocations of equivalent amounts to India, Brazil and South Africa each. BRICS countries have reportedly agreed recently that the NDB should allocate up to $15 billion to BRICS member countries to help them rebuild their economies (New York Times, 2020). The IsDB, in turn, has prepared what it calls a 'comprehensive integrated response package' worth $2billion aimed at strengthening health systems, financing trade and SMEs in core strategic value chains, supporting recovery and countercyclical spending more broadly[5].

However, like the regional MDBs, these three southern banks have further space to scale up lending. The BRICS, for example, could consider mobilizing the NDB to allocate loans not just to the BRICS themselves but also to other countries, and create a fund, to be hosted at the NDB, to provide finance at subsidized rates to the poorer nations, especially in Africa. They could also deploy their bank to coordinate in partnership with national development banks, a medium-term strategy focused on infrastructure investment in different sectors, needed for the recovery phase and ensure the developing