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Macroeconomic policy responses to the COVID-19 crisis in emerging market and developing economies: Current outcomes and evolving challenges

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Macroeconomic policy responses to the COVID-19 crisis in emerging market and developing economies: Current outcomes and evolving challenges[1]

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Background paper for the GEPR 2nd edition

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Introduction and Overview

This Policy Brief offers a succinct overview of macroeconomic policy responses to the COVID-19 crisis in emerging market and developing economies (EMDEs). The scope of macroeconomic policy responses includes fiscal stimulus packages, monetary policy accommodation as well as labour market and social protection policies.

The Brief explores whether countries, especially in EMDEs, have tightened macroeconomic policy instruments between mid-2020 and September 2021 in response to heightened concerns about worsening fiscal balances, inflationary pressures, and projections of growth recovery over the medium-term. If this is indeed borne out, then one could argue that the countries under review are reverting to macroeconomic orthodoxy analogous to trends that were observed in the wake of the 2008-2009 global financial crisis and during past crises.

The tentative evidence is that EMDEs appear to have maintained direct and indirect fiscal support to cope with the economic consequences of COVID-19, but there is also evidence of fiscal consolidation in 2021 and beyond. The available evidence suggests that policy rates by central banks have been maintained in many cases. Given current concerns about heightened inflation caused by supply-side factors, it is likely that policy rates might increase by 2022 across a range of EMDEs.

The Policy Brief commences with a prologue in which it highlights the key elements of macroeconomic orthodoxy as well as its limitations. Such a framework has had a pervasive influence on EMDEs that hobbled their capacity to fight economic downturns. The scale and scope of the policy responses to the COVID-19 crisis suggests that governments across the world have learnt the painful consequences of inappropriate macroeconomic policies. Yet, at the same time, countries that form part of the EMDEs might be forced into austerity measures despite anaemic recovery against a background of daunting challenges of ensuring adequate vaccination rates for its population – which is a sine qua non of resumption of normal economic activity – and of adequate financing of the SDGs. These challenges can only be met by a combination of national commitment and global cooperation.

Prologue: epochal events and the shaping of macro-policy in emerging market and developing economies

Prior to the global financial crisis of 2008-2009 and prior to the COVID-19 recession of 2020, policymakers in emerging market and developing economies (EMDEs) were generally under the influence of what might be called 'macroeconomic orthodoxy'. This emerged in the wake of the decline of Keynesian macroeconomics that held sway in the 1960s but began to unravel after the oil price shocks of the 1970s.

Orthodox macroeconomics gives primacy to monetary policy in dealing with business cycles while the primary role of fiscal policy is to manage debts and deficits based on prudential thresholds. Macroeconomic orthodoxy also entails a circumspect approach to labour market and social protection policies. The key elements of orthodox macroeconomics – and the salient assumptions underpinning it - are listed below.

Macroeconomic orthodoxy and its key elements, pre-GFC, pre-COVID[2]

- Inflation targeting (IT) regime operated by independent central banks, with policy rates used to engage in inflation-centric economic stabilization
- Floating exchange rate combined with open capital account
- Or fully fixed exchange rate combined with open capital account, thus giving up monetary policy autonomy
- Fiscal rules, preferably operated by independent fiscal councils, to target debts and deficits
- Structural reforms to support private sector-led growth

Key assumptions

1. Fully competitive product, labour and financial markets
2. Forward-looking economic agents
3. Negligible incidence of liquidity constrained households (HHs)
4. No effective lower bound (ELB) on central bank policy rates
5. Moderate frequency, duration and depth of business cycles

Relaxing one or more assumptions affect(s) the core tenets of macroeconomic orthodoxy. Thus, for example, if there is a significant presence of liquidity-constrained HHS, fiscal policy becomes highly relevant. Similarly, the presence of ELB renders conventional monetary policy tools ineffective.

Despite these well-known limitations, the influence of macroeconomic orthodoxy persisted for decades – see Table 1.The socio-economic benefits of such persistence are questionable, despite lower inflation rates, improved fiscal balances and greater reliance on private-sector led growth.[3] For example, the transition recession in Europe lasted for about six years, with extreme poverty shooting up to historically

[2] The intellectual roots of macroeconomic orthodoxy are discussed at some length in Chowdhury, A and Islam, I (2018) The Great Recession: *Rethinking macroeconomics for employment and development*, Nova science publishers, New York

[3] Duttagupta and Pazarabasioglu (2021) claim that the practice of IT regimes in EMDEs fostered low and stable inflation, while the IMF Fiscal Monitor of October 2021 has renewed its commitment to numerical fiscal rules on the ground that it engenders fiscal prudence and reduces borrowing costs. See Duttagupta,R and Pazarabasioglu, C (2021) 'Miles to Go', *Finance and Development*, June, 2021. None of these recent evaluations claim that such policy regimes produce faster growth and improve labour market and poverty outcomes perhaps because it is difficult to establish such evidence. See Islam, R and Islam, I (2015) *Employment and Inclusive Development*, Routledge, London and New York, chapter 4.

unprecedented levels.[4] Latin America suffered a lost decade as a result of the debt crisis.[5] Inappropriate policy responses to the Asian financial crisis deepened the region-specific recession.[6]

The GFC of 2008-2009 provided a short-lived opportunity to modify the more rigid elements of macroeconomic orthodoxy (the singular preoccupation with controlling inflation, debts and deficits in order to boost 'market confidence' combined with structural reforms). It was, however, the 2020 COVID-19 recession that seems to have led to a major disengagement with orthodox macroeconomics – see Table 1. Expansionary fiscal policy became *de rigueur*. There was a renewed commitment to labour market and social protection policies. Even emerging economies aggressively pursued expansionary monetary policy and experimented with unconventional monetary policy tools.

There is general acknowledgement that these massive macro-policy responses were successful. At the global level, the IMF, in its October 2021 World Economic Outlook (IMF) 2021a:19), reiterated the message that:

> …(W)ithout the direct fiscal actions and liquidity support policies implemented across Group of Twenty economies in 2020, the contraction in global activity could have been at least three times worse than the actual outcome.

The IMF Fiscal Monitor of October 2021 (IMF, 2021b:xi) contends that continued fiscal support both in the United States and European Union (EU) 'could add a cumulative $4.6 trillion to global GDP between 2021 and 2026'. [7]

Country-specific evaluations (USA, Thailand, Vietnam) suggest that these policy interventions engendered significant financial benefits at the household-level and staved off even worse outcomes in terms of output loss and labour market distress.[8]

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[4] Easterly, W (2002) *The Elusive Quest for Growth*, MIT Press, Cambridge, Chapter 6.

[5] Bértola, L. and Ocampo, J.A. (2012) The Economic Development of Latin America since Independence, Oxford University Press, New York

[6] Islam, I and Chowdhury, A (2001) *East Asian Political Economy*, Oxford University Press, Melbourne

[7] IMF (2021a*), World Economic Outlook*, October, Washington DC; IMF(2021b) Fiscal Monitor, October, Washington DC. Posen (2021) celebrates the 'good news' on fiscal policy and rebukes those who are preoccupied with debts and deficits. See Posen, A (2021) 'Fiscal Success During COVID-19 Says Believe the Good News', Forum, *Intereconomics*, 1 July

[8] USA: *The Washington Post*, September 14, 2021 based on latest Census data. Thailand and Vietnam: Dzung, B et al (2021) 'The Effects of Fiscal Policy on Households during the COVID-19 Pandemic: Evidence from Emerging Economies', *MAGKS Joint Discussion Paper Series in Economics*, No. 20-2021

Table 1: Epochal events and corresponding responses

Epochal event	Duration (year/s) and depth of recession (% GDP growth rate)	Macro-policy and related responses
Latin American debt crisis (LADC)	1982/1983, -2.8%	Fiscal consolidation, containing inflation, structural reforms to create competitive markets and private sector led growth
Transition recession in developing Europe	1990-1995, -8.7%	As above
Asian financial crisis (AFC)	1998, -8.1%, (ASEAN-5)	As above, rudimentary and time-bound social protection directed towards poor
Global financial crisis	2009, -5.7% (developing Europe), 2.8% (EMDEs)	Fiscal stimulus neutral monetary policy, Labour market and social protection policies, but reversal to orthodoxy by 2010, given sovereign debt crisis in Southern Europe
COVID-19 recession	2020, -7.0%, (Latin America and Caribbean), -2% (EMDEs)	Fiscal stimulus, Expansionary monetary policy, including use of unconventional monetary policy tools, Labour market and social protection policies.

Source: Author's compilation, with negative GDP growth figures from IMF data mapper.

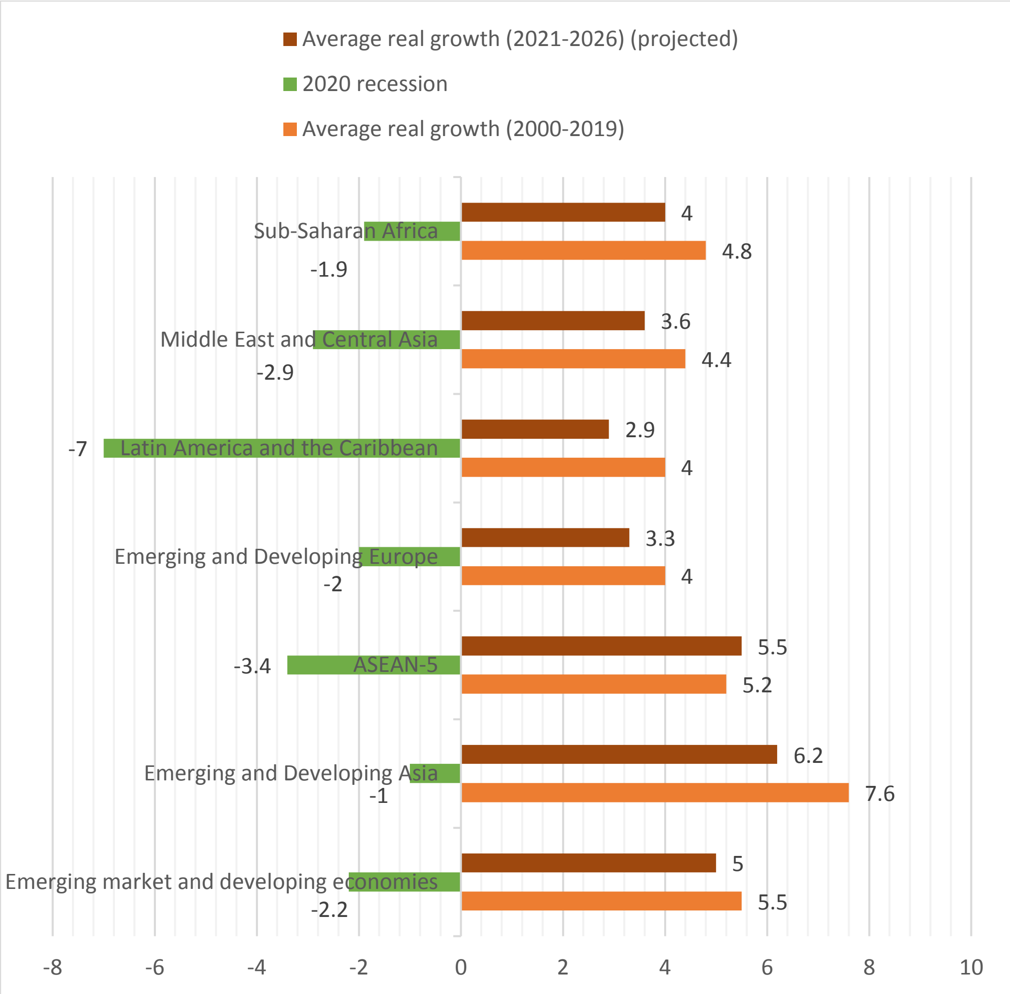
Macro-policy responses to the COVID-19 recession and their evolution over time (July 2020 to September 2021)

The overall impact of COVID-19 on 2020 GDP of EMDEs is -2%, but there are significant variations across regions. LAC is the worst hit region (-7%) , emerging Asia is the least hit (-1%). This is significantly better than the recession experienced by the advanced economies (AEs) which, in 2020, was -4.7 percent.[9] On the other hand, it ought to be emphasized that EMDEs as a whole registered moderate growth (2.8%) during the global financial crisis. Hence, from that perspective, the EMDEs have fared rather badly during the current pandemic. More importantly, AEs are expected to reach pre-pandemic output levels by 2022 while EMDEs are unlikely to regain their pre-pandemic growth momentum over the medium-term (2021-2026) largely due to the 'policy response gap' between the two groups of economies. There is expectation of reduced growth momentum for the next five to six years across every region in the developing world relative to 2000-2019 growth rates which were the best in decades – see Figure 1.

[9] IMF, G20 FWG Virtual Meeting, September 2021

How have governments across the world responded to the pandemic-driven recession? Has the policy response changed over time? Does one witness, at least at the regional level, any evidence of withdrawal of either fiscal or monetary policy support or both?

Figure 1: Real GDP growth, pre-COVID (2000-2019, recession (2020) and projected recovery (2021-2026) (%)



Source: Author's compilation based on [IMF data mapper.](#)

Changing fiscal policy responses to COVID-19 in EMDEs: overview

Table 2 depicts the changing nature of fiscal policy responses in AEs and EMDEs between June 2020 and September 2021. Fiscal support (as % of GDP) has increased substantially between June 2020 and July 2021 for AEs as a whole, while emerging market and middle-income economies (EMMEs) and low-income developing countries (LIDCs) have maintained their relatively modest direct fiscal support over the same period. Thus, the fiscal response gap has increased between advanced economies (AEs) and emerging market and developing economies (EMDEs) between

June 2020 and July 2021.There is some evidence that 'below-the-line' or indirect fiscal policy measures were reduced in the EMMEs during this period.

What is intriguing is the pattern of fiscal policy responses between July 2021 and September 2021. Apparently, both direct and indirect fiscal support as a share of GDP went up in the EMDEs, while it tapered off in AEs. Yet, alternative measures of fiscal policy stance (based on cyclically adjusted primary fiscal balance) suggest a rather different picture. Fiscal tightening is apparently already underway in EMDEs, while fiscal policy is still supportive in the AEs, most notably in the United States and EU (IMF, 2021a, chapter 1; IMF, 2021b, Executive Summary). How does one reconcile these apparently inconsistent trends?

The figures in Table 2 are derived from the IMF's fiscal policies database based on different vintages. These are *cumulative totals* expressed as a proportion of GDP. These totals are based on either announced or implemented measures. It is possible that at least part of the subsequent estimates reflects adjustments to previous totals rather than actual rise or decline. More importantly, the fiscal stimulus estimates focus only on COVID-19 related measures rather than changes in overall government expenditure or tax revenues. The standard measure of fiscal policy stance on the other hand, relies on estimated trends for overall expenditures and revenues (reflected in either overall or primary fiscal balances). Hence, it is possible for COVID-19 specific fiscal stimulus packages to increase even in a context of overall compression of the fiscal envelope.

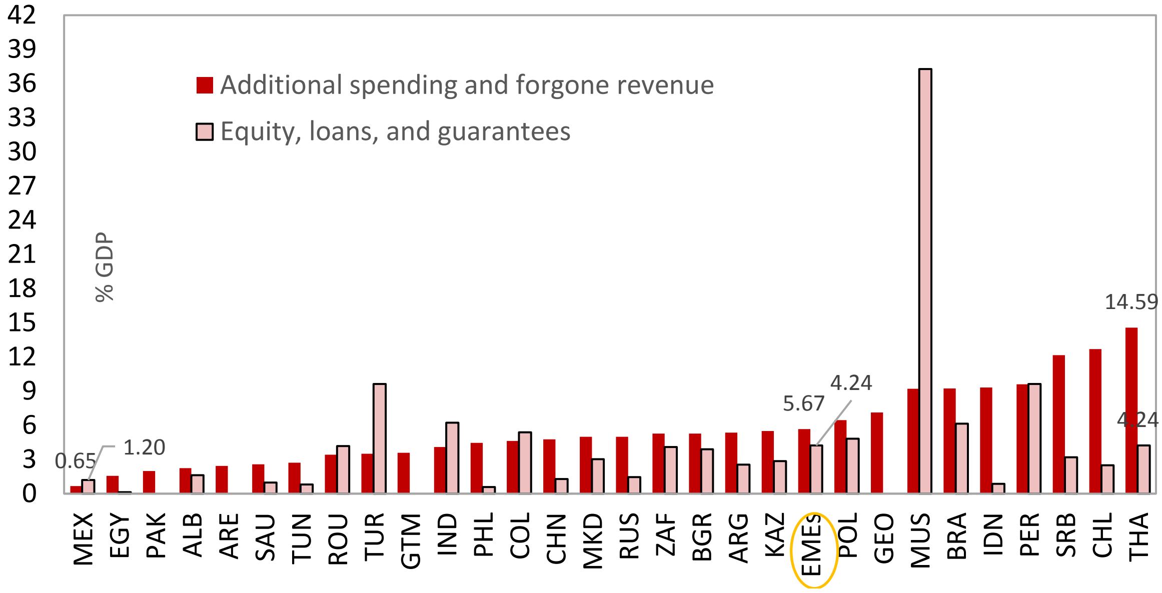
Table 2: Changing fiscal policy responses to COVID-19, AEs and EMDEs, June 2020-September 2021

		% GDP	
		Additional spending and foregone revenue	Equity, loans and guarantees
Advanced economies	Jun-20	8.9	10.9
	Jul-21	17.3	11.4
	Sep-21	11.7	11.4
Emerging market economies	Jun-20	2	3.1
	Jul-21	4.1	2.6
	Sep-21	5.7	4.2
Low income developing countries	Jun-20	1.03	0.1
	Jul-21	2	0.2
			0.9
	Sep-21	3.2	

Source: Author's compilation based on IMF fiscal policies database, September 2021

There is a considerable degree of variation in fiscal support across the countries that make up the group of EMMEs – see Figure 2 based on September 2021 estimates. As can be seen, Mexico has the lowest of level of fiscal policy response to COVID-19 (0.7-1.2% of GDP), while Thailand has the highest (up to 14.6 % of GDP).

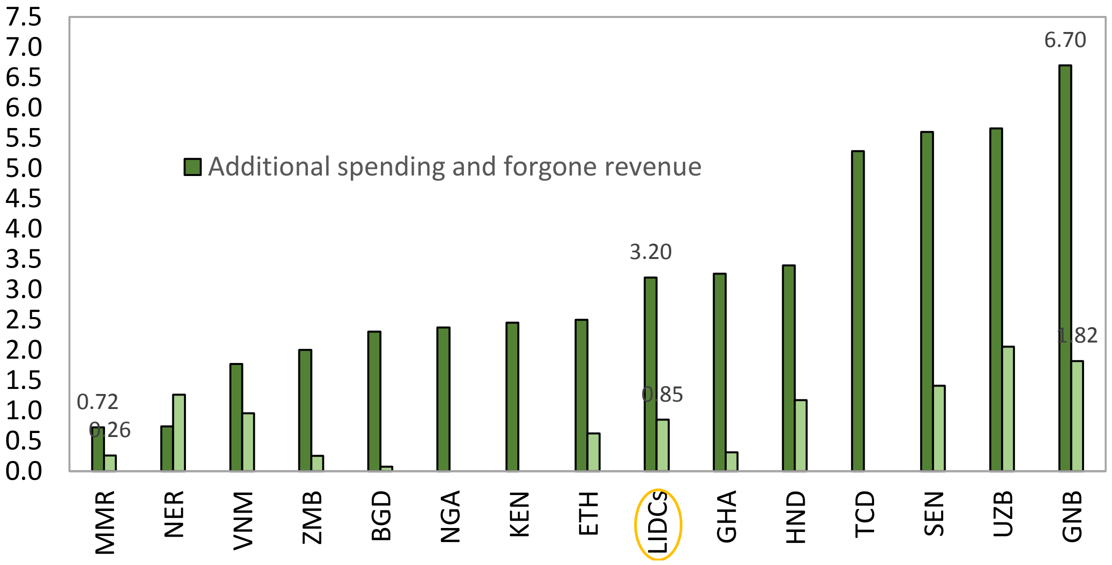
Figure 2: Fiscal policy responses across countries that are part of EMMEs



Source: [IMF fiscal policies database](), September 2021

Figure 3 depicts the diversity of fiscal policy responses to COVID-19 in LIDCs. Guinea Bissau in Sub-Saharan Africa has the most generous fiscal package (6.7 %) exceeding the benchmark for EMMEs as a whole (in terms of direct fiscal support). At the other extreme is Myanmar, which has provided barely negligible fiscal support in response to the COVID-19 recession.

Figure 3: Fiscal policy responses across countries that are part of LIDCs



Source: [IMF fiscal policies database](), September 2021

The Oxford Policy tracker enables one to highlight variations in fiscal support in summary form (income support and debt relief) across both advanced economies and EMDEs as well as over time. An illustration is offered for three countries (Mexico, India, Thailand). As can be seen, the fiscal support is generous in Thailand, modest in India and least generous in Mexico. There is some evidence of scaling back of fiscal support – see Table 3. In India, direct income support is withdrawn after June 2020, while in Thailand, it is reduced – but not withdrawn –between June 2020 and November 2021.

Table 3: Income support and debt relief in India, Mexico and Thailand, June, 2020 -November, 2021

Country	Income support (<50% of lost salary) (x for yes)	Income support (>50% of lost salary) (x for yes)	Narrow debt relief (x for yes)	Broad debt relief (x for yes)
India June 2020	x		X	
November 2020			x	
Mexico June 2020			x	
Mexico November 2021			x	
Thailand June 2020		x		x
Thailand November 2021	x			x

Source: Author's compilation based on Oxford Policy Tracker.

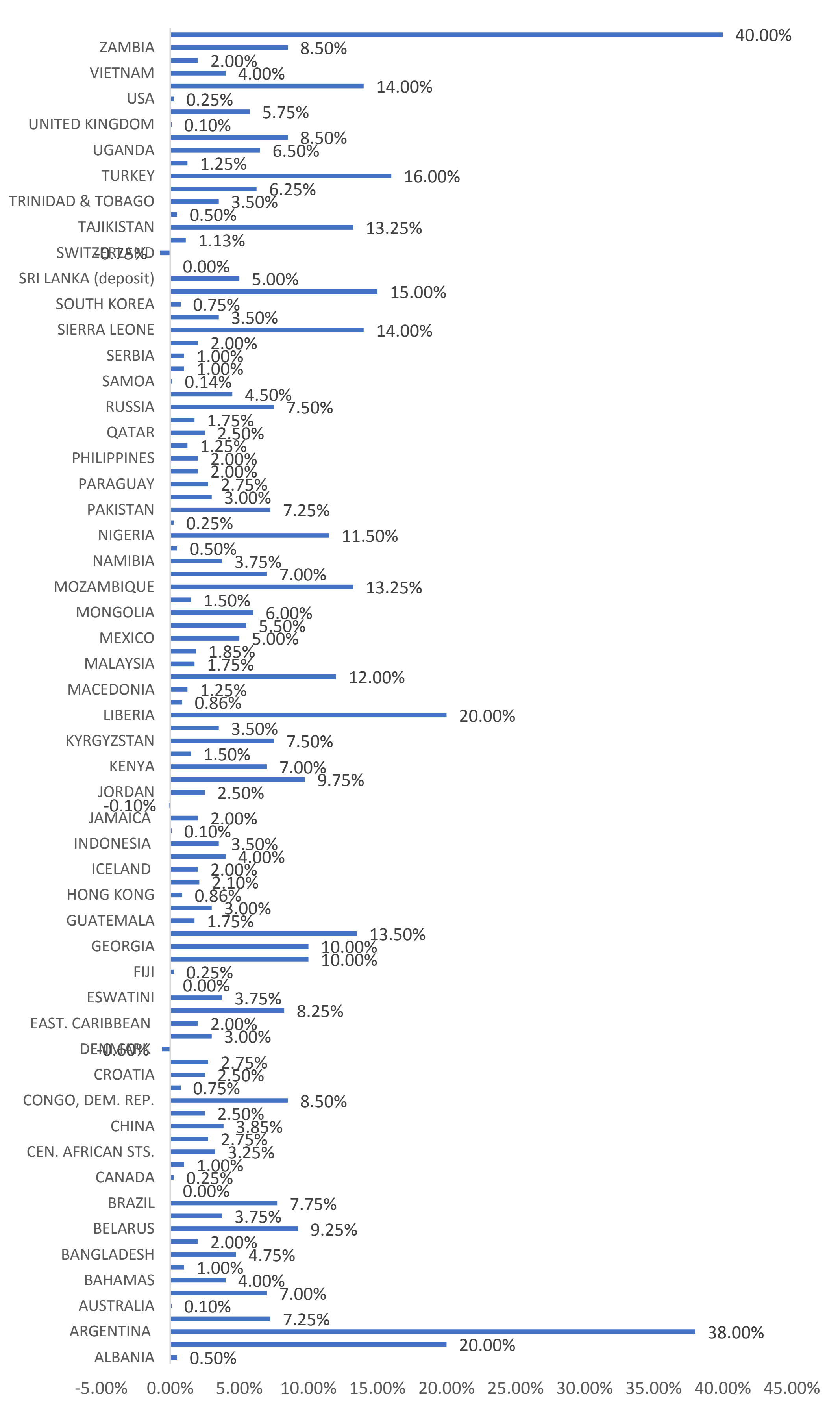
Notes: Income support shows whether the government is covering the salaries or providing direct cash payments, universal basic income, or similar, of people who lose their jobs or cannot work. Debt or contract relief shows whether the government is freezing financial obligations during the COVID-19 pandemic, such as stopping loan repayments, preventing services like water from stopping, or banning evictions.

Changing monetary policy responses to COVID-19: Overview

Unlike previous episodes of responses to crises and recessions, central banks in EMMEs have engaged in substantial loosening of monetary policy. They have cut policy rates and, and in many cases, maintained them. The Bank for International Settlements (BIS) provides data on movements in policy rates for 38 central banks. A private sector website (Central Bank News) provides data on 104 central banks. In the interest of wide coverage, this Policy Brief reports on policy rates as they have prevailed until mid-November, 2021 – see Figure 4). There are conspicuous cases of very high policy rates (such as Argentina and Zimbabwe), but the (weighted) average of policy rates for the more than 100 central banks is 5.1%. There are some cases of negative rates in AEs (Denmark, Japan, Switzerland), but there are also central banks in the EMDEs which have maintained very low rates (such as Albania, Fiji, Thailand) that are effectively close to zero.

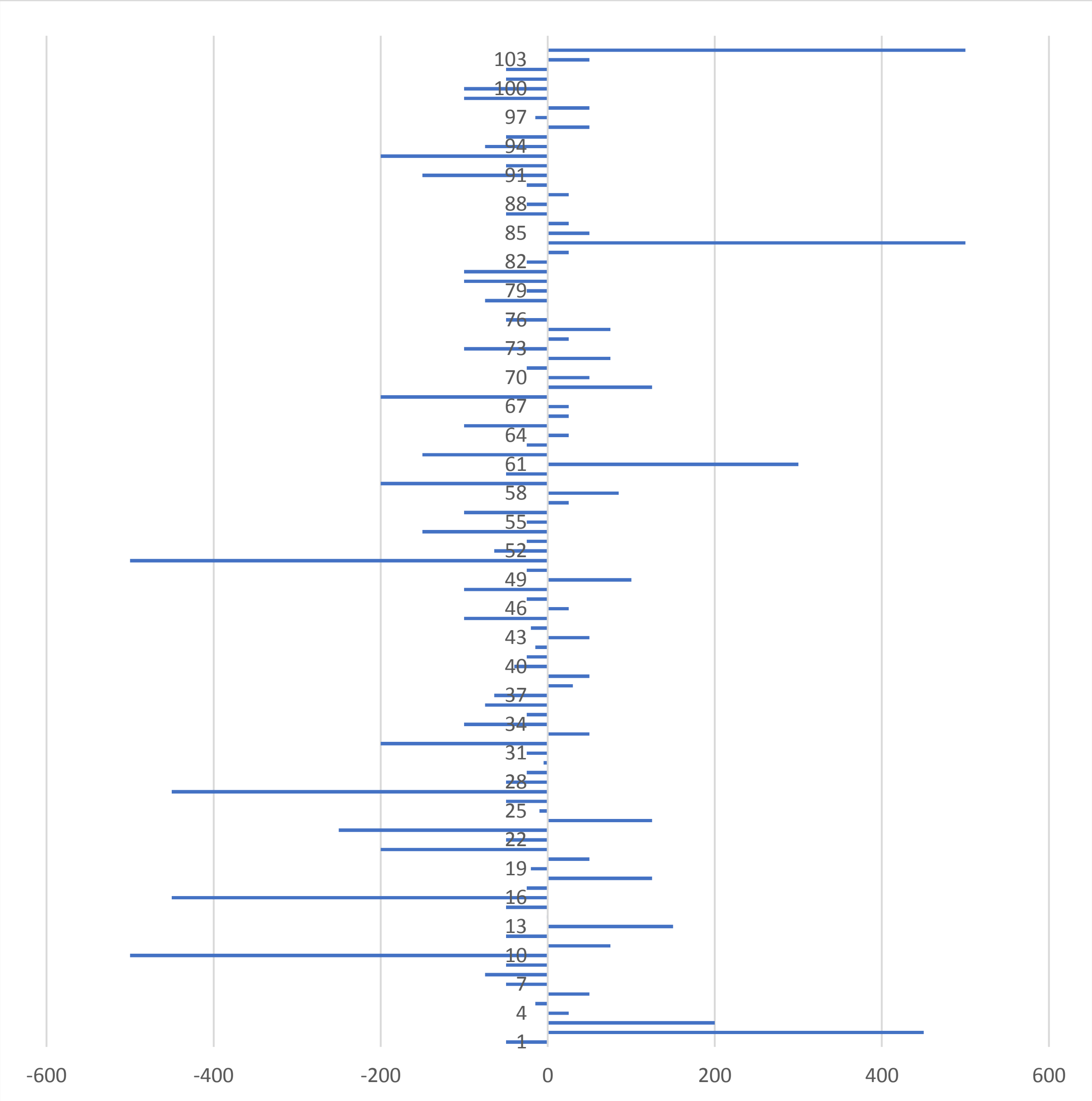
Figure 4 shows the cumulative change in policy rates measured in terms of basis points for 2021 (January to November). The (weighted) average suggests a modest increase (96 basis points or about 1%) in policy rates. Figure 4, however, suggests that the majority of central banks have not as yet increased policy rates. Among major central banks in EMDEs, Brazil has been the most aggressive, raising policy rates by more than 500 basis points between February 2020 and November 2021.

Figure 4: Policy rates (%), 104 central banks, mid-November 2021



Source: Author's compilation based on Central Bank News

Figure 5: Cumulative change in basis points (+/-) of central policy rates, January -November 2021, 104 cases



Source: Author's compilation based on [Central Bank News]

Several central banks in emerging markets have also implemented, for the first time, salient elements of unconventional monetary policy tools (the most notable of which is asset purchase programmes) – see Table 4.[10]

[10] The Reserve Bank of Australia (RBA) offers a lucid account of unconventional monetary policy, https://www.rba.gov.au/education/resources/explainers/unconventional-monetary-policy.html

Table 4: Use of unconventional monetary policy tools, selected emerging market economies

Country	Rate cut	Forward Guidance	Asset purchase	Expanded liquidity provisions	Programs to encourage bank lending	Regulatory easing
Brazil	Y	Y			Y	Y
Chile	Y				Y	Y
China	Y				Y	
India	Y	Y	Y		Y	
Indonesia	Y		Y	Y	Y	
Russia	Y				Y	Y
South Africa	Y		Y			Y
Turkey	Y		Y	Y	Y	

Source: Adapted from English et al (2021) and Pordeli et al (2021).[11] Note: Y = yes, otherwise blank.

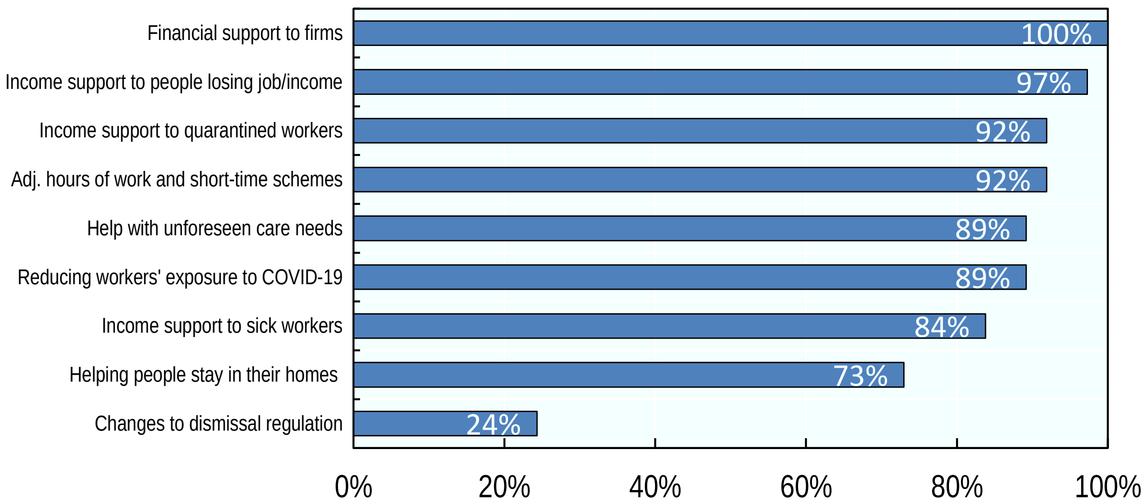
Labour market and social protection policies: Overview

The country-level responses to the COVID-19 crises have demonstrated how labour market and social protection policies have become part of the toolkit of macroeconomics. Such policies have been used in most G20 countries (90%) but is most prominent in OECD countries (92-97%) according to the OECD Policy Tracker (see Figure 6). Note that changes in labour regulations have only been sparingly used in OECD and non-OECD economies (30% of cases) to foster labour market flexibility and deal with job losses.

The ILO's Social Protection Monitor covers a comprehensive range of social protection measures that have been announced/implemented by countries across the world. The promising news is that many countries across all regions of the developing world has expanded social protection measures entailing a combination of increased coverage and more generous benefit levels with longer duration– see Figures 7 and 8. Furthermore, social protection measures specifically targeting the labour market (income/job protection and unemployment benefits) account for more than 28% of all measures that have been either announced or implemented to date (November, 2021). Despite these commendable developments, there is a long way to go before the developing world can claim to have attained universal social protection – which is one of the primary targets of SDG 1.

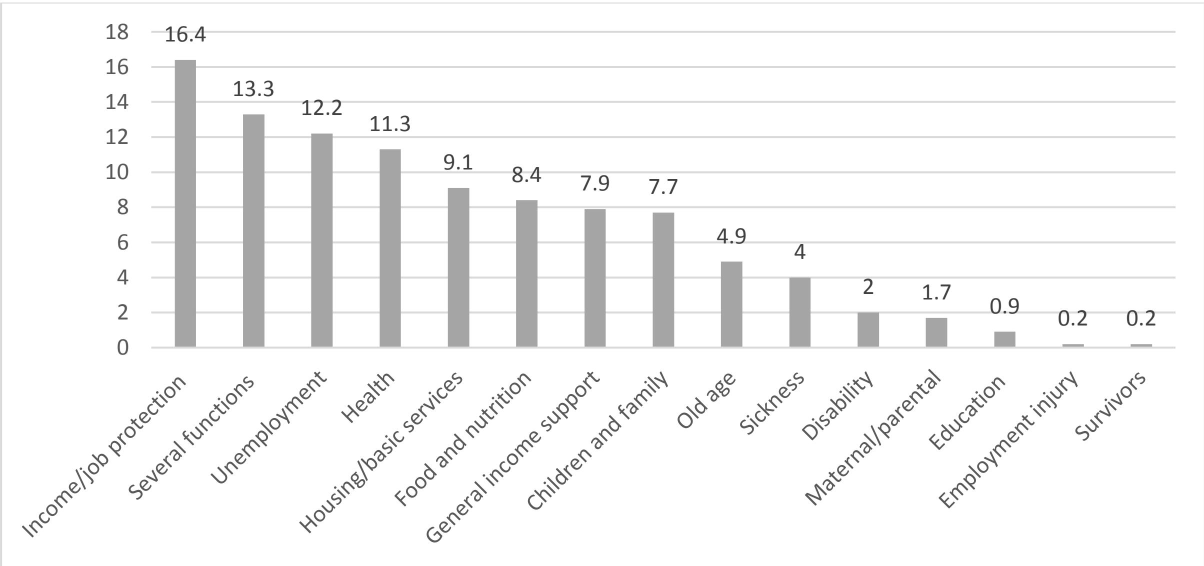
[11] English, B *et al* (2021) 'Monetary Policy and Central Banking in the Covid Era', 3 June, Voxeu. Pordelli, S *et al* (2021) 'The Response by Central Banks in Emerging Market Economies to COVID-19', 18 March 2021, Reserve Bank of Australia

Figure 6: Share of OECD countries that have introduced (or announced) new measures or expanded existing ones in response to COVID-19



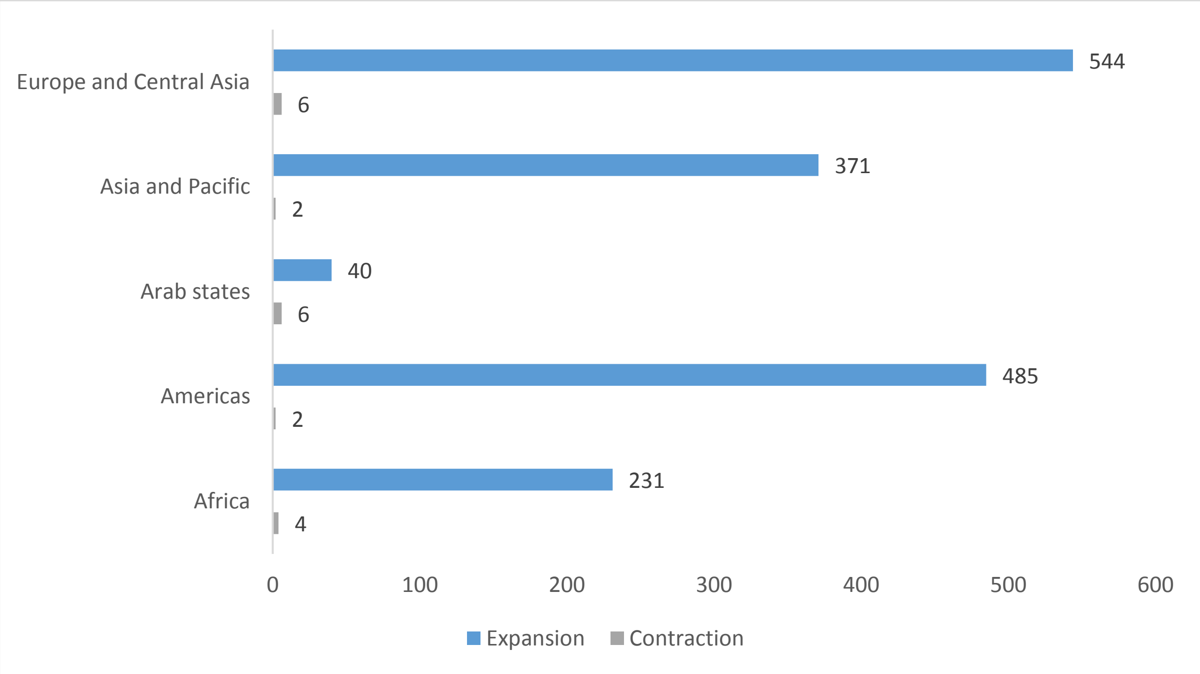
Source: [OECD policy tracker]

Figure 7: Social protection measures in response to COVID-19: Share of total (%)



Source: Derived from [ILO Social Protection Monitor]

Figure 8: Expansion/contraction of social protection measures by region in response to COVID-19



Source: Derived from ILO Social Protection Monitor

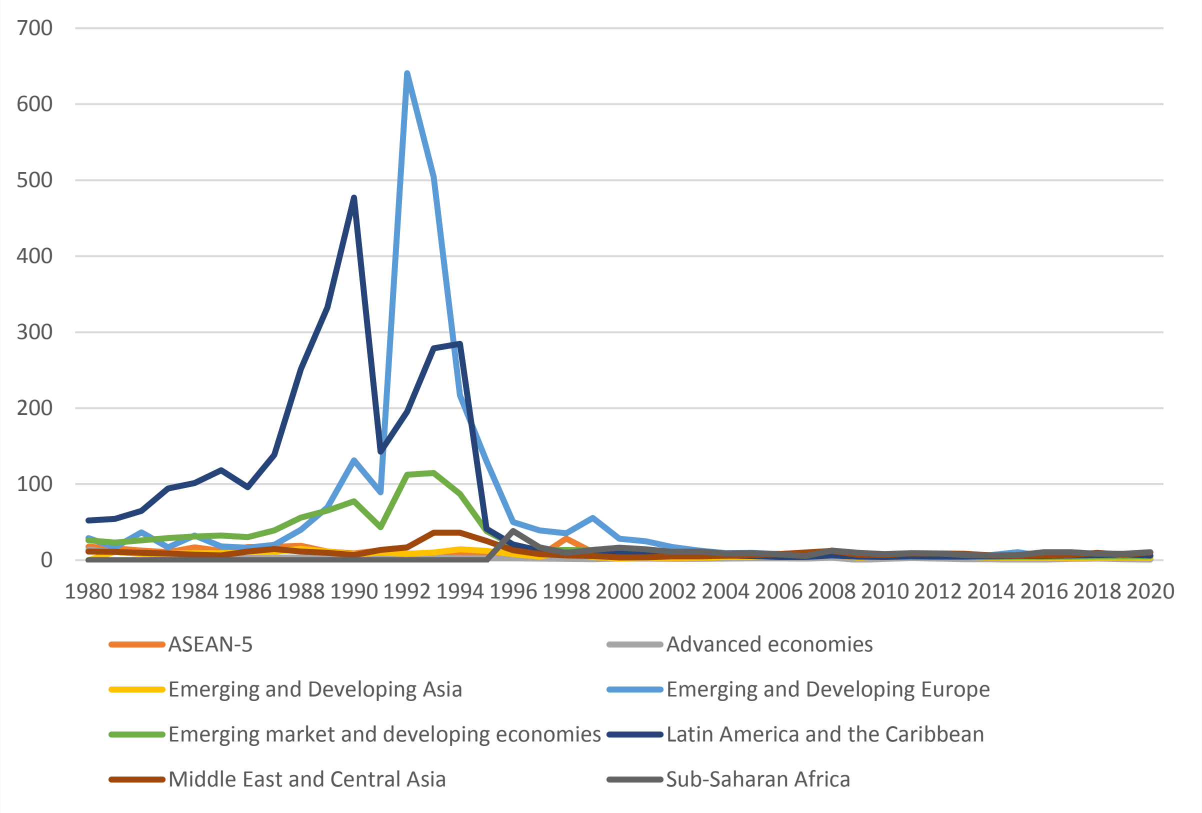
Constraints on policy responses: current concerns about inflation

There is a great deal of concern being expressed on inflation across many parts of the world today. What if the current state of monetary policy accommodation to support the expansionary fiscal stance of governments in systemically important countries is abandoned on the ground that inflation control should be accorded priority? The risk is that one might see the beginning of a new age of austerity by default that could derail an incipient recovery from the global recession of 2020 caused by COVID-19. The IMF (IMF, 2021a) has warned that fiscal tightening is already underway in EMDEs and that this could be reinforced by restrictive monetary policy as central banks in the developing world respond to current concerns about inflation. Such austerity by default, that is, policy actions that are forced by circumstances beyond one's control, is probably the biggest risk to sustainable economic and employment recovery in the developing world.

In dealing with the current inflation scare, adopting a historical and global perspective is important. The 1980s and 1990s were indeed the age of high inflation that bedevilled emerging market and developing economies (EMDEs). At one point (1993), inflation exceeded 100 % for EMDEs as a whole (!) – see Figure 9. This was primarily driven by hyperinflation in Latin America and developing Europe.

By the beginning of 2000, inflation for the EMDEs came down to single digits, while for Asia the reduction in inflation was even more impressive. It is this conquest of high inflation in the developing world that is the singular achievement of orthodox macroeconomics practiced by central banks and finance ministries who were, in turn, aided and abetted by the international financial institutions (IFIs). On the other hand, it was a Pyrrhic victory because the 1980s and 1990s were also the era of the 'lost decades' for many developing countries.[12]

Figure 9: Inflation rates by region (%), 1980-2020

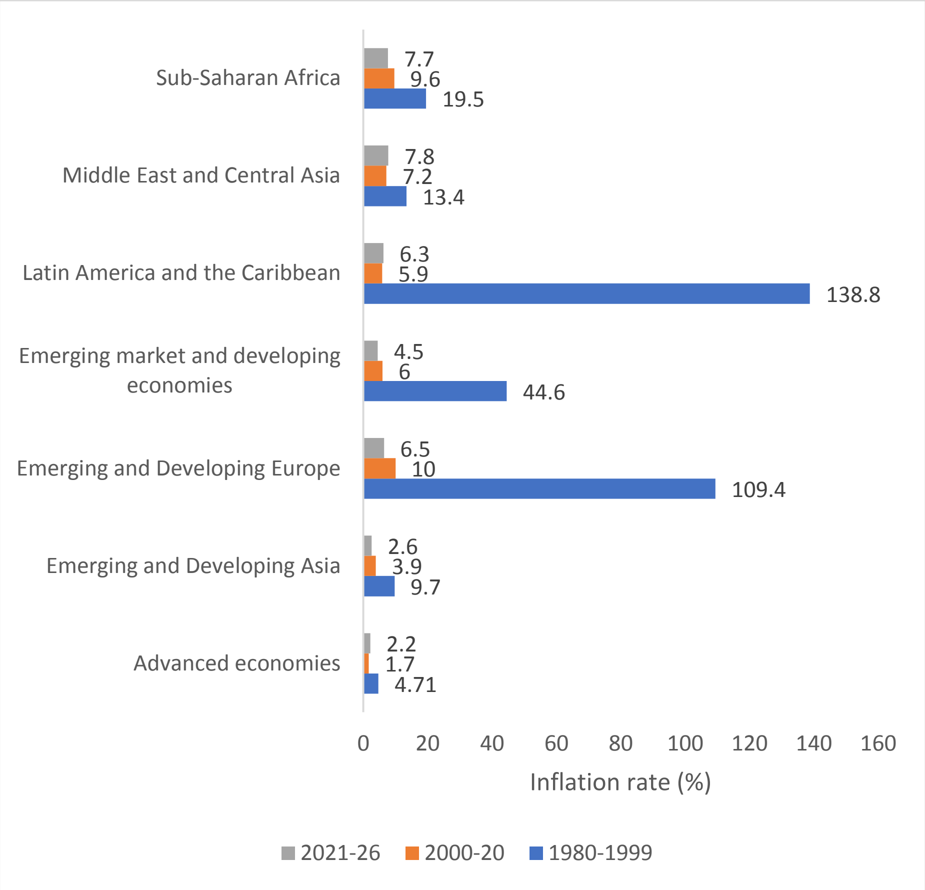


Source: Derived from IMF data mapper

For the last 20 years (2000-2020), the average inflation rate for EMDEs was 6%, ranging from 3.9% in Asia to 10 % in emerging Europe. Projections by the IMF for the 2021-2026 period suggest that many parts of the developing world are expected to experience even lower inflation rates, with the EMDEs as a whole projected to have an inflation rate of around 4.5%. This is within the range of inflation targets set by many central banks in the EMDEs. Hence, despite current alarmist discourse on the spectre of high inflation, one is unlikely to see a repeat of the 1980s and 1990s. It is reasonable to presume that the medium-term outlook for inflation for EMDEs is moderate. Of course, this regional analysis does not preclude the fact that individual countries in EMDEs do suffer from double-digit inflation rates and need to resolve them.

[12] Easterly, W (2002) *The Elusive Quest for Growth*, MIT Press, Cambridge, Chapter 6

Figure 10: Inflation rate (%), actual and projected, major regions, 1980-2026



Source: Derived from IMF data mapper

What about advanced economies (AEs)? The 'performance gap' on the inflation front during 1980-1999 between AEs and EMDEs was huge (4.7% vs 44.6%) as can be seen in Figure 10. This is no longer the case given that a significant degree of convergence has taken place since 2000 between AEs and EMDEs in terms of taming inflation.

Major central banks in the AEs, such as the US Fed, struggled to even reach the inflation target of 2% during the pre-pandemic period.[13] The average inflation rate for AEs as a whole for the 2000-2020 period was 1.7%. The projection for 2021-2026 is that the average inflation rate is expected to be around 2.2% which is in line with inflation targets for many central banks in AEs, such as Australia, Canada and New Zealand.

In sum, whether one considers the EMDEs, or the AEs, the prospect of a return to the high inflation era of the 1980s and 1990s appears unlikely. One should also note that a good deal of the current spike in inflation is due to disruptions in global supply chains.[14] Seeking to tame supply-side inflation using monetary policy instruments is

[13] Wessel, D (2019) 'What is average inflation targeting'? *Brookings,* May 30

[14] Rees, D and Rungcharoenkitkul, P (2021)'Bottlenecks: Causes and macroeconomic implications', *BIS Bulletin*, No.48, 11 November.

not a particularly effective strategy unless the initial inflationary impulse mutates into a persistent wage-price spiral fed by higher inflationary expectations.[15]

Inflation aversion of monetary authorities impose costs in terms of lost output and employment. Central bankers should remember that their collective mandate is – or ought to be – price stability *and* full employment rather than price stability per se. After all, New Zealand, the trailblazer for single mandate, inflation targeting central banks decided a couple of years ago to renew its commitment to the dual mandate of price stability and full employment.[16] Such transformation is worthy of emulation by other inflation-averse central banks.

Constraints on policy responses: current concerns about debts and deficits

Fiscal deficits and debts have increased sharply in both advanced and emerging economies because of the policy responses to COVID-19 as well as diminished revenues due to the recession. Significant improvement is projected beyond 2021 as fiscal support is withdrawn and revenues recover with resumption of growth. Both deficit and debt levels are expected to be elevated for EMDEs relative to pre-COVID norms (see Tables 5 and 6).

Table 5: Overall Fiscal Balance, EMDEs, 2001-2026

General government net lending/borrowing (% GDP)	2001-2019	2020	2021-26
Advanced economies	-3.64	-11.75	-4.5
Emerging and Developing Asia	-2.98	-10.6	-7.18
Emerging and Developing Europe	-1.57	-5.8	-2.78
Emerging market and developing economies	-2.19	-9.5	-5.8
Latin America and the Caribbean	-3.2	-8.7	-4.3
Middle East and Central Asia	-0.85	-5.4	-4.05
Sub-Saharan Africa	-1.8	-6.9	-4.3

Table 6: Public debt, EMDEs, 2001-2026

General government gross debt (% GDP)	2001-2019	2020	2021-26
Advanced economies	90.0	122.7	119.5
Emerging and Developing Asia	44.1	66.3	73.4
Emerging and Developing Europe	32.2	38.7	37.4
Emerging market and developing economies	43.4	63.1	66.1
Latin America and the Caribbean	52.4	77.7	73.4
Middle East and Central Asia	38.3	54.9	49.0
Sub-Saharan Africa	37.1	57.2	55.6

Sources for Tables 5 and 6: Derived from IMF data mapper

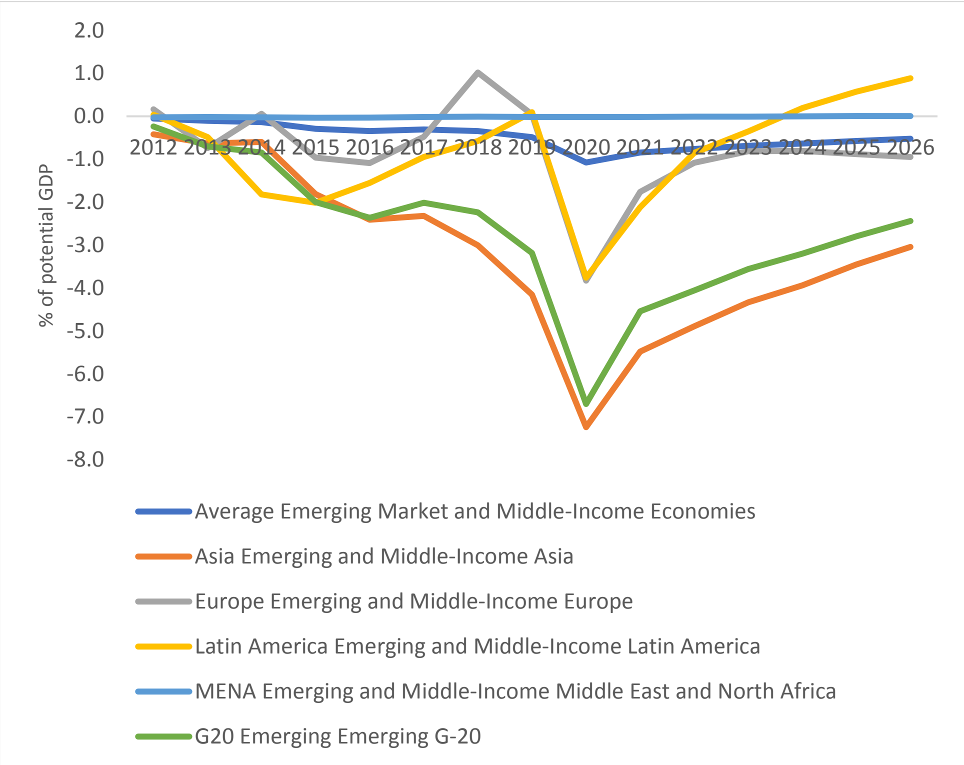
[15] Had this been the case, inflation forecasts by the IMF reported in the text should have picked up such a critical development. Other agencies support the notion of a benign inflation outlook. In the OECD, for example, the forecast inflation rate for the final quarter of 2022 ranges between 2.4 % and 1.3%. See OECD, https://data.oecd.org/price/inflation-forecast.htm

[16] Orr, A (2019) 'In Service to Society', 29 March, Speech delivered by the Governor of the Reserve Bank of New Zealand, Wellington

Fiscal tightening in 2021 and beyond for EMMEs is also reflected in the cyclically adjusted primary balance (that is, fiscal balance after adjusting for interest payments) for different regions represented by EMMEs (see Figure 11).

As noted, there is an apparent paradox in the fiscal numbers reported here. What seems to be happening is that, based on cumulative measures of fiscal stimulus packages, both direct and indirect policy support for COVID-19 measures is still being maintained, but this is happening in a context of fiscal consolidation. Is this juxtaposition justified? Is one witnessing fiscal austerity by default in the sense that EMDEs are being forced into this position by circumstances beyond their control that is provoking the fear of another debt crisis in the developing world? This fear, combined with rising concerns over inflation, might be pushing policymakers into austerity measures despite below-trend growth and subdued labour market conditions. These concerns should be subjected to careful, and critical, scrutiny.

Figure 11: EMMEs, cyclically-adjusted primary balance (% GDP), 2012-2026



Source: Derived from IMF Fiscal Monitor, October, 2021, Statistical Appendix

A core element of sovereign debt sustainability analysis is that rate of interest (i)-growth differential (g) should be negative and stable. As an important Policy Brief from the European Central Bank (ECB) points out:[17]

The difference between the average interest rate that governments pay on their debt and the nominal growth rate of the economy is a key variable for debt dynamics and sovereign sustainability

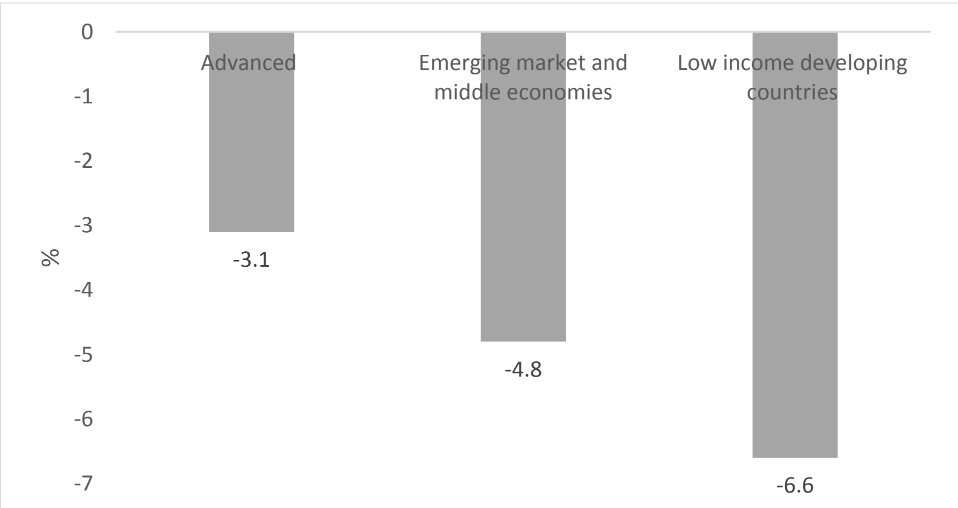
[17] 'Checherita-Westphal, C (2019) 'Interest rate-growth differential and government debt dynamics', *ECB Economic Bulletin,* Issue 2

analysis. ...If the interest rate-growth differential ... is strictly positive, a primary fiscal surplus is needed to stabilise or reduce the debt-to-GDP ratio...Conversely, a persistently negative (differential) ... would imply that debt ratios could be reduced even in the presence of primary budget deficits

Blanchard (2019), in a much-cited paper, drew on this fiscal arithmetic to argue that, for advanced economies, the core variable (i-g) is indeed negative and persistent in an environment of low inflation and stable growth during the pre-pandemic era.[18] Others have also highlighted evidence of a secular decline in (i-g) in the pre-pandemic era that has been sustained despite the COVD-19 recession.[19] This has led Blanchard (2019) to argue for a 'new fiscal consensus' that should motivate policy-makers to sustain expansionary fiscal policy to mitigate the baleful economic consequences of COVID-19 without having to worry about the unsustainability of public debt.

On the other hand, in a subsequent paper, Blanchard *et al* (2021) claim that the 'new fiscal consensus' applies primarily to AEs.[20] EMDEs cannot afford to continue with expansionary fiscal policies even though ironically (i-g) has generally been negative for EMDEs and is projected by the IMF to remain so for 2021-26 by an even larger margin relative to AEs (see Figure 12). Building on the experience of India, Blanchard et al (2021) argue that EMDEs fiscal position are actually much weaker when contingent liabilities are included. Furthermore, estimates of (i-g) in EMDEs are subject to considerable variability because of policy uncertainty. Hence, the default option is a programme of gradual fiscal consolidation despite a favourable (i-g) condition.

Figure 12: Projected interest rate - growth differential (%) 2021-2026

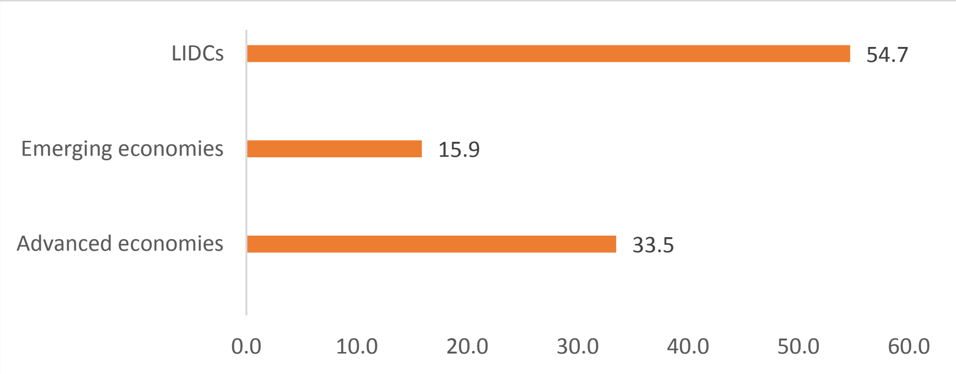


Source: Derived from IMF Fiscal Monitor, October, 2021, Statistical Appendix

[18] Blanchard, O (2019) "Public Debt and Low Interest Rates." American Economic Review, 109 (4): 1197-1229.
[19] Hudson, C et al, (2021) 'The Global Fiscal Response to COVID-19', 17 June, Reserve Bank of Australia
[20] Blanchard, O et al (2021) 'Does the New Fiscal Consensus in Advanced Economies Travel to Emerging Markets', *Policy Brief*, Petersen Institute for International Economics, March

One can think of additional reasons why, despite a negative and persistent (i-g), EMDEs might be vulnerable to fiscal distress. They include financial repression that could artificially lower borrowing costs on sovereign debt, the problem of capital flight caused by 'liability dollarization' (that is, external debt is acquired in dollars while revenues available for debt servicing are in local currency) and large ownership of domestic debt owned by non-residents. Indeed, LIDCs seem to have a high degree of domestic debt that is owned by non-residents – see Figure 13.

Figure 13: Ownership of public debt, AEs and EMDEs, 2020



Source: Derived from IMF Fiscal Monitor, October, 2021, Statistical Appendix

While the aforementioned concerns are valid, fiscal consolidation to keep public debt low to a pre-determined threshold is not necessarily an optimal response, especially under current economic circumstances. What is required is to target the sources and structural features that make EMDEs vulnerable to the risk of unsustainable debt. Removal of financial repression, greater fiscal transparency to account for contingent liabilities, reduction in policy uncertainty, reduction of liability dollarization and external ownership of domestic debt through prudential controls of the capital account represent a range of feasible and effective policy options. More importantly, these policy options would create the enabling conditions for the 'new fiscal consensus' to be equally applicable to EMDEs.

Short run and long run challenges facing EMDEs: resolving vaccine inequality and returning to the SDGs. Can the enhanced SDRs help?

The immediate challenge of vaccine inequality in EMDEs impedes the capacity of policymakers to cope with the current pandemic and thus resume normal economic activity. As of today (November 12, 2021), 65% of the population in high income countries had at least one dose of available vaccines, while just under 6% of the population in low-income countries had one dose. It would take a massive – and unaffordable - increase of 59% of health-care spending for low-income countries to inoculate 70% of the population against COVID. In contrast, advanced economies will only need to increase 0.8% of health-care spending to reach the same target.[21]

Given this grim challenge, the IMF - in conjunction with other international agencies - has proposed the provision of USD 50 billion plan to vaccinate 60 to 70% of the world's population and complement the global vaccination program with relevant COVID-safe health measures.[22] No concrete actions have been taken so far.

The announcement by the IMF of the largest allocation of special drawing rights (SDRs) amounting to USD 650 billion in August, 2021 might be one way to support the USD 50 billion-dollar plan.[23] Yet, critics are concerned that the new SDRs might raise a lot of expectations without fulfilling them. This is because SDRs will be distributed to countries in line with a country's quota share with the IMF. Given that EMDEs are 'minority' shareholders, it is not surprising that EMDEs as a whole are expected to get 42% of SDRs, while low-income countries are likely to get 3.2% of the new SDRs.[24] In some cases, even this modest amount might be a lot as a share of the GDP of low-income countries, but this might still fall short of their spending needs. On the other hand, advanced economies that do not really seem to have financial constraints in dealing with the pandemic, will have significant shares of SDRs which they might not be prepared to recycle to the poorer parts of the world. Hence, a proposal has been made that a COVID-19 trust be set up to recycle the SDRs as well as transfer them to the regional development banks.[25] Tentative steps by the IMF are being taken in this direction.[26]

There is the long-term development challenge of attaining and financing the SDGs. Given the rise in extreme poverty as a result of COVID-19 and lukewarm global cooperation pertaining to climate change mitigation, the SDGs are under threat of being derailed.

It is against such a sombre background that one should revisit the core issue of adequate financial and fiscal resources to support the SDGs. Even in the pre-COVID-era, there was a USD 2.5 trillion financing gap which, as a result of COVID-19, has increased to USD 4.2 trillion.[27] This has occurred against a background of modest trends in national tax revenues of EMDEs as well as aggregate trends in external finance – see Figure 14. Hence, as the international community approaches 2030, the key fiscal policy will revolve around finding sustainable means of resource mobilization to reduce the SDG financing gap.

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[21] These statistics are available at https://data.undp.org/vaccine-equity/

[22] https://www.imf.org/en/News/Articles/2021/06/01/a-new-commitment-for-vaccine-equity-and-defeating-the-pandemic

[23] https://www.imf.org/en/News/Articles/2021/07/30/pr21235-imf-governors-approve-a-historic-us-650-billion-sdr-allocation-of-special-drawing-rights

[24] These figures are based on data provided by the IMF (https://blogs.imf.org/2021/08/26/a-shot-in-the-arm-how-special-drawing-rights-can-help-struggling-countries.)

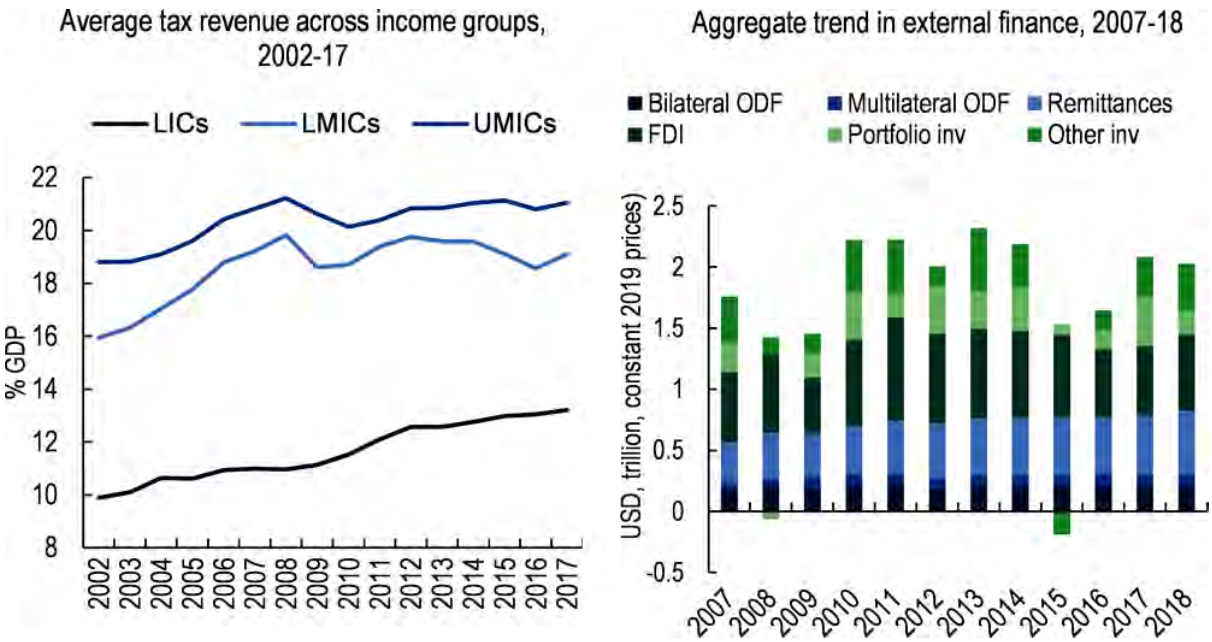
[25] Eichengreen, B (2021) 'This SDR allocation must be different', Project Syndicate, September 10

[26] IMF (2021c) 'Sharing the Recovery: SDR Channelling and a New Trust', 8 October

[27] OECD (2021), Overview | Global Outlook on Financing for Sustainable Development 2021 : A New Way to Invest for People and Planet | OECD iLibrary (oecd-ilibrary.org)

Concerns about debts, deficits and inflation that preoccupy orthodox macroeconomics pale into insignificance in the face of both the SDG attainment and financing gap as well as the immediate challenge of resolving vaccine inequality. There will have to a renewed commitment to global cooperation and national resolve to deal with vaccine inequality and invest in labour market and social protection policies that directly contribute to the attainment of the SDGs. This is where a new beginning in post-COVID, inclusive and pro-employment macroeconomics can be made.

Figure 14



Source: *OECD (2021)*