

OXFAM INTERNATIONAL MEDIA BRIEFING

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False Economy: Financial wizardry won't pay the bill for a fair and sustainable future

2023 could be a turning point. A year when the world emerges from unprecedented crises, and governments deliver progressive reforms that build a brighter future for all, and for the planet.

But despite the dire economic situation facing the poorest countries today, and much political discussion of the trillions needed to tackle poverty, inequality and climate change, there is no indication that rich countries are willing to pay the true price of a fair and sustainable future.

In fact, there is a risk that rich-country Finance Ministers meeting in Washington this week will celebrate progress on reforms that deliver just 0.1% of the climate and social spending gap in low- and middle-income countries (LICs and MICs) between now and 2030. And that they will do so through financial wizardry that doesn't cost them a cent.

This briefing spells out the dire reality and the true scale of the financing needed in low- and middle-income countries, the inadequacy of the solutions currently under discussion, and the action rich countries could be taking to raise the trillions of dollars that are truly needed.

The situation is dire

The Sustainable Development Goals (SDGs) are woefully off track and have been further [derailed by recent intersecting crises](#). Today, the world's poorest countries are also facing a devastating economic crunch that will undermine their ability to invest in tackling poverty and climate change for decades to come. Their budgets have been squeezed dry by the pandemic, by food and fuel price spikes exacerbated by Russia's invasion of Ukraine, and finally by interest rate hikes and dollar appreciation that have driven up the cost of borrowing. The results are:

- **Spiralling poverty and inequality:** Rising food and fuel prices forced around [71 million people](#) into poverty between March and June 2022. And [for the first time in 25 years](#) extreme wealth and extreme poverty have sharply increased at the same time.
- **Debt crisis:** [In 2022](#) the IMF warned that nearly one-third of emerging economies and two-thirds of LICs were in or near debt distress. [In 2021](#) LICs spent an average of 27.5% of their budgets on debt repayments. This was double the proportion spent on education, four times that spent on healthcare, and nearly 12 times that spent on social protection.
- **Widespread austerity:** It is [estimated that by 2025](#) over half (55%) of the population in LICs and 85% in MICs will still be affected by austerity measures. This is already leading to huge budget cuts in health, education and social protection that are hitting poor families, women and girls, and marginalised groups hardest. The IMF has encouraged these inequality-fuelling policies; Oxfam research found that 13 of 15 loan programmes agreed during the second year of the pandemic [required austerity measures](#).

Meanwhile [LICs and MICs are also facing the greatest harmful impacts of climate change](#), with the poorest people worst affected, despite the fact they have done least to cause it.

The potential for a broader [worldwide banking crisis and recession](#) is also a very real threat, and we know from the 2008 financial crisis that this would supercharge inequality and add fuel to the fire of this already dire situation.

The needs are great

Oxfam calculates that at least an additional \$27.4 trillion are needed between now and 2030 to fill financing gaps in health, education, social protection, and tackling climate change in low- and middle-income countries. That equates to an annual financing gap of \$3.9 trillion.

The full \$27.4 trillion black hole in LICs and MICs comprises the following elements (see methodology note for all sources):

- **\$8.5 trillion for health, education, and social protection.** Free public services and social protection are strong weapons in the fight against economic and gender inequality. An additional \$4.4 trillion are needed to meet the Sustainable Development Goals in the health, education, and social protection sectors in low- and lower-middle income countries, and another \$4.1 trillion are required in upper-middle income countries. This is recurrent public spending that requires on-budget finance.
- **\$13.7 trillion for climate mitigation.** These investments in energy, transportation, and agriculture sectors in LICs and MICs would combine to reduce greenhouse gases and slow climate change. These are long-term infrastructure investments that could generate some user fees and hence be partially funded by the private sector.
- **\$2.8 trillion for loss and damage** These investments would repair infrastructure destroyed by climate change in LICs and MICs. They are also long-term investments, but they are not attractive to the private sector as they don't generate new profits.
- **\$2.4 trillion for climate adaptation.** These investments in making infrastructure climate-proof in LICs and MICs would bring great social benefits, and reduce the future loss and damage bill, but do not lend themselves to private investment either.

Solutions on the table are inadequate

The same external shocks that have precipitated today's crises have also seemingly breathed new life and urgency into the debate on how to raise trillions for development and climate. The [Bridgetown Initiative](#) instigated by Prime Minister Mia Mottley of Barbados has helped to up the political ante, especially on climate finance, and French President Emmanuel Macron will host a Summit that promises a new [global financial pact](#).

But currently, the solutions on the table for discussion – starting at this week's Spring Meetings, G20 Finance Ministerial, and debt Roundtable – fall far short of what's needed to meet the \$27.4 trillion challenge.

Capital Adequacy Framework (CAF) reforms are likely to dominate the Spring Meetings and appear to be the option that rich countries are rallying around to unlock additional financing. It would involve changing the financial rules governing Multilateral Development Banks so that they can leverage their balance sheets further; essentially increasing the volume of lending without requiring any additional capital from shareholders. It is a good idea, but this is not the magic bullet that rich countries would like us to believe.

Crucially, it falls far short of raising the trillions needed. If the full spectrum of reforms outlined in the [independent review](#) commissioned by the G20 in 2022 are adopted, there is potential to unlock \$1 trillion in total. This falls to \$0.5 trillion in the (likely) event that reforms that reduce the MDBs' credit rating are excluded. And currently, there is discussion about a far smaller reform that would leverage just [\\$50 billion over 10 years](#). Between now and the SDGs 2030 deadline this low-ball option would deliver just 0.1% of what's needed to fill the \$27.4 trillion financing

black hole in LICs and MICs. And even if the full spectrum of CAF reforms were adopted immediately they would provide just 3.6% of the financing need between now and 2030.¹

CAF reforms also put the emphasis on lending in a time of widespread debt crisis, when many countries are already highly indebted, and hence lack borrowing capacity. The reforms risk becoming a distraction from the ambitious action needed from rich countries to increase aid and other concessional finance that would benefit LICs and MICs. Dwindling political will from rich countries has been evidenced recently in the International Development Association (IDA) replenishment process. Although IDA20 saw a record replenishment in 2021, this was not a result of increased donor contributions. In fact, donor contributions *declined* and the increased allocation was only achieved through the financial wizardry of 'balance sheet optimisation'. Now, with IDA20 commitments again being frontloaded due to mounting crises, there are fears that IDA is facing a [financial cliff](#) in the near future.

Disaster clauses in debt contracts are also gaining political traction. Such clauses would automatically and temporarily suspend debt payments after fast-onset natural disasters like hurricanes or earthquakes. This is a positive proposal but one that would have a limited impact in addressing financial distress in the poorest countries. Disaster clauses would not reduce the net present value of debts, meaning the debtor would need to catch up on repayments soon after. Thus these clauses merely help with liquidity. They do not contribute at all to addressing the huge financing gaps in low- and middle-income countries.

Other “financial innovations” are also increasingly touted as crucial to tackling development and climate challenges in poorer countries. But these options are no substitute for grant finance. For example 'green bonds' carry an interest rate below market rate, because they are used for environmental projects. But in reality the difference is [so small](#) as to be negligible.

The scale and reallocation of Special Drawing Rights (SDRs) are also far from adequate in addressing the needs of poorer countries. SDRs are international reserve assets that can be used by governments to repay debts, stabilise their currencies, shore up reserves, or fund social spending. In 2021 the IMF issued \$650 billion in SDRs which had a [dramatic and immediate impact](#) on the ability of the poorest countries to face the COVID crisis.

The majority of the \$650 billion issuance (over 60%) was allocated to HICs though, prompting discussions on how to reallocate these to benefit poorer nations. The richest economies pledged to reallocate the equivalent of \$100 billion, but so far only between [\\$60 and 85 billion has been committed, and far less delivered](#). And although SDRs are a debt-free instrument, the way they are being reallocated today is undermining this potential and adding to recipient country debt.

The \$650 billion issuance also fell short of demands for a [far larger one](#) – of trillions of dollars – to meet the scale of the crisis facing the world, and especially poorer countries. Given the current financial crunch facing LICs and MICs today there should be far more ambitious issuances and reallocations of SDRs on the table, starting with a second \$650 billion issuance right away.

But affordable solutions do exist

We know from recent history that when there is enough political will, governments find ways to raise huge amounts of money. When the pandemic hit rich countries immediately dug deep into their pockets to find trillions of dollars. This is the kind of ambition and urgency we need to see now.

There are 4 steps that rich countries could be taking in 2023 to address the \$27.4 trillion climate and social spending needs in LICs and MICs. They clearly illustrate that with enough political will from the richest countries, providing the scale and type of money needed to meet pressing social and climate challenges in LICs and MICs is both feasible and affordable.

Step 1: Keep aid promises and pay off the 'aid debt'

The first step is for the richest economies to keep their existing promises to poorer countries.

There is [compelling evidence](#) that aid saves lives and reduces inequality, especially when given as long-term predictable budget support. Yet rich countries have resolutely failed to deliver on aid promises, underpaying LICs and MICs to the tune of \$6.5 trillion since the UN 0.7% resolution was passed in 1970.

Rich countries have an obligation to meet their 0.7% commitments on an ongoing basis, and to start paying off their aid debt.

Together with a modest increase in progressive tax collection, meeting aid commitments in this way would provide enough finance to fill the health, education and social protection financing gap in LICs and MICs, and to fund debt cancellation that would bring their debts to sustainable levels.

It is also crucial to note that donors must also adhere to the highest aid effectiveness standards, and stop the accounting trickery of [syphoning off](#) large amounts of aid to spend in donor countries on things like in-country refugee costs and vaccine donations.

Step 2: Commit to a Big Debt Swap

Another underlying problem is that the current system expects LICs and MICs to borrow far too much to meet the climate challenge. This not only contributes to countries adding to their debt burden, but also reduces the sources of financing available to them. For example, [nearly two thirds of IDA-eligible countries](#) are in or at high risk of debt distress meaning they are no longer eligible for concessional loans, and around one quarter of IBRD-eligible countries are in or at high risk of debt distress which makes IBRD loans charging market rates inappropriate for them.

But there is a solution here too. High-income countries could themselves borrow \$11.5 trillion to help pay the climate bill in LICs and MICs. This is less than what they borrowed in response to the pandemic, and it would raise their debt-to-GDP ratio only slightly above the pandemic's peak.

This 'Big Debt Swap' could go a long way towards funding the climate mitigation, adaptation, and loss and damage needs of LICs and MICs to help them meet the climate challenge. This would be an essential part of high-income countries compensating for the fact that they have put the vast majority of climate-heating carbon emissions into the atmosphere.

Step 3: Commit to additional SDRs

The [benefits](#) of the 2021 \$650 billion issuance of Special Drawing Rights (SDRs) were enormous. 98 LICs and MICs used these SDRs, many to procure vaccines, fund welfare payments and wages, and for budget support, among other things. 55 countries also used them to repay \$7.6 billion worth of IMF debt, which 23 of these countries would not have had enough money to do otherwise.

Rich countries should not only expedite the reallocation of at least \$100 billion of the existing SDR issuance to LICs and MICs, but also commit to at least two new \$650 billion issuances by 2030. ***This simple measure could make a significant contribution to climate financing needs in LICs and MICs – and/or supporting increases in their social spending – as well as boosting the ability of HICs to meet the other financial commitments outlines above.***

To achieve this, any new issuance must include an up-front commitment for HICs to reallocate a fair share of their SDRs to LICs and MICs, and to do so in a way that ensures they are debt-free and conditionality-free for recipient countries.

Step 4: Bring in new taxes on rich individuals and corporations

The richest countries are discussing the need for financing as if we are living in a resource-constrained world. But in fact, nothing could be further from the truth. While public budgets are hollowed out by crisis after crisis, especially in the poorest countries, and while poverty and hunger soar, there are trillions of dollars in private hands and the richest people and companies continue to prosper. This huge increase in the assets owned by the richest is directly a result of government and central bank interventions in the economy, interventions that whilst necessary, had the knock-on impact of hugely inflating the private wealth of a small number.

Since 2020 billionaire fortunes have increased by [\\$2.7 billion](#) a day. And in 2022, while over 800 million people went to bed hungry, 95 food and energy companies raked in [\\$306 billion in additional windfall profits](#), a steep 256% increase on the average of the preceding 3 years. A huge proportion of these profits have been paid out directly to rich shareholders. These corporations and shareholders have benefited from external shocks, delivering windfall profits that are in no way a result of their actions.

The problem is not a lack of money, it's that far too much is in the hands of a small rich few. Bringing a significant proportion of this excessive wealth and profit back into public hands would be transformational and is essential to the mission of a fairer and more sustainable world.

Oxfam calculates that a progressive net wealth tax of up to 5% in rich OECD DAC countries alone would add just under \$1.1 trillion to their budgets each year. Along with SDRs, this would provide more than enough finance to cover the full aid bill outlined above and to service The Big Debt Swap.

It is also important to note that there are many other progressive taxation options that could raise large additional sums of money to tackle poverty and inequality at home, and to make further much-needed investments in fighting climate change. These include steep and progressive tax increases on the incomes of the super-rich, on property, land and inheritance, and on the profits of the wealthiest companies, especially windfall profits, as well as on fossil fuels, and on financial transactions. A [top-up tax](#) that deters investment in economic activities that do most harm to the environment and hasten climate breakdown should also be on the table.

In summary, if rich-country governments were willing to implement bold and progressive tax reforms there would be more than enough money to go round.

We cannot allow the richest countries to argue they 'cannot afford' to raise the trillions needed for social and climate spending in the poorest countries. It is clear that mobilising this money would simply take political will.

Put fighting inequality at the heart of World Bank and IMF policies

The economic reforms outlined in this paper are not just about raising trillions of dollars, they are also policies that will tackle economic inequality. It is essential that the World Bank and IMF also step up their ambition to ensure all their policies and lending contribute to this same objective.

The World Bank has opened a discussion about its future vision and mission; this Evolution Roadmap will be a hot topic at the Spring Meetings. The current Shared Prosperity goal failed to fully commit to closing the gap between the rich and the poor, by focusing on raising the income of the poorest 40% compared to the average income. Now is the time to agree an Inequality Goal that aims to close the gap between the poorest 40% and the richest 10% (aligned with the Palma ratio). This is fundamental to the Bank's mission: evidence is strong that poverty reduction efforts are harmed by high levels of economic inequality.

The IMF should also put reducing inequality at the heart of its discourse and loan programmes. Since 2022, with the cost of living and inflation crisis driven largely by monopolies and corporate greed, the IMF has consistently called for austerity measures to tame inflation. Interest rates hikes in the Global North have pushed poorer countries to the brink forcing them to adopt further austerity measures to avoid defaulting on debt. All of this promises to further exacerbate extreme economic inequality. Instead, the IMF should call on countries to pursue progressive tax reforms, *avoid* austerity measures, and ramp up spending on free public services and social protection.