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Public Money Creation to Maintain Fundamental Human Rights during the COVID-19 Pandemic

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As governments around the world respond to the COVID-19 pandemic with a range of policies aimed at mitigating the economic fallout, we argue that low- and middle-income countries (LMICs) should prioritize public money creation over foreign borrowing. Experience shows that the cost of servicing foreign debt diverts resources from public services and can undermine fundamental economic, social and cultural rights, such as the rights to clean water, sanitation, basic education and health care. Moreover, the conditions attached to any subsequent debt restructuring can make matters worse.[1]

Background

The COVID-19 pandemic is likely to follow a different trajectory in LMICs than in high-income countries for multiple reasons: for example, their generally younger populations may mitigate its impact, whereas weaker health systems may amplify it. As in other outbreaks, the indirect health effects will be huge, with mortality due to non-COVID-19 conditions also increasing. Furthermore, the social and economic fallout in LMICs will probably be even greater in these countries than in wealthier ones because: 1) multiple sectors of the economy are grinding to a halt as supply chains fragment, commodity prices fall, and capital drains out of these countries; 2) remittances from abroad are waning; 3) currencies are depreciating; 4) many countries are struggling to service their debts. In addition, their international reserves are diminishing and slim government revenues are depleted at a time when public spending needs to escalate dramatically.[2] Globally, the International Monetary Fund (IMF) has requested a standstill on debt servicing, has provided US$1.4 billion in grants to help service debts, and has offered emergency loans to the tune of US$1 trillion. Other interventions have called for debt cancellation, capital controls to prevent more capital hemorrhaging out of LMICs and, as was done in 2009, the distribution of reserve assets held by all IMF member countries which can be issued without extra cost and with no new debt.[3]

Previous experience of debt

During the 1980s debt crisis, despite directing more of their annual budgets to debt servicing than to public services many LMICs were still unable to repay or service their debts after interest rates increased. For example, between 1992 and 1997, Zambia allocated 40% of its budget to debt servicing, and only 6.7% to public services.[4] International financial organizations offered support on certain conditions (deregulation, liberalization, and privatization). Often policy reforms were introduced to boost a country's economy and facilitate debt repayment but these also impacted public services and fundamental rights. For example, reducing tariffs on imported goods reduced government revenue overall, and budgets were diverted towards debt servicing while expenditure on public services was reduced and privatization encouraged.[5] Indeed, the United Nations Human Rights Council has recognized that unsustainable sovereign debt burdens are a "serious impediment" to the realization of fundamental rights and that the conditions attached to financial rescue packages can make it extremely difficult for countries to achieve economic growth.[6] An independent United Nations expert on the effect of foreign debt noted that countries with large illicit financial

flows—illegal movements of capital from one country to another, usually to avoid taxes—are especially burdened with external debts and have to make a difficult choice between servicing debt and providing public services.[7] Debt relief initiatives in the 1990s provide further evidence that debt servicing can come at the cost of fundamental rights: when debt was cancelled, many LMICs were able to abolish fees for schools and health care, which increased their use.[8] Nevertheless, many LMICs continued to struggle to pay their debts and some accumulated more debts when interest rates were low after the 2008 financial crisis when capital flowed into these countries seeking better returns. Thus, today most LMIC debt is external and in foreign currencies, exposing countries to fluctuations in global financial markets.[9]

Public money creation

Government expenditure must be met by taxation, borrowing (from either domestic or foreign sources), or money creation. At the heart of a country's financial system is a sovereign government that can create money, which means the government cannot go bankrupt as it can always create money to pay its debts. Normally, however, most of the credit or money in an economy is created (out of thin air) when commercial banks make loans to consumers, usually households and companies. In effect, the bank purchases a loan contract from a consumer and records this as a deposit in their account, thereby creating money. A country's central bank can stimulate this type of money creation by lowering interest rates, which encourages consumers to take out loans and thus increases the credit or money in an economy.

In the process of public money creation, in contrast, the central bank creates new money to directly finance government expenditure by crediting the government's current account at either the central bank or a commercial bank. Public money creation has been used to stimulate economies when interest rates were already so low that lowering them any further would be ineffective.[10] Furthermore, money created for projects that are productive, such as environmental infrastructure projects, will generate economic growth and increase tax revenues, thereby financing public services without causing inflation.[11] In the past, countries in east Asia, including Japan, China, Taiwan, and Korea, used this approach to achieve economic growth quickly. Today, governments in high-income countries are using public money to implement both fiscal measures, such as tax waivers, and monetary policies, such as government-backed loans. The G20 group of countries have created and injected trillions of dollars of credit into their economies.

During and after the COVID-19 pandemic, LMICs are likely to require credit. If they borrow from overseas, credit will be created (out of thin air) by foreign banks, which must be repaid in foreign currencies.[12] As the domestic currencies of LMICs generally depreciate over time, the cost of repaying in foreign currencies is likely to increase and the cost of servicing debts can often exceed the original amount borrowed. In fact, the debt crisis in the 1980s was unnecessary because, for most purposes, countries did not need to borrow from abroad—the credit required for productive investment and economic development could have been created by domestic banks.[13]

We suggest that, in addition to making use of debt cancellation, capital controls, and reserves held at the IMF, LMICs should use the power of productive public money creation and avoid increasing external debt. We know that investing in human capital is productive. For example, an increase in educational expenditure by 1% of gross domestic product (GDP) raises per-capita GDP growth by 1.6% per year, with two-thirds of the impact apparent within five

years.[14] Thus, public money creation could be used to meet obligations during the pandemic and reduce the risk that LMICs will acquire unsustainable foreign debts, which will likely compromise the governments' commitment to fulfilling their human rights obligations. A complex balancing act is required: the public money created must be used productively and support must be withdrawn at the right rate and time. Over-reliance on money creation should be avoided and governments should bolster their revenue by other means, such as curtailing tax avoidance due to illicit financial flows.[15] In addition, the international community could help remove impediments to LMIC governments providing public services and meeting their human rights obligations by tackling two yawning gaps in global governance: sovereign debt crisis resolution and international tax cooperation.[16]

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