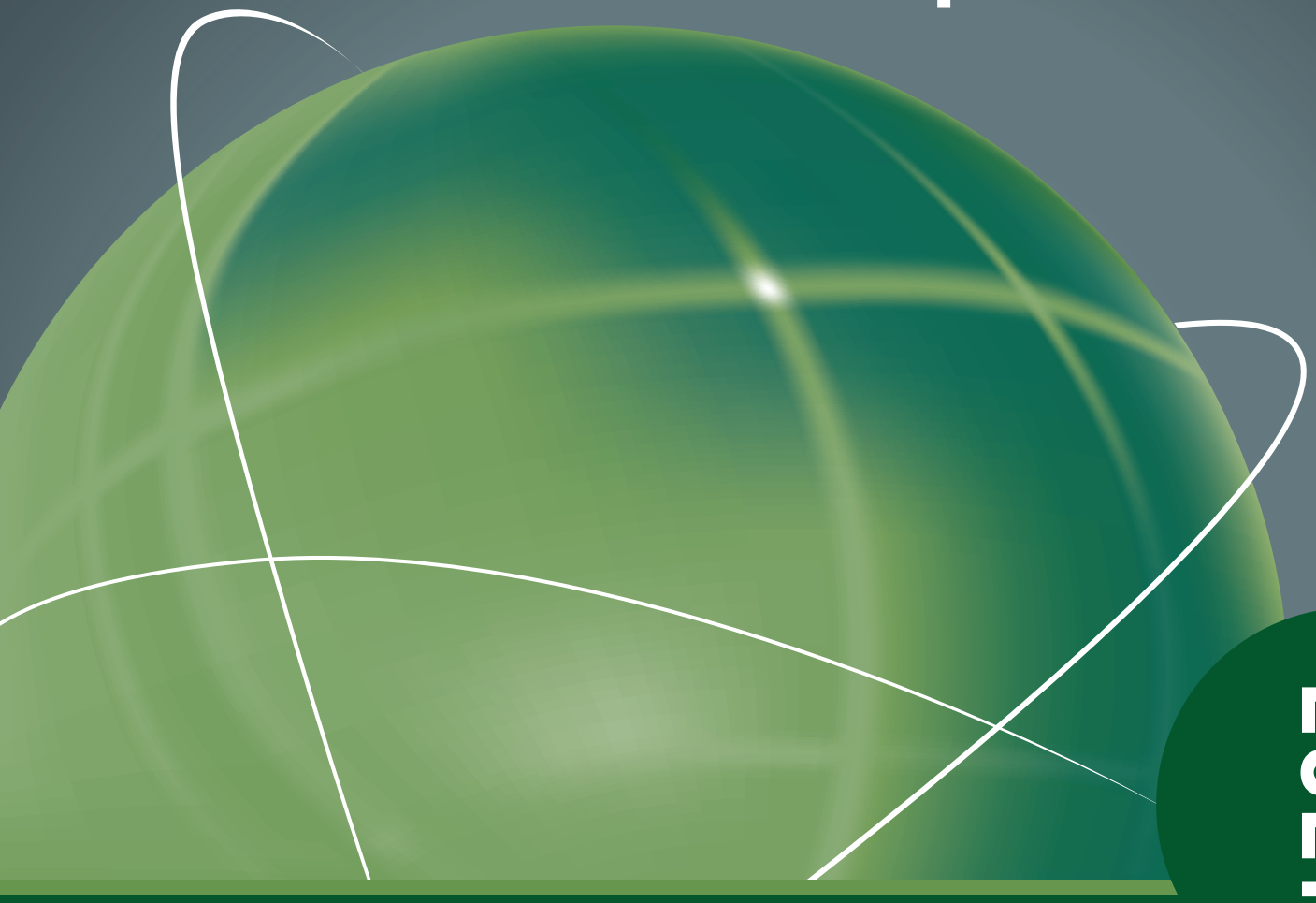
World Economic Situation and Prospects



2021

United Nations

CHAPTER I

Global Economic Outlook

The Great Disruption

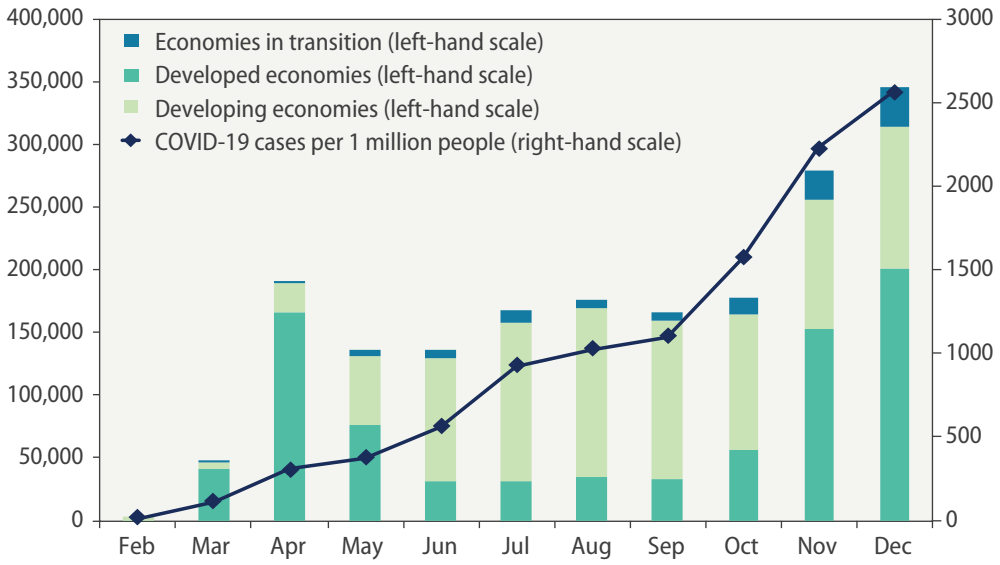
World economy on a cliffhanger

The world economy is still reeling from the COVID-19 pandemic, which brought economic activities to a grinding halt during the second quarter of 2020. Governments around the world introduced social distancing, lockdown and quarantine measures and restricted a wide range of economic activities to tame the spread of the virus. A Great Disruption ensued, which helped to save lives but also disrupted the livelihoods of hundreds of millions of people worldwide. An estimated 420 million full-time equivalent (FTE) jobs were lost on average during the second and third quarters of the year (ILO, 2020).

Governments introduced a wide range of measures to tame the spread of COVID-19...

Figure I.1a

Monthly COVID-19 related deaths



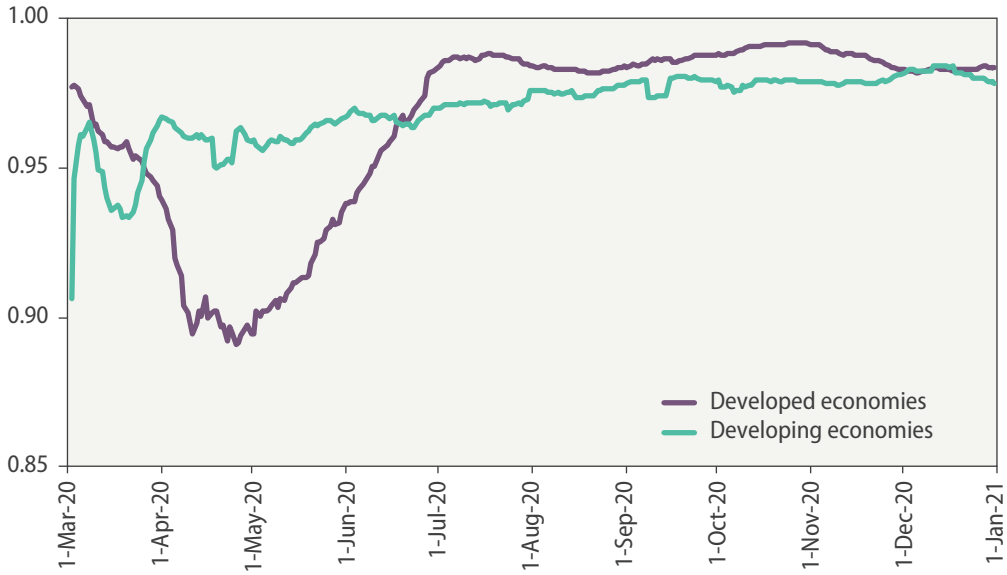
Source: UN DESA, based on data from Johns Hopkins University.

Note: As of 1 January 2021.

Against the backdrop of massive stimulus spending and the possibility of a vaccine roll-out, a quick economic recovery seemed just around the corner in the third quarter of the year. The hope for a quick recovery soon dissipated with the second wave of the pandemic hitting the major economies in October 2020. In November 2020, COVID-19 related deaths worldwide exceeded the previous highest monthly death toll of April by 45 per cent (figure I.1a). Although the survival rate among the confirmed cases has improved through a better understanding, and treatment, of the disease (figure I.1b), the daily death tolls continue to rise, with the total death toll of the pandemic reaching 1.7 million worldwide by mid-December. The number of infections per million people is showing no signs of decline. Economic costs of the pandemic continue to mount, while uncertainties about a next wave keep the world economy on a cliffhanger.

...which saved lives but also disrupted livelihoods

Figure I.1b
Daily COVID-19 survival rate



Source: UN DESA, based on data from Johns Hopkins University.

Note: As of 1 January 2021. Survival is calculated as a 7-day moving average of the difference between COVID-19 confirmed cases and COVID-19 related deaths divided by number of COVID-19 confirmed cases.

Thanks to massive fiscal stimulus measures worldwide—as large as 14 per cent of world output in 2020—the impact of the shock has been less pronounced than predicted during the second quarter of the year. While the short-term impacts of the pandemic prompted policymakers to roll out large fiscal responses, the long-term impacts of the pandemic on consumer behaviour, economic structures, growth, income distribution, trade, debt sustainability and financial stability have received less attention in policy discussions. The pandemic has disproportionately affected people at the bottom of the skills and income distribution, especially those who have been unable to work remotely. The asymmetric employment effect is worsening already high levels of income and wealth inequality in many developed and developing countries.

The pandemic's uneven impacts will likely further polarize societies in both developed and developing countries

The pandemic—and its uneven economic impact on the poorer segments of the population—will likely further polarize societies in both developed and developing countries. While timely and massive fiscal interventions helped to prevent the worst, they did not mitigate the broader discontent rooted in marginalization and stark inequality that divide the haves and the have nots in society. The pandemic responses need to prioritize efforts to reduce inequality not only in income and wealth but also in access and opportunities to pave the path for a resilient recovery.

With the crisis accelerating the pace of automation and digitalization, millions of lost jobs will not come back

While the short-term impacts of the pandemic have been devastating, its long-term impacts will be equally severe and will be felt for years to come. Like the 1918 influenza pandemic more than a century ago, the COVID-19 pandemic will also change the world (box I.1). With the crisis accelerating the pace of digitalization, automation and changing economic structures, millions of jobs that were lost in 2020 will not come back. Unemployment rates will remain elevated in the near term. While productivity in some sectors of the economy will rise during the post-crisis period, average productivity growth—along with potential output—will likely remain weak in the near term. Unless massive fiscal and monetary stimulus measures manage to boost investment, economic growth will continue to falter. A toxic

Box I.1
The 1918 pandemic and COVID-19: then and now

COVID-19 is the fifth influenza pandemic[a] to have disrupted human lives on a global scale in the past 100-odd years. Among these, the 1918 influenza pandemic stands out for its severity, which infected nearly one third of the world's population and killed an estimated 20 million-50 million people worldwide. The severity of the current pandemic thus raises the question whether the experience of the 1918 influenza pandemic can offer the world any lesson on how to avoid mistakes and steer recovery.

There are noteworthy differences between the two pandemics. Unlike COVID-19, the 1918 pandemic had an exceptionally high case mortality rate, of 2–3 per cent among young and healthy individuals, which can be attributed in part to the less advanced treatment and therapeutics available at the time. Its detrimental health implications made the 1918 pandemic the deadliest health crisis in recent history. The devastating human losses from the 1918 pandemic—and the First World War—led to a severe shortage in labour supply and rising wages in the United States of America (Garrett, 2009). This stands in stark contrast to the labour-market implications of the COVID-19 outbreak. Further, many countries engaged in the war actively censored information on the 1918 pandemic which, in conjunction with large-scale troop movements, led to a faster spread of the pandemic in its early stages.

Still, the two pandemics are in many ways similar, with the influenza virus being transmitted through respiratory droplets and aerosols in both cases. In both pandemics, similar mitigation strategies—including the use of face masks, social distancing and quarantine measures—were deployed. The fiscal climates at the time the pandemics struck were comparable, with extraordinarily high levels of public debt in many countries. Massive government spending as part of the war effort had significantly increased public debt prior to the 1918 pandemic. Similarly, public external debt since the financial crisis has recently more than doubled, while public external debt owed to private creditors has increased nearly 200 per cent (Stiglitz and Rashid, 2020).

In addition to the looming debt crisis, the stock market has witnessed the build-up of a massive bubble, while stock market confidence indexes reached their lowest levels in many years (Shiller, 2020). The 1918 pandemic marked the beginning of the Roaring Twenties—a decade that witnessed reckless borrowing and spending and the build-up of a massive bubble which culminated in a crash and the Great Depression. The lessons from the 1918 pandemic should guide the fiscal and monetary responses to prevent financial bubbles and direct resources towards investments.

Despite the risks, every disruption can present opportunities. The 1918 pandemic, which exposed the risks to labour supply, became a major driving force for investments in new technology and automation, which unleashed high productivity growth. Similarly, COVID-19 could change the way we live and work for the better. It could boost digitalization, lead to a reduction in greenhouse gas emissions from commuting and business travel, and enable the development of scalable, high-quality online education resources. However, unsustainable debt levels, an increasing risk of market volatility, and growing inequality—exacerbated by the COVID-19 pandemic—must serve as a serious warning signal.

a The other four being the so-called Spanish flu (1918–1919), Asian flu (1957–1958), Hong Kong flu (1968) and swine flu (2009–2010) pandemics.

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combination of weak investment, low inflation and low growth will make debt unsustainable for many developed and developing countries.

Many developing countries will see their growth and development path adjust downward

Many developing countries buffeted by the pandemic that are unable to respond with large fiscal responses will likely see their growth and development path adjust downward relative to pre-crisis trends. This may reverse the trends or at least delay the long-term convergence of the per capita incomes of the developed and developing countries, thwarting the objectives of reducing inequality between countries as envisaged under the 2030 Agenda for Sustainable Development.[1] The crisis demands policy responses that strike a delicate

1 General Assembly resolution 70/1.

balance between meeting short-term urgent needs and advancing the long-term sustainable development priorities to build resilience and realize the 2030 Agenda for Sustainable Development.

Economic growth plunged worldwide

Developed countries were the hardest hit...

World gross product fell by an estimated 4.3 per cent in 2020—the sharpest contraction of output since the Great Depression (table I.1). During the Great Recession in 2009, world output contracted by 1.7 per cent. The pandemic clearly hit the developed economies the hardest, with many countries in Europe and several States of the United States of America adopting strict lockdown measures early on during the outbreak. Output in developed economies is estimated to have shrunk by 5.6 per cent in 2020, with growth projected to recover to 4.0 per cent in 2021.

...while developing countries experienced a relatively less severe contraction

The developing countries experienced a relatively less severe contraction, with output shrinking by 2.5 per cent in 2020, owing partly to the delayed outbreak of the pandemic and the generally less restrictive measures taken by Governments to contain its spread. Their economies are projected to grow by 5.7 per cent in 2021. The least developed countries (LDCs) saw their gross domestic product (GDP) shrink by 1.3 per cent in 2020, with growth projected to reach 4.9 per cent in 2021. There are, however, significant differences in the size of the shock among developing countries, with Latin America and the Caribbean and the South Asian economies taking the hardest hits (figure I.2A). In contrast, the economies in East Asia fared relatively better than all other developing regions, with GDP expanding by 1 per cent in 2020. On the back of a quick and robust recovery in China, the East Asian economies are forecast to grow by 6.4 per cent in 2021.

G20 economies need to jump-start recovery and make the world more resilient to future shocks

The Group of Twenty (G20) economies—accounting for nearly 80 per cent of world GDP—contracted by 4.1 per cent, largely mirroring the performance of the world economy and signifying the systemic importance of these major economies. Only China, among the G20 members, managed to register a positive growth rate in 2020 (figure I.2B). It is critical that the G20 economies jump-start their economies, not only to accelerate recovery but also to make the world economy more resilient to future shocks. Among regional economic groups, the economic contraction was most severe in the member States of the European Union and the South Asian Association for Regional Cooperation, while the members of the East African Community experienced the shallowest decline in growth (table I.2).

The baseline scenario of the current forecast assumes that infection rates will slowly begin to decline during the first quarter of 2021 with growing shares of the population in developed countries receiving a vaccination. Businesses and households will further adapt to social distancing and other precautionary measures. Elevated levels of unemployment and underemployment—relative to pre-crisis levels—are expected to depress labour-force participation rates and the labour share in national income, contributing to lower potential output under the baseline scenario.

In contrast, the pessimistic scenario assumes a higher number of new infections in major economies during the first half of 2021—with vaccination drives failing to secure herd immunity and new variants of the virus spreading more quickly—requiring Governments to reintroduce some form of lockdown measures. Under this scenario, global output would grow by just 2.8 per cent in 2021 and remain at about 2.6 per cent per year until 2025 (figure I.3). The optimistic scenario—though unlikely—assumes a more successful containment of

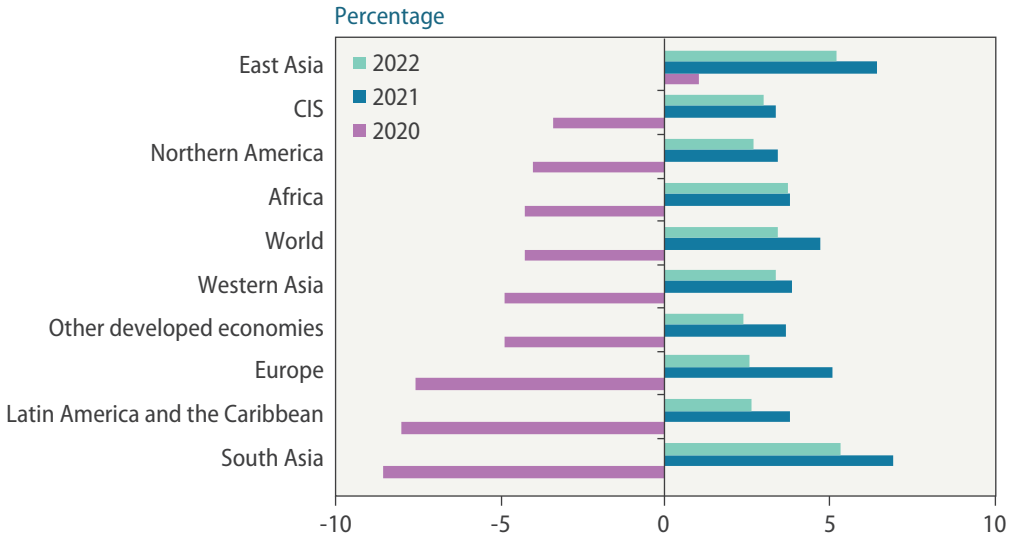
Table I.1
Growth of world output and gross domestic product

					Change from WESP 2020	
Annual percentage change	2019	2020[a]	2021[b]	2022[b]	2020	2021
World	2.5	-4.3	4.7	3.4	-6.8	2.0
Developed economies	1.7	-5.6	4.0	2.5	-7.1	2.3
United States of America	2.2	-3.9	3.4	2.7	-5.6	1.6
Japan	0.7	-5.4	3.0	1.8	-6.3	1.7
European Union	1.5	-7.4	4.8	2.7	-9.0	3.1
Euro area	1.3	-7.9	5.0	2.6	-9.3	3.5
United Kingdom of Great Britian and Northern Ireland	1.5	-9.5	6.8	2.0	-10.7	5.0
Other developed countries	1.6	-4.9	3.6	2.4	-8.6	3.0
Economies in transition	2.2	-3.4	3.4	3.0	-5.7	0.9
South-Eastern Europe	3.5	-3.8	4.0	3.1	-7.2	0.6
Commonwealth of Independent States and Georgia	2.2	-3.4	3.4	3.0	-5.7	1.0
Russian Federation	1.3	-4.0	3.0	2.4	-5.8	1.0
Developing economies	3.6	-2.5	5.7	4.6	-6.5	1.4
Africa[c]	2.8	-3.4	3.4	3.6	-6.6	-0.1
Northern Africa[c]	2.9	-3.3	4.9	4.1	-6.9	1.2
East Africa	6.5	-0.7	3.0	4.1	-6.7	-3.2
Central Africa	1.9	-4.3	2.9	3.6	-7.2	-0.2
West Africa	3.3	-2.7	2.5	3.7	-6.3	-1.3
Southern Africa	-0.2	-6.4	2.9	2.6	-7.3	1.0
East and South Asia	4.9	-0.5	6.5	5.2	-5.7	1.3
East Asia	5.3	1.0	6.4	5.2	-4.2	1.2
China	6.1	2.4	7.2	5.8	-3.6	1.3
South Asia[d]	3.1	-8.6	6.9	5.3	-13.7	1.6
India[d]	4.7	-9.6	7.3	5.9	-12.3	0.7
Western Asia	1.2	-4.8	3.8	3.4	-7.2	1.0
Latin America and the Caribbean	-0.3	-8.0	3.8	2.6	-9.3	1.8
South America	-0.7	-7.9	3.8	2.7	-9.0	1.8
Brazil	1.4	-5.3	3.2	2.2	-7.0	0.9
Mexico and Central America	0.6	-8.3	3.8	2.4	-9.9	1.9
Caribbean	0.4	-7.8	3.8	2.8	-13.5	0.4
Least developed countries	4.8	-1.3	4.9	4.6	-6.4	-0.5
Memorandum items						
World trade[e]	1.0	-7.6	6.9	3.7	-9.9	3.7
World output growth with PPP weights[f]	2.5	-4.4	4.9	3.8	-7.6	1.5

Source: UN DESA.
a Estimated.
b Forecast.
c Excludes Libya.
d Growth rates provided are on a calendar-year basis. For fiscal-year growth figures, please refer to the Statistical annex.
e Includes goods and services.
f Based on 2015 benchmark.

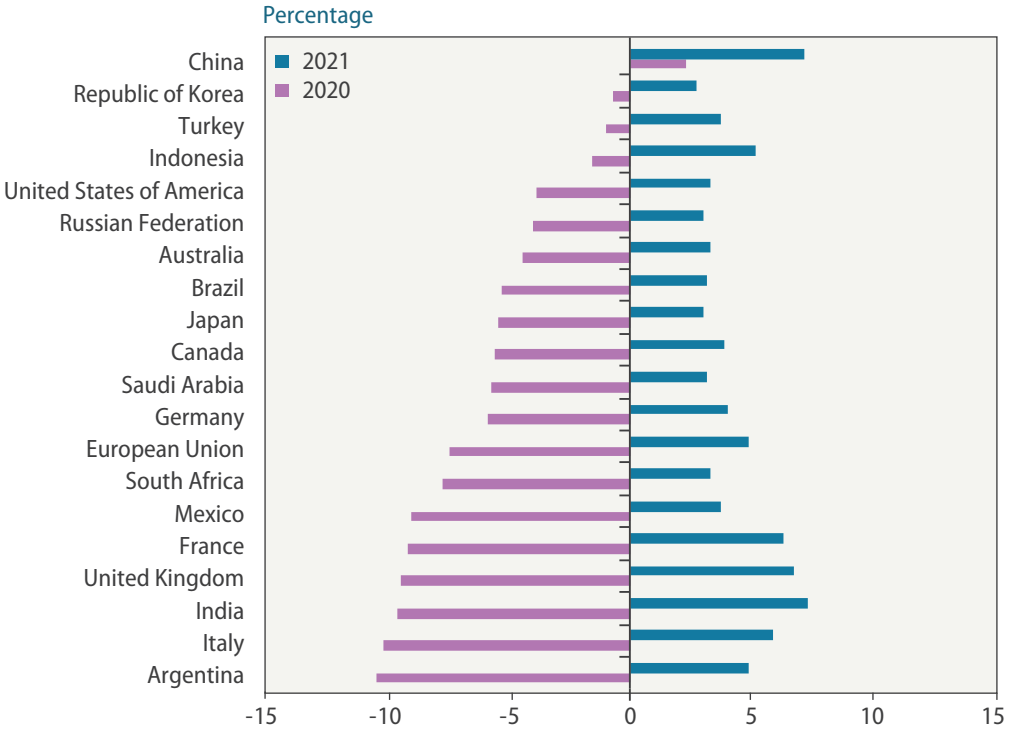
Figure I.2
Growth of gross domestic product

a. World regions



Source: UN DESA, based on projections and scenarios generated by the World Economic Forecasting Model (WEFM).

b. G20 members



Source: UN DESA, based on projections and scenarios generated by the World Economic Forecasting Model (WEFM).

Note: Growth rates for India are on a calendar year basis.

the virus than is assumed under the baseline, with fast and widespread vaccination and progress in treatments contributing to improved consumer confidence and the return of economic activities to pre-crisis trends during the first half of 2021. Global growth under this scenario will reach 5.8 per cent in 2021, before declining to about 3 per cent by 2025.

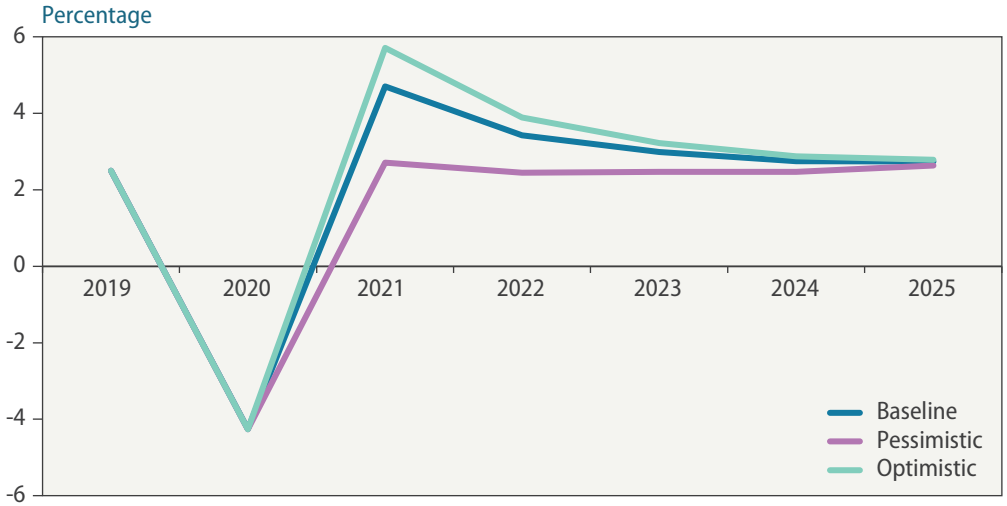
Table I.2
Growth of gross domestic product in selected regional economic groups

Annual percentage change	2019	2020	2021	2022
SAARC	4.5	-8.0	7.1	5.5
EU-27	1.5	-7.4	4.8	2.7
SIDS	1.5	-6.8	4.7	3.0
MERCOSUR	0.5	-6.5	3.6	2.3
OECD	1.7	-5.5	4.0	2.6
G7	1.6	-5.5	4.0	2.5
GCC	0.6	-5.4	3.5	2.5
SADC	0.8	-5.1	2.8	2.8
World	2.5	-4.3	4.7	3.4
G20	2.6	-4.1	4.8	3.4
ASEAN	4.3	-3.7	5.6	4.7
CIS	2.2	-3.4	3.4	3.0
ECCAS	0.8	-3.3	2.3	3.2
ECOWAS	3.3	-2.7	2.5	3.7
LLDC	4.3	-2.4	4.1	4.4
G77	4.0	-2.2	6.1	4.9
LDC	4.8	-1.3	4.9	4.6
BRICS	5.1	-0.5	6.5	5.3
EAC	6.4	-0.3	3.2	4.1

Abbreviations: ASEAN, Association of Southeast Asian Nations; BRICS, Brazil, Russian Federation, India, China and South Africa; CIS, Commonwealth of Independent States; EAC, East African Community; ECCAS, Economic Community of Central African States; ECOWAS, Economic Community of West African States; EU, European Union; G7, Group of Seven; G20, Group of Twenty; GCC, Cooperation Council for the Arab States of the Gulf; MERCOSUR, Southern Common Market (Mercado Común del Sur); OECD, Organization for Economic Cooperation and Development; SAARC, South Asian Association for Regional Cooperation; SADC, Southern African Development Community; SIDS, small island developing States.

Source: UN DESA, based on projections and scenarios generated by the World Economic Forecasting Model (WEFM).

Figure I.3
Global growth scenarios



Source: UN DESA, based on projections and scenarios generated by the World Economic Forecasting Model (WEFM).

Not all are in the same boat

The pandemic is not an egalitarian crisis...

The pandemic has affected different countries and population groups differently. While the developed economies received the most severe blow, certain demographics and income groups bore the brunt of the health and economic shocks of the crisis. The most vulnerable population groups exposed to the virus—the elderly, caregivers, first responders and health-care professionals—took the hardest hit. Countries with larger shares of a younger population and populations in better health before the onset of the pandemic, on the other hand, managed to keep both the infection and mortality rates low through timely identification, containment, treatment and post-treatment easing of restrictions.

The pandemic also disproportionately affected low-skilled services sector workers, who are unable to work remotely. While the health response to the pandemic varied across countries, the preparedness of the health-care system, the social protection coverage and the overall timeliness and quality of government initiatives generally determined the health and economic impacts of the pandemic.

...as it disproportionately affected the most vulnerable population groups, including women, and low-skilled services sector workers

Preliminary evidence suggests that the level of inequality partly explains the cross-country differences in the speed and intensity of the spread of the coronavirus (box I.2). A population's vulnerability to diseases is usually income and wealth inequality and COVID-19 is no exception. In the case of COVID-19, inequality additionally impacted social distancing-related choices, linking initial socioeconomic conditions with the spread of the disease. The cost of social distancing is higher for members of poorer households who cannot work remotely and maintain their level of income. For millions of low-income workers, the harsh prospects of losing livelihoods potentially outweighed their concerns for exposure to COVID-19. It was also likely that high levels of inequalities undermined social cohesion and trust in government policies, which affected citizens' willingness to comply with government-mandated lockdowns, social distancing and other preventive measures, enabling the spread of the disease.

Lockdown measures triggered discontent and protests...

Lockdown measures and restrictions on economic activities bred discontent, especially among low-income groups in both the developed and the developing countries, as they disproportionately hurt low-skilled, low-wage workers—including temporary, migrant and informal sector workers—who typically lack social protection or personal saving, cannot work remotely and cannot afford to lose work for a few months. The pandemic exposed how stark inequality affected the ability of people to cope with the economic impact of the crisis.

...with the pandemic exposing how stark inequality determined people's ability to cope with its economic impact

There have been numerous demonstrations against lockdown measures during the pandemic, as those measures affected the lives of millions of people worldwide. In the United States, large-scale protests occurred in April and May in parts of the country where the number of cases of infection was relatively low, and where many workers deemed lockdown measures as unnecessarily undermining personal freedom. Often anti-lockdown protests coalesced with broader anti-government sentiments and general discontent with government policies, which were perceived to favour the rich. In France, protests erupted as social distancing requirements imposed an undue burden on overcrowded poorer neighbourhoods compared with wealthier ones.

Argentina, among other developing countries, witnessed several demonstrations during the third quarter of 2020 against the Government's handling of the coronavirus crisis and the economic effects of the lockdown. In Brazil, protests flared up against lockdowns imposed by State governors. Despite the massive spread of the virus and one of the highest

Box I.2

The spread and intensity of COVID-19: did inequality matter?

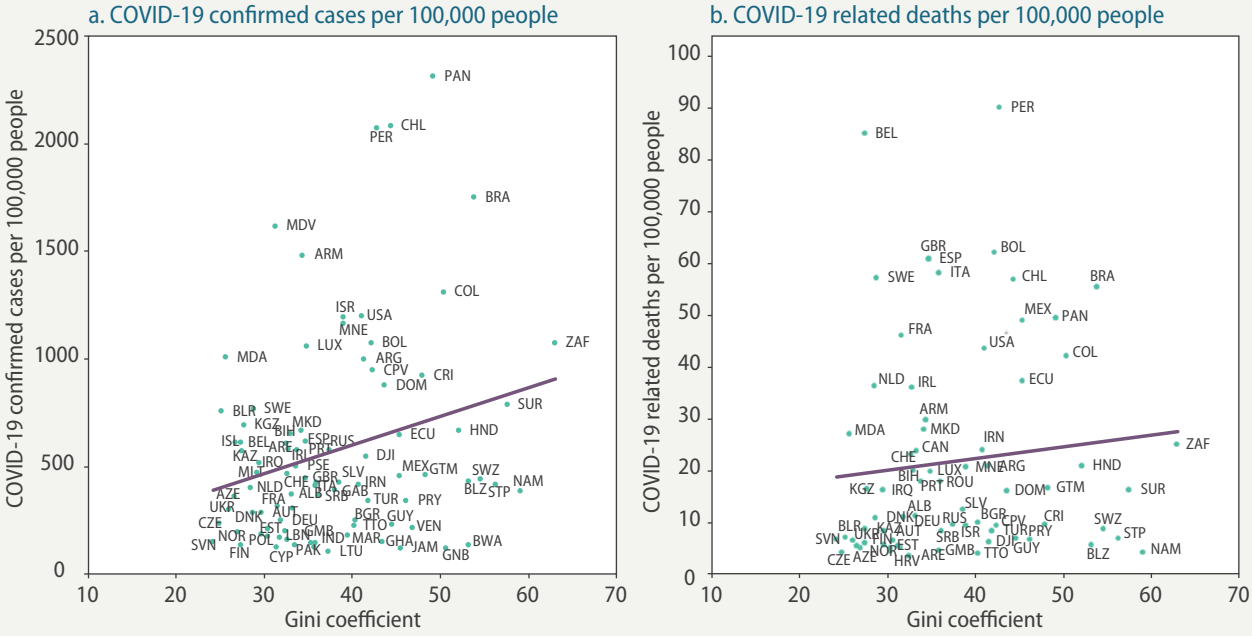
The COVID-19 pandemic has spread with varying speed and intensity across the world. Several factors may explain the disparities in infections and deaths between countries, including population age structure, level of preparedness of health systems, political commitment, effectiveness of government response, and public confidence in official sources of information. Socioeconomic inequalities potentially played an important role in explaining the cross-country differences in COVID-19 infections and mortality rates, acting as a catalyst for a faster and more widespread transmission of the virus.

Inequalities influenced the spread of the virus through several channels. Inequalities are associated with worse health conditions of populations and poverty (Pickett and Wilkinson, 2015). Poverty, in turn, often limits access to sanitation, housing and health care which are essential for preventing infectious diseases. Moreover, socioeconomic inequalities combined with behavioural risk factors affect chronic disease outcomes (Nordahl, 2014) and impose an unequal burden of morbidity and mortality on the poor. Elevated socioeconomic inequalities may also hinder some forms of social capital, such as confidence in State institutions and civic engagement, which has been an important factor in combating this epidemic (Elgar, Stefaniak and Wohl, 2020). Moreover, inequalities influence social distancing choices (Weill and others, 2020), as the cost of greater social distancing is higher for members of poorer families who cannot isolate and still maintain their incomes and levels of consumption. Previous studies have shown that inequalities actually play a crucial role in the spread of infectious diseases (Rutter and others, 2012).

Data show that countries with higher levels of inequality have had higher levels of COVID-19 cases and deaths (figure I.2.1). While this does not control for other important dimensions at the coun-

Figure I.2.1

Cases and deaths per 100,000 population and Gini coefficient by country



Source: UN DESA, based on data from John Hopkins University and World Development Indicators (World Bank).

Note: Cumulative number of cases and deaths at the sixth month of the epidemic for each country. Charts display countries with at least 100 cases per 100,000 people and 3.5 deaths per 100,000 people.

(*continued*)

Box I.2 (*continued*)

try level, it is indicative that there is a link between inequality and how fast the virus can spread. In fact, some large countries with relatively high levels of income inequality, such as Brazil, Mexico, South Africa and the United States of America, have been battered by the pandemic. As of 10 December, these four countries accounted for almost 40 per cent of the global death toll from the pandemic, while accounting for only 9.5 per cent of the world's population.

How inequality correlates with cases and mortality rates across countries raises an important question, while controlling for levels of development, stringency of measures to control the pandemic, poverty, share of urban population, share of population over age 65, and quality of institutions, among other variables (Afonso and Vergara, 2021, forthcoming). A preliminary empirical analysis, based on monthly data for cumulative cases and deaths since the first recorded case in each of 154 countries, confirms that a country's share of urban population has a positive and significant correlation with COVID-19 cases and deaths, while the share of population above age 65 is positively correlated to mortality rates but not to cases. The results also show that poverty is not correlated either to cases or to deaths.

The preliminary empirical results exhibit a positive and significant correlation between the different inequality measures—the Gini coefficient, the Palma ratio and the income share held by the highest 10 per cent of earners—and the number of COVID-19 cases across countries. A positive but weaker correlation with mortality rates was also found. This suggests that inequalities accelerate the transmission of the virus and thus contribute to a higher number of cases, which indirectly increases mortality. The statistical insignificance of poverty suggests that inequality possibly impacts COVID-19 cases mainly through differences in labour-market conditions, such as contact intensity of jobs and teleworking possibilities. In sum, preliminary research confirms that high levels of inequality mattered in the spread of the COVID-19 pandemic, and that fighting inequality will remain critical for reducing vulnerability to health shocks and enhancing resilience of societies.

Authors: Helena Afonso and Sebastian Vergara

death tolls in the world, the message that the economy must stay open at all costs resonated with millions of poor Brazilians. In May, violent protests erupted in India, when the Government extended lockdown measures and suspended all inter-city travel, which left millions of migrant workers stranded. In Indonesia, public discontent with government policies in support of jobs and incomes found broader expression as massive protests erupted against the implementation of new labour laws and other planned unpopular economic reforms.

Low inflation, new worries

Income and consumer demand fell sharply, dampening inflationary pressures

The Great Disruption choked global supply chains during the second quarter. But the supply-side shocks were less pronounced than the shock to income and consumer demand, dampening inflationary pressures throughout the world. The abrupt decline in aggregate demand also drove down energy prices, while the prices of agricultural commodities remained relatively stable and metal prices rebounded strongly.[2]

Consumer price inflation is projected to remain low in 2021 as unemployment rates are expected to remain higher than the pre-crisis level in most economies, diminishing the prospects of demand-pull inflation in the near term. On an annual basis, commodity prices are projected to see mild gains in 2021. The expected recovery of demand for consumer durables and housing is expected to create moderate inflationary pressures. In several developed economies, there has been a surge in the demand for housing in the second half

2 See www.macrotrends.net/1476/copper-prices-historical-chart-data.

of 2020, which may continue into 2021 against the backdrop of strong stock market performances and asset price bubbles. A correction in financial and real estate markets will likely further dampen inflationary pressures.

In developed economies, the broad money supply grew rapidly in 2020, but the impact of monetary expansion on the real economy will likely remain limited. The rapid credit expansion in 2020—part of stimulus packages—provided liquidity. These credits mostly filled revenue shortfalls but did not go towards new investments, which could boost aggregate demand and output.

Massive liquidity did not go into investments

The prospects for large-scale depreciation of exchange rates, and the attendant likelihood of imported inflation, also remain weak for most developing and emerging economies. Expected slow recovery in import demand will prevent sharp increases in current account deficits. But the risks of a looming debt crisis can add downward pressure on exchange rates and increase inflation expectations. It will be critical for many commodity exporters in Africa and Latin America—with large external debt servicing burdens—to proactively manage capital flows and exchange rates so as to prevent unexpected inflation.

Paradoxically, the crisis has created a massive financial bubble...

Despite the massive injection of liquidity and historically low interest rates, low inflation expectations will likely persist, posing two policy challenges: the risk of a financial bubble and consequent financial instability, and the risk of rising real public and private debt. As debts are typically contracted in nominal values, lower-than-expected inflation tends to increase the real value of debt. The rising real value of debt and stagnant public revenues will likely undermine public, corporate and household debt sustainability. While central banks around the world have been broadly successful in pursuing unconventional monetary policy, injecting liquidity and keeping long-term interest rates low, they have been less successful in meeting their explicit and implicit inflation targets, with actual inflation falling below expectations. The environment of excessive-liquidity and low inflation has allowed firms to underprice risks and increase the acquisition of financial assets, as evidenced in the surge of asset prices in most stock exchanges around the world. The crisis has paradoxically created a massive financial bubble, diverting financial resources away from real investments, while rising unemployment and loss of income are hurting millions of people worldwide.

Global employment has taken a big hit

...while rising unemployment and loss of income hurt millions worldwide

The GDP growth numbers in 2020 mask the severity of the employment crisis unleashed by the pandemic. By April, full or partial lockdown measures affected almost 2.7 billion workers, representing about 81 per cent of the world's workforce. According to the International Labour Organization (ILO) (2020), total working-hour losses averaged 10.7 per cent during the first three quarters of 2020, representing $3.5 trillion in lost labour income, which is equivalent to about 5.5 per cent of global output in 2019. The aggregate unemployment rate among the Organization for Economic Cooperation and Development (OECD) member states reached 8.8 per cent in April, before falling to 6.9 per cent in November 2020. Unemployment rates may still climb back to about 8 per cent or higher in early 2021, as France, Germany and the United Kingdom reintroduced lockdown measures in late 2020.

Job protection strategies prevented further increases in unemployment in most developed economies...

Various job protection strategies prevented further job losses in most developed economies. Australia, the Baltic States, Canada, Denmark, Germany, Hungary, the Netherlands, New Zealand and the United Kingdom of Great Britain and Northern Ireland introduced new

schemes or expanded the coverage of existing short-time work schemes (subsidizing hours not worked), or provided wage subsidies (in the case of full-time employment)[3] to protect jobs, especially in small and medium-sized enterprises. Denmark, for example, implemented an employee furlough scheme, paying 75-90 per cent of wages, as well as a compensation scheme to assist self-employed workers who recorded significant losses of revenue.

...while the COVID-19 crisis battered labour markets in the developing world

The COVID-19 crisis has wreaked havoc on labour markets in the developing world. By mid-2020, unemployment rates had quickly escalated to record highs: 27 per cent in Nigeria, 23 per cent in India, 21 per cent in Colombia, 17 per cent in the Philippines and above 13 per cent in Argentina, Brazil, Chile, Saudi Arabia and Turkey. As the number of discouraged workers rose, labour-force participation fell. Pre-existing inequalities along educational, gender, age, racial and migration divides largely explained the employment impacts of the crisis. The livelihood and income impacts have been particularly harsh for about 2 billion informal workers with limited social protection, especially those self-employed in the informal economy. The informal sector accounts for more than 60 per cent of jobs in a number of large developing countries, including India, Indonesia and Mexico.

The pandemic has disproportionately affected labour-intensive services sectors in both developed and developing countries. Commercial air travel, tourism, catering, leisure, personal care and retail industries, manufacturing, trade and transportation—which typically employ large numbers of low-skilled workers—faced the largest job losses. Many of the jobs in these sectors cannot be performed remotely, making them vulnerable to lockdown and quarantine measures. The pandemic has also adversely affected female labour-force participation in labour-intensive sectors, as more than 50 per cent of workers in those sectors are women, and they are often the entry point into work for women, youth, migrant workers and the rural population.

The capacity to work remotely varies sharply across educational and income divides...

The ability to work remotely varies significantly across educational and income divides. For example, nearly 75 per cent of employees in the top income quintile in the European Union (EU) are able to work remotely—which makes them less susceptible to the risks of infection—compared with less than 5 per cent of the workers in the lowest quintile who can do the same (figure I.4). In the United Kingdom, women were one third more likely than men to work in a shut-down sector. These jobs will remain vulnerable until the pandemic is brought completely under control (Scudellari, 2020). Workers holding jobs in these sectors have faced disproportionately high health risks because of their physical proximity to the customers they serve. Those who are more educated, skilled and economically secure have faced fewer financial and health risks from the pandemic—a harsh reality that will profoundly impact both the supply of, and demand for, labour in the future.

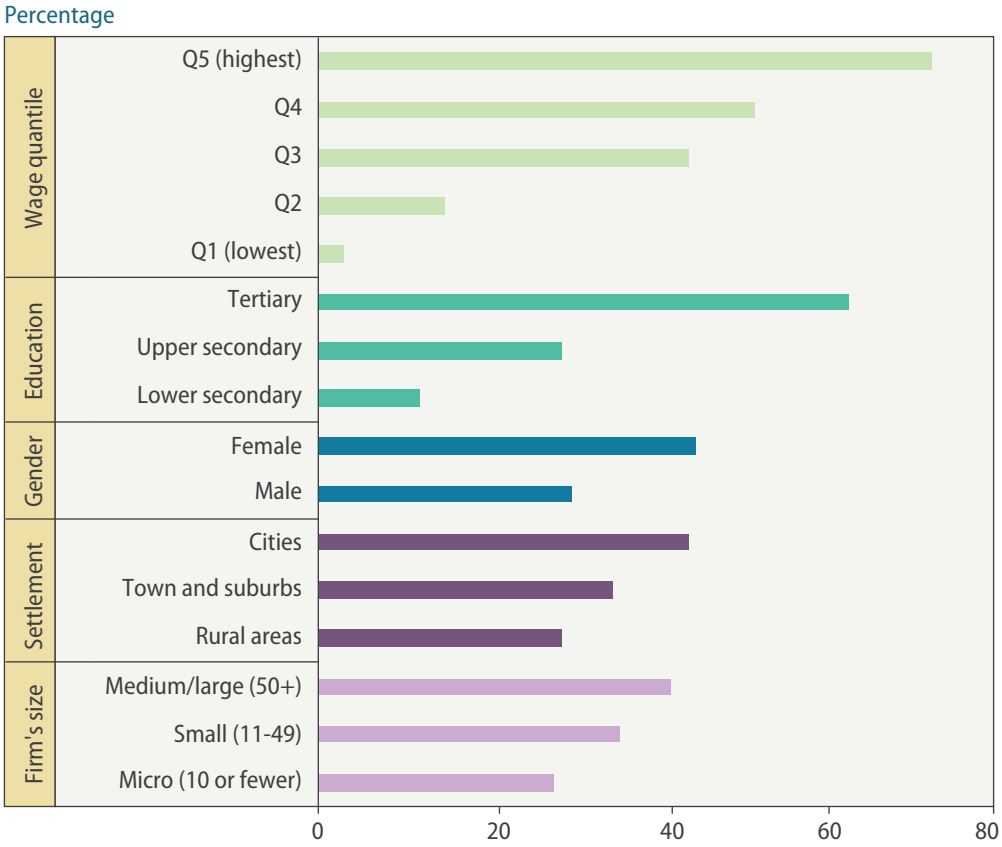
Short-term pain, long-term scars

...and those who are able to work remotely face fewer pandemic-related health and financial risks

The pandemic will likely transform consumer behaviour and economic structures. It is unlikely that in-person interactions will quickly return to pre-crisis levels even if millions are inoculated against COVID-19. Remote work will likely become the new norm for many service sector jobs. Meetings and conferences may remain largely digital, reducing demand for business travel-related services. Consumer spending will increasingly move online. Leisure and entertainment will also become increasingly digital, replacing brick-and-mortar venues

3 For further details on job retention policies, see OECD (2020c); and United Nations, Department of Economic and Social Affairs (2020).

Figure I.4
Employees in teleworkable occupations, by workers' characteristics, EU-27



Source: Calculations by Sostero and others (2020), based upon EU Labour Force Survey and Structure of Earnings Survey.

for retail and entertainment. These shifts will likely reduce local government revenues and adversely impact the delivery of basic services—health, sanitation, education, transportation and public safety—in urban centres worldwide. These shifts, already under way before the pandemic, will profoundly impact the trajectory of sustainable development.

The temporary underutilization of capital and labour due to pandemic-related restrictions on economic activities will likely increase the level of risk aversion and precautionary savings among households and businesses and depress investment in the long run. Private investments in fixed capital never fully recovered from the global financial crisis, which pushed the world economy onto a lower growth path during the past decade. The current shock to aggregate demand—and the hysteresis effects of the crisis—will likely reduce the potential output of the world economy. Some research suggests that a one percentage point decline in actual output in Europe could lead to a 0.6 per cent loss in potential output in the long run (Heimberger, 2020).

Furthermore, the pace of digitalization, automation and robotization will likely accelerate during the post-pandemic period, as businesses will pursue resilience and safeguards against shocks to labour supply. Accelerated and more widespread automation and digitalization will likely make many job losses permanent. While automation and innovation typically increase the productivity of workers and firms that can embrace new technologies, they also displace less productive workers and firms. In a post COVID-19 world, firms and

sectors that can quickly adapt digital technologies will likely fare better, while making many existing jobs redundant. This will likely widen wage and income inequality both within and across sectors. While there will be increases in marginal productivity in those sectors, average productivity growth in the global economy will likely remain subdued. Lower average productivity growth will translate to lower output growth.

Rising poverty and inequality: adding insult to injury

Massive job and income losses are quickly pushing millions into poverty

The pandemic has laid bare the cost of inequality in societies, with the most vulnerable income and demographic groups facing the gravest risks. Massive job and income losses are quickly leading to massive increases in poverty. While nearly 8 million people in the United States have lost their jobs and 4 million exited the labour force permanently since March 2020 and the national poverty rate jumped from 9.3 per cent in June to 11.7 per cent in November 2020 (Long, 2020), the total wealth of 644 United States billionaires increased by 31.6 per cent between 18 March and 13 October 2020, from $2.95 trillion to $3.88 trillion.[4] The five richest among them saw their total wealth increase by 66 per cent, from $358 billion to $596 billion, during the same period. While only 4 per cent of the highest-income workers had lost jobs, about 20 per cent of the jobs that the lowest-income workers had held in February no longer existed in June.

The impact of the crisis on poverty is more pronounced worldwide. The total number of people living in poverty is expected to have increased by 131 million in 2020 alone (figure I.5), representing a sharp rise from the earlier projections presented in the *World Economic Situation and Prospects 2020* mid-year update, released last June. Given the current shock to poverty, as many as 797 million people will still be living in extreme poverty in 2030, representing a poverty headcount ratio of over 9 per cent. Even under the best-case scenario of a vigorous and universal economic recovery combined with declining inequality in all developing countries, the overall eradication of extreme poverty by 2030 will remain beyond reach (Slotman, 2020).

COVID-19 is making inequality worse both within and across countries

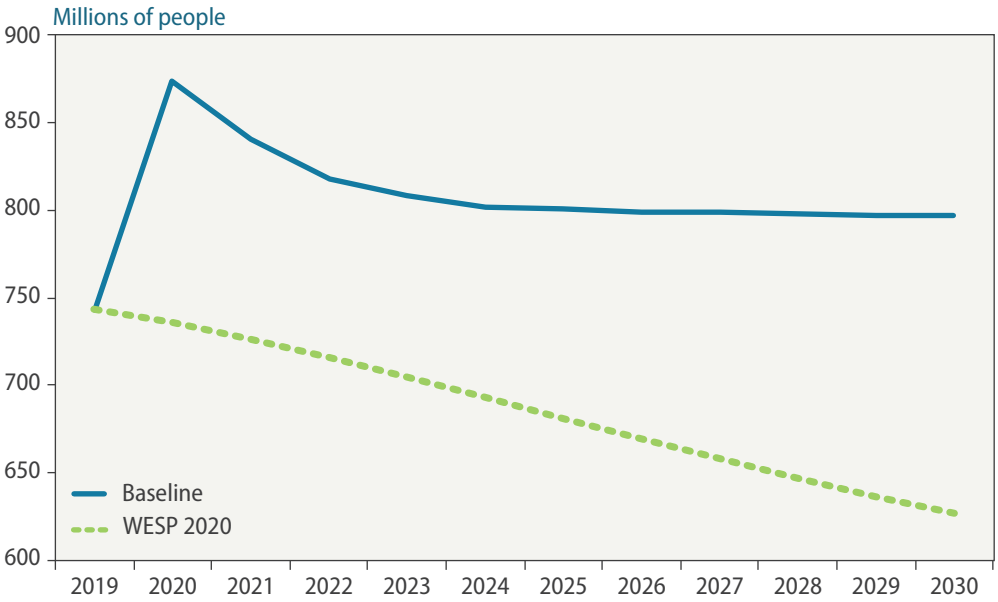
The pandemic is worsening inequality both within and across countries. As millions fall below the poverty lines at the national levels and the income of the top quintiles rise or even remain unchanged, income inequality will inevitably increase. The combination of low growth and high job losses will disproportionately affect people in the lowest income group. Analysing five previous pandemics, Furceri and others (2020) found that after a pandemic event, the shares of incomes going to the top deciles increased and those going to the bottom deciles fell. They expect that, given the magnitude of the current pandemic, the inequality impact will be significantly larger. Rising income inequality will likely further reinforce structural inequalities in access and opportunities, often determined by age, gender, race, disability, rural/urban divides and other dynamics of inequality.

Digital divides will worsen inequality between and among countries

The existing digital divides within and between countries will contribute to a further worsening of inequality. Even in the most developed countries, the lack of access to broadband Internet during the pandemic has been disproportionately undermining the learning opportunities for children from low-income households. A study undertaken by the RAND Corporation showed that only 30 per cent of teachers in high-poverty schools in the United

4 https://americansfortaxfairness.org/billionaires/.

Figure I.5
Poverty projections before and after COVID-19



Source: UN DESA, based on projections and scenarios generated by the World Economic Forecasting Model (WEFM).

States reported that all or nearly all of their students had access to the Internet at home, compared with 83 per cent of teachers in low-poverty schools (Stelitano and others, 2020). UNICEF has reported that one third of the world's schoolchildren (463 million) and nearly half of the schoolchildren in Africa have no access to remote learning (UNICEF, 2020). Seventy-two per cent of schoolchildren who are unable to access remote learning live in their country's poorest households. These structural impediments related to learning opportunities during the pandemic will impact the lifelong income potential of the children affected and further exacerbate income and wealth inequality.

Inequality among countries is also expected to worsen through growth, trade and debt channels. Developing countries falling behind in recovery will likely see a greater divergence in per capita income growth during the post-pandemic period. Weak recovery of exports and the likelihood of a debt crisis—depressing investment growth—will further accentuate the divergences in per capita income growth and worsen inequality between countries.

Many Sustainable Development Goals are suffering collateral damages

The pandemic is quickly turning into a hunger crisis. An estimated 270 million people worldwide are now facing the prospect of crisis-level hunger, a majority of them in conflict countries. The number of people facing hunger has increased by 82 per cent since the outbreak of the pandemic (World Food Programme, 2020; Oxfam International, 2020). Latin America has seen an almost 300 per cent increase in the number of people requiring food assistance, with job and income losses driving millions into destitution. The hunger crisis is also rapidly unfolding in West and Central Africa, with nearly a 135 per cent jump in the number of food-insecure people since the onset of the pandemic.

The pandemic is exacerbating health outcomes

Beyond directly affecting the health of populations (covered under SDG 3), the pandemic is also exacerbating health outcomes and contributing to an increase in death due to AIDS, malaria and tuberculosis and in neonatal mortality, as the response to the pandemic is constraining the capacities of national health systems to address other health concerns. Rising livelihood losses during the pandemic are contributing to increases in alcohol abuse and suicide rates. With lockdowns, levels of schooling and learning for the current cohort of students (SDG 4) have fallen, disproportionately affecting the most marginalized and vulnerable groups—girls, ethnic minorities and persons with disabilities. While some crimes have registered a decline, women and girls are increasingly becoming victims of violence during the implementation of stay-at-home measures (SDGs 5 and 16) and child marriages will likely see a global uptick on account of rising poverty.

Rising poverty will likely lead to increases in child labour (SDG 8), as many poor households will need additional sources of income. Lingering financing constraints and subdued demand will likely hinder development of small-scale industries and industrial development at large (SDG 9). The pandemic has also resulted in an unprecedented decline in demand and revenue for public transport worldwide, posing a great challenge to its future in cities (SDG 11). Recycling operations have reportedly declined owing to safety precautions and, in some countries, all municipal waste has been treated as non-recyclable and sent for incineration or to a sanitary landfill during the outbreak (SDG 12), potentially exacerbating environmental degradation. Commitments to fight climate change have taken a back seat as the fight against the pandemic has become the fiscal priority (SDG 13), diverting resources away from mitigation and adaptation efforts. The consumption of single-use plastics as a consequence of the pandemic is increasing plastic pollution and environmental degradation worldwide (SDG 14). Wildlife conservation efforts are also suffering setbacks, as a result of reduced funding, restrictions on the operations of conservation agencies, and elevated human threats to nature (SDG 15). Moreover, with government revenues, foreign direct investment (FDI) flows and remittances plummeting and debt servicing rising, most developing countries will face significant challenges to mobilize resources for sustainable development (SDG 17).

A few SDGs have seen some progress during the outbreak; but without sustained action the progress will be fleeting

A few of the Goals have seen some progress but without sustained action this progress will be fleeting. As a result of lockdowns, a significant number of deaths were averted through a reduction in both road traffic injuries and ambient air pollution (SDGs 3 and 11). In some countries, lockdowns saved more lives by restraining ambient air pollution than by preventing COVID infection (Burke, 2020; Giani and others, 2020; Khomsi and others, 2020). Water and sanitation efforts gained renewed importance as access to clean water and frequent hand washing became imperative for stopping the spread of the virus (SDG 6). Ambient water quality improved during lockdowns, for example, in the Yamuna River (Patel, Mondal and Ghosh, 2020) and Sabarmati River in India (Aman, Salman and Yunus, 2020), as did water-use efficiency in Europe (Roidt and others, 2020). The share of renewable energy in total energy increased during the pandemic, an effect that should last into 2021 (International Energy Agency, 2020) (SDG 7). These unintended consequences can be leveraged and built upon with appropriate policy measures to sustain current progress. Otherwise, these improvements will quickly return to business as usual. The pre-pandemic progress in SDG achievement has helped some countries cope better with COVID-19 and limit SDGs-related

damages, demonstrating that sustainable development can strengthen resilience to unanticipated health and economic shocks.

Extraordinary crisis, extraordinary responses

Governments and central banks around the world responded to the pandemic with massive stimulus measures aimed at mitigating its health, humanitarian and economic fallouts. The global fiscal response amounts to $12.7 trillion, including $5.9 trillion for additional spending and $5.8 trillion in liquidity support (figure I.6a). At 15.8 per cent of world gross output in 2020, this is the largest fiscal response since the Second World War.

Fiscal responses to the pandemic reached a staggering $12.7 trillion...

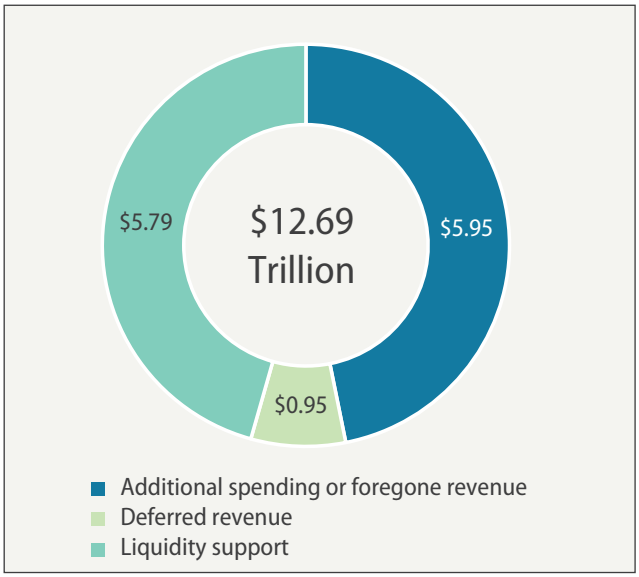
Fiscal stimulus has saved the day

Assuming an average fiscal multiplier of 1.6—with every dollar of additional fiscal outlays generating 60 cents of additional output—then $5.9 trillion of pandemic-related fiscal spending and tax cuts generated an additional output of about $3.6 trillion in the world economy (Blanchard and Leigh, 2013). This is equivalent to about 4.5 per cent of world output in 2020. Without massive fiscal stimulus measures, world output would have contracted by double digits in 2020, instead of experiencing the estimated 4.3 per cent decline. The impacts on employment, household income and poverty would have been significantly more catastrophic. The unprecedented fiscal stimulus interventions helped the world avert an even worse catastrophe.

Figure I.6

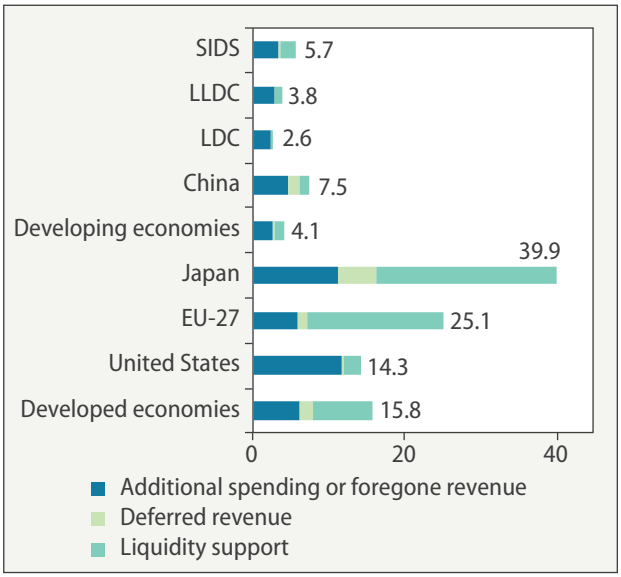
a. Global fiscal response

Trillions of US dollars



b. Fiscal response as a share of GDP

Percentage



Source: IMF Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, available at https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19.

Note: Fiscal response as a share of GDP represents unweighted averages for the countries and country groups.

...which helped avert Great Depression-scale suffering

The fiscal support included additional spending, tax cuts and tax deferrals, all of which had direct budgetary impacts and increased fiscal deficits. The fiscal measures also included "below the budget line" support measures—equity injections, loans, asset purchases and guarantees—with long-term budgetary implications. As a result, most Governments face significantly higher levels of deficits and debt, which will increase even further should the recovery falter. A robust recovery of the world economy—and a return to a path of sustainable development—will depend not only on the effectiveness of the vaccines but also on the efficacy of the stimulus measures.

The developed countries' outlays accounted for almost four fifths of fiscal stimulus worldwide

The fiscal outlays of the developed countries represented nearly 80 per cent of all fiscal stimulus worldwide, with the United States, Germany and Japan accounting for more than half of the worldwide fiscal stimulus. In contrast, the responses from the developing countries have been modest relative to the magnitude of the shock. The COVID-19 crisis hit many developing countries—especially in Africa and Latin America and the Caribbean—when their public finances were already under strain. The group of 46 least developed countries, for example, collectively managed to increase direct and indirect fiscal support by only 2.6 per cent of their GDP, while the size of the stimulus for the developed countries averaged 15.8 per cent of their GDP.

In dollar terms, stimulus spending per capita averaged $9,836 in the developed countries, while it amounted to only $17 per capita in the least developed countries. That is, for every additional dollar per capita of stimulus rolled out by the LDCs, the developed countries spent nearly $580. The disparity in the size of the stimulus between the LDCs and the developed economies dwarfed the income disparity between these two groups of countries. The per capita income of the developed countries is only 30 times larger than the per capita GDP of the least developed countries.

The disparities in the size of the stimulus reflect the stark reality of the differing financing constraints faced by the developed and the developing countries, with significant consequences not only for the pace of their recovery from the crisis but also for their long-term growth and development trajectory. Many developing countries buffeted by the pandemic and unable to respond with large fiscal responses will likely see their growth and development path adjust downward relative to the pre-crisis trends. This may reverse the trends or at least delay the long-term convergence of the per capita incomes of the developed and developing countries, thwarting the objectives of reducing inequality between countries as envisaged in the 2030 Agenda for Sustainable Development, as noted above.

Not only the quantity but also the quality of stimulus matters

The large fiscal stimulus measures—protecting jobs and supporting household consumption—differed greatly across countries, not only in size but also in scope and priorities, reflecting differences in governance structures, political preferences and the levels of commitment to social protection. The welfare protection systems and automatic fiscal stabilizers allowed most countries in Europe to protect jobs and income immediately (Fatas, 2019). The United States, the United Kingdom and Canada, among others, as well as Japan, relied more on discretionary fiscal policy measures in pursuing similar objectives of protecting

jobs and income.[5] In the EU and Japan, fiscal responses provided largely liquidity support, while in the United States direct income support to households helped to sustain consumption. In contrast, China's stimulus measures largely promoted new investments to support job growth and recovery. How these types of emergency spending will shape recovery and growth remains an open question. However, if these measures do not stimulate investment and growth, public debt will likely become unsustainable and force Governments to cut back spending, undermining the prospects of recovery.

Governments faced hard choices in addressing urgency on the one hand...

While the size of stimulus packages matters, the quality of fiscal spending matters equally, if not more. There are growing concerns about the distributional impacts and effectiveness of these emergency fiscal spending. Governments clearly faced difficult trade-offs in addressing urgency on one hand and exercising due diligence on the other to prevent misallocation, mis-targeting, corruption and fraud in the use of public resources. Under an ideal scenario, Governments should be able to target additional fiscal spending to households and businesses that are facing the gravest economic risks from the pandemic. If a stimulus measure is too broad in scope, it may stretch resources too thin to help anyone. On the other hand, if the stimulus is targeted too narrowly, it may exclude many businesses and households that deserve to receive government support. In the United States, for example, a mere 1 per cent of firms—many deemed as not facing any significant pandemic related risks—received 25 per cent of the disbursements from the $523 billion Paycheck Protection Program that was rolled out to support small and medium-sized businesses (Cowley and Koeze, 2020), raising concerns about misuse and mis-targeting of scarce fiscal resources. Striking a delicate balance among the imperatives of timeliness, scope, reach and effectiveness of stimulus measures required a deliberative vetting process, but the urgency of the response made such due diligence politically untenable.

...and exercising due diligence on the other to prevent mis-targeting and fraud

In many developing countries, citizens concerned about corruption and fraud in the deployment of stimulus packages. In South Africa, allegations of corruption related to overpricing and potential fraud in the procurement of personal protective equipment (PPE) and the distribution of social grants and food parcels, have provoked a public outcry and prompted investigations. There are calls in Argentina for an investigation of irregularities in the use of COVID-19 related funds. In Indonesia, concerns arose that a new stimulus package contained measures that could undermine workers' protections and cause widespread environmental damage.

The crisis response also raises the broader question of how Governments should assist businesses during a crisis and what risks they should assume while averting moral hazards. In Germany, for example, the Government's decision to take a significant ownership stake in Lufthansa, partially nationalizing the country's biggest airline, sparked debates over whether the Government should assume downside risks of a business entity or simply extend a loan to save the flagship carrier. Fiscal stimulus also provided an opportunity for Governments to shift the behaviour of firms towards creating public goods. In France, the government assistance package for Air France-KLM came with expectations that the airline group would promote environmental sustainability.

5 By activating the general escape clause of the Stability and Growth Pact, the European Commission has allowed Governments to take the budgetary action necessary to fight the pandemic. However, internal disagreements and the lack of a meaningful central fiscal capacity within the European Monetary Union have constrained the discretionary fiscal response.

Austerity cannot be an option

The fiscal responses will have differing long-term consequences for the sustainability of public debt, as most of the additional spending, tax cuts and deferrals have been funded in many countries with additional borrowing by their Governments. Countries saddled with high levels of public debt—and constrained by fiscal rules—may be forced to cut back spending too quickly to balance their budgets. Many developing countries are already facing significant debt distress and additional debt will only further weaken their debt sustainability. With a benign inflation outlook, real public debt will remain high relative to real GDP. It will be politically and economically infeasible for many Governments to raise taxes during the recovery phase. These constraints may encourage Governments to look to the devastating alternative of cutting fiscal spending to reduce deficits and debt.

Premature austerity will stifle recovery

A premature path to austerity will inevitably weaken the speed and quality of the recovery (UNCTAD, 2020) and undermine resilience to future shocks, as the experience of the last global financial crisis amply demonstrated. Austerity measures almost always cut back social sector spending on health and education and public services with far- reaching consequences for many SDGs. The developed countries pursuing austerity will also likely reduce their official development assistance (ODA), limiting the availability of development finance for the many developing countries that partly rely on ODA for budgetary support. The global spillover effects of spending cuts will have devastating consequences for sustainable development.

Robust monetary responses to complement fiscal measures

Central banks have rolled out unprecedented monetary measures...

The impact of COVID-19 on financial markets prompted central banks across the world to roll out monetary measures on an unprecedented scale. Since March 2020, 92 central banks have cut policy rates 241 times. Many central banks implemented additional monetary and prudential measures to boost liquidity and ensure financial stability. China, Indonesia, Malaysia and the United Arab Emirates, for example, lowered bank reserve requirements to inject liquidity. Argentina, Brazil, Sri Lanka, Taiwan Province of China and the United Kingdom launched or expanded special credit facilities for small and medium-sized enterprises. Brazil, Mexico, the Republic of Korea and Singapore, among others, established temporary United States dollar swap lines with the Federal Reserve. Hong Kong SAR, Norway, South Africa and the United Kingdom relaxed macroprudential regulations—suspending countercyclical capital or liquidity buffers—to enhance credit flows.

Responding to the pandemic, several central banks have also announced changes in their monetary policy frameworks to enhance policy flexibility and improve monetary transmission. The Fed announced a shift to "average inflation targeting" (Powell, 2020), which allows for inflation to overshoot its target for some time, in order to support a sustained recovery in labour markets. The European Central Bank has also hinted that it will commit to allowing inflation to overshoot its target following a period of weak price growth.

The Bank of England, the Bank of Canada and the Reserve Bank of New Zealand are exploring the possibility of introducing negative interest rates. Currently, the European Central Bank, and the central banks of Denmark, Japan and Switzerland, have a negative policy rate. Evidence on the effectiveness of negative interest rates in stimulating economic growth is somewhat mixed, and there are growing concerns over adverse side effects, including the potential for under-pricing risk. An extended period of negative interest rates could also

erode bank profitability, leading to weaker balance sheets and reduced lending capability. In several countries, negative yields have dampened investment returns for insurance companies and pension funds, making it harder for them to meet their obligations. In December 2019, Sweden ended its negative interest rates policy, citing concerns over unintended side effects. Andersson and Jonung (2020) concluded that the Riksbank's negative policy rate from 2015 to 2019 had not contributed to significantly higher inflation, while creating major imbalances in the process.

In many countries, household saving rates have increased substantially since the outbreak of the pandemic. In normal times, this could be considered good news. But during these extraordinary times, it reflects a higher degree of risk aversion. Given elevated uncertainties over future income and employment conditions, precautionary savings will remain high. Low interest rates are unlikely to stimulate spending and investment, particularly in countries with weak social protection. Dossche and Zlatanos (2020) report that households in the euro area expect to spend less on major purchases over the next year, notwithstanding their accumulated savings. Amid a weak demand outlook and elevated debt, firms are more likely to postpone or cancel new capital spending plans, regardless of financing costs.

Lenders of last resort are becoming buyers of last resort

In times of financial turmoil, demand for equity and fixed income assets plummets, which can quickly dry up liquidity, push up yields and increase rollover and borrowing costs. The global financial crisis in 2008 prompted the United States Federal Reserve to engage in purchase of fixed assets directly from the financial market—the unconventional monetary policy tool that came to be known as quantitative easing—to increase liquidity and reduce long-term interest rates, which are critical for investments.

...and many are engaged in direct asset purchases

As many as 30 central banks are now engaged in direct asset purchases (Central Bank News, 2020). Developing country central banks have also started their own asset purchase programmes. The central banks of Chile, the Philippines, the Republic of Korea, Turkey and South Africa launched asset purchase programmes for the first time, buying mostly government bonds to signal their willingness to assume the role of buyer of last resort (Arslan, Drehmann and Hofmann, 2020).

Both the Federal Reserve and the Bank of Japan announced the unlimited purchase of government-backed debt and also started to buy corporate bonds for the first time, while the European Central Bank launched a €750 billion emergency bond-buying programme, with the amount later increased to €1.85 trillion. The balance sheets of the three largest central banks have increased by nearly $7.5 trillion—nearly 8 per cent of world gross product—since March 2020 (table I.3). Early evidence suggests that the monetary policy measures in major developed and emerging economies helped to ease liquidity constraints, while fueling a sharp rebound in financial markets (see, for example, Altavilla and others (2020)).

Table I.3
Asset purchases by major central banks

Central Bank	Asset purchases between March–November 2020 (billions of US dollars)
United States Federal Reserve	3,021
European Central Bank	3,028
Bank of Japan	1,405

Sources: United States Federal Reserve Board, European Central Bank and Bank of Japan.

Liquidity is not stimulating investments

The onset of the pandemic in March 2020 set off a rush to safety and a scramble for liquidity. Reminiscent of the panic at the beginning of the global financial crisis in September 2008, corporate and financial sector entities scrambled for cash, selling off bonds and pulling back from commercial paper markets and money market funds. Even the demand for United States Treasuries—the safest and most liquid financial asset—fell as financial markets panicked. The large-scale liquidity support from central banks, especially the United States Federal Reserve, eased the liquidity constraints and calmed the financial markets. By the end of April, central banks' bold actions had successfully mitigated the liquidity crisis (BIS, 2020). The unprecedented level of actions of central banks, at times in coordination with fiscal authorities, averted a financial meltdown and stabilized credit flows (IMF, 2020c).

Ten months into the pandemic, the financial markets are now awash with liquidity. While credit flows stabilized, there has been little growth in fixed investment. In the United States, fixed non-residential investments fell by 7.8 per cent in the second quarter, while money supply increased by 23.2 per cent during the same period (table I.4). The pandemic and the associated persistent uncertainties have further weakened the correlations among liquidity, credit and fixed investment. Acquisition of financial assets do not increase fixed investments, which are critical for boosting growth and employment.

While M2 in the United States has increased by $1.4 trillion since March, the excess reserves of the banks also increased, by about $1.0 trillion during the same period, having very little effect on credit creation. Evidence suggests that macroprudential tools—providing incentives for banks to lend to priority sectors and discouraging credit flows to speculative sectors—can be far more effective in stimulating credit growth and investment. This explains why the increase in the monetary base through quantitative easing (QE) itself does not usually have a multiplier effect unless it changes banks' lending behaviour.

But a surge in global liquidity poses a threat to financial stability

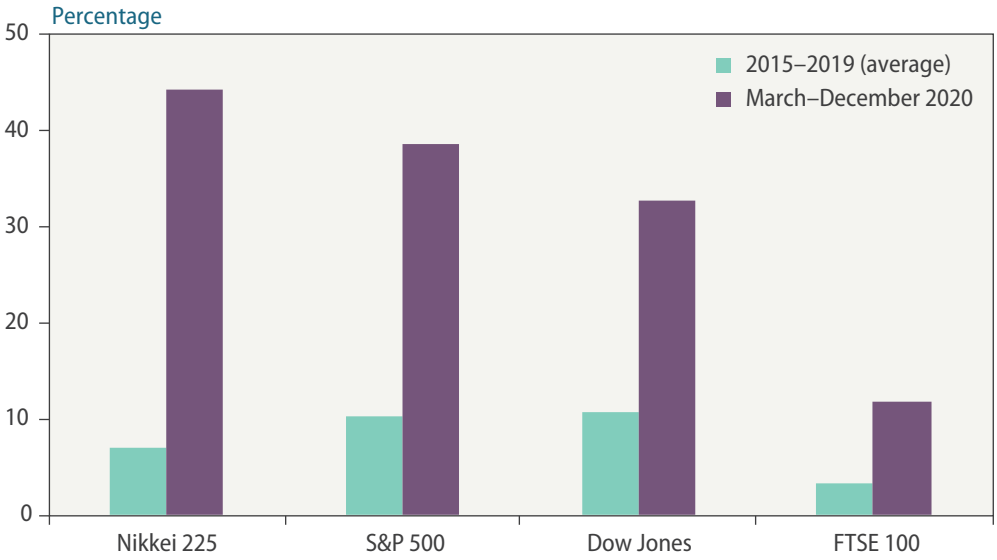
The surge in global liquidity has contributed to the under-pricing of risk in financial markets, posing a threat to longer-term financial stability. There has also been a growing disconnect between the performance of financial markets and the real economy. Igan, Kirti and Martinez Peria (2020) concluded that unprecedented central bank support in mid-March 2020 directly resulted in a significant decline in both risk premiums and risk-free discount rates, driving up asset prices to record levels. The world is witnessing the build-up of a massive financial bubble with major stock market indices registering record increases during the past 10 months. The S&P 500 index, for example, rose by nearly 40 per cent compared with average annual increases of 10 per cent during the past five years (figure I.7). There is a clear

Table I.4
Money supply and gross fixed capital formation

Percentage change	Money supply		Gross fixed capital formation	
	2019	Q1–Q2 2020	2019	Q1–Q2 2020
United States	6.0	23.2	0.7	-7.8
Euro area	5.4	8.9	7.3	-20.5
Japan	2.6	7.9	-2.0	-7.3

Source: United States Federal Reserve Board; European Central Bank; Bank of Japan; United States Department of Commerce, Bureau of Economic Analysis; Eurostat; and Japan, Cabinet Office.

Figure I.7
Change in major stock market indices



Abbreviations: FTSE, Financial Times Stock Exchange.

Source: UN DESA, based on data from stock exchanges in New York, London and Tokyo.

Note: The variation for March-December 2020 was calculated using monthly averages. Data extend until 15 December 2020.

need for central banks to deploy macro- and micro-prudential tools to ensure that massive liquidity boosts investments in the sectors that present significant potential for growth, such as digital and physical infrastructure, health and climate mitigation and adaptation.

A combination of ultra-low interest rates, high uncertainty and excessive liquidity have weakened monetary policy transmission. Not only are overburdened monetary policies less effective in stimulating economic growth, but they also entail significant costs, including distorting markets and exacerbating financial stability risks. The further lowering of borrowing costs in the current context is unlikely to stimulate real investment materially. Instead macroprudential tools and more nuanced and more targeted policies, such as those specifically intended to limit housing credit in countries experiencing a real estate bubble, can positively impact both credit growth and financial stability (Araujo and others, 2020; Akinci and Olmsted-Rumsey, 2015; Lee, Asuncion and Kim, 2015).

Borrowing from the future

Public finance is facing steeper challenges than during the 2008 financial crisis...

The crisis has created a perfect storm for public finances, undermining economic activities and affecting both the revenue and expenditure sides of the budget. Public finance is facing steeper challenges now than during the global financial crisis in 2008-2009. In almost one in five developing and transition economies, the government deficit is projected to reach double digits as a percentage of GDP in 2020. Losses in fiscal revenues contribute significantly more than increases in expenditures to explain projected deficits.

On a GDP-weighted basis, the global public debt-to-GDP ratio is projected to have increased from 106 per cent in 2019 to 127 per cent in 2020. While borrowing costs have declined for most Governments because of extraordinary monetary responses to the crisis (interest rate cuts, expansion of large-scale asset purchase programmes, provision of unprecedented amounts of liquidity), reduced borrowing costs will not be sufficient to bridge large financing gaps and improve fiscal balances. In an environment of low inflation, interest

rates and borrowing costs will likely remain low in the foreseeable future, as central banks have pledged to keep interest rates at current levels for some time.

...with government gross debt projected to have increased globally by $9.9 trillion in 2020

Globally, government gross debt is projected to have increased by $9.9 trillion—12.3 per cent of world output—in 2020 (figure I.8). This represents the largest increase in public debt in any given year. In contrast, public debt increased by $4.2 trillion in 2009, when Governments hurriedly deployed their financial resources to confront the fallout of the global financial crisis.

Most developed countries with high levels of public debt—particularly Germany, Japan and the United States—were able to increase their debt significantly without facing any borrowing constraints. Government debt of the United States is projected to increase by 17 per cent in 2020, without any commensurate increase in government bond yields. The yield on 10-year United States Treasuries remains at a record low. Germany and Japan will see their public debt increase by 8 per cent and 20 per cent, respectively. Borrowing constraints—the limits on fiscal space—clearly do not apply to large economies with the ability to borrow domestically and internationally in their own currencies. A large number of developing countries in Latin America and Western Asia also experienced massive increases in public debt relative to increases in debt during the global financial crisis (figure I.9).

The borrowing constraint is, however, binding for many developing countries, even those with low levels of public debt before the crisis. Cambodia, the Democratic Republic of the Congo and Guatemala (figure I.10), for example, will see little increase in their debt. Despite significantly low levels of public debt, many of these countries will find it difficult to borrow during an economic crisis. Credit and debt often flow uphill, especially during an economic crisis. Liquidity dries up quickly in domestic and international capital markets at the first sign of a crisis, which makes it extremely difficult for many developing countries to roll over their existing debt and undertake new debt to mitigate the effects of the crisis. There is a clear need for expanding access to credit for developing countries, especially those with thin domestic capital markets. Support from the IMF emergency credit facilities has been timely but will fall short of what is required to support the recovery efforts of many developing countries.

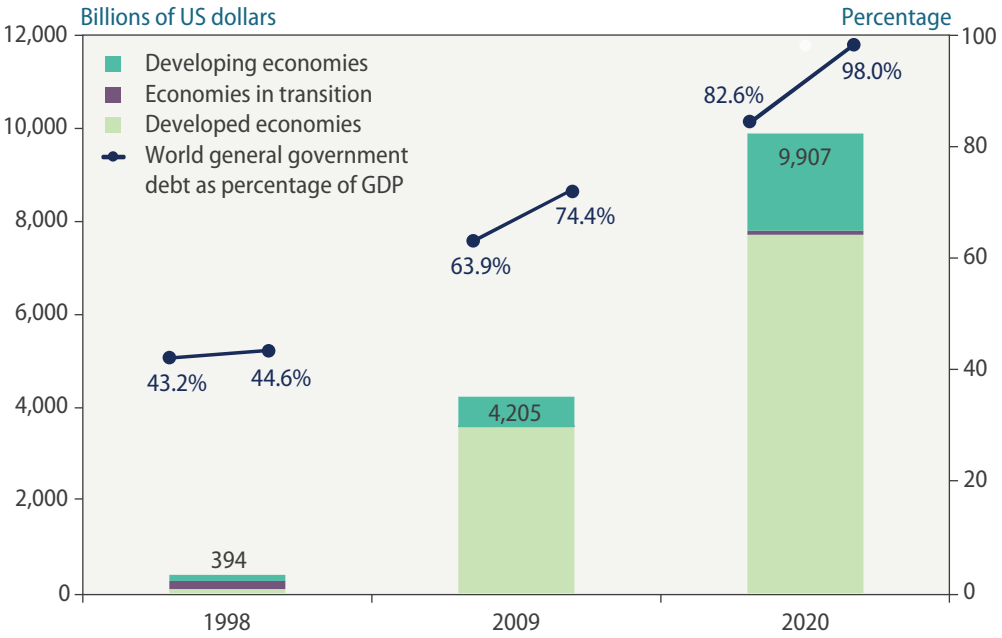
There is a pressing need to expand the access of developing countries to credit...

Financing constraints are compounded by elevated risks of debt distress and default. As of 30 September 2020, 35 low-income countries were either in debt distress or at a high risk thereof according to the IMF/World Bank debt sustainability analysis (IMF, 2020d). But the situation has also become more difficult for many middle-income countries. Sovereign debt downgrades by the major credit-rating agencies have soared in 2020, reaching the highest level in 40 years (Bulow and others, 2020). Argentina, Ecuador, Lebanon, Suriname and Zambia have defaulted on their sovereign debt and are at different stages of restructuring their debt. Even if the dire scenario of widespread debt distress and disorderly defaults does not materialize, protracted fiscal paralysis could severely undermine countries' prospects of achieving the Sustainable Development Goals by 2030. A large number of developing economies are at risk of becoming trapped in a vicious cycle of high debt and low growth. Currently, the threat of higher future debt burdens already limits policy responses to Covid-19.

...with many developing countries at risk of getting stuck in a vicious cycle of high debt and low growth

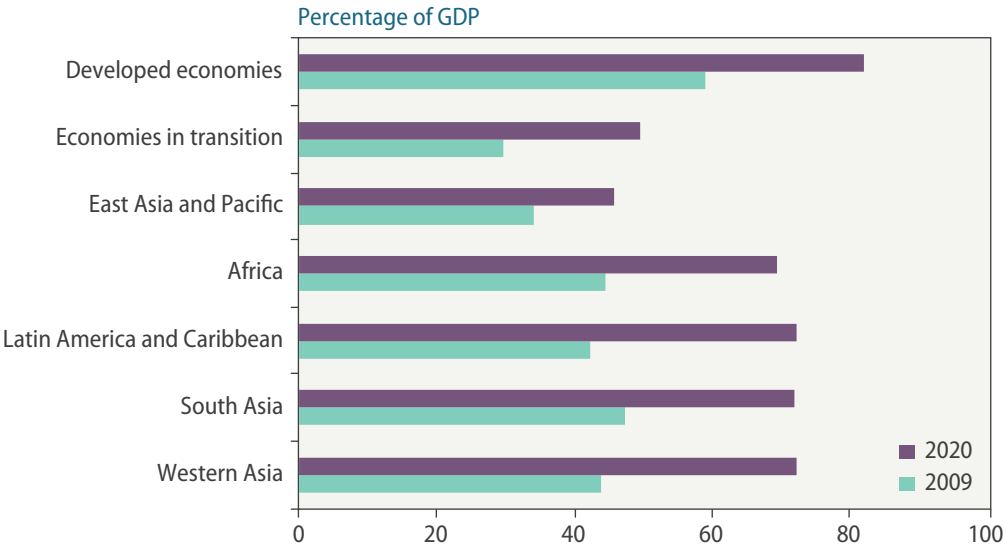
Governments across the world have borrowed nearly $10 trillion from the future to minimize the impact of the crisis on the current generation. The current generation in turn has the responsibility to make sure that the money borrowed is well spent and invested to ensure that its well-being does not jeopardize the well-being of future generations. The urgency and emergency of the current crisis cannot justify depriving future generations of their right to enjoy prosperity. The rise in public debt should not in itself be a concern as long

Figure I.8
Increase in general government debt during recent crises



Source: UN DESA, based on IMF (2020g).

Figure I.9
General government gross debt, 2009 and 2020

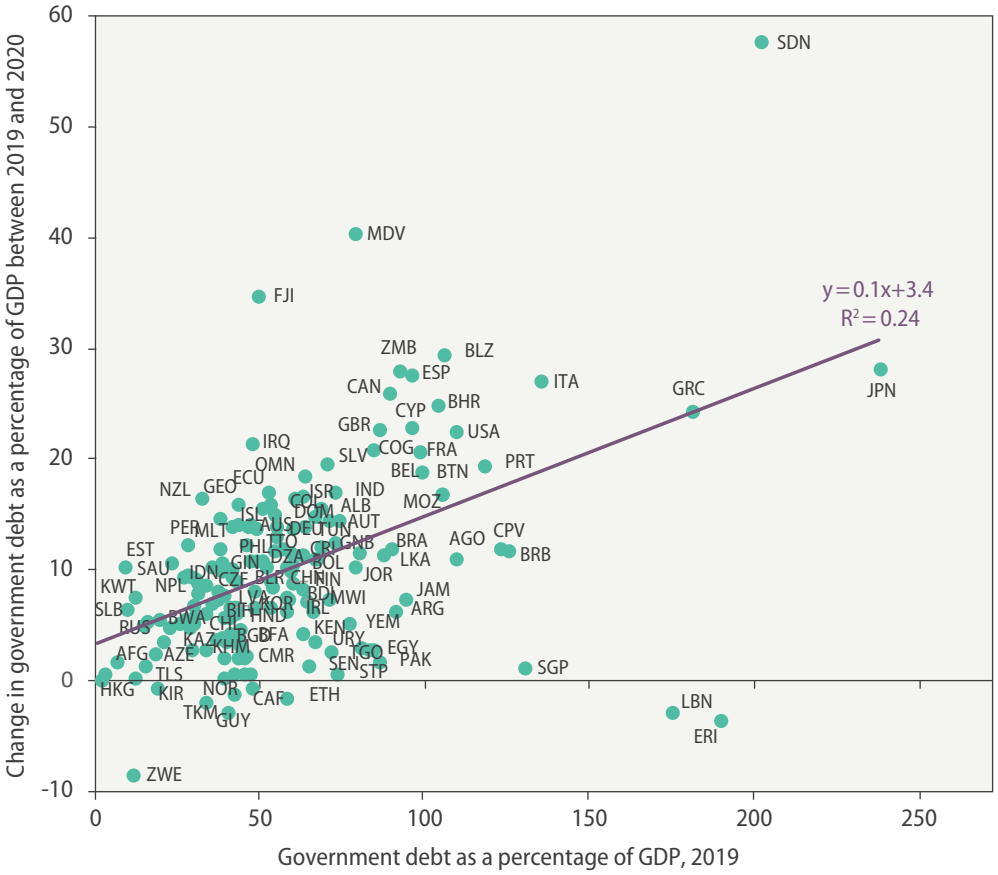


Source: UN DESA, based on IMF (2020g).

Note: 2020 values are estimated.

as additional debt boosts economic growth and generates sufficient additional government revenues to pay for additional debt services. Revenue growth, however, is often inelastic relative to growth in public debt. Even when revenue increases, there can be time inconsistencies between increases in debt service payments and new revenue generated, adding strains on government budgets. There are also risks that contingent liabilities of stimulus measures—loans, equity injection and guarantees—will go sour if firms and financial institutions receiving government support fail to recover from the crisis.

Figure I.10
Changes in government debt in 2020



Source: UN DESA, based on IMF (2020g).

Note: Government debt is general government gross debt. 2020 values are estimated. Some country labels have been removed to ensure better visibility.

The current generation should ensure that its borrowings do not risk the prosperity of future generations

The path to recovery and progress on the SDGs will critically hinge on the ability and political commitment of countries to make sure that the crisis response ensures equity within and across generations and builds resilience against economic, social and environmental shocks in future. The imperatives of strengthening public finance and debt sustainability, expanding social protection and building climate resilience must inform today's policy choices to put the world on the trajectory of sustainable development.

Recovery with resilience

The pandemic has laid bare the fragility of the world economy. What began as a health crisis quickly devastated the world economy, plunging production and consumption, destroying jobs and throwing millions into poverty. The economic crisis is still unfolding amid a high degree of uncertainties, despite significant breakthroughs in medical treatment and vaccine development (Box I.3). COVID-19 killed more people in December 2020 than it did during its last peak in April.

The extreme and collective nature of the vulnerability to the pandemic—and its rapid transformation into a catastrophic economic crisis—is a wake-up call for policymakers. The crisis has exposed and exacerbated the weaknesses that persist because of the lack of

Box I.3

COVID-19 vaccines: the race to save lives

With the global economy on a cliff-hanger and COVID-19 still killing tens of thousands daily, breakthroughs in vaccine development are delivering some hope to the world. Globally, over 50 different vaccine candidates are in clinical trials on humans, with more than 100 additional preclinical vaccines under active development. At the time of finalization of the present report, 14 vaccines had reached the last stage of large-scale efficacy testing (Zimmer, Corum and Wee, 2021).

Pfizer and BioNTech confirmed the development of their COVID-19 vaccine in early November, with a confirmed 95 per cent efficacy, demonstrating an unprecedented success in vaccine testing and development. In early December 2020, the United Kingdom of Great Britain and Northern Ireland became the first country to authorize emergency use. The United States of America followed in mid-December. A growing number of other coronavirus vaccines are advancing through clinical trials. By the end of 2020, seven vaccine candidates had been locally approved for limited or early use. Similar to Pfizer and BioNTech, Moderna has had its emergency use application approved in the United States and the European Union; together, they expect to produce up to 2.3 billion doses in 2021. AstraZeneca-Oxford, whose vaccine has been cleared in the United Kingdom and India, expect to supply up to 3 billion doses of their easy-to-make COVID-19 vaccine, and developers of other final-stage vaccine candidates will likely produce comparable quantities once they receive the necessary authorization.

Despite successful clinical trials and approvals, manufacturing capacities will remain limited in the near term. The ultra-low temperature requirements of some vaccines will complicate their delivery, particularly in the global south. Production constraints and logistical challenges are compounded by the fact that many developed countries have ordered millions of doses of the vaccines to hedge against the risks of not obtaining them in time. The race to pre-order millions of doses not only reflects coordination failures but also lays bare the inequities in access to vaccines. High-income countries have currently secured their claim to 3.9 billion doses, which would allow some of them to vaccinate their entire population six times over (Duke Global Health Innovation Center, 2020). Although not all of these vaccines will necessarily receive approval, the imbalance is also at play in the context of procurement of the most promising vaccine candidates.[a] Given that low-income countries have not been able to make any public deals, it is likely that they will rely on vaccine coverage for 20 per cent of their population in 2021 through the COVID-19 Vaccines Global Access (COVAX) Facility, co-led by Gavi, the Vaccine Alliance; the Coalition for Epidemic Preparedness Innovations; and the World Health Organization. Leveraging their own drug-manufacturing strengths may be key for developing countries' efforts in securing advance market commitments. A world divided along the lines of those who have vaccines and those who have not would only reinforce the pains inflicted by inequality within and between countries.

While the vaccine outlook for most of the developing countries remains bleak, the end of the pandemic by the third or fourth quarter of 2021 looks increasingly likely for many developed countries. Pairing vaccines with more effective health measures, treatments and diagnostics, together with the benefits of seasonality, could lead to an even earlier transition towards normalcy, in the second quarter (Charumilind, 2020).

There are, however, still many unknowns and uncertainties. The degree of efficacy of the vaccines for children under 18 years of age is still largely undetermined. If only adults receive the vaccine, the coverage ratio for reaching herd immunity would be very high, particularly in regions with younger demographics. It is also unclear how long the vaccines' protection will last and how effective they would be against mutations of the coronavirus. New evidence is emerging that the virus may mutate and become more lethal or transmit faster, which will make it an increasingly treacherous adversary and vaccine development an increasingly wild goose chase.

These risks and uncertainties underscore the necessity of fair and equal access and greater global coordination to ensure that the people most at risk—regardless of where they live—are the first to receive the vaccine. People living in developed countries will not be safe if the pandemic continues to infect the vast populations of developing countries. More effective multilateral cooperation and coordination will remain key to ensuring that the vaccine reaches—and protects—those most vulnerable worldwide.

a The United States purchased 200 million doses from Pfizer-BioNTech and Moderna with an option to purchase up to 900 million more. The EU has purchased 360 million doses from Pfizer-BioNTech and Moderna with an option to purchase up to 100 million more. Japan, Canada and the United Kingdom have similar, albeit smaller-scale agreements in place.

progress in the implementation of the 2030 Agenda for Sustainable Development. Policies have not changed fundamentally to drive structural transformations needed for sustainable development—to eradicate poverty and hunger; to rein in rising inequalities, including the flagrant injustice of gender inequality; to accelerate energy transformation and take decisive and effective action against climate change; to halt biodiversity losses and environmental degradation; and to reinvigorate and revitalize the spirit of multilateralism.

This crisis is indeed universal, affecting all, but its impact is not even. Economic activities in some sectors came to a virtual standstill (e.g., tourism and travel, hospitality), with a massive loss of income and employment. Employees in some (mostly higher-skilled) sectors have been able to work remotely from the relative safety of their homes, while others in occupations requiring personal contact with customers have either lost their jobs or have been compelled to expose themselves to potential infection to earn any income. Women have been disproportionately affected by these predicaments, and many have left workforce to care for children amid school closures. While some schoolchildren have been able to continue their schooling online, for others that possibility is out of reach. The COVID-19 pandemic has exposed and widened existing inequalities in access and opportunities across the board, highlighting in particular, the depth of the digital divide between groups in all societies and between countries.

It will be too costly for the world to view the health crisis as an isolated, once-in-a-century event and ignore its long-term impacts on jobs, income and sustainable development, as outlined earlier in the chapter. The world witnessed three major economic crises during the past decade: the global financial crisis in 2008–2009, the European debt crisis in 2011–2012 and the commodity price collapse in 2014–2016. The global financial crisis greatly undermined progress on the Millennium Development Goals and reversed years of development gains. Absent bold and radical policy changes at national, regional and global levels to resuscitate and intensify the implementation of the 2030 Agenda as the foundation of the recovery, the current crisis will have far more devastating long-term impacts and will derail the realization of the Sustainable Development Goals.

There is no sustainable development without resilience

The world made little progress towards sustainable development before it faced the catastrophic pandemic. Meaningful progress in sustainable development—especially progress in health and educational opportunities—would have offered greater resilience against the pandemic. The current crisis demonstrates that there is no sustainable development without resilience and there is no resilience without sustainable development. The world was clearly not prepared to face the calamity. The 2030 Agenda for Sustainable Development provides a universal, cohesive and integrated framework for a sustainable, just and equitable recovery.

The path out of the current crisis presents a unique opportunity to build back better and put in place new foundations for resilience against future shocks, taking into account health, environmental and climate risks, all of which will likely become more frequent and more intense in the future. The efforts to build resilience must entail a holistic approach, with inclusive and sustainable development as its overriding objective.

The economic recovery from the crisis must go well beyond restoring GDP growth. High GDP growth is a means to an end, not an end goal. Economic growth must deliver not only decent green jobs, improved living standards and prosperity and greater equality, including gender equality, but also greater resilience against future shocks. It must do so while improving the environmental and social sustainability of our economic activities. To achieve the objectives of inclusive and sustainable growth and resilience, recovery efforts

must strengthen fiscal and debt sustainability frameworks to ensure that Governments worldwide can deliver the public goods of health, education, a clean environment and social protection for all. The failure to deliver these essential elements of the sustainable development agenda can no longer be an option.

A fair and inclusive recovery must not undermine inter-generational equity. Protecting the well-being of the current generation should not unfairly burden future generations with unsustainable levels of debt, debt overhang and recurrent fiscal crises. Recovery efforts—and the trillions of dollars in stimulus money—must prioritize fights against inequality and climate change to make societies more cohesive, united and resilient.

Understanding resilience

Vulnerability and resilience are flip sides of the same coin. Several indicators highlight levels of vulnerability on a global scale. As much as 55 per cent of the world's population—more than 4 billion people—lack any form of social protection benefits, which makes them extremely vulnerable to an economic or a health shock. In addition, many people worldwide—even those who are not income-poor—are highly vulnerable to economic shocks. On average, about 40 per cent of the total population of an OECD member country do not have enough financial wealth to live at the income poverty line for three months—a much more widespread phenomenon than income poverty (Hacker, 2018). Social protection schemes can act as automatic stabilizers, smooth household consumption and minimize the impact of a shock, while reducing income and consumption inequality.

Building resilience requires an integrated ex ante and ex post risk management system

People deal with shocks and uncertainties through social insurance, market insurance, self-insurance (such as precautionary saving) and self-protection (such as investment in human capital and migration). Building systemic resilience requires an integrated risk management system, which covers ex ante risk adaptation, risk shifting and spreading, and ex post risk coping mechanisms.

While insurances spreading risk across a pool of people may be sufficient for idiosyncratic risk...

Social and market insurances that spread risk across a pool of people are often sufficient for dealing with idiosyncratic risks faced by individuals such as an illness or an accident, but they are less effective in dealing with the kind of adverse systemic events that impact a large number of people simultaneously, such as a major financial crisis or a pandemic. In such situations, ex ante forms of adaptation, such as saving schemes that encourage the accumulation of assets to help households sustain themselves during difficult times, and ex post risk coping mechanisms, such as emergency loan programmes, can be helpful. Resilience to economic shocks at the macro level, however, critically depends on the effectiveness and efficacy of fiscal policy and good governance—and the availability of necessary fiscal space—for supporting both ex ante and ex post risk adaptation and mitigation measures.

Rethinking fiscal and debt sustainability

...resilience to aggregate shocks will require robust fiscal and debt sustainability frameworks

Governments worldwide face daunting challenges in managing their finances during this crisis. Globally, public debt increased by over 15 per cent in 2020, as governments struggled to respond effectively to the twin health and economic crises amid collapsing public revenues, and many developing countries are facing debt distress—if not an outright debt crisis—amid stagnant exports and slow recovery. There will be economic and political pressures—in de-

veloped and developing countries alike—to quickly balance budgets, reduce public debt and restore fiscal discipline during the post-pandemic period. However, the experience during the last global financial crisis demonstrates clearly that cutting back spending indiscriminately and shifting to austerity prematurely will slow the recovery and make resilience elusive. More importantly, any significant cuts in social spending, which are often the target of austerity measures, will exacerbate inequalities, undermine resilience and further weaken solidarity and social cohesion.

The challenge of resisting the pressure for a rapid return to a less accommodative fiscal stance is further complicated by the uncertain trajectory of the pandemic. Even with the successful roll-out of vaccines and the increasing possibility of putting the virus on the retreat by the first half of 2021, economic and policy uncertainties—which have risen significantly in recent months[6]—will remain high amid increased political polarization and rising discontent within and across countries, and will further constrain countries' recovery efforts.

Governments will need to rethink fiscal frameworks, prioritizing fights against poverty, inequality and climate change

To respond to this challenge, governments in both developed and developing countries will need to rethink and redesign fiscal frameworks, making the fight against poverty, inequality and climate change the overarching priorities for accelerating recovery and building resilience. Not only the size of the stimulus but also the quality and effectiveness of stimulus and other spending will determine the recovery of growth and the sustainability of public finance. Most Governments will be unable to raise domestic revenues sufficiently in the near term to meet their current obligations. Given the high levels of public debt many Governments, particularly those in developing countries, will face the prospects of debt overhangs, which will constrain their ability to accelerate their sustainable development efforts. International support will remain critical to enable these countries to restructure and reduce their public debt so that they have necessary fiscal space to finance sustainable development.

Universal social protection schemes are the foundation of societal resilience

The pandemic has laid bare the weaknesses in existing fiscal frameworks: the procyclical nature of the present patterns of borrowing and spending, and the lack of fiscal buffers for responding to an extraordinary crisis. Countries with larger fiscal space have been able to respond to the crisis with large fiscal stimulus packages and are therefore weathering the current shocks better. Building and maintaining fiscal space during good economic times will remain key to building economic resilience. Amid persistent uncertainties and growing risks of crisis, an optimal fiscal policy framework would need built-in flexibility in its crisis response mechanisms. Expanded and universal social protection schemes—which can act as automatic stabilizers and offer built-in and flexible crisis response mechanisms—must serve as the foundation for fighting inequality and building economic resilience.

Social protection programmes such as unemployment insurance—which can kick in at a given threshold, independent of political considerations—could help minimize the impact of an economic crisis. But for a large-scale, long-lasting crisis like the current one, standard automatic stabilizers—based on a strict rules-based fiscal framework—will remain insufficient. Brazil and the EU, for example, suspended their fiscal rules to roll out large stimulus measures, while Mexico was unable to increase spending because of a constitutionally mandated policy on new debt issuance (IMF, 2020b). New fiscal frameworks would need to incorporate objective criteria for defining a crisis—such as the level of GDP contraction or

6 As illustrated by the Economic Policy Uncertainty Index (available at https://www.policyuncertainty.com/index.htm).

the level of increase in aggregate unemployment rates—which would trigger an escape from the rules-based fiscal framework and allow Governments to quickly increase discretionary spending, while avoiding costly political debates and delays.

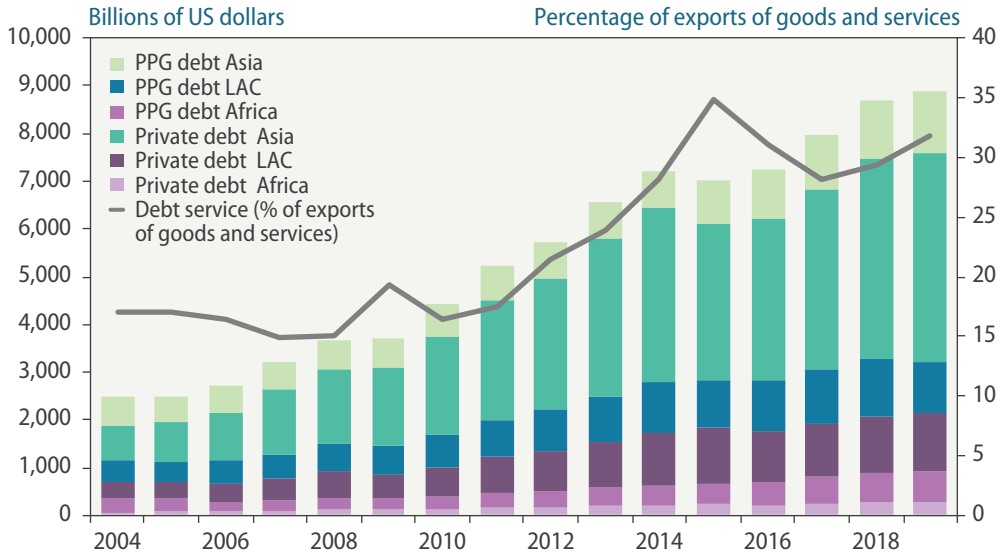
New fiscal frameworks will need strategies for dealing with increased liquidity...

New fiscal and monetary frameworks will also need to incorporate strategies for dealing with, and mitigating, the unintended consequences of increased liquidity stemming from large stimulus packages worldwide. As discussed earlier, macro- and micro-prudential policies must be part of the toolbox for preventing financial market volatility and the formation of big speculative asset price bubbles, as witnessed after the global financial crisis. The financial bubbles, and their subsequent burst, have significant macroeconomic consequences. The current stimulus spending, especially in the form of loans, guarantees and liquidity support given to businesses, must be well targeted for specific sectors and must meet specific investment objectives to ensure that the additional liquidity does not fuel an ever larger speculative bubble, as has been observed since March 2020.

There is no fiscal sustainability without debt sustainability. Since the global financial crisis, most developing countries have seen a sharp increase in their external debt (box I.4). The global debt-to-GDP ratio reached a record 331 per cent in Q1 2020, with private debt accounting for more than two thirds of all debt worldwide (Institute of International Finance, 2020). Public external debt of developing and emerging countries rose from $1.5 trillion in 2009 to $3.0 trillion in 2019, with the African countries registering the sharpest increase (figure I.11). The external debt of the private sector increased from $2.2 trillion to $5.8 trillion during the same period. Average debt servicing costs on external debt—as a percentage of exports of goods and services—rose from about 16 per cent in 2010 to over 30 per cent in 2019. The massive amounts of the fiscal stimulus and quantitative easing in the aftermath of the global financial crisis drove interest rates down even further, which allowed both the private and public sectors in developing countries to borrow extensively. An increasing share of their external debt came from foreign private creditors.

Figure I.11

External debt stock and debt servicing burden in developing countries



Source: International Monetary Fund, Inter-Agency Task Force on Finance Statistics (IATF) database (2020).

Note: PPG, public and publicly guaranteed.

Box I.4

External debt of the developing countries: the need for comprehensive restructuring

The COVID-19 shock has exacerbated debt trends around the world. Global debt across all sectors reached $255 trillion in April 2020, 40 percentage points higher than at the start of the 2008 financial crisis (Institute of International Finance, 2020). While debt growth was fuelled mainly by private sector debt in developed economies, developing countries experienced an increase in both public and private borrowing (United Nations, Inter-agency Task Force on Financing for Development, 2020). Lending from private creditors was the fastest-growing component of the external debt of developing countries, up fivefold since 2010 (World Bank, 2020). Before the onset of the pandemic, 36 of 70 least developed and other low-income countries and some middle-income countries were already at high risk of—or already in—debt distress.

The pandemic has exerted further pressure on countries' public finances owing to both additional financing needs and dwindling revenues. As of September 2020, many countries had announced unprecedented discretionary fiscal support measures. Debt-financed discretionary fiscal policy measures have helped advanced economies address the health crisis and contain the economic consequences of the pandemic. But unlike advanced economies, many developing countries face tight financing constraints which will likely inhibit necessary fiscal responses. While there has been a global easing in financial conditions since the spread of the coronavirus, more than half of emerging market economies still experienced outflows in the first half of 2020 and saw an increase in the cost of their borrowing.

To help the most vulnerable countries, international financial institutions have responded with emergency measures. As of October 2020, the International Monetary Fund (IMF) had disbursed roughly US$ 30 billion in non-concessional funds for pandemic-related financing through its Rapid Financing Instrument, doubled access to its Rapid Financing Instrument and granted debt service relief of US$ 260 million through its Catastrophe Containment and Relief Trust. The World Bank Group has announced its intention to have provided up to US$ 160 billion, including US$ 50 billion of International Development Association (IDA) resources on grant and highly concessional terms, by the end of 2021. However, while these emergency measures are vital, they do not address the scale of the problem.

G20 responded to the crisis with the Debt Service Suspension Initiative (DSSI), which allows 73 low-income developing countries to temporarily suspend payments of debt service to their bilateral official creditors. As of August 2020, 43 countries had received a temporary debt service suspension of US$ 5 billion, out of more than US$ 11.5 billion initially projected. The initiative, which was extended in October 2020 by another six months,[a] encourages multilateral development banks (MDBs) and private creditors to participate on comparable terms. Multilateral development banks have declined to participate in the DSSI, out of fear that a debt service suspension would impact MDB credit ratings, and instead have agreed to net positive flows to IDA countries. No private creditors have joined the Debt Service Suspension Initiative and borrowing countries have been reluctant to approach their private sector creditors for fear of credit-rating downgrades, along with consequences for longer-term market access.

While the DSSI provides much needed liquidity support, it fails to address solvency concerns in many developing countries. Many of those countries will be confronted with a decision on whether to default on debt service obligations to address the economic fallout from the COVID-19 pandemic. In October 2020, the members of G20 and the Paris Club acknowledged the significant debt vulnerabilities of many low-income countries and agreed in principle on a Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative to deal with solvency issues on a case-by-case basis.

Debt relief discussed within the context of the Common Framework should be part of a broader strategy which takes Sustainable Development Goal (SDG)-related investment needs into consideration. Depending on countries' specific circumstances, official creditors and/or donors could either write down bilateral debt or fund debt buybacks of commercial debt, with recipient Governments com-

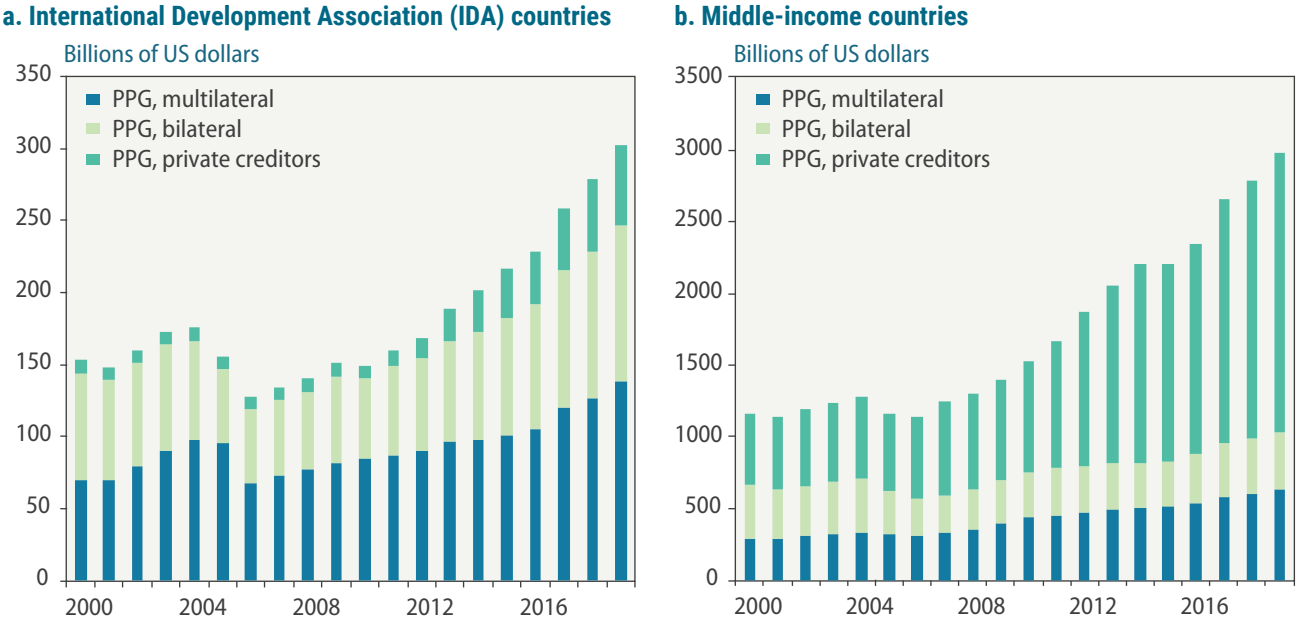
(*continued*)

a The Debt Service Suspension Initiative will be extended to 30 June 2021, subject to renewal for another six months if the economic and financial situation so requires.

mitting to use freed resources for crisis- and SDG- related investments. Debt swaps (including the development of standardized term sheets) and regional resilience funds could channel debt service payments into crisis response expenditures or SDG- and climate-related investments. Moreover, there is a pressing need to address the gaps in the current international sovereign debt architecture. This could include improving market-based approaches to debt restructuring, for example, by developing and encouraging the adoption of model majority restructuring clauses on payment terms for loans and other forms of sovereign debt. Targeted domestic and international law options could help undermine the litigation tactics employed by uncooperative and hold-out creditors and prevent them from blocking agreements on the restructuring of already existing debt stocks. The scale of the current challenges clearly underlines the need for a systematic and timely approach to sovereign debt crisis resolutions.

Box I.4 (*continued*)

Figure I.12
Public and publicly guaranteed external debt, by creditor



Source: World Bank, International Debt Statistics, October 2020.
Note: PPG, public and publicly guaranteed.

...but there is no fiscal sustainability without debt sustainability

The longer-term macroeconomic impacts of rising external debt can be positive if it boosts investment and outputs. But, during the past 10 years, most developing countries increased external borrowing to meet their current account obligations: to pay for rising imports, pay interest on existing foreign debt and repatriate income, dividends and profits of foreign investors, while the average growth rate of fixed investment—a key driver of long-term output growth—fell from 8 per cent in 2009 to 2.5 per cent in 2019. The more debt they accumulated, the more debt they needed to borrow to service their debt. Furthermore, many developing countries may find it increasingly difficult to meet the rising external debt service costs within the context of the worsening of their terms of trade during the past decade.

An ever-larger share of public and publicly guaranteed (PPG) debt in developing countries is owed as sovereign bonds to private creditors (figure I.12), which also poses signif-

icant macroeconomic externalities. As yields on developing country sovereign bonds fell at the onset of the pandemic, many developing countries saw downgrades of their credit ratings and faced massive capital outflows and exchange rate depreciations which made servicing of existing debt more difficult, in addition to making it harder to roll over and issue new debt.

Excessive external borrowing has also weakened the exchange rate adjustment mechanisms for many developing countries. When a country runs a trade deficit, its real exchange rate depreciates. Exchange rate depreciation increases demand for its exports, which restores the balance-of-payments equilibrium. But the demand for foreign exchange remains high with high debt servicing burdens, which prevents the exchange rate depreciation that can stimulate exports.

The United Nations and the G20 have called for debt relief for the world's poorest countries. The G20 Debt Service Suspension Initiative, which took effect on 1 May 2020 and was extended through June 2021, has so far delivered approximately $5 billion in debt service deferrals for about 40 countries.[7] Meanwhile, as of 15 December, the IMF had provided debt relief via the Catastrophe Containment and Relief Trust to 29 countries, totaling $488.7 million.[8] Through its various lending facilities, the IMF has provided total financial assistance of $102 billion to 83 countries.

These are timely initiatives, but they are only a drop in the ocean. They exclude the majority of the indebted middle-income countries, and they do not provide relief on debt to multilateral development banks, often major creditors of developing countries.

There is a pressing need for a comprehensive restructuring of external debt, with significant and meaningful reduction of the current debt stock, to ease the debt burden of the developing countries and to help build their resilience to external shocks. Unless the current debt level is reduced significantly, the accumulation of new and additional debt will only make their debt even more unsustainable and further constrain their limited fiscal space. It is critical that the international community comes together urgently to address and mitigate the risks of a looming debt crisis. A debt crisis on the heels of a devastating economic crisis will derail recovery efforts by years. Comprehensive debt standstills, debt swaps, replacing current bonds with green bonds to support climate action while reducing debt burden, and debt buybacks are on the table and merit serious consideration as initiatives for easing the debt burden of developing countries (Stiglitz and Rashid, 2020) and improving their debt sustainability. Without such an improvement, there is little prospect of accelerating recovery with resilience, and the continued weakness of these indebted countries will be a drag on the overall global recovery.

These options must be built into globally agreed permanent mechanisms for debt restructuring and reduction as a matter of the utmost urgency, in order to eliminate the uncertainties of the ad hoc arrangements in force today. Such mechanisms must also include private creditors.

Such mechanisms must be based on a redefined concept of debt sustainability, taking into account both public and private debts owed to official and private creditors. New debt

7 See IMF, "Questions and answers on sovereign debt issues", available at www.imf.org/en/About/FAQ/sovereign-debt.

8 See IMF, "COVID-19 financial assistance and debt service relief", available at https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#CCRT.

contracts will need to ensure greater responsibilities for creditors and their participation in debt restructuring mechanisms, while safeguarding the interests of the sovereign debtors. These new debt sustainability frameworks should reflect the principles for a rules-based, fair and equitable sovereign debt workout mechanism—as envisaged under General Assembly resolution 69/319 of 10 September 2015 containing the Basic Principles on Sovereign Debt Restructuring Processes.

Ensuring universal social protection

Universal protection against economic, health and environmental shocks is a moral imperative...

The increasing vulnerability of hundreds of millions of people to economic, health and environmental shocks underscores the need for universal social protection. Stagnant wages and income—constraining levels of consumption and access to basic services—have made vulnerability an existential reality for millions in both developed and developing countries. Ubiquitous income and wealth inequality, with people at the top of the distribution enjoying unprecedented prosperity—while the bottom 40 per cent of the world's population lack access to basic food, shelter and health care—makes universal social protection not only a moral issue, but also an economic imperative.

...which can boost aggregate demand during both crisis and normal times

Universal social protection will help preserve aggregate demand in the global economy not only during a crisis but also during normal times. As was seen during the global financial crisis, social protection enhances resilience and can act as an automatic economic stabilizer in cases of shock.9 Yet social protection is far from universal. In Africa, for example, 80 per cent of the population has no social protection coverage (ILO, 2017).

Box I.5

Universal basic income: Pros and cons

For all its apparent advantages, the concept of universal basic income (UBI) does not enjoy universal support. There are concerns that unconditional cash transfers to all adults could generate worse outcomes than today's targeted and means-tested social protection programmes. Some are concerned that individuals could use the income for consumption of items such as alcohol or tobacco, which could increase the health and social costs of such a programme. Others are worried that a UBI could disincentivize work, especially work that is deemed unattractive or dangerous. But studies find no evidence that a UBI encourages suboptimal consumption or discourages work. Evidence from a Stanford Basic Income Lab meta-analysis of 16 review reports on UBI-type programmes worldwide indicates that diverse interventions in low-, middle- and high-income countries had a minimal impact on aggregate measures of labour-market participation (Hasdell, 2020, p. 16 and table 1). When reductions in work occur, time is channeled into other valued activities such as caregiving.

Some also argue that UBI may have unfavourable distributional implications. Means-tested schemes favour families with children, the elderly and the disabled. If a budget neutral UBI replaces current targeted social protection schemes, it could direct a larger share of income to less vulnerable groups and potentially reduce disposable incomes for the bottom of the income distribution. However, if UBI is substantially supplemented by existing and more targeted social protection schemes, its implementation will cause a large downward redistribution of income towards those most vulnerable (Hoynes and Rothstein, 2020).

9 See https://www.social-protection.org/gimi/ShowMainPage.action.

Countries have been encouraged by the pandemic to roll out some type of universal basic income (UBI) plan

Given the difficulties in designing and implementing effective social protection schemes, there is growing interest in providing universal basic income (UBI) to all adults, without exclusion or any type of means- testing (Hasdell, 2020) (see box I.5). The pandemic has encouraged a number of countries to roll out some form of UBI, without necessarily defining these interventions as such. These countries include the United States, with its $1,200 monthly payout (Ståhl and MacEachen, 2020); Canada, with its Emergency Response Benefit of $500 per week (ibid.); and Spain, with its UBI experiment providing 850,000 low-income households with unconditional monthly payments of up to €1,015 (Arnold, 2020).

But financing constraints will limit the feasibility of an effective and sizeable UBI during normal times. In the United States, for example, a UBI of $12,000 per year for an estimated 236 million adult citizens would cost $2.8 trillion (Clifford, 2020). Even though a distributionally favorable UBI could replace and rationalize current social protection expenditure in part, its implementation would likely still require an increase in taxation, or a cut in other areas of public spending, including spending cuts in public health, education or environment, which could face strong political opposition. Globally, the cost of a UBI could be as high as 15 per cent of GDP. Many developing countries simply do not have the means to fund a UBI, especially when their total tax-to-GDP ratio is often less than 10 per cent. The smaller the fiscal space of a country and the weaker its governance, the more difficult the challenges it will face in funding an UBI.

While a comprehensive implementation of UBI might currently be out of reach for many developing countries, policymakers should proceed immediately to implement a universal social protection floor,[10] supplemented where possible by means-tested and well-targeted social protection programmes to build resilience for the most vulnerable segment of their population. However, the ultimate objective should remain the introduction of a robust universal social protection system, though this will require considerably more financing.

While the limits of fiscal space are a constraint, there are opportunities to raise revenues that could be used for social protection, including: reallocating public expenditures that are inconsistent with the 2030 Agenda; increasing certain types of taxes; drawing on official development assistance, where available; utilizing the fiscal space created by eventual debt restructuring and debt relief; and global action to reduce and eventually eliminate illicit financial flows. Some of these measures can have important co-benefits in terms of sustainable development. For example, an environmental tax on carbon and the elimination of perverse subsidies on fossil fuels can potentially fund social protection schemes, be it a UBI or other forms of social protection, while also disincentivizing carbon-intensive consumption and associated externalities.

Building climate resilience

Building resilience against climate shocks must include considering differences in vulnerability and exposure

Efforts aimed at enhancing resilience must encompass climate-related shocks, which will likely become increasingly frequent and intense and affect millions of vulnerable people in both developed and developing countries. The impacts of shocks, on one hand, and structural inequalities, on another, are mutually reinforcing. Vulnerability and exposure to shocks are closely linked to existing underlying inequalities: differences in access to physical and financial assets; unequal opportunities to access quality health services, education and employ-

10 The ILO estimates that introducing a comprehensive social protection floor would cost on average just over 4 per cent of GDP, based on a sample of 57 low-income and lower middle-income countries. See Ortiz and others (2020).

ment; and inequality with respect to voice and political representation. When hit by shocks, people afflicted with poverty and social exclusion suffer relatively greater losses in terms of lives and livelihoods than those in more secure circumstances. Such disproportionate impacts further aggravate existing inequalities and may actually undermine the capacities of people to cope and adapt. Exposure to growing climate risks will likely exacerbate existing inequalities within and across countries.

Building resilience against climate shocks must take into account different levels of vulnerability and exposure. The level of exposure to climate risk and the financing and institutional capacities of a country to cope with and mitigate those risks must match. But most developing countries lack the necessary fiscal capacities for dealing with climate risks. A continuum of well-integrated economic, social and environmental policies for building climate resilience would help to build public support for effective and harmonized adaptation and mitigation efforts. No-regret and low-regret policies constitute a good starting point, as they can address immediate vulnerabilities and structural inequalities, without compromising the foundations of future resilience.

The desirable strategy for increasing resilience to climate shocks encompasses both preventive and remedial elements. The preventive measures should include increasing investments in sustainable and climate-resilient physical infrastructure and boosting fiscal reserves. Risk pooling, which includes private and public insurance mechanisms, can be another major strand of such measures. But it will also require greater international and multilateral coordination (Catalano, Forni and Pezzolla, 2020). Building resilience against climate shocks must also balance inter-temporal equities. The protection of, and benefits for, the current generation must not inflict harm on future generations. In terms of resource allocation across time, preventive actions against climate change taken early are preferable to remedial measures taken later. Waiting comes at an increasing cost, and spending earlier, before damages to capital stock have occurred, increases resilience.

Box I.6

Regional economic responses to the crisis

There has been concerted and coordinated economic responses at the regional level. The Asian Infrastructure Investment Bank (AIIB), for example, launched the COVID-19 Crisis Recovery Facility, a $13 billion fund which will extend emergency loans to support public and private entities that have been impacted by the pandemic.[a] Financial resources will be channelled towards supporting public health-care needs, and closing budgetary and liquidity gaps, as well as supporting investments in infrastructure, economic and social protection. Similarly, the Asian Development Bank (ADB) created a $20 billion COVID-19 response package, consisting of grants, concessional loans and guarantees. The African Development Bank (AFDB) established a $10 billion COVID-19 Rapid Response Facility (African Development Bank Group, 2020). Its funds are providing flexible and rapid support to African countries to finance public health interventions, social protection programmes and the injection of liquidity to stabilize and support their economies. The Inter-American Development Bank (IDB) approved a record $21.6 billion in new financing in 2020 to assist its 26 member countries in addressing the ongoing health emergency and the socioeconomic fallout from the crisis (Inter-American Development Bank, 2020). Among other measures, the IDB has mobilized $1 billion to help members acquire and distribute COVID-19 vaccines. Similarly, the European Bank for Reconstruction and Development (EBRD) has launched a €21 billion solidarity package to support the recovery efforts of its member States.

a See COVID-19 Crisis Recovery Facility Toolkit, available at www.aiib.org/en/policies-strategies/COVID-19-Crisis-Recovery-Facility/_download/CRF-Toolkit-Final-1.pdf.

Revitalizing multilateralism: United We Stand, Divided We Fall

The crisis is a missed opportunity for bold multilateral action

The pandemic unleashed itself on the world at a low point in multilateral cooperation. Lack of effective cooperation, pervasive mistrust and blame games constrained the multilateral response to the pandemic. In the initial response to the crisis, many countries increased trade protection, and restricted exports of PPE and other medical supplies, which weakened collective responses to the crisis. Despite the efforts of the G20, IMF and a few multilateral institutions (see box I.6), the overall global economic responses to the crisis remained inadequate. Most developing countries—many with severe financing constraints and huge debt—have been left on their own to face the worst crisis in a century.

Regional initiatives cannot be a substitute for an open, inclusive and rules-based multilateral system...

While these bold regional initiatives of the development finance institutions have helped countries fight the pandemic and finance recovery efforts, they cannot be a substitute for an open, inclusive and rules-based multilateral system. In the absence of a comprehensive debt restructuring and debt relief initiative, the financing support from the regional development banks will also increase the overall debt burden of many developing countries.

The crisis and the inadequate collective actions in response also present the multilateral system with a lesson learned. It is clear that the world stands strong only if it remains united. Divisions are costly, not only during the pandemic but more so during recovery. Stronger multilateral cooperation must underpin global recovery efforts. As discussed in chapter II, the multilateral trading system must receive a new impetus to revitalize global trade, support growth objectives and enhance resilience of the global economy. Effective climate action, halting biodiversity loss, combatting illicit financing flows, overcoming the digital technological divide and taming inequality are sustainable development imperatives that s cannot be achieved in the absence of multilateral cooperation and renewed solidarity among countries.

...but the multilateral system must reinvent and revitalize itself to confront the challenges of recovery and resilience

The pandemic has exposed the weaknesses and inadequacies of the current practice of multilateralism by consensus. It is often hard to reach consensus in multilateral processes when confronted with high degrees of uncertainty and divergent national interests and priorities. The global efforts towards steering a resilient recovery will need new and binding rules in the areas of climate mitigation and adaptation, debt restructuring and meaningful debt reduction, the exploitation and use of natural resources, illicit financial flows and sustainable finance, and universal social protection, among other pressing issues. Decisions by majority—while safeguarding minority positions and letting countries join the majority decisions when they are in a position to do so—may help reinvigorate the current multilateral system and make it fit for purpose in taking up the challenges of accelerating recovery with resilience. The multilateral system—in its many forms and manifestations—must reinvent, reboot and revitalize itself to accelerate recovery and strengthen resilience for people, the planet and prosperity.