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TRADE AND DEVELOPMENT REPORT 2021

FROM RECOVERY TO RESILIENCE:
THE DEVELOPMENT DIMENSION

40th
ANNIVERSARY EDITION



UNITED NATIONS

TRADE AND DEVELOPMENT REPORT 2021

FROM RECOVERY TO RESILIENCE:
THE DEVELOPMENT DIMENSION

Report by the secretariat of the
United Nations Conference on Trade and Development



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Contents

Chapter 1

GLOBAL TRENDS AND PROSPECTS: POSITIVE VIBRATIONS OR WAITING IN VAIN?	1
A. Introduction	1
B. The Global Economy: Building Back Separately?	2
1. Global growth prospects	2
2. Inflationary Pressures: Nothing to Fear but Fear Itself	6
3. Fiscal Policy and Public Debt	10
4. Timing counter-cyclical measures or targeting development?	14
C. Global Finance and Developing Country Vulnerabilities	17
1. Debt sustainability in developing countries: No sign of relief on the horizon	21
D. Trends in International Trade	24
1. Goods and services	24
2. Commodity markets	28
E. Regional Trends	31
1. North America and Europe	31
3. The Russian Federation and Central Asia	33
4. East Asia	34
5. South Asia	35
6. South-East Asia	35
7. Western Asia	36
9. Africa	37
Notes	38
References	40
Annex: Methodological Note for Box 1.1	44

Chapter 2

THE TROUBLED HISTORY OF BUILDING BACK BETTER: FROM THE 1980S DEBT CRISIS TO COVID-19	1
A. Introduction	1
B. The Trade and Development Report at 40	2
1. Swimming Against the Tide	2
2. A Lost Decade	3
3. Birth of the Hot	4
4. Winners and Losers	5
5. Growth Picks up; Imbalances Widen	7
6. A Feature not a Flaw	8
7. A New Normal versus a New Deal	9
8. Back to the Future	10
C. Living in the Past	11
1. The growth picture	12
2. The triggers of the slowdown	13
3. Unfavourable conditions for most developing regions	14
4. Overcoming the dilemmas of interdependence	17
D. From Economic Recovery to Building Back Better	18
1. Avoiding separate development	19
2. Taming the rentiers	22

3. Making green recovery packages work.....	24
E. Towards a new economic settlement	29
Notes.....	32
References.....	33
Annex	38

List of figures

Figure

1.2	The economic impact of GFC, 2009–2010, vs. Covid-19, 2020–2021	4
1.1	World output level, 2016–2022.....	4
1.3	Real income growth, selected countries, 2021 over 2019.....	5
1.4	Real GDP and personal consumption expenditures in the United States, 2019–2021.....	6
1.5	Employment-population ration in the United States, January 2005–July 2021.....	6
1.6	Consumer inflation, selected economies, December 2005–December 2020	7
1.7	Variation in exchange rate of selected currencies vis-à-vis the dollar of the United States, selected time periods, 1 Jan. 2020–30 Jul. 2021.....	8
1.8	Consumer inflation in the United States and the euro area	8
1.9	Price gap from a 2 per cent inflation trend, selected economies, December 2005–April 2021	9
1.10	Ten year break even inflation in the United States.....	9
1.11	Real wage in the United States, January 1979–March 2021.....	9
1.12	Additional primary outlays in 2020 relative to inherited debt ratios in developing and developed economies.....	13
1.13	Public and private investment in selected country groups, 1995–2016.....	14
1.14	Net private capital flows to developing countries, 2017–2021.....	17
1.15	Total external debt to export revenues, developing countries, 2009–2020.....	22
1.16	Sovereign bond repayment profiles, selected regions, 2021–2030.....	23
1.17	Gross government debt to government revenues, selected developing country regions and advanced economies, 2000–2026.....	24
1.18	World merchandise trade, January 2015–May 2021	25
1.19	Metric tons of world exports by vessel type, 1 January 2020–31 May 2021.....	26
1.20	Monthly commodity price indices by commodity group, January 2002–May 2021	29
2.1	The slowdown in global economic growth, 1971–2020	5
2.2	Main drivers of the scenario: global aggregates, 2001–2030	13
2.3	Current account, selected groups, 2001–2030	15
2.4	Private and public sectors net lending, 2001–2030.....	16
2.5	Projected growth performance according to macro-financial patterns, 2022–2030	17
2.6	Housing, shares and output in developed countries, first quarter 2000 to first quarter 2021.....	20
2.7	Labour share in the United States in the aftermath of recessions	20
2.A.1	Stock and housing appreciations in selected countries, first quarter 2000 to first quarter 2021	38

Box Figure

B1.1	Estimated size of Covid-19 fiscal stimuli, 2020.....	11
B1.2	Proposed 2021 SDR allocation to developing country groups	19
B1.3	Utilization of existing SDR allocations by country group, as of 31 May 2021	20

List of tables and boxes

Table

1.1	World output growth, 1991–2022	3
1.2	World primary commodity prices, 2008–2021	30
2.1	Average annual per capita growth, by region 1951–2020.....	6
2.2	Economic growth of world regions, 2001–2030.....	12
2.3	CO ₂ Emissions and Economic Growth for China, United States and the European Union, 1999–2018.....	25

Box

1.1	Fiscal stimuli in 2020: An ex-post assessment.....	11
1.2	The rocky road to public debt sustainability: A developmental perspective.....	15
1.3	Money for something: Moving on to an expanded role for Special Drawing Rights	19
1.4	Increased food insecurity amid rising food prices	38

GLOBAL TRENDS AND PROSPECTS: POSITIVE VIBRATIONS OR WAITING IN VAIN?

A. Introduction

At this writing, eighteen months have passed since the Covid-19 outbreak was declared a pandemic by WHO. It has tested the responsiveness of governments and the resilience of economic systems everywhere; it has changed social behaviour and personal habits in ways previously unthinkable. The dedication of essential workers has shone through dark times, while the scientific community has harnessed the power of collaborative research and public money to develop a vaccine at breakneck speed.

At the same time, the pandemic has exposed just how unprepared countries, including the wealthiest, are for unexpected shocks, a point underscored by a series of extreme weather events this year, and just how deeply divided the global economy has become. Four decades of eroding government services, heightened inequalities, unchecked financialization and impunity for financial and corporate elites have taken their toll.

On the economic front, the dramatic collapse of output, as countries locked down to contain the spread of the virus, was so dramatic as to trigger unprecedented responses. Massive Central Bank action in rich countries stabilized financial markets and unparalleled (at least in recent times) government spending cushioned firms and households against the worst of the downturn. A global recovery began in the second half of 2020, as countries adopted less draconian ways to manage the health risks, and is still unfolding, even as regional and country prospects vary widely amid disparities in fiscal space, new virus variants and uneven vaccination rates.

Global growth is expected to hit 5.3 per cent this year, the fastest in almost half a century, with some countries restoring (or even surpassing) their output level of 2019 by the end of 2021. The global picture beyond 2021, however, remains shrouded in uncertainty.

Next year will see a deceleration in global growth but for how long and by how much will depend on policy decisions, particularly in the leading economies. Even assuming no further shocks, a return to the pre-pandemic income trend could, under reasonable assumptions, still take until 2030 – a trend that, it should be remembered, itself reflected the weakest growth rate since the end of the Second World War. This is a worrying prospect for many countries. The damage from the Covid-19 crisis has exceeded that from the global financial crisis (GFC) in most parts of the global economy but has been particularly draining on the developing world. The recent decision by the IMF Executive Board to allow a \$650 billion issue of special drawing rights (SDRs), the largest in its history, offers a glimmer of hope but the international community has still to acknowledge the scale of the challenge facing many developing countries.

Any crisis does, however, bring with it an opportunity. The scope and scale of governmental support in 2020–21, particularly in advanced economies but also in some emerging markets, broke new ground, or, for those with a sense of history, rediscovered old territory. This response brushed aside entrenched policy dogmas and opened the political space to change the balance of power between the state and the market in managing the economy even as it has

served to highlight the constraints on fiscal and policy space that many countries continue to face in a world of footloose capital. In less than a year President Biden's wide ranging policy initiatives have begun to effect concrete change. Domestically, legislation to expand social protection, financed through more progressive taxation, breaks with a long-term trend that has transferred income to top and risk to the bottom of the income distribution. Internationally, the support from the United States for the new SDR allocation, global minimum corporate taxation, and a waiver of vaccine-related intellectual property rights in the World Trade Organization (WTO) anticipate a renewal of multilateralism that could begin to rein in hyperglobalization and resolve the deepening environmental crisis.

Whether or not the world builds back better from the pandemic will not, however, depend on the actions of a single country but on concerted efforts to rebalance the global economy. Hurdling the barriers to greater prosperity will depend on improved coordination of the policy choices made in leading economies over the coming years as they push to maintain the momentum of recovery and build resilience against future shocks (see Chapter II). The reluctance of other advanced economies to follow the lead of the United States on the vaccine waiver is a worrying sign and a costly one; on one recent estimate, the cumulative cost (in terms of lost income) of delayed vaccination will, by 2025, amount to \$2.3 trillion with the developing world shouldering the bulk of that cost (EIU, 2021).

But coordination among the leading economies will not be sufficient either. Renewed international support is needed for developing countries, many of which face, given their limited access to vaccines and the spread of new virus variants, a spiralling health crisis, even as they struggle with a growing burden of debt and face the prospects of a lost decade. That effort should also prompt us to rethink – or, perhaps, revive – the role that fiscal policy can play, beyond the countercyclical interventions of late. Delivering the necessary support will also require the kind of systemic reforms to the international economic architecture that were promised after the global GFC but were quickly abandoned in the face of resistance from the winners of hyperglobalization (*TDR 2017*). And amid all these efforts, policymakers will need to stay wary of inflation scaremongering that would derail progress before it has really taken off.

This chapter is organized into four sections. Section B outlines key developments in the global economy in 2020–21, focusing, in particular, on misguided fears of inflation and the role of fiscal policy and public debt beyond the pandemic. Section C analyses the situation of developing countries in the system of global finance, focusing on the issue of debt sustainability and counter-cyclical measures. Section D reviews the trends in global trade and commodities markets. Section E surveys regional macroeconomic trends in greater depth.

B. The Global Economy: Building Back Separately?

1. Global growth prospects

The global economy is set for a strong recovery in 2021, albeit with a good deal of uncertainty clouding the details at the regional and country levels over the second half of the year. As in the past, policy makers continue to pay undue attention to financial markets, whose horizon rarely stretches beyond quarterly macroeconomic and earnings data and whose sentiment appears jittery even in the face of small changes in leading indicators.

After a 3.5 per cent fall in 2020, UNCTAD expects world output to grow 5.3 per cent this year, partially recovering the ground lost in 2020. However, considering the average annual global growth rate of 3 per cent in 2017–2019, world income will still be 3.7 per cent below where its pre-pandemic trend would have put it by 2022 (Figure 1.1). Based on the nominal

gross domestic product (GDP) estimates for this year, the expected shortfall represents a cumulative income loss of about USD 10 trillion¹ in 2020–21. Looking ahead UNCTAD expects world output to grow 3.6 per cent in 2022 (Table 1.1).

Despite this two-year boost to the global economy, it will take several years for world income to recover the loss from the Covid-19 shock. Assuming, for example, an annual growth rate of 3.5 per cent from 2023 onwards (an optimistic assumption), global output will only revert to its 2016–2019 trend by 2030. Since the pre-Covid 19 trend was, as discussed in previous *Reports*, unsatisfactory – average annual global growth in the decade after the 2009–10 financial crisis was the slowest since the end of the Second World War – this is a prospect that should raise alarm in policy circles.

TABLE 1.1 World output growth, 1991–2022
(Annual percentage change)

Country groups	1991–2001–2009–																
	2000 ^a	2008 ^a	2018 ^a	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 ^b	2022 ^b
World	3.0	3.6	2.9	-1.3	4.5	3.3	2.8	2.7	3.1	3.1	2.7	3.4	3.2	2.5	-3.5	5.3	3.6
Africa	2.5	5.7	3.0	3.9	5.6	-1.0	8.0	0.7	3.3	2.6	1.7	3.4	3.3	2.9	-3.4	3.2	2.9
North Africa (incl. South Sudan)	3.1	5.4	1.0	3.7	4.7	-11.1	13.3	-6.8	-0.3	1.7	2.7	5.1	4.1	3.2	-5.2	4.2	3.1
South Africa	2.1	4.4	1.8	-1.5	3.0	3.3	2.2	2.5	1.8	1.2	0.4	1.4	0.8	0.2	-7.0	4.0	2.3
Sub-Saharan Africa (excl. South Africa and South Sudan)	2.1	6.5	4.8	5.7	7.1	5.7	6.1	5.5	5.9	3.4	1.5	3.0	3.5	3.4	-1.5	2.5	2.9
America	3.5	2.8	2.0	-2.5	3.3	2.3	2.3	2.1	2.2	2.3	1.1	2.2	2.6	1.7	-4.4	5.6	2.9
Latin America and the Caribbean	3.2	3.9	1.9	-2.1	6.2	4.6	2.7	2.9	1.1	0.3	-0.9	1.3	1.1	0.1	-7.1	5.5	2.6
Central America (excl. Mexico) and Caribbean	3.1	4.8	3.3	-0.7	3.5	3.9	3.6	3.3	3.3	4.2	2.9	3.0	3.1	2.1	-8.1	3.9	2.9
Mexico	3.2	2.2	2.6	-5.3	5.1	3.7	3.6	1.4	2.8	3.3	2.6	2.1	2.2	0.0	-8.3	6.2	2.8
South America of which:	3.2	4.3	1.5	-1.3	6.9	4.9	2.3	3.3	0.3	-1.1	-2.5	0.8	0.4	-0.2	-6.5	5.5	2.5
Argentina	4.0	5.0	1.2	-5.9	10.1	6.0	-1.0	2.4	-2.5	2.7	-2.1	2.7	-2.5	-2.1	-9.9	6.7	2.9
Brazil	2.8	3.7	1.1	-0.1	7.5	4.0	1.9	3.0	0.5	-3.5	-3.3	1.3	1.8	1.4	-4.1	4.9	1.8
North America of which:	3.6	2.5	2.0	-2.6	2.6	1.7	2.2	1.9	2.6	2.9	1.7	2.4	3.0	2.1	-3.7	5.7	3.0
Canada	3.0	2.5	1.9	-2.9	3.1	3.2	1.8	2.3	2.9	0.7	1.0	3.0	2.4	1.9	-5.4	5.1	2.9
United States	3.6	2.6	2.0	-2.5	2.6	1.6	2.3	1.8	2.5	3.1	1.7	2.3	3.0	2.2	-3.5	5.7	3.0
Asia (excl. Cyprus)	4.3	5.9	5.2	2.4	7.8	6.0	5.0	5.4	4.9	4.9	4.9	5.1	4.6	3.8	-1.1	5.9	4.7
Central Asia	-3.3	8.5	5.5	3.3	7.6	8.1	6.0	6.9	5.6	3.5	3.2	4.5	4.7	4.7	-0.3	4.3	3.1
East Asia of which:	4.4	5.8	5.3	2.8	8.0	5.9	5.2	5.5	5.0	4.8	4.7	5.2	4.8	4.3	0.3	6.7	4.7
China	10.6	10.9	7.9	9.4	10.4	9.6	7.9	7.8	7.4	6.9	6.7	6.9	6.7	6.1	2.3	8.3	5.7
Japan	1.2	1.2	1.0	-5.7	4.1	0.0	1.4	2.0	0.3	1.6	0.8	1.7	0.6	0.3	-4.7	2.4	2.1
Republic of Korea	6.8	4.9	3.2	0.8	6.8	3.7	2.4	3.2	3.2	2.8	3.0	3.2	2.9	2.0	-0.9	3.9	2.8
South Asia of which:	4.8	6.7	5.9	4.0	8.7	5.6	3.4	5.0	6.1	6.4	8.0	6.6	4.9	3.1	-5.6	5.8	5.7
India	5.9	7.6	7.0	5.0	11.0	6.2	4.8	6.1	7.0	7.9	8.2	7.2	6.6	4.6	-7.0	7.2	6.7
South-East Asia of which:	4.9	5.7	5.1	2.0	7.8	4.9	6.0	5.0	4.5	4.7	4.8	5.3	5.1	4.4	-3.9	3.5	4.7
Indonesia	4.2	5.2	5.4	4.6	6.2	6.2	6.0	5.6	5.0	4.9	5.0	5.1	5.2	5.0	-2.1	3.6	4.9
Western Asia (excl. Cyprus) of which:	4.1	5.5	4.1	-1.3	5.7	8.0	4.6	4.9	3.3	3.8	3.2	2.3	2.1	1.3	-2.9	3.5	3.2
Saudi Arabia	1.7	4.5	3.7	-2.1	5.0	10.0	5.4	2.7	3.7	4.1	1.7	-0.7	2.4	0.3	-4.1	2.7	3.3
Turkey	3.9	6.0	6.0	-4.8	8.4	11.2	4.8	8.5	4.9	6.1	3.3	7.5	3.0	0.9	1.8	3.9	3.6
Europe (incl. Cyprus) of which:	1.6	2.5	1.2	-4.5	2.4	2.0	0.1	0.5	1.7	1.9	1.8	2.5	2.0	1.5	-6.2	4.3	3.0
European Union (EU 27) of which:	2.1	2.1	1.1	-4.4	2.3	1.9	-0.7	0.0	1.6	2.3	2.0	2.8	2.1	1.6	-6.2	4.0	3.3
Euro area of which:	2.1	1.9	1.0	-4.5	2.2	1.7	-0.9	-0.2	1.4	2.1	1.9	2.6	1.9	1.3	-6.6	4.1	3.4
France	2.0	1.8	1.0	-2.9	2.0	2.2	0.3	0.6	1.0	1.1	1.1	2.3	1.8	1.5	-8.0	5.2	3.4
Germany	1.6	1.3	1.6	-5.7	4.2	3.9	0.4	0.4	2.2	1.5	2.2	2.6	1.3	0.6	-4.9	2.2	3.2
Italy	1.6	0.9	-0.3	-5.3	1.7	0.7	-3.0	-1.8	0.0	0.8	1.3	1.7	0.9	0.3	-8.9	5.5	3.0
Russian Federation	-4.7	6.8	1.3	-7.8	4.5	4.3	4.0	1.8	0.7	-2.0	0.2	1.8	2.5	1.3	-3.0	3.8	2.3
United Kingdom	2.9	2.5	1.7	-4.1	2.1	1.3	1.4	2.2	2.9	2.4	1.7	1.7	1.3	1.4	-9.9	6.7	2.1
Oceania of which:	3.7	3.4	2.7	1.9	2.4	2.7	3.7	2.1	2.8	2.6	2.9	2.7	2.8	1.9	-2.4	3.1	2.8
Australia	3.8	3.4	2.6	1.9	2.4	2.7	3.9	2.1	2.6	2.3	2.8	2.5	2.8	1.8	-2.5	3.2	2.8
Memo items:																	
Developed (M49, incl. Republic of Korea)	2.5	2.5	1.7	-3.5	2.8	1.7	1.3	1.4	2.0	2.3	1.7	2.4	2.4	1.7	-4.7	4.7	2.9
Developing (M49)	4.9	6.7	5.2	3.3	8.1	6.3	5.6	5.1	4.9	4.5	4.3	4.9	4.6	3.7	-1.8	6.2	4.7

Source: UNCTAD secretariat calculations, based on United Nations Global Policy Model; United Nations, Department of Economic and Social Affairs (UNDESA), National Accounts *Main Aggregates* database, and *World Economic Situation and Prospects* (WESP): *Update as of mid-2021*; ECLAC, 2021; Organisation for Economic Co-operation and Development (OECD), 2021; International Monetary Fund (IMF), *World Economic Outlook, April 2021*; Economist Intelligence Unit, *EIU CountryData* database; JP Morgan, *Global Data Watch*; and national sources.

Note: Calculations for country aggregates are based on GDP at constant 2015 dollars.

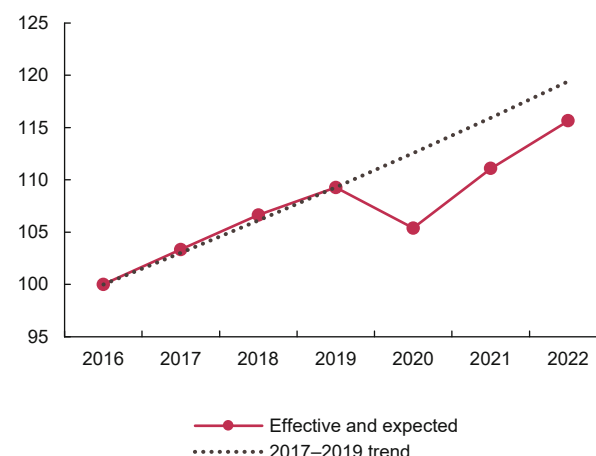
^a Average.
^b Forecasts.

Such an environment would not get the 2030 Agenda for Sustainable Development back on track and would hinder efforts to mobilize the additional resources needed to address the climate challenge. Moreover, if unanticipated shocks – whether of an epidemiological, financial or climatic nature – hit again, or policy efforts to sustain the current recovery begin to falter, the negative economic impact of Covid-19 would last longer. This is an outcome that cannot be dismissed lightly, given what happened in the aftermath of the GFC and the current, broken state of international policy coordination (see also Chapter II).

The recovery has to date been unbalanced reflecting fault lines that were present before the pandemic. There have been substantial differences in GDP growth between regions and countries, with many developing countries falling behind; a sectoral divide between the recovery in services and goods production but also within the service sector between booming financial and digital services and the depressed hospitality and entertainment sectors; and a sharp divergence in income (and wealth) gains amongst social groups. So far, the world economy appears to be building back separately.

In most regions, but particularly in the developing world, the damage from the Covid-19 crisis has been much greater than after the GFC, notably in Africa and South Asia (Figure 1.2). Geographically, as of mid-2021, post-lockdown growth accelerations were concentrated mostly in North America, with close

FIGURE 1.1 World output level, 2016–2022
(Index numbers, 2016 = 100)

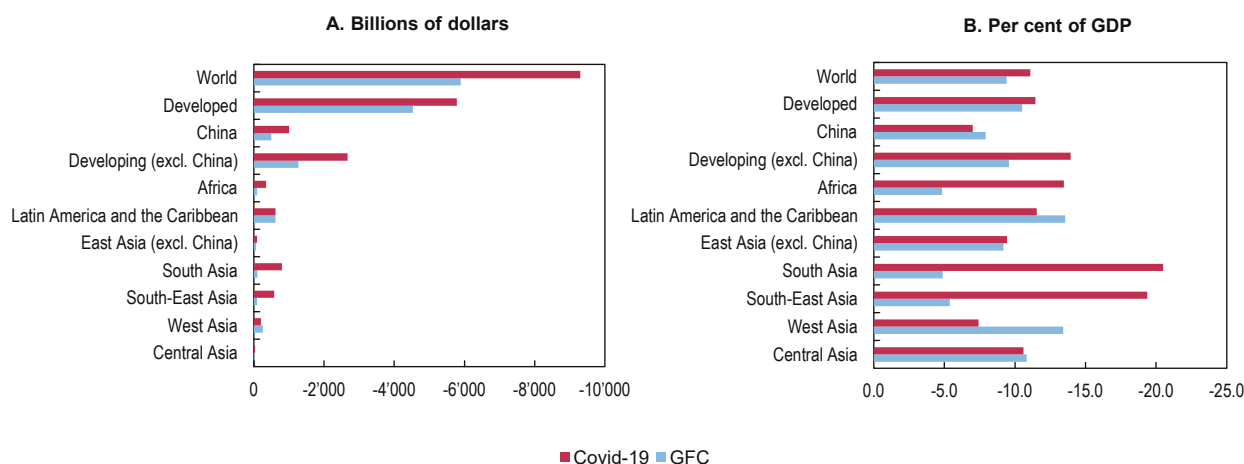


Source: See Table 1.1.

regional trade linkages reinforcing a strong fiscal stimulus and monetary accommodation in the United States, and in East Asia, where an infrastructure investment drive (through state-owned enterprises) in China has helped growth ripple across the region.

Regional trends in the world economy are surveyed in the final section of this chapter. Here, an initial evaluation of differences in the speed of recovery can be made by examining expected cumulative GDP growth between 2019 and 2021 in countries in the Group of Twenty (G20)² (Figure 1.3).

FIGURE 1.2 The economic impact of GFC, 2009–2010, vs. Covid-19, 2020–2021



Source: UNCTAD secretariat calculations, based on official data and estimates generated by United Nations Global Policy Model.

Note: Estimated loss from GFC corresponds to the accumulated income loss of 2009 and 2010, relative to 2006 to 2008 trend; and the estimated loss from Covid-19 corresponds to the accumulated income loss of 2020 and 2021, relative to 2017 to 2019 trend.

The standout performances, on this measure, have taken place in the two G20 countries that avoided a recession in 2020: China and Turkey. In the case of China, an early lockdown policy, combined with massive testing and related public health measures, followed by a rapid vaccine roll out from the middle of 2021, helped to contain the spread of the virus and allow for a relatively swift rebound of activity. On the demand side, the maintenance of domestic investment projects and the post-lockdown surge in the foreign demand for industrial goods have helped maintain the pace of recovery, although concerns remain about the financial position of some highly indebted state-owned enterprises and the danger of new virus variants.

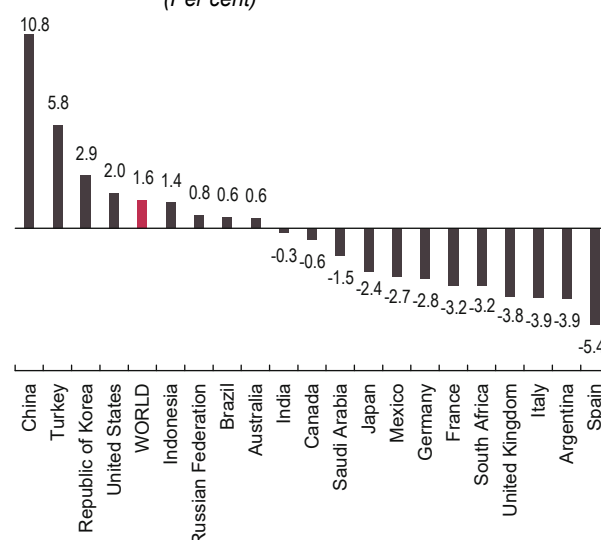
Turkey did see a sharp contraction in the second quarter of 2020, but this was followed by strong growth in the third quarter, largely thanks to accommodative monetary policy and the ensuing credit boom. Despite a resurgence in infections during the second quarter of 2021, growth has been driven by the country's industrial sector and budgetary support to businesses from the government. Rising prices and pressures on the lira are, however, clouding growth prospects for the second half of 2021, raising concerns about its sustainability.

China's growth and the resulting demand for manufactures is expected to help the Republic of Korea make a full recovery from the pandemic in 2021. The same holds for Australia, albeit less rapidly due to extended lockdowns in 2021, and propelled by commodity exports rather than manufactures. In contrast, despite the expansion in net export demand of goods, sluggish domestic demand is expected to keep GDP in Japan below its pre-Covid level.

India suffered a contraction of 7 per cent in 2020 and is expected to grow 7.2 per cent in 2021, while Indonesia had a milder contraction of 2.1 per cent in 2020 and is expected to grow 3.6 per cent in 2021, which is fairly weak given its growth rates in recent years. As the discussion of regional trends shows in section E, the recovery in India is constrained by the ongoing human and economic cost of Covid-19, and the negative impact of food price inflation on private consumption.

Rising commodity prices will help recovery in oil-exporting countries, albeit unevenly. The Russian Federation will almost triple its 2019 GDP growth of 1.3 per cent this year, but a similar bounce back will not hold for Saudi Arabia, due to the greater reliance of its economy on oil production and OPEC's output

FIGURE 1.3 Real income growth, selected countries, 2021 over 2019 (Per cent)



Source: See Table 1.1.

quotas (even if it raises them). The spike in commodity demand and relative prices will also be insufficient to raise South Africa's 2021 GDP above its 2019 level, due to a weak investment climate (which pre-dates the pandemic) and stringent fiscal constraints.

In the Americas, the fast recovery in the United States recovery is expected to raise GDP to 2 per cent above its pre-Covid-19 level. This should help Canada to approach its 2019 level. In contrast, despite the pull of demand of the United States, Mexico will fall short of its pre-Covid-19 income in 2021 because of its relatively deeper recession and small domestic fiscal relief in 2020. Argentina is in a similar situation due to tight financial constraints, resulting in large part from its heavy pre-pandemic external borrowing. Brazil should grow slightly above its 2019 GDP this year, thanks to the positive effect of higher commodity exports and a relatively larger and well-targeted fiscal stimulus than in Mexico and Argentina.

Europe is experiencing a disappointing growth recovery, despite a very accommodative monetary policy stance adopted by the ECB. The policies agreed by eurozone governments have been too little and too late. In numbers, despite the recovery in its net exports, the German GDP in 2021 is expected to be almost 3 per cent below its 2019 level. The recovery tends to be even weaker in France, Italy and the United Kingdom, where Brexit disruptions have counteracted the effects of fiscal expansion and rapid vaccine roll out. Europe's historical coordination problem will be felt hardest in Spain and Italy, where

the 2021 GDP is expected to be 5.6 and 3.8 per cent below their pre-pandemic level, respectively.

In terms of the sectoral composition of the recovery, the disruptive effects of the pandemic on some global value chains and the rebound in the demand for goods have created bottlenecks (Goodman and Chokshi 2021). The problem has been most acute in semiconductors, which has had a knock-on impact on electronics and auto production in many countries (Wu and Pogkas, 2021), and construction materials, which raised the cost of residential investment (AGC 2021).

In the service sector, as of mid-2021, output was still depressed in relation to its pre-pandemic level in many economies, especially in personal urban services (Furman and Powell III 2021). The increased adoption of remote work is expected to have a long-lasting negative effect on business travel and lodging (McKinsey 2021), but the reopening of many economies after their vaccination drives should see a partial recovery in personal recreational services by the end of 2021 and beginning of 2022 (European Commission, 2020).

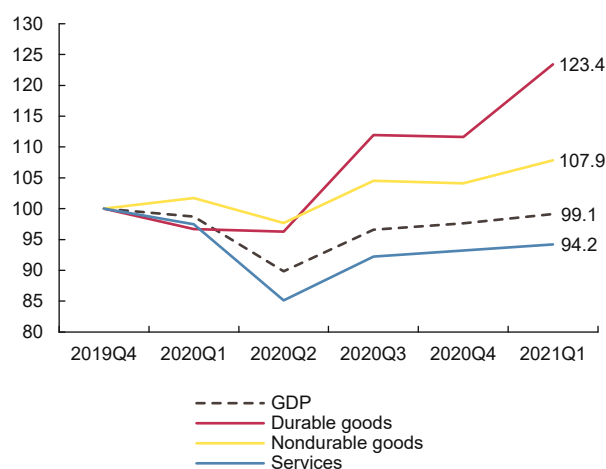
Even in the United States, where the economy is recovering quickly from the Covid-19 shock, there was still a large gap between the rebound in the demand for goods and the demand for services in the beginning of 2021 (Figure 1.4). Since services account for most jobs in advanced economies, the rebound to pre-pandemic levels in the United States labour market is likely to be incomplete during 2021, especially if we measure labour slack by the employment-population ratio of prime-age workers and factor in the previous negative impact of the GFC (Figure 1.5).

2. Inflationary Pressures: Nothing to Fear but Fear Itself

The initial economic impact of Covid-19 were the deep recession and lower inflation. However, since the second half of 2020, due to a combination of the quick recovery of global aggregate demand and some adverse supply shocks, prices have been accelerating in the world's advanced economies.

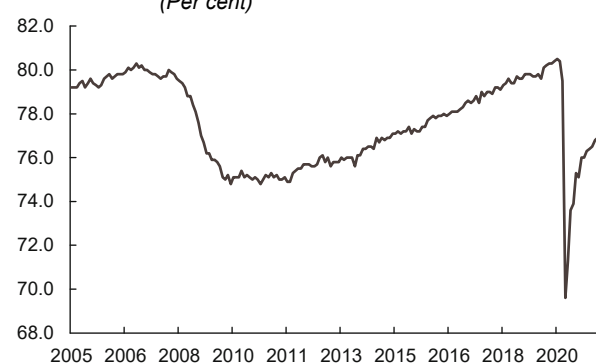
Globally, the rise in commodity prices has pushed the cost of basic inputs higher. Since mid-2020, metal and oil prices have been on the rise and, in May of 2021, annual food inflation reached almost 40 per cent, its highest value in ten years according

FIGURE 1.4 Real GDP and personal consumption expenditures in the United States, 2019–2021
(Index numbers, Q4 2019=100)



Source: United States Bureau of Economic Analysis.

FIGURE 1.5 Employment-population ratio in the United States, January 2005–July 2021
(Per cent)



Source: St. Louis Federal Reserve bank.

to the FAO food price index. The increase in food prices has contributed to the rise in the world hunger index since the pandemic, with the greatest harm in developing countries (see Box 1.4 and FAO, 2021a). The pandemic has caused bottlenecks in global value chains, especially in sectors that depend heavily on semiconductors, which, in turn, has raised the price of capital goods and durable consumer goods around the world, with a stronger impact in advanced economies. Figure 1.6 shows the inflation history of the main economies of the world since 2005.

Unsurprisingly, prices have been accelerating faster in countries which had been experiencing higher inflation before the pandemic due to exchange-rate pressures, such as Argentina and Turkey (see Figure 1.7). In Brazil, domestic political factors drove a

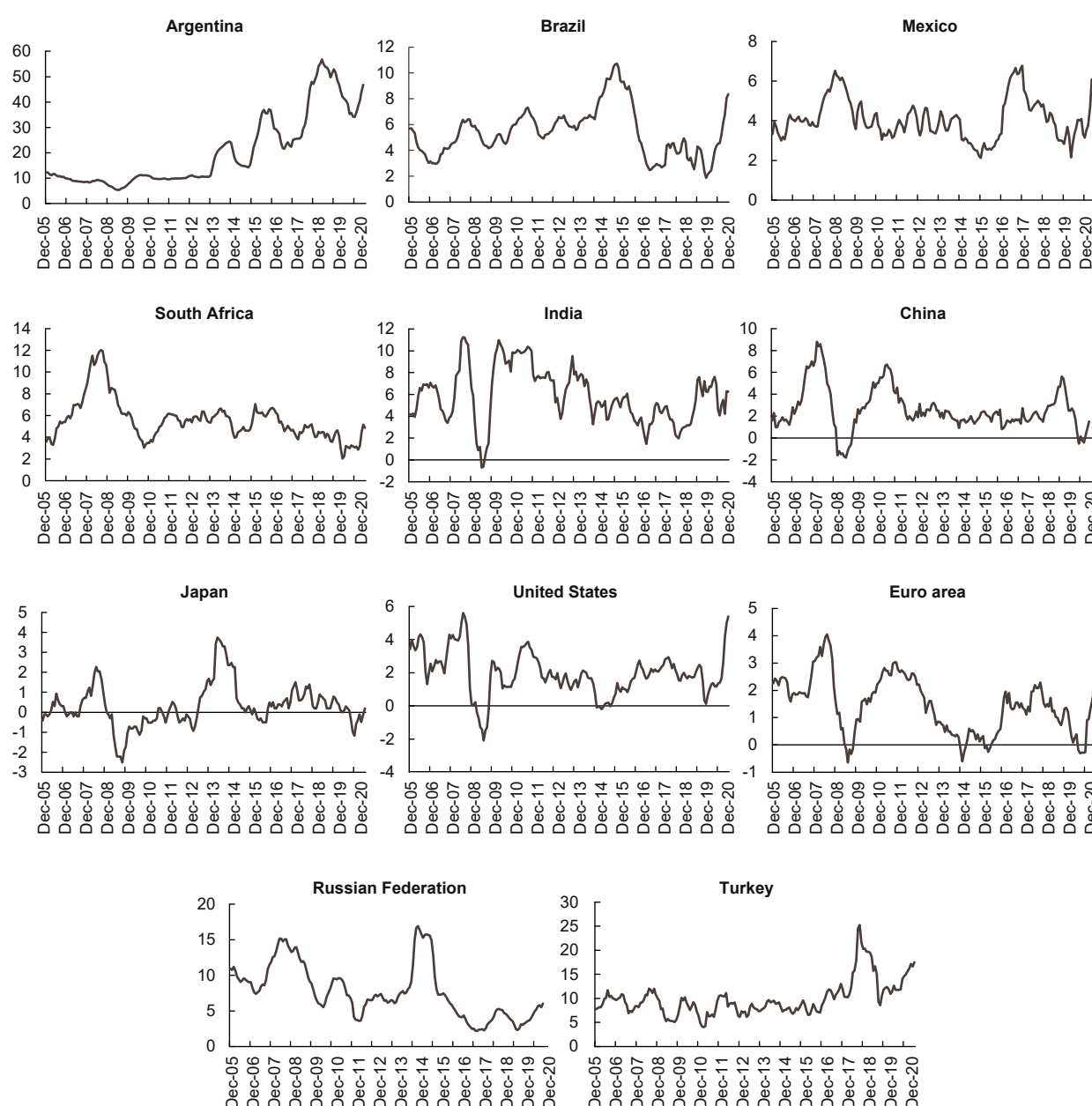
depreciation of the domestic currency relatively faster than in other developing countries, while a severe drought pushed the economy to use more expensive sources of electrical power. In mid-2021, the two adverse shocks increased inflation to almost 9 per cent, prompting the Brazilian Central Bank to hike its short-run interest rate.

Currency depreciations and commodity price rises have also pushed inflation up in Mexico, South Africa, and the Russian Federation, but so far at a

more moderate pace than in Brazil. As of mid-2021, these three economies have registered consumer price inflation between 4 and 6 per cent, which, in turn, has prompted the Central Banks in Mexico and the Russian Federation to tighten monetary policy.

In India, consumer inflation was already at 6 per cent before the pandemic. The Covid-19 shock caused a temporary dip in prices, but as the economy recovered and food prices accelerated, the country returned to a 6 per cent inflation rate in mid-2021.

FIGURE 1.6 Consumer inflation, selected economies, December 2005–December 2020
(Per cent)



Source: UNCTAD secretariat calculations based on Refinitiv data.

In contrast, in China, the government had been adopting restrictive measures to fight inflation before the Covid-19 shock. In mid-2020, the sudden stop of the economy increased the impact of the restrictive measures and pushed the economy briefly into deflation. As the economy recovered, inflation became positive again, yet still low (around 2 per cent) by international standards.

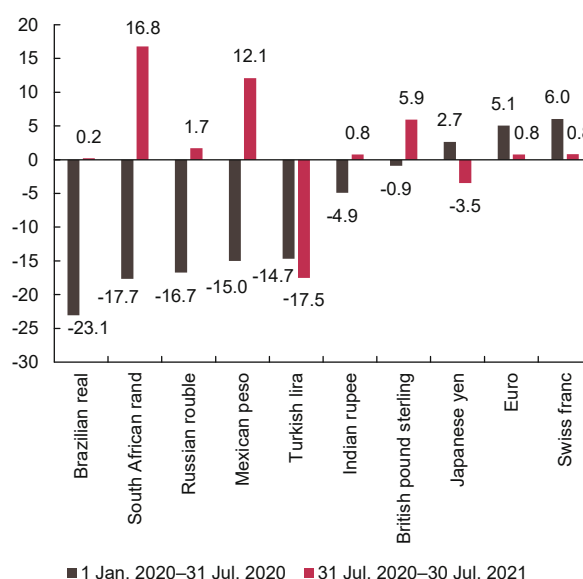
In the advanced world, Japan is still struggling with a deflationary trend, meaning the recent acceleration in prices has been insufficient to offset the deflationary pressures caused by the pandemic. A more moderate version of the Japanese story is unfolding in Europe, where inflation has been on the rise, but still not sufficiently to compensate for almost eight years of effective price stagnation with annual increases below the target of 2 per cent.

So far, in the advanced world, stronger inflationary pressures seem to be a feature of the United States recovery. As of mid-2021, the United States economy registered its highest consumer inflation in ten years (5.4 per cent), which some have taken as indication that macroeconomic policy has been too expansionary. To emphasize how the United States has deviated from its pattern in the last ten years, Figure 1.8 compares the United States with the euro area inflation. The two regions fluctuate together, but contrary to what happened after the GFC, the inflation in the United States has been deviating from its previous “European path” since mid-2021.

To analyse the inflation picture in the main advanced economies, it is important to see whether the recent price accelerations deviate from an average inflation target of 2 per cent. Setting December 2005 as a benchmark, Figure 1.9 shows the current price gap in the United States, Japan and Europe. The recent rise in inflation has been clearly insufficient to bring euro area prices back to where they would have been if the ECB had met its 2 per cent inflation target. In Japan, the situation is even more striking. Despite annual fluctuations, the cumulative price gap shows inflation of just 5 per cent since 2005. In contrast, the United States price index ran slightly above the two per cent inflation trend until 2014, and slightly below it from 2014 to 2020. The recent price acceleration pushed the United States price index once more above the two per cent inflation trend, which in turn will probably lead to tighter Federal Reserve monetary policy in the near future.

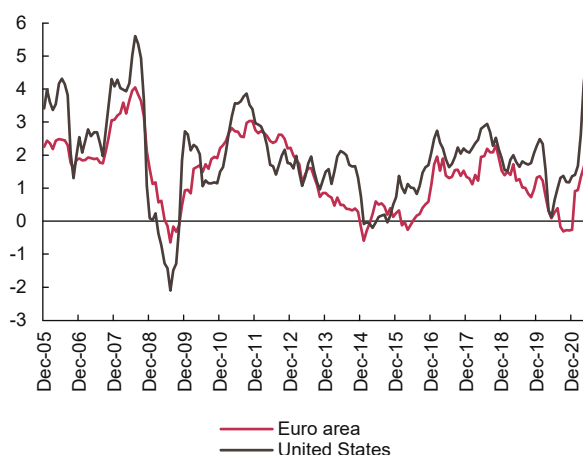
Temporary inflation spikes are normal after deep recessions; they occurred in the recovery from the

FIGURE 1.7 Variation in exchange rate of selected currencies vis-à-vis the dollar of the United States, selected time periods, 1 Jan. 2020–30 Jul. 2021 (Per cent)



Source: UNCTAD secretariat calculations, based on Refinitiv data.
Note: A positive value corresponds to an appreciation.

FIGURE 1.8 Consumer inflation in the United States and the euro area (Per cent)



Source: UNCTAD secretariat calculations based on Refinitiv data.

GFC and are happening again now. The question for policy makers is whether or not temporary price hikes are likely to trigger a self-perpetuating process of accelerating price rises. Is inflation becoming a structural problem? Probably not.

To see why, it is necessary to put inflation expectations and long-term interest rates into the picture. If the inflation shock is temporary, expected inflation remains anchored on the government’s target

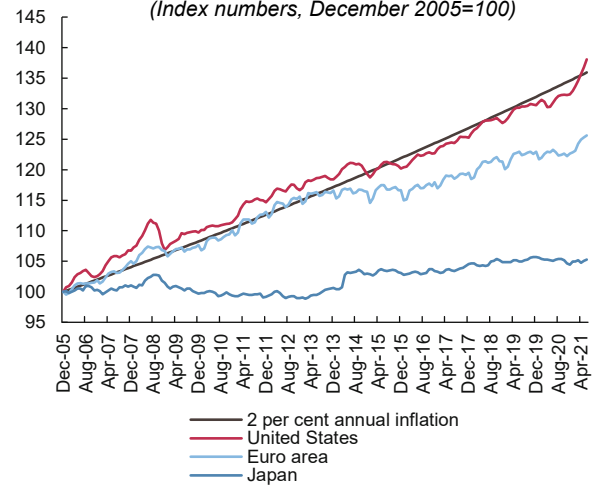
and long-run interest rates show a reversion to the mean. Focusing on the United States, which sets the standard for bond markets elsewhere, Figure 1.10 shows the 10-year breakeven inflation implicit in United States Treasury Securities. The number is the expected inflation that makes the return on inflation-indexed bonds equal to the return on non-indexed bonds. Because of risk aversion, the breakeven inflation tends to overestimate expected inflation by a constant value.

As of mid-2021, the 10-year breakeven inflation implicit in the United States government bonds was 2.4 per cent, a substantial increase from the depth of the Covid-19 shock in 2020, when this variable fell to 0.5 per cent. However, when the change in expected inflation is put in historical perspective, the recent increase seems to be a return to normal. The same thing happened after the GFC and the current breakeven inflation is approximately equal to its value in 2005–07 and 2011–13. So far, there is no evidence of rising inflation expectations in the United States economy. In fact, the recent increase in expected inflation seems to be a correction of the low-inflation forecasts that predominated in 2014–19.

Inflation tends to become a problem when it ignites a price-wage spiral that feeds on itself, as happened in many economies during the 1970s, when two oil shocks and a productivity slowdown in overheating economies led to a cost-induced inflation, wage increases, and another round of cost-induced inflation. Today, because of the relatively lower bargaining power of workers in the United States economy, it is unlikely that the recent price acceleration will turn explosive. On one side, (see Figure 1.11) the United States labour market does show a recovery in real wages, which started before Covid-19 and for statistical reasons was amplified during the critical months of the pandemic (lower-wage workers lost their jobs and this pushed the mean real wage up). However, on the other side, the recent increase in real wage is happening after 35 years of stagnation, meaning it is simply too early to state that the current recovery will start a wage-price spiral.

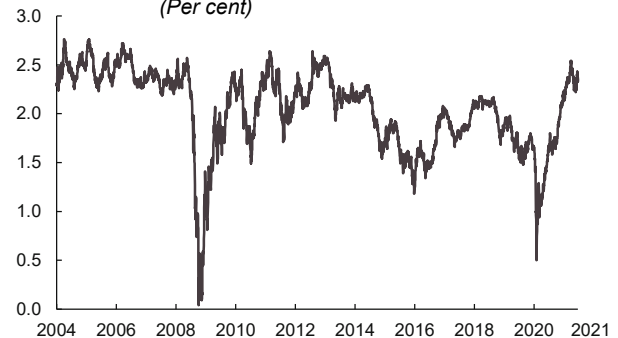
The inflationary impact of the real wage depends on labour productivity. If the real wage grows but labour productivity grows faster, the labour share of output falls. As a result, the profit share goes up and prices may even fall, if firms decide or are forced to pass the gain to customers (Barbosa-Filho and Taylor 2006; *TDR* 2020). The data from the United States economy shows an increase in the workers' share of

FIGURE 1.9 Price gap from a 2 per cent inflation trend, selected economies, December 2005–April 2021
(Index numbers, December 2005=100)



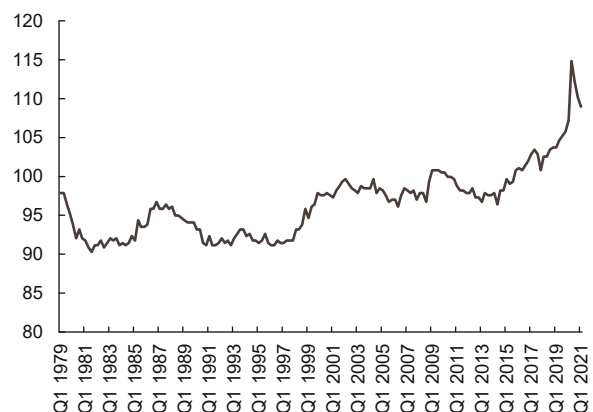
Source: UNCTAD secretariat calculations, based on national sources.

FIGURE 1.10 Ten year break even inflation in the United States
(Per cent)



Source: FRED, Federal Reserve Bank of St. Louis.

FIGURE 1.11 Real wage in the United States, January 1979–March 2021
(Index numbers, 2010=100)



Source: FRED, Federal Reserve Bank of St. Louis.

income immediately after the Covid-19 shock and subsequently a fall, but like with the real wage rise, it is too early to know whether these fluctuations in income distribution will cause a structural change in inflation, for two reasons.

First, the initial impact of a sudden stop of the economy is to reduce profits, and the labour share jumps up for temporary reasons; and as discussed in Chapter II, this may already have been reversed. Second, even with the recent increase, the United States labour share only just returned to its value reached before the GFC, which in turn was approximately 5 per cent below its average in 1980–90. In other words, since 2000, there has been a substantial wage squeeze in the United States. Because of the low starting point in 2019, firms in the United States still have large profit margins to absorb a higher real wage without raising inflation. In an extreme case, the economy's recovery and initial increase in the labour cost may push firms to innovate, which, in turn, raises productivity and accommodates the higher real wage without excessive inflationary pressures (Storm and Nastepead 2012).

3. Fiscal Policy and Public Debt

In developed countries the aggressive spread of the virus prompted a set of equally aggressive measures to counter its paralyzing consequences. In contrast, most of the developing world faced the same financial, structural and political constraints that had hampered their ability to intervene in the economy over previous decades, resulting – in most cases – in an exacerbation of domestic and international inequities.

However, even in countries with fiscal space, there is a risk of premature withdrawal of fiscal (as well as monetary) stimulus. While a consensus has emerged about the need for significant public sector intervention, there is no clear agreement yet about its composition or duration. If, as in previous recessions, state intervention is confined to absorbing the immediate shock, it is likely that the deep sources of instability will not be addressed.³ If that becomes the case, the much-heralded post-pandemic paradigm shift in policymaking would prove to be more a matter of rhetoric than reality.

The lesson from previous crises and recovery experiences strongly suggests that the political space created by the pandemic should be used to re-assess the role of fiscal policy in the global economy, as well as the practices which have widened inequalities.

(a) Speculation and austerity: tame one to stop the other

At the onset of the pandemic, most governments were quick to announce large spending packages, as recommended by international organizations (IMF, 2020a; *TDR 2020*). Yet, in the absence of an internationally coordinated effort, the global stimulus was not as effective as it could have been. In many cases, actual measures were insufficient and considerably smaller than initial announcements (see Box 1.1).

According to IMF data, 41 developing countries actually reduced their total expenditures in 2020, 33 of which nonetheless saw their public debt-to-GDP ratios increase. A similar divergence is evident also within the group of developed economies (Box 1.1, Table B1.1),⁴ but Figure 1.12 shows how the constraints between the two groups remain significantly different: developed countries were able to increase their total primary outlays, relative to the past, significantly more than developing countries with similar or lower public debt ratios in 2019.

To understand why this has happened, two relevant factors are worth recalling. First, while modern economies are structured to create money for the purpose of public and private spending, liquidity creation does not necessarily improve access to foreign currency for developing countries, an essential requirement to sustain spending in an open and financialized system (*TDR 2020*), nor for developed countries in common currency arrangements (Izurietta, 2001). Second, under these conditions, a government's budgetary strategy is subject to private, mostly foreign, investors' willingness to lend, which is, under current structures and practices, influenced by a short-term and speculative logic and a pro-austerity bias (Chandrasekhar, 2016). As such, global financial markets as currently structured exert considerable influence on policy, to the detriment of its public functions (Nesvetailova and Palan, 2020).

Agreement on practical solutions to reduce fiscal constraints has proven elusive. Actions taken over the past months to lessen foreign exchange constraints on developing economies have been narrow in scope and temporary in nature: the G20 granted a suspension of the debt servicing of bilateral loans to a small number of countries, and the IMF and the World Bank offered emergency credit. No significant action was taken regarding private financial claims, or to address the urgent need of direct assistance (in cash, services or

BOX 1.1 Fiscal stimuli in 2020: An ex-post assessment

In response to the economic damage caused by the pandemic and accompanying lockdowns, governments across the globe adopted a series of fiscal stimulus measures and support packages during 2020. Key components of these packages included the channelling of significant resources to specific economic sectors, the provision of temporary wage support or replacement schemes, increases in unemployment benefits in terms of both amount and duration, direct cash transfer to households, as well as the ramping up of health expenditures (*TDR 2020*).

While these fiscal packages differed considerably across countries, particularly between developed and developing countries, they were in many cases of an unprecedented scale and scope. At the time of their introduction, estimates were tentative relying on the announcements made by the governments. Now that data is available for 2020, it is possible to derive more detailed estimates and compare them to recent historical benchmarks.

Table B1.1 summarizes the main findings for selected economies¹⁸. The table compares *a priori* announcements of the fiscal responses with the estimates of the effectively applied fiscal stimuli. These are separated into two categories:

- (a) additional amount of Government spending (*G*) on goods, services and investment. These are direct injections to the stream of aggregate demand; and
- (b) transfers (including subsidies and unemployment benefits) from the Government to the private sector (*T*), net of taxes and contributions to social security (after rebates and deferrals are taken into account). These are additions to the flow of income for the private sector.

Estimates of *G* and *T* are based on levels of spending and transfers that would have likely materialized absent the pandemic. The relevant benchmark for government spending on goods, services and investment (*G*) is their trend level in real terms. For net transfers (*T*) the benchmark is the average proportion of GDP of past years, applied to the level of GDP of 2020 (to take account of the fact that the bulk of such flows depends, in large part, on the level of economic activity and incomes generated).

Main observations**i. Large gaps between announcements and actual stimuli**

As can be seen from Table B1.1, there are substantial differences between the announced and effective size of the Covid-19 fiscal stimuli measures introduced in 2020. This is particularly the case for several developed countries, namely Australia, Canada, Germany, Japan and the United Kingdom. In these countries, the actual size of the Covid-19 fiscal stimuli packages was between 6 and 9 percentage points of GDP lower than the announced size of these packages.

TABLE B1.1 Estimated size of Covid-19 fiscal stimuli, 2020
(Per cent of GDP)

	Government Spending (<i>G</i>)	Government Transfers (<i>T</i>)	<i>G</i> + <i>T</i>	Announced measures
Argentina	-0.5	4.1	3.3	3.8
Australia	0.1	10.0	10.2	16.1
Canada	-0.4	8.8	8.3	14.7
France	-0.5	4.6	3.3	7.6
Germany	0.5	3.0	3.3	11.0
India	-0.9	3.4	2.4	3.3
Italy	0.5	4.9	5.4	6.8
Japan	0.3	7.5	8.0	15.5
Mexico	0.2	1.8	2.0	0.7
Republic of Korea	-0.5	2.0	1.8	3.4
South Africa	-0.4	4.2	4.2	5.3
Spain	0.2	4.7	4.9	4.1
Turkey	-0.5	1.7	1.4	1.0
United Kingdom	2.1	5.6	7.1	16.3
United States	-0.4	9.2	9.1	10.6

Note:

G refers to general government gross fixed capital spending and consumption spending in goods and services (excluding payments or transfers) and is estimated as that above the trend over the recent past (2017–2019).

T refers to net transfers from the government to the private sector. It encompasses transfers, including subsidies and all payments to other sectors (including unemployment benefits and direct income transfers), minus government revenues (including personal current taxes and contributions to government social security); and it is estimated as the difference with its past average (2017–2019) as a proportion of GDP applied to 2020 GDP.

There are various possible explanations for the discrepancies. Although the initial announcements intended to show the strength of the policy responses to the Covid-19 shock, the packages may have included outlays that were already budgeted, and which would have occurred absent the pandemic. Moreover, spending in other areas was in many cases cut to compensate for the increases in Covid-19-related outlays. Likewise, included in the packages were tax deferrals and accelerated spending measures that would have taken place later in the same cycle, i.e. spending brought forward from the fourth quarter to the second quarter. Lastly, the announced packages often included spending presumably to be deployed in 2021 or beyond.

ii. Significant divergences between developed and developing economies

The results underscore that the size of the stimuli enacted by governments of most developed countries are significantly larger than those of developing countries.¹⁹ Policymakers in developing countries are particularly vulnerable to the policies imposed on them by international investors, credit-rating agencies and lending institutions to cut debt ratios (even if these are smaller than those of developed economies). Furthermore, their vulnerability to external economic shocks requires greater caution when increasing public debt because of recurring private sector bankruptcies prompting government bailouts. Finally, larger fiscal programmes in developing countries tend to involve larger current account deficits, which cannot be filled by domestic liquidity injections alone without triggering currency vulnerabilities.

iii. Biases in the composition of the fiscal packages

Another key result from Table B1.1 is that actual additional government spending (G) was systematically lower than net transfers to the private sector (T), in addition to the fact that direct spending was either only marginally larger than historic norms or even smaller. This is relevant from a macroeconomic perspective for two reasons. First, the impact of direct spending on aggregate demand is larger than that of reductions of taxes or increases of transfers (*TDR 2013*; *TDR 2019*). With larger multipliers, funds injected into the economy represent a more effective cushion to economic shocks. Second, while not all goods and services can receive a demand boost during a lockdown, many can and should. For example, medical services, training, production of equipment; educational programmes online to maintain or improve labour skills; planning activities to lay down infrastructure projects, and more.

Thus, the bulk of fiscal stimulus came in the form of net transfers (T), i.e. tax cuts, income transfers, additional or extended unemployment benefits, and subsidies. There is no denying that programmes to protect the incomes of households, especially of those who were out of work, have been necessary during the pandemic. This is especially the case for wage-earners in the lower income deciles, who live from pay-check to pay-check, both in developed and developing countries. In the latter case, moreover, where a large proportion of workers are involved in informal sectors and activities relying on personal contact, such transfers represent the only effective livelihood support tool. Other forms of financial support via existing welfare or unemployment benefits programmes are out of reach for the majority of households in developing economies. By contrast, the prevalence of transfers over direct spending in developed economies is harder to justify, all the more while public spending, educational and health-related, as well as infrastructure provisions were partially left unattended or even reduced in some cases.

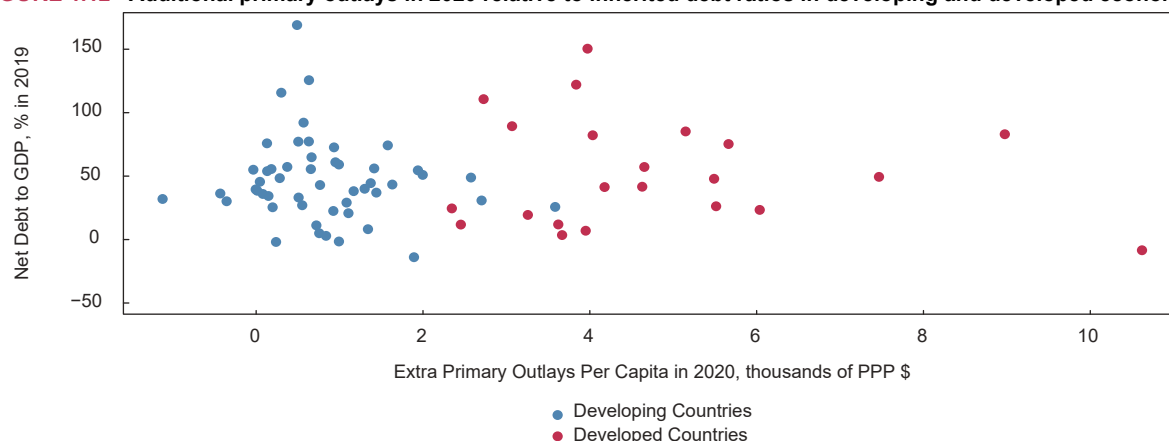
The unprecedented build up in household savings in some countries in 2020, resulting in part from the additional net transfers enacted, cannot be ignored. To mention the clearest example, households in the United States²⁰ increased their savings in 2020 from \$1.2 to \$2.9 trillion²¹ — representing nearly 8 per cent of GDP, while the economy contracted by 3.5 per cent. In this case, as in most other cases, the build-up of savings was concentrated in the upper income deciles (Rennison, 2021), while low-earning households continue to remain financially constrained, as well as subject to more precarious employment prospects (Dua et al., 2021). Not unrelated to such disparities is the observation that an outsized share of the build-up in household savings during 2020 was funnelled towards stock markets, thus fuelling financial speculation and inflating equity prices as opposed to propping up real spending and demand within the economy. In this way, the over-reliance on transfer payments can not only prove ineffective, it can also be destabilizing as well as increase wealth inequality (Stiglitz and Rashid, 2020).

Finally, while fiscal support and stimulus measures have the primary aim of counteracting a downturn in economic activity in order to keep businesses afloat and maintain employment, as well as providing assistance to households in need, they also represent an opportunity to plan and undertake investments in physical and social infrastructure, including education, that will boost productivity and push towards more sustainable and resilient productive models (Jotzo et al., 2020). This is especially pertinent when economies face the imminent

challenge of revamping the productive structure and consumption patterns to drastically reduce greenhouse gas emissions.

While the immediate priority of fiscal measures in 2020 was to support households and businesses, the chance to capitalize on fiscal injections to boost aggregate demand with proactive investments that have a long-lasting and positive impact in terms of productivity, growth and climate goals was largely missed, as evidenced by the broadly subdued nature of government spending in 2020. Fiscal packages, moreover, have tended to exacerbate the disparities between developed and developing economies, with lasting consequences.

FIGURE 1.12 Additional primary outlays in 2020 relative to inherited debt ratios in developing and developed economies⁵



Source: UNCTAD secretariat calculations from IMF WEO database, April 2021.

Note: Extra primary outlays refer to the difference between the primary outlays of the general government in 2020 and its average over the period 2016–2019. *Developing economies are:* Albania, Algeria, Barbados, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Cabo Verde, Cameroon, Chile, Colombia, Djibouti, Dominican Republic, Egypt, Equatorial Guinea, Eswatini, Ethiopia, Fiji, Ghana, Guyana, Indonesia, Islamic Republic of Iran, Jordan, Kazakhstan, Kenya, Lebanon, Lesotho, Liberia, Mali, Mauritania, Mexico, Morocco, Namibia, Niger, Nigeria, North Macedonia, Oman, Pakistan, Panama, Paraguay, Peru, Saudi Arabia, Serbia, South Africa, St. Vincent and the Grenadines, Taiwan Province of China, Trinidad and Tobago, Turkey, Uruguay, Yemen, Zambia. The grouping excludes former transition economies that are part of the European Union, the Solomon Islands and the Seychelles and all the countries for which data is not available. *Developed economies are:* Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Netherlands, New Zealand, Portugal, Spain, Sweden, Switzerland, United Kingdom United States. It excludes former transition economies and all the countries for which data is not available.

equipment, let alone waivers on patents) to combat the health crisis.

Thus, while massive amounts of public money were used by the major Central Banks to keep private credit institutions afloat, governments in developing countries continued to experience severe constraints both on servicing their external debt and supporting production, exports, income and employment throughout the pandemic. The overriding concern continues to be avoiding domestic actions that could trigger financial turmoil or anticipating when the major Central Banks will decide to withdraw their massive liquidity injections or raise their interest rates (see Box 1.2). Moreover, fear of upsetting private creditors has prevented many eligible countries from taking advantage of the G20 Debt Service Suspension Initiative: only 46 of 73 eligible countries have participated (World Bank, 2021).

Hence, whilst the pandemic has brought back the shock-absorbing dimension of fiscal policy into the mainstream of counter-cyclical demand management,

it is clear that additional steps are necessary to guarantee that all countries can employ even those minimal fiscal measures in line with their own domestic circumstances and to the benefit of global recovery and financial stability.

This view, long held by many developing countries, has recently received support from some G7 members. United States Treasury secretary Janet Yellen has finally endorsed a proposal to create \$650bn of new SDRs, an important, if still insufficient, step in the right direction (see Section C). Similarly, supportive signals have emerged in the European Union, where member countries have no lender of last resort and, according to Mario Draghi, former ECB president and current Italian Prime Minister, “we must reason on how to allow all [EMU] member states to issue safe debt to stabilize economies in case of recession” (Draghi, 2021, *our translation*). Since Italy holds the G20 presidency in 2021, there is hope that this argument can also be extended beyond the borders of the European Union.

With these small steps in the right direction, the debate will continue. But the world has not yet absorbed the central lesson. For state to re-emerge as a central institution of *public* policy, the autonomy and impunity enjoyed by global finance over the past decades, need to be seriously circumscribed.

4. Timing counter-cyclical measures or targeting development?

During the GFC, the need to rescue the private sector after years of ample credit creation once again showed the limits of monetary policy as an instrument to smooth out recessions (Godley and Izurieta, 2009). This experience helped revive the legitimacy of active fiscal policy as a temporary shock absorber that should, however, be promptly withdrawn, leaving market forces to shape the eventual recovery (Bernanke, 2008). By 2010, the G20 and the IMF started to signal the need for fiscal withdrawal. Many of these same voices have since recognized their mistake. Public support ended too soon, leaving economies in a fragile situation and threatened by debt deflation (IMF, 2012; Fatàs and Summers, 2015).

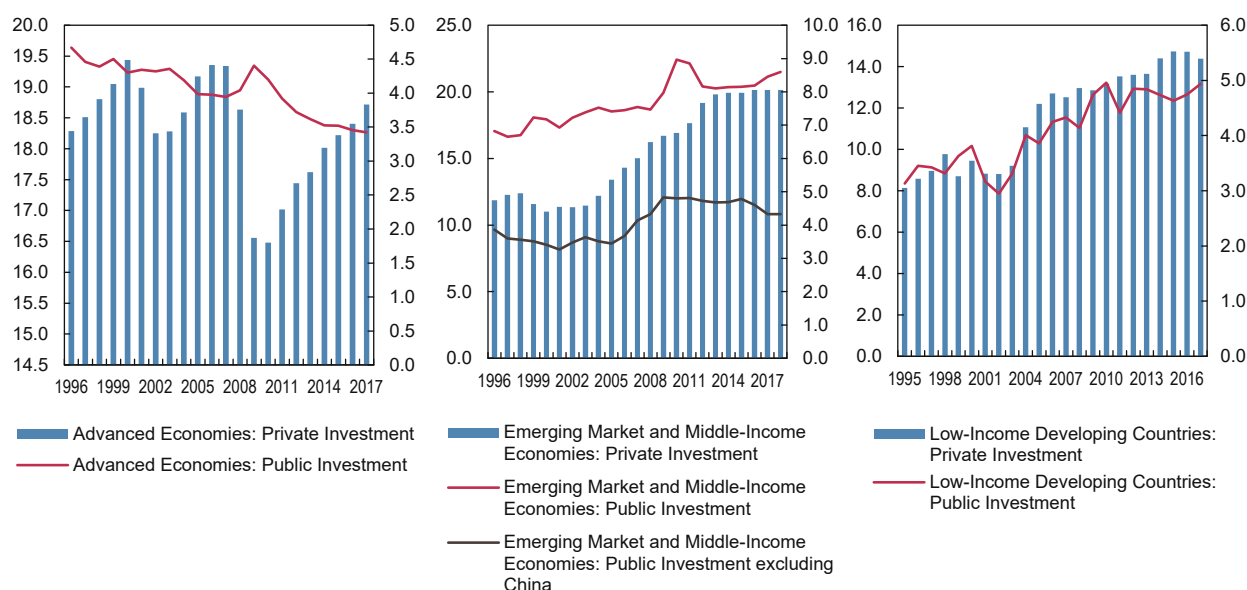
Mindful of this experience, since the beginning of the pandemic a consensus seems to have materialized in favour of maintaining fiscal and monetary support beyond the immediate recovery (*TDR 2020*; IMF, 2020b). However, the question remains whether fiscal policy will remain a countercyclical

tool for macroeconomic emergencies, or if it merits a more structural role to promote development and sustained job creation (Costantini, 2020), especially in developing economies where leaving structural change to market forces has, invariably, ended in disappointment (see Figure 1.13).

A fiscal policy that withdraws stimulus at the earliest possible point in the cycle, even if extended to prevent possible damage to long-term growth from skill obsolescence or debt deflation, cannot play its necessary structural role. The current approach, despite giving fiscal policy a relatively longer span of action, continues to imply that governments cannot actively prevent or pre-emptively reduce the size of downturns, which simply occur from time to time despite demand-management policy. The function of fiscal policy then should be solely countercyclical, mostly prompted in the downward part of the cycle.

More ambitiously, measures such as guaranteed minimum income schemes and progressive taxation can provide a floor to the fall in disposable income. As championed by Gunnar Myrdal in the 1930s, and more recently suggested by Haughwout (2019) and Orszag et al. (2021), public investments, pre-approved and scheduled to start at the earliest manifestation of a downturn, can also play a similar role.⁵ But this type of proactive steps rarely materialize, and did not in 2020, when the fiscal response was disproportionately geared toward transfers (see Box 1.1).

FIGURE 1.13 Public and private investment in selected country groups, 1995–2016
(Per cent of GDP)



Source: IMF, Fiscal Monitor, April 2020.

BOX 1.2 The rocky road to public debt sustainability: A developmental perspective

In an accounting framework for the closed economy, where international and macroeconomic constraints, as well as policy and institutional feedbacks are put aside, it is possible to identify the specific relation between primary budget balance, interest rate, and rate of GDP growth that, given an initial debt to GDP ratio, guarantees, on average, its stability over time (Domar, 1944; Blanchard et al., 1994; Pasinetti, 1998). In particular, if the interest rate that applies to the stock of debt is higher than the rate of growth of income (that determines the size of GDP), the primary budget must be in surplus to avoid an unrelenting increase in the debt ratio.

Real world situations, as reviewed in the *TDR 2020* (Chapter IV) are far more complex, given a variety of exogenous factors (domestic and external to each economy) that alter the ‘ r minus g ’ measure, such as changes in expectations or sudden external shocks affecting exchange and interest rates (Barbosa-Filho and Izurieta, 2020). But there are also different ways in which structural constraints and policy choices influence the fiscal budget, the rate of economic growth, prices and interest rates. Indeed, frameworks of policy analysis that target public debt sustainability by means of primary budget surpluses and assume that economies are organically geared to grow, with small oscillations around technologically driven output potential and well-tuned expectations about prices and interest rates, are misleading.

Alternative paths ahead need to rely on a different set of internationally agreed financial conditions, with respect to liquidity provision as well as debt management and restructuring, and most importantly on a more realistic set of assumptions about the functioning of developing economies, as discussed below.

By abandoning the mainstream approach to macroeconomic analysis, a first question is about the correct interpretation of fiscal deficits in the circumstances at hand (Godley and Izurieta, 2004). For instance, a deficit today can be an indication that the government is spending too little rather than too much: it may conceal an austerity policy that is reducing growth to a point that budget cuts do not produce the desired reduction in net spending while eroding fiscal revenues. This would not only worsen current conditions but threaten debt sustainability. Conversely, deficits can be a sign that the government is supporting a growth strategy, investing in social and physical infrastructure, growth capacity and the expansion of the productive potential. If those policies are successful and sustained for a sufficiently long period, debt-to-GDP ratios may not only be stable but possibly declining over time. As the growth rate of income exceeds the real interest rate, a moderate primary deficit (rather than a surplus) could become a structural feature of a successfully developing economy. Within this long-term perspective, it makes sense to allow the debt-to-GDP ratio to increase and, depending on the stage of a country’s development, until the targets of sustainable growth and wellbeing are achieved.

Conversely, especially in economies operating with unemployed or underemployed resources, when governments cut their budgets to reduce public debt, they affect aggregate private income to the extent that unemployment tends to increase, especially those of the income groups which are more reliant on public services. They also constrain the ability of private wealth holders to acquire non-risky public debt as assets, thus increasing overall portfolio risks (Lisandrou and Nesvetailova, 2020). All this affects the resilience of the economy and of the society to economic shocks. Similarly, if the size of the public sector shrinks, for example due to privatizations, a larger part of the economy depends on private expectations. As a result, income fluctuations tend to be larger and increasingly driven by unchecked and fickle private credit movements.

In sum, public debt solvency indicators and targets of any kind gain some meaning only in the presence of a framework that determines the macroeconomic relationship among variables as well as the appropriate horizon for the analysis (Costantini, forthcoming). The problem is that access to finance is a pre-requisite for determining the timing and direction of the development process as well as of any reconfiguration of the debt sustainability profile when external shocks occur or international macroeconomic conditions change significantly.

Indeed, even if macroeconomic dynamics are put aside, several factors can stand in the way of public debt sustainability, which are especially relevant in developing economies, where a significant proportion of assets and liabilities of the public sector are denominated in foreign currency (Barbosa-Filho, 2021). A speculative attack on the domestic currency, leading to exchange rate depreciations, inflationary spirals and interest rate adjustments can derive from political instability in response to contractionary fiscal policies, triggering a vicious circle of growth collapse, rising fiscal deficits and a debt crisis. Several other outcomes are possible,

exposing as a common feature that aiming at primary surpluses becomes an elusive means to contain debt ratios, be it because changes in expectations could adversely affect the discount rates when fiscal prudence is interpreted as a worrying sign of trouble ahead (Guzman and Lombardi, 2017), or because shocks beyond policy control alter exchange rates or foreign interest rates. The accounting framework can be expanded to allow for the real-world case where governments also hold fixed-income financial assets, which can soften the required fiscal adjustment when either governments accumulate fixed assets at a faster rate of GDP growth, or when the interest rate on assets is greater than on liabilities. For most developing economies, where the accumulation of financial assets is limited and where most often the interest payments on fixed assets or loans are low, debt dynamics can be worsened (Akyüz, 2021). Exchange rate complications would tend to exacerbate these patterns, because earnings on foreign reserves are typically lower than debt payments, and even more so when foreign interest rate premiums rise faster than the pace of domestic currency depreciations after external shocks or changes in foreign investors' expectations (Barbosa-Filho, 2021).

More generally, the liquidity risk associated with an expansionary fiscal policy is higher, the tighter the balance of payment constraint. This means that different stages of development are associated with typical liquidity risk configurations (Akyüz, 2007). On the one hand, least developed countries and low-income developing countries have trouble accessing credit and exports are often the only source of foreign currency. On the other hand, middle and high-income developing countries can sometimes be the destination of speculative capital inflows which can overwhelm the domestic financial and credit market, induce misallocation of assets and push inflation and imports.

From this point of view, it is market discipline, or being exposed to liquidity risk, that prevents countries spending their way to a structurally sustainable path of debt sustainability. If, partly, mitigating liquidity risks can be an immediate national policy target, addressed for example by price and capital controls, it is mainly something that only international coordination can tackle and solve, creating the policy space needed for a reduction of the external dependency of countries on global finance. Achieving the required degrees of policy coordination around a pro-development revamp of the global financial architecture is not trivial and, in many respects, may look unachievable. But intermediate steps carried out at regional or South-South level of cooperation can help approach the goal (Kregel, 2016; *TDR 2019*).

The widespread, underlying assumption is that the economy's growth and development path is fully determined by its factors of production and technology with cyclical and mostly self-correcting features. In this view, "well-crafted automatic stabilizers are the best way to deliver fiscal stimulus in a timely, targeted, and temporary way" (Boushey and Shambaugh 2019: 5). Since in normal times no such support should be present, these programs should "contain triggers, which assure markets that neither excess spending nor premature austerity will harm the economy going forward" (Altman et al., 2019: 3).

However, it has been amply documented that such counter-cyclical expansions do not allow economies to develop sufficiently or for a sufficiently long time to *sustain* the increase in potential output that results from a stable growth of income, aggregate demand and technical progress (McCombie, 2002; Ocampo et al., 2009; Storm and Naastepad, 2012). For instance, for the United States, Storm (2017), Taylor (2020), and earlier Minsky (1969) show that the failure to contribute to income generation and effective aggregate demand has produced subdued productivity growth and a systematic displacement of jobs from high- to low-wage sectors. Celi et al.

(2018) show how austerity and an abandonment of industrial policy in Southern Europe have produced slow productivity growth, increased dependency on imports and, in many cases, high private indebtedness.

Sustained fiscal support is even more necessary for developing countries. Wade (1992) shows this in the NIEs of East Asia centred on the simultaneous promotion of exports and domestic absorption as the infrastructure and technology transfers triggered the expansion of the industrial sector⁶. Meanwhile, Palma (2011) shows that the abandonment of active import substitution policies in Latin America brought premature de-industrialization and productivity slowdown (see also Khan and Blankenburg, 2009; Tregenna, 2016).

The countercyclical approach to fiscal policy not only appears inappropriate to face the great challenges of reducing inequality and mitigating the impact of climate change, but it is even detrimental to its own declared objective of fiscal sustainability (see Box 1.2). Decades spent in (often failed) pursuit of balanced budgets have intensified the cyclical fluctuations of income and employment, at the same time reducing fiscal space in the downturn.

C. Global Finance and Developing Country Vulnerabilities

As highlighted in previous *Reports* (see Chapter II), developing countries have integrated into global financial markets: since the 1990s in high-income emerging market economies, and more recently, low- and middle-income so-called frontier economies.⁷ This change has left them vulnerable to the volatility and procyclical nature of private capital flows. Subject primarily to external factors (such as monetary and fiscal policy decisions in the United States or commodity price movements) rather than local factors, these flows pose substantive challenges for the management of macroeconomic imbalances, debt sustainability and monetary and fiscal spaces in developing countries (see also Section B.3).

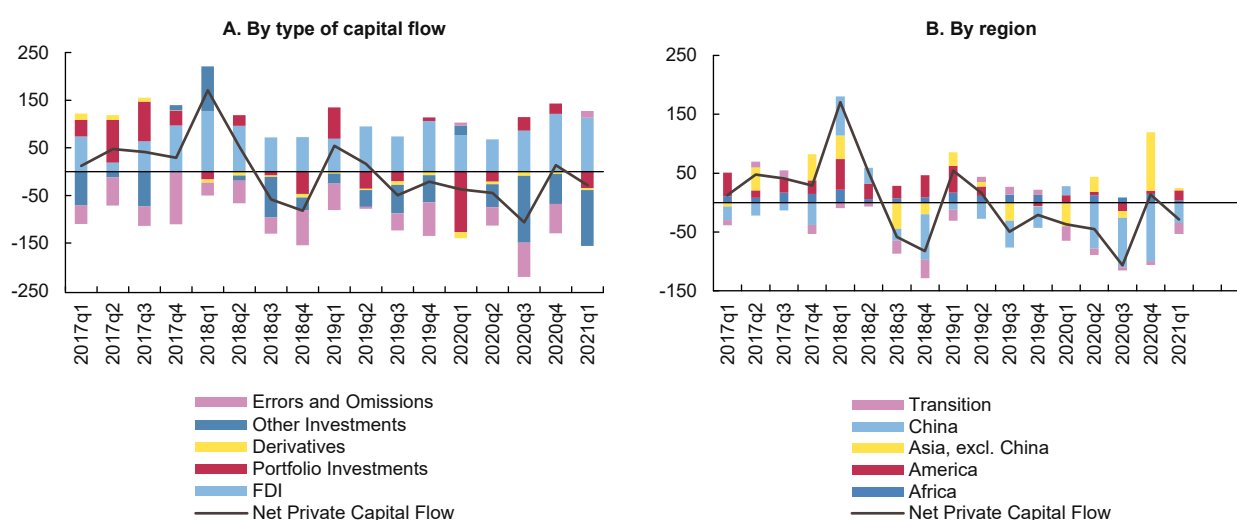
The ongoing Covid-19 pandemic has thrown these vulnerabilities into sharp relief. As Figure 1.14 shows, the deterioration of net capital flows to developing countries in the initial phase of the pandemic was led by record portfolio outflows in the first quarter of 2020, amounting to \$127 billion. Since then, the picture has been one of much reduced, but still volatile, portfolio flows, with outflows of \$21 billion in the second quarter of 2020 followed by inflows

of \$51.6 billion in the second half of the year, and another round of outflows (\$34.5 billion) in the first quarter of 2021. From the second quarter of 2020, massive outflows of ‘other investments’, totalling just under \$370 billion between the 2020Q2 and 2021Q1, have accounted for overall net negative capital flows to developing countries in this period.⁸ By contrast, FDI flows to developing countries have remained stable overall, despite their initial reduction in the first quarter of 2020.

This broad picture shrouds more complex dynamics of net capital flows to developing countries in the wake of the pandemic, including uneven regional impacts (see also Figure 1.14 right hand side - By region).

Net portfolio flows to developing countries are largely driven by non-resident investment in debt and equity (*TDR 2020*: 6; UNCTAD 2021: 3; IMF, 2021). Following the record negative shock to these flows in the first quarter of 2020 that hit all developing regions, the earlier-than-expected return of portfolio funds is likely to have been bolstered by prospects

FIGURE 1.14 Net private capital flows to developing countries, 2017–2021
(Billions of dollars)



Source: UNCTAD secretariat calculations based on national data.

Note: Negative values indicate outflows. The samples of economies by country group are as follows:

Transition Economies are: Kazakhstan, Kyrgyzstan, the Russian Federation and Ukraine. *Africa*: Botswana, Republic of Cabo Verde, Egypt, Ghana, Mauritius, Morocco, Mozambique, Namibia, Nigeria, South Africa, the Sudan and Uganda. *Latin America*: Argentina, the Plurinational State of Bolivia, Brazil, Chile, Colombia, Ecuador, El Salvador, Mexico, Nicaragua, Paraguay, Uruguay and the Bolivarian Republic of Venezuela. *Asia excluding China*: Hong Kong (China), India, Indonesia, Jordan, Lebanon, Malaysia, Mongolia, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Thailand and Viet Nam.

of a substantive new allocation of SDRs and by a growing consensus around the need to recycle unused SDRs from advanced to developing countries (see Box 1.3), whereas investor expectations of rising long-term interest rates in the United States have driven outflows in early 2021 (Wheatley, 2021). While the high volatility and reduced volume of portfolio flows since the second half of 2020 reflect financial markets' uncertainty regarding the future trajectory of the virus and to uneven economic recovery patterns in developed and developing countries, their impact on developing countries has been amplified by deepening financial vulnerabilities after the GFC of 2007–09.

As pointed out previously (*TDR 2020*, Box 1.1), this new round of financial integration was marked by a number of trends. First, the expansion of the external balance sheets of emerging market economies gained momentum,⁹ with asset managers from advanced economies, in addition to targeting foreign-currency denominated corporate bond markets, increasing their participation in domestic sovereign bond markets. While greater reliance on domestic-currency denominated public debt mitigates the currency mismatch in the balance sheets of developing country governments, it also creates maturity mismatches, arising from the prohibitive costs of issuing long-term government securities in most developing countries. It also shifts the currency risk to global lenders, thus heightening exposure to speculative, non-resident investor behaviour (Berensmann et al., 2015).

Second, non-resident portfolio investments in foreign-currency denominated sovereign debt in frontier economies increased sharply, reflecting both investors' search for yield and dwindling public international resource mobilization. Third and relatedly, the rise of asset management as an industry within global finance has resulted in highly synchronized pro-cyclical portfolio investment strategies (Haldane, 2014; Miyajima and Shim, 2014; Raddatz et al., 2017).¹⁰

Fourth, during the crisis, sovereign ratings and outlooks by the “Big Three” private credit rating agencies (CRAs) have played an increasingly problematic role in further limiting access to international financial markets, just as beleaguered developing countries needed it most, to help bolster financial (and fiscal) breathing space. In addition to driving up refinancing costs in these markets, CRAs hampered the effective implementation of

international emergency initiatives, such as the G20 Debt Service Suspension Initiative (DSSI). While participation in the DSSI was not considered a default event, seeking equal treatment under the terms of this initiative from private creditors has been deterring participating countries from taking such action (Li, 2021; Griffith-Jones et al., forthcoming).

As a result of these vulnerabilities, strongly net negative, if fluctuating, portfolio flows to developing countries translated into a vicious cycle of currency depreciations, weakening debt sustainability and reduced fiscal spaces. During 2020, emerging market currencies depreciated against the United States dollar by more than 20 per cent and some frontier economies' currencies by between 20 to 50 per cent,¹¹ triggering hikes in sovereign credit spreads and driving up the value of their foreign-currency denominated debt, thus also affecting private borrowers' balance sheets and refinancing risks (Hofmann et al., 2020).

A stop-go pattern of portfolio flows has been particularly prevalent in Africa and in Latin America and the Caribbean (LAC). In 2020 in Africa, portfolio outflows were the primary factor reducing the regions' total private capital inflows. Although, in 2019, the region recorded portfolio inflows of just over \$39 billion, this trend was all but wiped out in 2020. Most African governments and companies faced difficulties in issuing new debt in international financial markets from the second quarter of 2020. High borrowing costs compared to other regions combined with deteriorating credit ratings, hampered their ability to raise capital in these markets. It is not a coincidence that African sovereign bond issuance in 2020 was equivalent to one third of 2019 and almost no issuance occurred after the second quarter of 2020 (Munevar, 2021).

The LAC region has been similarly affected by high portfolio flow volatility, with outflows in the first half of 2020 amounting to \$30 billion, followed by a partial reversal at \$19 billion in the second half of the year and renewed outflows in the first quarter of 2021, albeit at a lower level (-\$2.6 billions). At the same time, while FDI flows into African regions have remained fairly stable, the LAC region has seen a brief but sharp decline in FDI in the second half of 2020, returning only partially to more normal levels, compared to pre-crisis trends, in the first quarter of 2021.

BOX 1.3 Money for something: Moving on to an expanded role for Special Drawing Rights

The record new allocation of Special Drawing Rights (SDRs) of \$650 billion (or around 457 billion SDRs at the current SDR/\$ exchange rate²²) – approved by the IMF’s Board of Governors in August 2021 – more than doubles the total stock of SDRs (currently SDR 204 billion) amounting to more than 2.5 times the general allocation of SDRs made in 2009 following the global financial crisis.

First created by IMF in 1969, SDRs are an international reserve asset to supplement the foreign exchange reserves of member countries. They represent a potential claim on freely usable currencies of IMF members²³ for use in transactions between member states’ central banks and between them and IMF, but not directly for operations in private markets (see also *TDR 2020*, Box 4.5).

TABLE B1.2 Proposed 2021 SDR allocation to developing country groups
(as per cent of total allocation, in billions of current United States dollars, and as per cent of 2019 GDP, international reserves and short-term debt)

Country group	No. of countries	Quota (% of total SDRs)	2021 Allocation (billion USD)	SDR/ GDP	SDR/ Reserves	SDR/ ST debt
Transition economies	18	4,2	27,52	1,1%	3,8%	23,8%
Low-income developing countries (LICs)	29	1,4	9,21	1,9%	18,4%	70,3%
Middle-income developing countries (MICs)	58	9,6	62,12	0,8%	4,8%	19,4%
High-income developing countries (HICs)	45	22,2	144,01	0,6%	2,5%	6,3%
Total all developing countries and transition economies	150	37,4	242,86	0,7%	3,1%	8,9%

Source: UNCTAD secretariat calculations, based on World bank, IMF and national sources.

Note: As per World bank International Debt Statistics, Short Term (ST) debt includes all debt with an original maturity of one year or less and interest in arrears on long-term debt.

SDRs are unique: they are allocated to IMF member states without eligibility criteria, do not create new debt²⁴, while boosting a country’s international reserves and providing unconditional liquidity support with regard to a country’s macroeconomic policies. For developing countries, simply holding SDRs as a reserve asset may benefit the way they are perceived by global investors and credit rating agencies (see also *TDR 2020* and Hawkins and Prates, 2021).

The 2021 SDR allocation is, however, based of IMF’s historical quota system which, as has long been noted, favours developed countries.²⁵ Of the 190 IMF member countries, 40 developed countries will receive roughly 63 per cent of this allocation (around \$407 billion) and 150 developing countries, taken together, will receive just over 37 per cent (\$243 billion) of this allocation, which on average accounts for 0.7 per cent of their combined 2019 GDP (see Table B1.2). While the quantum of the proposed SDR allocation for low-income countries (LICs) is significantly smaller than for other country groups, at \$9.2 billion, its relative share to GDP at 1.9 per cent, of reserve assets at 18.4 per cent and of short-term debt at 70.3 per cent shows how potentially important this SDR allocation is to LICs. By contrast, the economic impact of the new SDR allocation is considerably less in MICs, many of which, including Small Island Development States (SIDS), face particularly high levels of debt as well as environmental vulnerabilities.

It is not only the historically skewed quota system for SDR allocations that rankles but the low utilization rate of SDR allocations by developed countries. As shown in Table B1.3, 71 per cent (108) of IMF members have employed their SDRs. But whereas 82 per cent of SIDS have made use of 44 per cent their SDR allocations and 69 per cent of LICs have used 86 per cent of their allocations, the 65 per cent of developed countries that employed their allocations made use of only 13 per cent of their allocations. This raises the question of whether (and how), in addition to new allocations, voluntary reallocations of unused SDRs (sometimes referred to as SDR recycling) from developed to developing member states could be undertaken.

SDR recycling: Old wine in new bottles?

Broad estimates for SDR recycling from the Group of Seven (G7) to developing countries (excluding the planned new 2021 SDR allocation) suggest a figure in the region of \$100 billion (Reuters, 2021). Compared to \$266.5 of the new SDR allocation going to these countries, and if broadened beyond the G7, such SDR recycling could be significant. The most prominent proposals for such SDR recycling currently mooted include channelling SDR reallocations through of IMF’s poverty reduction growth trust (PRGT) and the establishment of a separate

IMF Resilience and Sustainability Fund for vulnerable economies including MICs, aimed at supporting their Covid-19 recovery and promoting climate change (Shahal and Jones, 2021). The idea is that recycled SDRs (to IMF) will be used to boost the funding of concessional IMF lending facilities. This, however, not only compromises the non-debt creating characteristic of SDRs, but recycling SDRs through IMF lending facilities runs the danger of stripping them of their role as policy-unconditional liquidity support that (indirectly) helps to free up much needed fiscal space in developing countries.

TABLE B1.3 Utilization of existing SDR allocations by country group, as of 31 May 2021

Country group (total number of countries in brackets)	Share of countries that <i>utilized past SDR allocations</i>	SDR utilization (Share of allocation)
Transition economies (18)	67%	38%
Low-income developing countries - LICs (29)	69%	86%
Middle-income developing countries - MICs (44)	73%	63%
High-income developing countries - HICs (31)	68%	35%
Small Island Developing States - SIDS (28)	82%	44%
Total all developing economies (150)	72%	47%
Developed countries (40)	65%	13%
Total (190)	71%	28%

Source: UNCTAD secretariat calculations, based on World Bank, IMF and national sources.

Note: LICs and MICs exclude SIDS.

Other proposals include the creation of earmarked funds outside the IMF, such as a Covid-19 response investment fund, a Global Vaccine Fund or a Global Social Protection Fund, but without clear answers as to how country eligibility criteria, potentially competitive priority setting for ear-marked purposes and the more detailed functioning of such funds in regard to their lending activities should be designed (e.g. Ghosh, 2021). The alternative is to allow decision-making in developed countries with a low utilization rate of their allocated SDRs to lend or donate unused allocations to developing country partners on a unilateral basis (e.g. Plant, 2020).

A bolder option: Leveraging SDRs for multilateral cooperation to achieve global goals

Under the pressure of global emergencies quick responses will inevitably entail working within given structures to achieve the best short-term outcome. But this should not obscure the urgent need to move beyond the use of SDRs solely as a “fire-fighting” crisis-response tool.²⁶ The most obvious option would be a further and deeper review of IMF’s quota system to address current biases in favour of developed countries. Given the many years it took to arrive at the marginal 14th General Quota Review, implemented in 2016, this is also the least realistic option due to lack of political consensus. Another still challenging, but perhaps more achievable, option is the creation of new ear-marked types of SDRs – such as Special Environmental Drawing Rights or Special 2030 Agenda Drawing Rights – to establish SDR-based global funds for purposes that command a high degree of collective and multilateral support. Under this proposal, participating countries would develop national investment plans to meet specific (environmental and/or SDG-related) targets and specify budgetary requirements. For countries that cannot self-finance these plans, a zero-interest loan facility at the IMF could be put into place, whose maximum funding capacity would be measured using Special Purpose Drawing Rights that link claims on these directly to planned earmarked investments (*TDR 2019*: 92-93). This would have several advantages:

- i. It would de-link an *expansion* (and more regular use) of *new types* of SDRs from the IMF quota system.
- ii. It would provide a flexible and, in principle, unlimited mechanism for the predictable, stable and affordable financing of environmental and development targets and objectives without mechanical reliance on counter-productive policy conditionalities or ad-hoc eligibility criteria.
- ii. It could also channel recycled ‘standard’ SDRs in coordinated fashion towards complementary global environmental and developmental goals.

While this idea, as with other proposals,²⁷ will likely require changes to IMF’s Articles of Agreements, action is urgent, if the achievement of interrelated environmental and developmental goals is to be taken seriously.

Looking at both parts of Figure 1.12 in conjunction, it becomes clear that net private capital flows to developing regions in 2020 and the first quarter of 2021 have been dominated by a few emerging market economies, in particular China, as well as other emerging Asian economies and to a lesser extent, large emerging market economies in Latin America. For these countries, changes in the net external assets of their residents are significant, since the expansion of their external balance sheets over the last decade has involved the build-up not only of international reserves but also of other foreign assets (Akyüz, 2021). Although China was the main recipient of net portfolio and foreign direct investments between mid-2020 and the first quarter of 2021 (with non-resident portfolio inflows and FDI much larger than Chinese portfolio and direct investments abroad), as mentioned, substantive outflows of Chinese other investments in corporate and commercial bank deposits overseas, bank lending abroad and, to a lesser extent, trade credits and advances, have been important in accounting for net negative capital flows to developing countries overall in this period (SAFE, 2021; Westbrook and Zhou, 2021). While other Asian economies have, throughout 2020 and into 2021, seen the largest portfolio outflows of all regions – including substantive non-resident investor flight from domestic sovereign bond markets in some cases – the region overall has benefited most from inflows of other investments as well as from strong FDI, in particular, into India (UNCTAD, 2021a; World Bank, 2021).

1. Debt sustainability in developing countries: No sign of relief on the horizon

Even though spiralling sovereign debt crises were avoided in 2020, developing countries' external debt sustainability further deteriorated, revealing growing pressures on external solvency in addition to immediate international liquidity constraints. Growing optimism about financial resilience in developing countries is premature.

The external debt stocks of developing countries reached \$11.3 trillion in 2020, 4.6 per cent above the figure for 2019 and 2.5 times that for 2009 (\$4.5 trillion).¹² The slower growth of these stocks in 2020 compared to average annual growth rates between 2009 and 2020 (7.7 per cent) reflects a combination of more limited access to international financial markets, increased reliance on concessional financing sources and the temporary impact of partial debt

service payment suspensions through the G20 DSSI for low-income economies. Rising commodity prices from around the 2020Q2 helped to alleviate balance of payment constraints in developing country commodity-exporters, but also were a contributory factor to inflationary pressures and to rising food insecurity in commodity-importing developing countries, while the recovery of remittances has been very gradual (Malik, 2021) and tourism revenues have remained subdued (see Section D). But these rebounds, as well as the gradual return of global investors to some developing countries (see above), have been insufficient to compensate the impact of their drastic collapse in the first half of the year on the ability of developing countries to service their external debt obligations.

At the same time, substantive debt relief has not materialized. The only lasting multilateral relief is being provided by the IMF through the cancellation of debt service obligations in 29 countries due to it, amounting to \$727 million between April 2020 and October 2021. The G20 DSSI delivered around \$5.7 billion in debt service suspensions by participating bilateral creditors to 46 out of 73 eligible recipient countries in 2020, with a further \$7.3 billion expected to apply in the first half of 2021.¹³ This not only is at best a proverbial drop in the bucket, but also will increase debt repayment burdens from the end of the DSSI in December 2021 for participating countries who will have to add suspended payments to their repayment schedules from 2022. The provision of emergency concessional financing by the IMF, the World Bank and – to a lesser degree – other multilateral development banks,¹⁴ while required, also represents new debt that needs to be serviced.

Numerous sovereign debt crises across the developing world have, therefore, been postponed rather than resolved. As Figure 1.15 shows, the external debt stocks of developing countries have been growing faster than their export earnings again since 2018, with this trend clearly accelerating in 2020, pointing to rising external solvency constraints. The consequent strong rise in the ratio of total external debt stocks to exports from 110 per cent in 2019 to 129 per cent in 2020 for developing countries overall has been driven by much sharper increases, from higher levels, in low-income developing countries (from 179 per cent in 2019 to 220 per cent in 2020), least developed countries (from 158 to 202 per cent, respectively) and in particular, in small island developing states (SIDS), from 158 to no less than 293 per cent in the space of a year. This trend has been most

pronounced in African countries and the LAC region (Figure 1.16, right side).

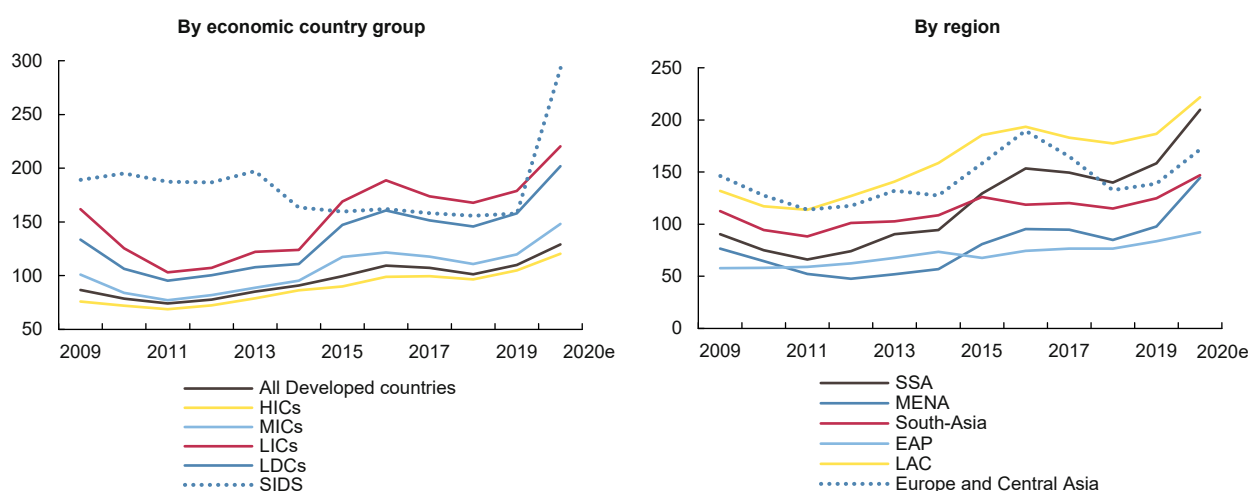
Debt service on total external debt, as a percentage of exports, thus rose to 15.8 per cent in 2020 for all developing countries, from 14.7 per cent in 2019 and compared to an annual average of 11.3 per cent between 2009 and 2020. This figure reached 17.5 per cent in middle-income countries and an unprecedented 34.1 per cent in SIDS, both country groups with a substantive exposure to the refinancing of public external debt in international financial markets and to growing shares of private in total external debt. In this context, it is worth recalling that the 1953 London Agreement on German external debt considered that the amount of export revenues that West Germany could spend on debt servicing should be limited to 5 per cent of the total in any year in order not to impede its post-war recovery (*TDR 2015*: 134).

Pressures on external debt sustainability are set to remain high over the coming years since many developing countries face a wall of upcoming sovereign debt repayments in international bond markets (Figure 1.16). Taken together, developing countries (excluding China) face total repayments on sovereign bonds already issued to a value of \$936 billion until 2030, the year earmarked for achievement of the Sustainable Development Goals (SDGs), consisting of \$571 billion in repayments of principals and \$365 billion in coupons or the annual interest rate paid on a bond's face (or nominal) value.

Of particular concern are countries in sub-Saharan Africa, many of whom are low-income countries. At the time of writing, the third wave of the pandemic is rampant across the African continent with very low levels of vaccination, and there is no assurance that countries in sub-Saharan Africa will be in a position to meet bond obligations scheduled for 2023, nor that they will have time to recover by 2025, a watershed year in which these countries need to repay \$13 billion (in principal outstanding and coupon disbursement).

In mostly middle-income LAC countries, the wall of sovereign bond debt immediately following the pandemic is also palpable, with over \$25 billion due in 2024 and 2025. Both regions also face high coupon disbursement burdens (or shares of coupon disbursements in total repayments on foreign-currency denominated sovereign bonds due in any one year under the period of observation), well above those in other developing countries (excluding China), in particular in the first half of this decade. This challenge reflects the fact that countries in these regions pay higher coupon or annual interest rates on their sovereign bonds in international financial markets than the average for developing countries as a whole (Munevar, 2021). Thus, the data highlights the consequence of historically high coupons in LAC countries, with the coupon disbursement burden well above 60 per cent until 2023, only gradually falling in subsequent years to reach 16 per cent in 2030. For countries in sub-Saharan Africa, the coupon disbursement burden is very high at the start of the period

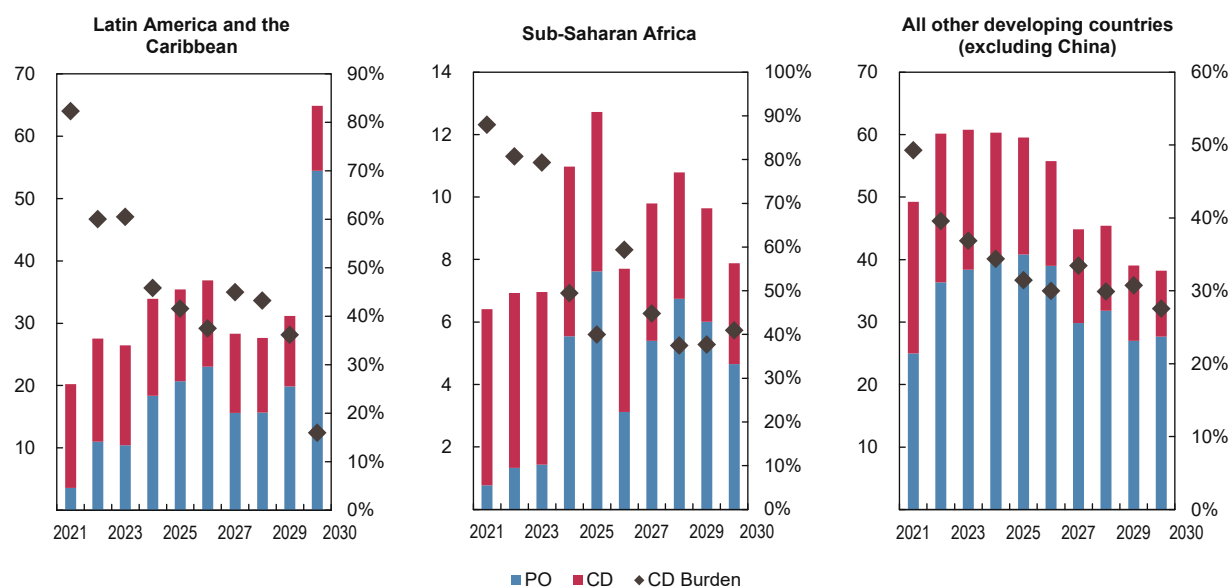
FIGURE 1.15 Total external debt to export revenues, developing countries, 2009–2020
(Percentage)



Source: UNCTAD secretariat calculations, based on World Bank International Debt Statistics.

Note: 2020 = estimates.

FIGURE 1.16 Sovereign bond repayment profiles, selected regions, 2021–2030
(Billions of current United States dollars (left scale) and percentage of total debt service (right scale))



PO= Principal outstanding and maturing. CD=Coupon disbursement (left-hand side).
CD Burden= Coupon disbursement burden (per cent of total debt service, right-hand side).

Source: UNCTAD secretariat calculations based on Refinitiv.

Note: Sovereign bonds included are those issued in foreign currencies. Coupon disbursements reflect currently available information and may underestimate the coupon disbursement burdens since a number of sovereign bond contracts have variable interest rates (coupons) over the period under consideration. Red dot represents the average coupon, as of current information available.

at over 80 per cent, and although it then declines somewhat, is still estimated to stand at 41 per cent of the total debt servicing bill in 2030.

Beyond sovereign bond debt, the overall composition of external debt has changed, with public and publicly guaranteed long-term external (PPG) debt overtaking private non-guaranteed long-term external (PNG) debt as the main component of developing countries' external debt profiles in most countries since 2018, a trend clearly reinforced by the onset of the Covid-19 pandemic. While PNG debt became a driving factor of developing countries' overall indebtedness in the aftermath of the GFC (see *TDR 2019*), the recent faster growth of PPG compared to PNG debt reflects the stronger reliance on public borrowing in times of crises. Thus, while PPG debt grew at 8.7 per cent in 2020 – well above its average annual growth rate since 2009 of 7.5 per cent – PNG debt grew at only 2.9 per cent. Current shares of PNG debt, in both long- and short-term external debt, nevertheless remain high by historical standards (amounting to 48 and 34.7 per cent, respectively, in 2020), entailing considerable contingent liabilities for public sectors.

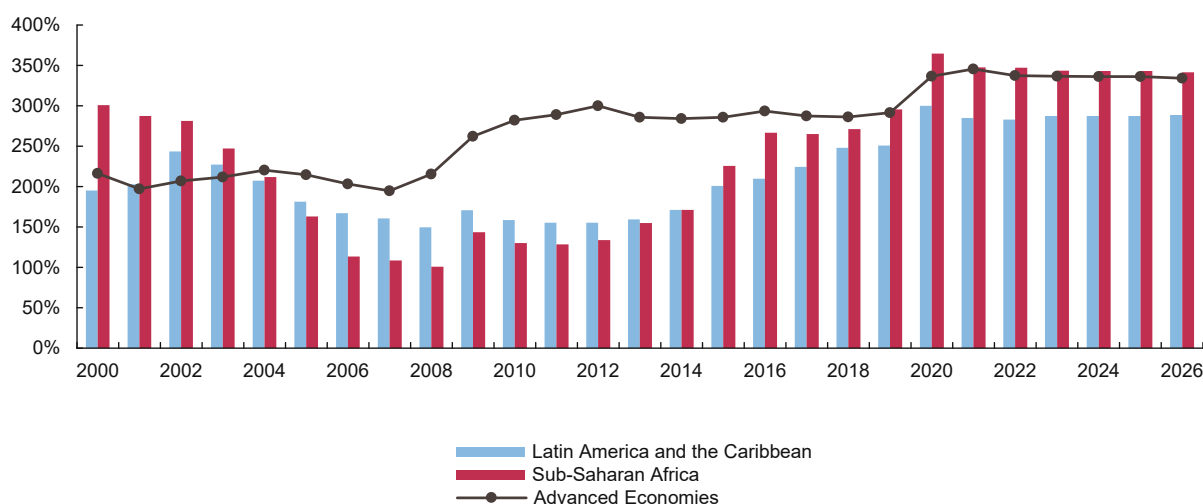
Finally, and to fully grasp the severity of the situation, it is necessary to look beyond external debt

burdens to the evolution of public debt burdens overall, as an indicator of pressures on fiscal space and on repayment capacities in developing countries. As Figure 1.17 shows, the economic fallout from the Covid-19 pandemic has, unsurprisingly, spurred a build-up in public debt as government revenues have collapsed and health and social expenditure has increased. As a percentage of government revenues, total gross government debt reached unprecedented levels in sub-Saharan Africa (364 per cent) and LAC (300 per cent), surpassing high levels at the start of the century. In the case of sub-Saharan Africa, this also means that the success of the multilateral debt relief initiatives of the 1990s and early 2000s has been obliterated. Such high levels of public debt are more typically associated with advanced countries, whose management of this degree of indebtedness benefits from far lower debt service costs and the ability to issue internationally accepted domestic currencies to finance their government budget deficits. For developing countries, the outcome is likely to be higher balance of payments constraints. While the degree of policy space and the link between the fiscal and external constraints varies across developing countries (see *TDR 2020*, p. 98-100), there is little reason to doubt current IMF projections that these high public debt ratios will continue into 2026.

Given this outlook, more concerted and bolder international action is urgently needed to reduce the debt overhang in developing countries through substantive debt relief and outright cancellation. The alternative to addressing structural solvency constraints and putting developing countries' external

debt burdens on a more sustainable, long-term footing is another lost decade for development marked by developing countries struggling under unsustainable debt burdens rather than investing in more promising approaches after the pandemic and achieving the 2030 Agenda.

FIGURE 1.17 Gross government debt to government revenues, selected developing country regions and advanced economies, 2000–2026
(Per cent)



Source: UNCTAD Secretariat calculations, based on IMF WEO April 2021. Country grouped by IMF WEO country classification.

Note: 2021 to 2026 = estimates.

D. Trends in International Trade

1. Goods and services

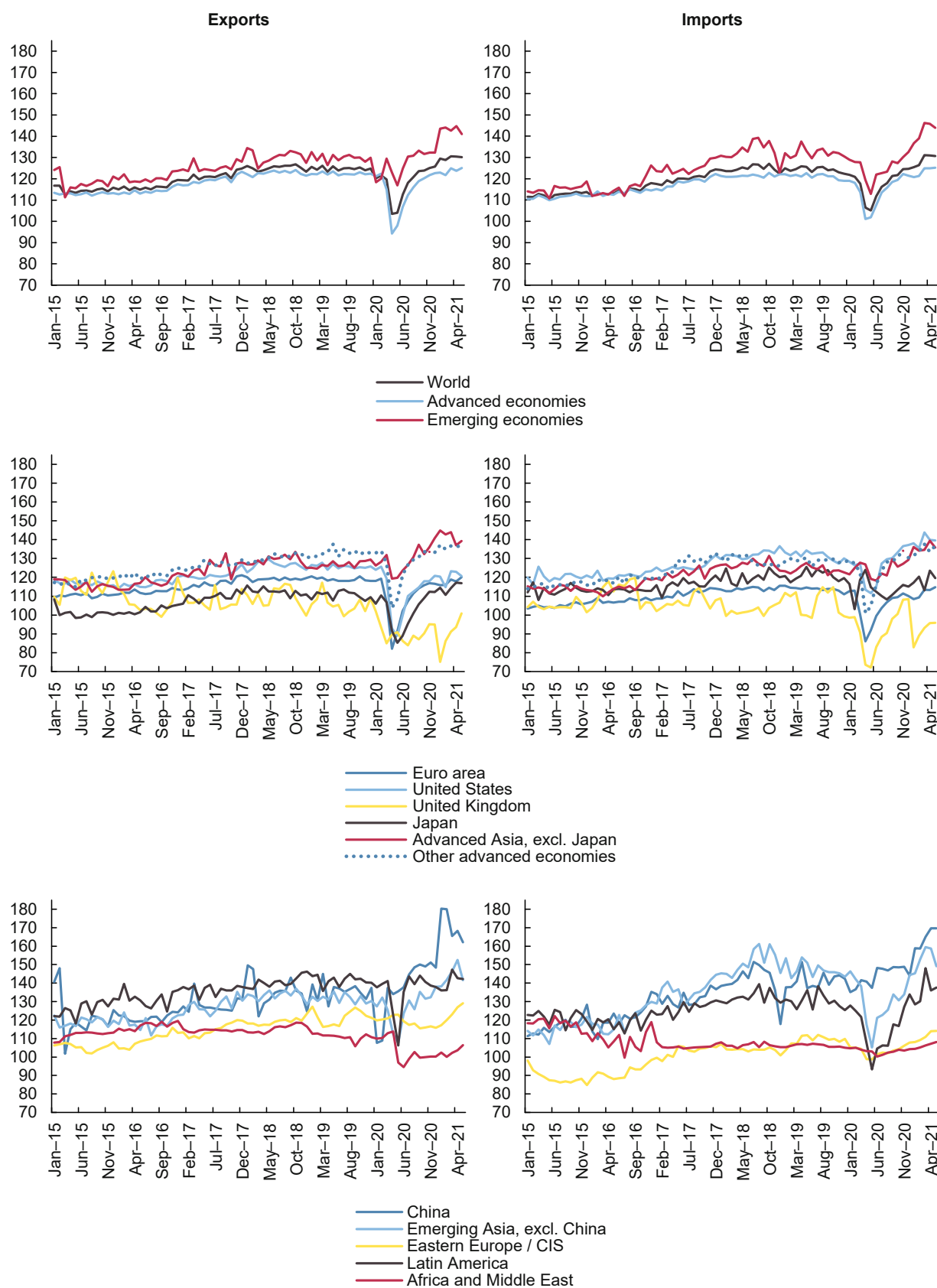
Extraordinary measures such as lockdowns, quarantines and travel restrictions had dramatic effects on trade; the international flow of goods and services drop by 5.6 per cent in 2020. Nevertheless, this downturn proved less severe than had been anticipated, as month-on-month merchandise trade flows in the latter part of 2020 rebounded almost as strongly as they had fallen earlier (Figure 1.18). The modelling projections underpinning the economic growth results in Section B yield an annual real growth of global trade in goods and services of 9.5 per cent in 2021. Still, the recovery has been extremely uneven, and scars will continue to weigh on the trade performance in the years ahead.

Risks remain tilted to the downside. First, the recent uptick in international trade may be short-lived, as it partly reflects an inventory restocking cycle in early 2021 after very low inventory-to-sales

ratios were registered in many developed economies. Furthermore, the pandemic-induced shift in consumption habits, notably the relative increase in demand for goods, is expected to shift back as demand patterns normalize in high-contact sectors. This dynamic could boost trade in services if the rollout of vaccines improves worldwide. Yet, as of mid-2021, the spread of the Delta variant, including in the advanced economies with relatively high vaccination rates, is a reminder of just how fragile and uncertain the current situation is. The new variant could also prolong bottlenecks in international shipping caused by the pandemic, resulting in delays and price hikes in container shipping rates.

Apart from these near-term effects, trade tensions between the United States and China remain elevated. Similarly, global disputes over trade more broadly remain unresolved. These wrangles include the failure to end a deadlock on appointments to the Appellate Body of the World Trade Organization

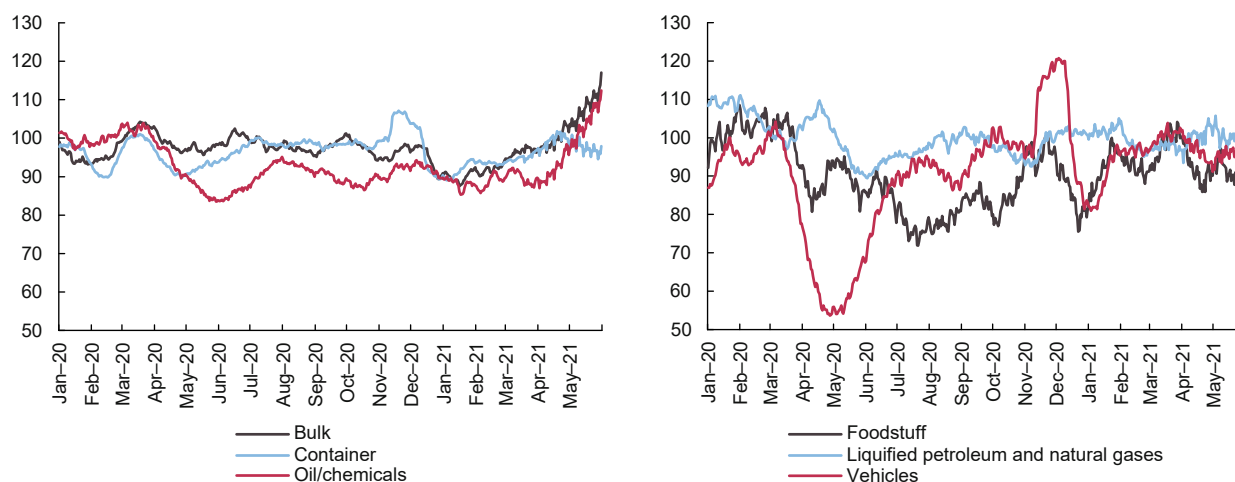
FIGURE 1.18 World merchandise trade, January 2015–May 2021
(Index numbers, average 2010 = 100)



Source: CPB Netherlands Bureau for Economic Policy Analysis, World Trade Monitor database.

Note: Country group classification in this figure relies on Ebregt (2020).

FIGURE 1.19 Metric tons of world exports by vessel type, 1 January 2020–31 May 2021
(Index numbers: average 2019 = 100 ; 31-day centred moving averages)



Source: UNCTAD secretariat calculations, based on Cerdeiro et al. (2020) and AIS data collected by MarineTraffic (available at UN COMTRADE Monitor).
Note: Data after 15 June 2021 were not used because by the cut-off date the coverage was still insufficient to get a meaningful world aggregate.

(WTO), the highly uncertain future of the Doha Round and persistent differences over reform of the multilateral trading system. The upcoming WTO Ministerial in December, where calls for a more development-friendly trade agenda are likely to clash with efforts to add an environmental dimension to the trading rules, seems unlikely to iron out major differences.

Geographically, trade patterns have diverged since the beginning of 2020. The dominant position of Asia has prevailed, with an increased contribution to world trade in 2020 and 2021. China rebounded earlier and sharper than most other countries, both in terms of exports and imports. During the first half of 2021, China's monthly trade flows already exceeded their pre-pandemic levels by more than 10 per cent. Moreover, Chinese imports appear as an outlier as they do not show a strong decline in the first semester of 2020 compared to their historical trend. Robust domestic investment led to a strong appetite for raw materials that has persisted through 2021. In a similar vein, several other Asian economies have also performed strongly. These include, inter alia, Hong Kong (SAR), Taiwan (Province of China) and Viet Nam, which all saw their monthly exports exceed their pre-Covid-19 peak by late 2020 or early 2021 and have continued to surge through this year.

A number of other large economies saw their monthly merchandise trade flows, both exports and imports, close to the pre-Covid-19-crisis peaks by mid-2021.

Lagging are the United Kingdom, Africa and the Middle East region, whose figures remained in many cases more than 20 per cent below their historical high by mid-2021. In the United Kingdom, weaknesses mostly resulting from post-referendum uncertainties, have severely disrupted trade with the European Union. In early 2021, lockdown measures, together with the winding-down of a rush to stockpile products ahead of the end of the Brexit transition period in late 2020, led to a second significant collapse of trade flows in less than 12 months. In Africa and the Middle East, total export volumes largely depend on oil. As its extraction has been sharply reduced after the OPEC+ agreement of April 2020, this largely explains why exports remain depressed, even though positive price effects have boosted external revenues for the large oil-exporting economies. Meanwhile, imports of this group have remained extremely flat, mirroring the subdued rebound in economic activities in these countries.

The evolution of trade flows since the emergence of Covid-19 has also diverged markedly from pre-pandemic patterns, as measured by their components. Overall, trade in goods has shown greater resilience than trade in services, though large disparities exist within these two broad categories.

For goods, estimates of world seaborne exports from Cerdeiro et al. (2020) track maritime merchandise trade by their respective vessels in real time (Figure 1.19). These can be used as proxies to unravel specific patterns in real time, which is especially relevant in

the current environment. As seaborne trade represents more than half of the value of all trade in goods – compared to ‘air’ and ‘other transport modes’ (i.e. mostly land) which account respectively for only 12 per cent and 31 per cent of the global freight services in 2019 (WTO, 2020) – these data provide a good sense of what is currently happening to these specific segments.

Seaborne transportation also experienced mixed patterns. As for the other dimensions of trade, data point to a multi-paced recovery. Containers, which represent roughly two thirds of the world maritime transport in terms of metric tons of cargo, registered a kind of W-shaped trajectory between March 2020 and June 2021.¹⁵ Overall, this type of vessels did not register more than 5 per cent decline in activity in the first half of 2021 compared to 2019 and 2020, though a misallocation of containers led to a significant surge in shipping costs, especially from East Asia to Europe (see below). By contrast, compared to 2017 and 2018, container shipments were about 18 per cent lower, reflecting trade disputes and general subdued economic activities preceding the Covid-19 shock.

For the other two main categories of maritime transport – i.e., bulk and oil/chemicals, both accounting for slightly less than one fifth of the total – the patterns also differ markedly. Bulk has been much more constant than any other type of cargo. Indeed, the Covid-19 shock is hardly visible in the data when compared to previous oscillations. In the second quarter of 2021, however, it gradually increased, to reach an all-time high towards the end of May amid strong demand for raw materials.

Tanker shipping, by contrast, oscillated between the 2020Q1 and 2021Q1 at a level roughly one-tenth below its pre-pandemic plateau. Gas shipments have been relatively resilient while vehicles point to a deep drop in March-April 2020 due to the closure of many automotive assembly plants and the decline in the purchasing of vehicles in Europe and North America. After this episode, vehicle shipments rebounded quickly owing to the release of pent-up demand, especially in Asia, followed by a continued increase in the second half of 2020.

In trade in services, the shock from the pandemic has been sharper, with key sectors within this catch-all category still suffering severely from the pandemic-related disruptions. Tourism, at one-fourth of the total the largest component of trade in services prior to the pandemic, dropped to only one tenth

in 2020 due to the collapse in travel and remains heavily depressed. Recent estimates point to global financial losses of \$2.4 trillion in 2020 followed by another \$1.7–2.4 trillion in 2021 depending on the scenarios for the rest of the year (UNCTAD, 2021b). Aside from these projections, recent data shows that in January–May 2021, international tourist arrivals worldwide remained 85 per cent lower than their corresponding levels of 2019. Asia and the Pacific continued to register the largest declines with a 95 per cent drop in international arrivals during the first five months of 2021, compared to the same period two years ago. The situation was slightly better in North America and the Caribbean, though the evolution in these figures still point to declines of 70 per cent and 60 per cent, respectively (UNWTO, 2021a).

Confidence in this industry has been slowly rising as the vaccination rollout in some key source markets together with policies to restart tourism safely have boosted hopes for a rebound in some locations. However, uncertainty remains high due to the uneven rollout of vaccines and the surge of new variants, which altogether tend to have a greater impact on long-haul destinations given the likelihood to have greater asymmetries in terms of health conditions and lesser harmonization of travel measures against Covid-19. In this context, almost half of all experts saw a return to 2019 levels only in 2024 or later (UNWTO, 2021b).

Transport, accounting for about one sixth of the trade in services, registered its lowest level of activity since 2010, with a 19-per cent drop in 2020. Apart from the sea transport described above, which weathered the crisis relatively well, except for most of the world’s 1.7 million commercial seafarers who have been left stranded by the pandemic, air transport services remain severely depressed as passenger flights struggle to recover. In this context, airlines passenger revenues were down 74 per cent in the first quarter of 2021, compared to the same quarter in 2019. By contrast, air cargo has registered intense activity owing to the pandemic-induced logjams in maritime transport that prevent on-time delivery for high-value goods. The sudden rush for medical appliances and PPE at the onset of the pandemic and the subsequent rise of e-commerce, have further supported this subsector. In this context, cash-strapped airlines have converted passenger planes to cargo carriers as they looked for alternatives to limit their financial losses. This switch led to a year-on-year increase in cargo revenues by 50 per cent during the first quarter of 2021, though it was insufficient to compensate for the sharp loss

in passenger flows, which resulted in a 65 per cent drop in overall revenues.¹⁶

As of mid-2021, several other types of trade in services remain depressed. These include commercial, maintenance and repair, construction and to a lesser extent personal, cultural, and recreational services. By contrast, trade in ICT, insurance, pension, and financial services, have benefitted to an extent from pandemic-induced effects, such as the rise of activities being conducted over the Internet due to social distancing and remote work.

Aside from these specific developments, disruptions of all kinds have interrupted international trade in 2020 and 2021. Some of these disruptions still weigh on the outlook. Crippling supply chain bottlenecks that may have bolstered shipping profitability have also increased pressure on supply chains and thus trade. By early 2021, maritime freight rates surged, surcharges proliferated, service reliability declined, congestion in ports increased while delays and dwell times went up (UNCTAD, 2021c).

Supply chains have come under considerable pressure over the last year for a variety of unrelated reasons: the surge in consumer demand for manufactured goods, especially in the United States; transport capacity constraints; shortages affecting equipment and container; renewed virus infections in some parts of the world, including in Yantian terminal, a critical international container port in China; and a week-long blockage of the Suez Canal caused by the grounded container ship *Ever Given*. These disruptions are holding up the recovery for some major industries, especially in Europe. In parallel, the self-isolation of workers in large factories or warehouses, like in the United Kingdom also disrupted the production of manufactured goods. Automotive industry plants, for instance, had to close temporarily due to missing critical components and parts or at least to cut production because of labour shortages. Together, these experiences heightened the push back against long-haul trade, extended supply chains and the over-reliance on single-source suppliers.

2. Commodity markets

Commodity prices have, through mid-2021, continued their upward trajectory observed since mid-2020, with all commodity groups recovering to pre-pandemic levels, and some groups far exceeding those. The aggregate commodity index registered a drop of over 35 per cent from December 2019 to April 2020

– the date at which the price index reached its lowest point – with fuel commodities experiencing a fall of just shy of 60 per cent during this period (Figure 1.20).

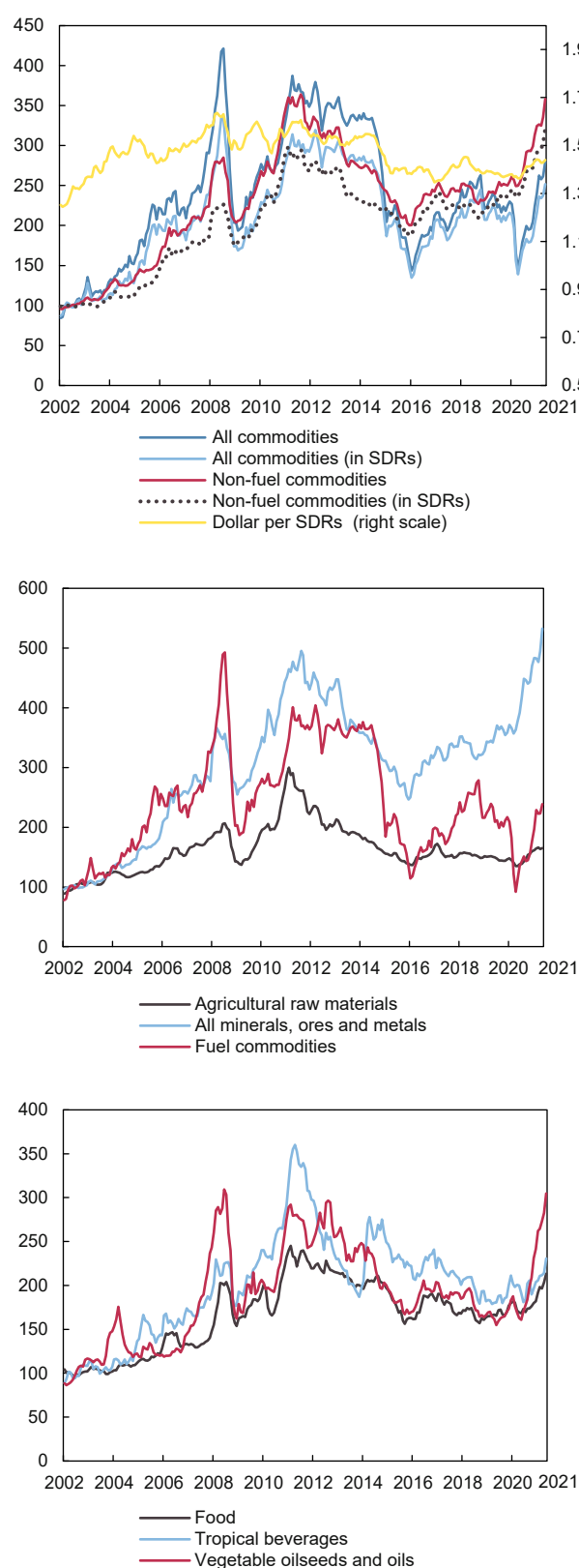
The imbalance between global oil supply and demand explains the unprecedented decline of international crude oil prices. A subsequent agreement reached by OPEC+ members in April 2020 to reduce daily oil production by 10 million barrels a day – the largest ever coordinated cut in production – proved effective in stabilizing crude prices.

A slightly positive trajectory for minerals, ores and metals during the first months of 2020 reflects the significant price gains registered for precious metals, a main refuge for financial investors during times of market uncertainty. These gains compensated the decline in the prices of industrial metals as international demand for these materials plunged.

Lastly, the commodity groups of food, beverages and vegetable oilseeds saw fairly moderate price declines at the beginning of 2020. Despite the weakening aggregate demand outlook and the sharp drop in fuel prices (which particularly affects the prices of biofuel crops such as corn and soybeans), as well as record high production for some food groups (particularly grains), the downward pressure on food prices during the first few months of 2020 was not as acute as that of other commodity groups. This was in part due to their lower income elasticity of demand. Similarly, increasing concerns regarding food security amidst the spread of the pandemic – particularly for poorer developing nations – due to disruptions in supply chains and transport networks also served to attenuate the downward pressure on food prices. The implementation of trade restrictions (including export bans) and increased imports with the intention of stockpiling certain food commodities further eased any downward pressure on prices. These factors account for the modest price declines in these commodity groups during the initial phase of the pandemic.

By the end of 2020, the aggregate commodity price index lay only marginally below the level observed in December 2019. The only group which remained significantly below the level observed prior to the pandemic was fuels, which ended 2020 with their price level 18 per cent below that registered a year earlier. By contrast, the prices of minerals, ores and metals and of vegetable oilseeds and oils, ended the year over 30 per cent above their pre-pandemic levels. In the case of metals, a ramping up of investment

FIGURE 1.20 Monthly commodity price indices by commodity group, January 2002–May 2021
(Index numbers, 2002 = 100)



Source: UNCTAD secretariat calculations, based on *UNCTADstat*. For more details on the data sources see <https://unctadstat.unctad.org/wds/TableViewer/tableView.aspx?ReportId=140864>.

spending in infrastructure projects in China as well as the Chinese authorities' decision to replenish strategic stockpiles led to a vertiginous increase in import demand for industrial metals such as copper and iron ore during the second half of the year. At the same time, the closure of key mines in Brazil due to virus outbreaks constrained supply and applied further upward pressure on the prices of these metals. Likewise, in the cases of food and vegetable oilseeds, increased demand for soybeans and wheat from China, coupled with lower-than-usual rainfalls in key producers in South America – due to the periodic cooling of ocean surface temperatures in the Pacific known as La Niña – which resulted in depressed grain volumes, lifted the prices of these agricultural goods towards the end of the year.

In 2021, the positive trajectory of commodity prices from the trough observed in the second quarter of 2020 has continued. The aggregate commodity index registered an increase of 25 per cent from December 2020 to May 2021, mainly due to the price of fuels, which surged by 35 per cent, while that of minerals, ores and metals registered an increase of 13 per cent.

The principal factors on the demand side exerting upward pressure on industrial commodity prices in 2021 include the ongoing rebound in industrial output in China and the strong recovery observed in the United States. These developments helped lift growth prospects and provide greater buoyancy to industrial commodities in 2021. Similarly, the Biden Administration's initial proposals to ramp up investment spending on major infrastructure projects further raised the growth outlook, and particularly boosted the demand for commodities such as aluminium, copper, iron ore and crude oil in the near term. Yet subsequent revisions and clarifications of the investment plans point to a significantly smaller increase in spending than that originally indicated, dampening the expected boost to demand.

Similarly, the surge seen in the prices of industrial metals in 2021 has been supported by supply constraints. Copper prices, which rose by 24 per cent over the course of the first half of 2021, have been lifted by mining disruptions in Peru and Chile. Likewise, iron ore prices, which surged by 38 per cent during the same period, were bolstered by disruptions to supply in Australia. Adding to the upward pressure on metal prices have been problems with regards to transportation of these goods largely due to increased congestion at strategically important ports, as well as difficulties with shipping personnel linked to

quarantine requirements in certain locations. Finally, the strong recovery in fuel prices has also increased transportation costs.

Moderating somewhat the uptick in the price of minerals, ores and metals has been the negative, albeit mild, trajectory in the price of gold. The downturn corresponds to a decline in demand for the commodity – which is seen as a safe asset – as the real yield on United States Treasury securities has nudged upward in 2021.

The commodity groups of food, beverages, and vegetable oilseeds and oils saw increases of 17 per cent, 13 per cent and 26 per cent, respectively, through the first half of 2021. Food insecurity concerns continue to be a factor in driving up prices. Meanwhile, sustained robust demand from China – particularly for feed commodities such as soybeans and maize as the country's livestock sector recovers from an outbreak of African Swine Fever – has been a factor driving global demand for these goods. The surge in fuel prices has also boosted the prices of grains and oilseeds that are used as biofuels.

On the supply side, the previously mentioned adverse weather conditions linked to La Niña towards the end

of 2020 and into 2021 have severely affected grain production in South America and the United States, adding upward pressure to grain prices in 2021.

Despite the continued buoyancy in commodities prices since mid-2020, sources of fragility remain. In June 2021, the suggestion that the Fed may move to tighten policy earlier than had been previously envisaged was sufficient to drive down the prices of raw materials such as copper and lumber – both of which are key inputs in the construction sector – in the week following the Fed's announcement. Strategic policy turns can also sway the trajectory of prices. For instance, in June Chinese authorities released national reserves of various industrial metals, including copper, aluminium and zinc, in order to moderate their steep price increases over the first half of 2021.

Continued curbs on oil production by the OPEC+ alliance has supported the upward movement in fuel prices. Maintaining these limits on supply is contingent on adherence to the agreed output cuts within the OPEC+ framework. Recent fractious negotiations among OPEC+ members to extend production curbs highlights the possibility of loosening supply restraints, which would inevitably lead to a swift ramping up of global oil output. The sharp decline in

TABLE 1.2 World primary commodity prices, 2008–2021
(Percentage change over previous year, unless otherwise indicated)

Commodity groups	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021 ^a
All commodities ^b	33.4	-31.6	24.3	28.6	-3.0	-3.7	-7.9	-36.2	-9.4	17.4	16.0	-7.4	-15.9	43.5
Non fuel commodities ^c	22.2	-17.8	26.1	18.9	-12.7	-6.5	-8.0	-18.9	2.3	9.1	-2.2	0.1	4.2	41.0
Non fuel commodities (in SDRs) ^c	18.3	-15.7	27.3	14.9	-10.0	-5.7	-8.0	-11.9	3.0	9.4	-4.2	2.5	3.4	34.5
All food	32.6	-10.4	12.0	24.0	-6.5	-9.6	-0.8	-15.6	3.6	-1.3	-6.5	-2.0	6.5	28.1
Food and tropical beverages	31.1	-2.2	11.6	23.6	-9.9	-9.1	3.8	-14.2	2.2	-1.6	-6.7	0.3	3.6	13.7
Tropical beverages	19.2	1.1	19.8	31.2	-22.4	-19.8	24.1	-10.3	-3.3	-3.1	-8.5	-5.1	4.8	8.2
Food	34.9	-3.2	9.1	21.1	-5.6	-6.0	-1.2	-15.4	4.0	-1.2	-6.1	1.9	3.3	15.2
Vegetable oilseeds and oils	35.2	-24.1	13.0	24.8	0.7	-10.5	-9.6	-18.8	7.0	-0.5	-6.2	-6.9	13.4	61.8
Agricultural raw materials	8.4	-16.4	37.0	24.5	-19.2	-8.8	-11.8	-13.3	-0.4	5.3	-1.8	-3.9	-2.0	16.6
Minerals, ores and metals	19.7	-12.9	33.6	20.5	-6.9	-9.5	-12.8	-17.2	4.6	11.3	1.3	6.2	15.5	34.6
Minerals, ores and non-precious metals	17.5	-25.4	39.0	12.2	-16.8	-2.0	-14.6	-24.8	1.4	25.7	2.6	3.4	3.7	62.7
Precious metals	23.4	7.5	27.5	30.8	3.4	-15.8	-11.0	-9.9	7.1	0.4	0.0	8.9	26.3	14.3
Fuel commodities	37.9	-38.6	23.1	32.0	-0.5	-1.2	-7.5	-44.4	-17.5	25.9	27.5	-12.6	-32.1	54.8
Memo item:														
Manufactures ^d	4.9	-5.6	1.9	10.3	-2.2	4.0	-1.8	-9.5	-1.1	4.7	4.7	-2.1	1.4	

Source: UNCTAD secretariat calculations, based on UNCTAD, *Commodity Price Statistics Online*; and United Nations Statistics Division (UNSD), *Monthly Bulletin of Statistics*, various issues.

Note: In current dollars unless otherwise specified.

^a Percentage change between the average for the period January to May 2021 and January to May 2020.

^b Including fuel commodities and precious metals. Average 2014–2016 weights are used for aggregation.

^c Excluding fuel commodities and precious metals. SDRs = special drawing rights.

^d Unit value of exports of manufactured goods of developed countries.

oil demand and prices in the first half of 2020 caused a string of bankruptcies among shale producers in the United States, as well as a severe drop in investments in new shale production facilities. However, going forward persistently high oil prices would likely translate into greater investment and production in the United States.

Looking beyond 2021, the shift towards renewable energy sources has important implications for the commodities sector, and not necessarily in the direction one might assume, particularly in the short-term. In the case of certain materials such as copper, lithium and cobalt, the move away from internal combustion engines will lead to a strong uptick in their demand as these products are key inputs in

electric vehicles. The recent proposal put forward by the European Union to ban the sale of new petrol and diesel cars by 2035 will only bolster this trend. Moreover, copper is not only used in electric vehicles but is also a key input for green infrastructures such as solar and wind energy. The green transition will therefore actually exert sustained upward pressure on the demand and prices for certain commodities. In fact, somewhat paradoxically, the investment drive to build the renewable energy infrastructure required for the green transition – with the accompanying rise in employment and economic growth associated with this investment push – will likely provoke, in the nearer term, an increase in the prices of the very same traditional energy commodities that this green infrastructure will later replace.

E. Regional Trends

1. North America and Europe

In 2020, the GDP of the United States contracted 3.5 per cent, the worst recession since the end of the Second World War. While all components of private demand contributed to the drop, a sharp fall in private consumption was responsible for three-quarters of the contraction, despite massive transfers from the Federal government. In response, the government expanded its net contribution to aggregate demand by the largest amount on record, including through the \$1.9 trillion (9 per cent of GDP) American Rescue Plan, but this only offset the downturn by a small fraction.

After slowing down amid the second wave of Covid-19 contagion in 2020 Q4, the recovery picked up again in 2021 Q1–Q2, as sanitary restrictions eased, and the impact of stimulus packages cascaded through the system. The expansion was driven by private consumption (especially of durable goods), professional services and residential investment; individual cash transfers ended by mid-year. Overall, growth is projected to be 5.7 per cent in 2021 and 3 per cent in 2022.

In Canada GDP contracted by 5.4 per cent in 2020, dragged down by consumption and investment spending, like in the United States, despite a substantial increase of government's contribution to aggregate demand. However, recovery has been moderately strong in 2021, partly thanks to an expansion of spending for social protection and partly on the

back of fast growth in the United States. Growth is projected to reach 5.1 per cent in 2021 and 2.9 per cent in 2022.

In Europe, between March 2020 and 2021 Q2, the three largest economies of the eurozone repeatedly went into lockdowns with adverse effects on growth. Indeed, France, Germany and Italy registered, respectively, -8.0, -4.9 and -8.9 per cent in 2020, while growth rates in the first quarter of 2021 relative to the first quarter of 2020 were negative for Germany and Italy (-3 and -1 per cent, respectively). In response, governments introduced extraordinary measures, which prevented layoffs and many bankruptcies and preserved the accumulation of aggregate private savings. In France, the total primary outlays of the general government grew by 12.8 per cent; in Germany by 13.5 per cent. Italy saw an 18.8 per cent increase, which reflects the extremely austere budgetary policies of the previous years.

At the same time, the intra-eurozone differences reflect a long-standing lack of coordination in the area, with the strongest economy, Germany, running a relatively small primary fiscal deficit-to-GDP ratio, -3.5 per cent, while the same ratio was -7.9 per cent in France and -6 per cent in Italy, the hardest hit eurozone economy. European Union-level measures were unprecedented but insufficient to overcome this structural limitation. In particular, ECB's support, including a € 1.85 trillion emergency bond purchasing program, reduced, but did not eliminate, the yield spread between national

government bonds and guaranteed liquidity access to banks and firms.

In France and Germany, the fiscal effort more than compensated the steep fall in primary incomes of households but could not prevent the dramatic reduction in personal consumption, most of which was concentrated in the sectors directly affected by the public health restrictions. In Italy, total after-tax household income fell slightly despite a 10.6 per cent increase in social transfers in cash and an almost 50 per cent increase in its non-pension share from 2019. The fall in personal consumption was almost twice as large as that in the other two economies (-11.8 per cent). Investment shrank at a similar rate everywhere and across the spectrum of activities, but most dramatically in the transport sector. Overall, there was no significant disruption in exports and net external demand bounced back quickly with the recovery of the global economy and an easing of travel restrictions, especially in Italy and Germany.

As the three countries progress with vaccinations and ease public health restrictions for the summer, tourism and consumption are projected to resume, together with some private investment. Both fiscal and monetary supports will remain in place for the time being, while early signs of pressure on prices have generally been taken as temporary. With growth expected in the remaining quarters of the year, and barring any new negative health developments, the real growth rate in 2021 is expected to reach 5.5 per cent for Italy and 5.2 per cent for France. The projected rate for Germany is 2.2 per cent, reflecting the smaller contraction of the past year together with the significant contraction of the first quarter. These rates will leave the respective economies below 2019 GDP levels. Given the already stagnant pre-Covid-19 conditions, prolonging a recovery beyond the bounce-back will depend on the capacity of new planned fiscal stimulus to expand public and private investment in a durable way, reinforcing domestic demand.

The European Union has suspended its fiscal rules throughout 2022, allowing room for further expansionary fiscal policies. Moreover, in June 2021, the European Union Commission began disbursement of the Next Generation EU funds, which will finance stimulus measures complementing the national budgets. The national recovery plans (only partly funded by European Union grants) include public investments which amount to an estimated 6.4 per cent of 2019 GDP spread over 6 years in Italy, 4.1 per cent in France and 0.7 per cent in Germany. Considering

the small size of these investment programs, the outcome of the ongoing debate about reforming the fiscal rules, as well as the criteria for the ECB bond purchasing programs, is crucial. Uncertainty on the matter is especially binding for Italy, which is the only country of the triad that we do not project to return to the 2019 GDP level in 2022, when it is projected to achieve a 3.0 per cent GDP growth rate. France and Germany with respectively 3.4 per cent and 3.2 per cent growth rates next year are both expected to reach previous levels in 2022.

The United Kingdom's GDP fell by nearly 10 per cent in 2020, the second largest contraction in the region, largely owing to plummeting domestic demand. The government's net contribution to aggregate demand increased more than 10 per cent of GDP compared with 2019, a record amount, partially absorbing the shock. A second wave of Covid-19 infections, met with restrictions to economic activity and school closures, led to a large contraction of retail sales in 2021 Q1, which brought GDP down by 1.5 per cent and its level 8.7 per cent below where it was in the last quarter of 2019. However, during this period employment began to recover. For 2021, growth is projected at 6.7 per cent and for 2022 at 2.1 per cent, assuming no more restrictions will be imposed and employment will continue to recover toward its 2019 level. However, post-Brexit adjustment processes still weigh over medium-term growth prospects of the United Kingdom.

2. Latin America and the Caribbean

The Latin American and the Caribbean region was severely hit by Covid-19, with high contagion and mortality rates, together with a sharp economic downturn. The GDP of the whole region fell 7.1 per cent in 2020 and is expected to grow just 5.5 per cent in 2021. Latin America is also struggling with rising inflation, due to the international spike in food prices, and volatile exchange rates, caused by the region's overspecialization on commodity exports and high exposure to speculative international capital flows (Campello and Zucco, 2020).

The Mexican economy contracted 8.3 per cent in 2020 and is expected to rebound 6.2 per cent this year. Part of the recovery reflects the booming United States economy, through higher Mexican non-oil exports. The other part is domestic, due to the easing of social distancing and the vaccination of the general population, which should pull up the demand for urban services. Fiscal policy has been a drag, since

Mexico continues to have the smallest fiscal impulse to fight the Covid-19 recession. In contrast, despite the increase in the short-term interest rates, monetary policy has tended to remain neutral, as the Bank of Mexico raised its base interest rate in line with the increase in expected inflation. The acceleration of the economy in the second half of 2021 will create a positive base effect for 2022, helping the economy grow 2.8 per cent next year, slightly above the country's pre-Covid-19 growth trend.

In Brazil, despite the heavy human cost of the pandemic, the economy contracted by just 4.1 per cent in 2020, the smallest impact among the largest Latin American economies. Expansionary fiscal and monetary policy helped Brazil wither the economic impact of Covid-19 and, in 2021, the recovery in commodity prices and a gradual phase out of the fiscal stimulus is expected to help GDP grow by 4.9 per cent. On the upside, vaccination and services' demand tend to accelerate in the second half of 2021. On the downside, supply shortages from hydropower plants have been pushing inflation up, which in turn is forcing the Brazilian Central Bank to hike the short-term interest rate to a contractionary level. The negative forces and political uncertainty associated with Brazil's next presidential election is likely to weigh on prospects in 2022, with growth slowing to just 1.8 per cent.

Similar to Mexico, Argentina's GDP was also heavily affected by the Covid-19 shock, falling by almost 10 per cent in 2020. The country's pre-pandemic recession and balance-of-payments problems also account for the sharp contraction, since the Argentine government had limited flexibility to attenuate the pandemic shock. In 2021, the increase in commodity prices, especially of food items, reduced the country's financial constraint and is expected to help the economy grow by 6.7 per cent. Going forward, the structural public and foreign-exchange imbalances remain a challenge, together with rising inflation. Assuming the government manages its foreign liabilities and the central bank avoids a wage-price spiral, economic growth is estimated at 2.9 per cent in 2022, a positive result in view of the Argentine performance before Covid-19.

The Andean economies have also been hard hit by Covid-19 in 2020, with double-digit GDP contraction in Peru, and a fall between 6 per cent and 8 per cent in Colombia, Chile, and Ecuador. The recovery in commodity prices, especially copper in the case of Chile, is helping most of the region recover to

nearly 6 per cent this year. The exception is Ecuador, where the currency peg limits the stabilizing role of fiscal and monetary policy. For 2022, the Andean economies can expect to return to their pre-Covid-19 trend, growing around 3.4 per cent.

Finally, the reduction in tourism and remittances from the United States pushed Central America (ex-Mexico) and the Caribbean into a deep recession in 2020, with double-digit GDP contractions in many island economies. In contrast, assuming vaccination accelerates and most of the restrictions on international traveling come down, the region tends to recover fast by the end of 2021 and return to its pre-pandemic 3.0 per cent growth trend in 2022.

3. The Russian Federation and Central Asia

In 2020, the Russian Federation GDP dropped by 3 per cent, slightly better than some of the official expectations, which had forecast a 3.9 per cent contraction. Like in other oil-exporters, the decline is accounted for by Covid-19 restrictions internally, as well as sharp fall in the external demand for energy exports. More specifically, the downward dynamics of GDP in 2020 was affected by the 5 per cent fall in final consumption, and the net trade balance, where deceleration in imports (-13.7 per cent) dominated over exports (-5.1 per cent).

In 2021, recovery was observed across most economic sectors, with manufacturing, investment, retail trade, as well as people's disposable incomes, growing, after having dropped by 2-5 per cent, on average, in 2020. By mid-2021, consumer activity had reached its pre-pandemic levels. The major factor that has slowed growth internally was a 6.4 per cent inflation of food prices. It pushed the overall inflation rates above the Central Bank's target, prompting the central bank to raise interest rates repeatedly in 2021. In 2021, inflation is projected at 4.6 per cent. The financial buffers built during the two decades of relative prosperity have allowed the government to add stimulus which sustained aggregate demand during the pandemic. The key to the 2021 growth has been growth in consumption, continued decline in Covid-19 cases (at least until the summer of 2021), and investments, which were partly funded out of the National Wealth Fund (NWF). The July 2021 decision by OPEC to expand the volume of oil extraction has further brightened the prospects for short-term recovery. UNCTAD estimates that the Russian GDP will grow by 3.8 per cent in 2021 and by 2.3 per cent in 2022.

The Central Asian region, which includes the countries in the Eurasian Economic Union, registered a mild contraction of 0.3 per cent in 2020. The sharp downturn in economic activity in many of the region's key trading partners and the drop in the international price of commodities (amongst which hydrocarbons and industrial metals represent key export products for several countries in the region) during the first half of 2020 were partially offset by the introduction of targeted fiscal and monetary support measures and a recovery in external demand, particularly from the European Union, during the second half of the year. For 2021, UNCTAD expects relatively moderate growth of 4.3 per cent, as the continued recovery in external demand and international commodity prices provide the main impetus for growth, while a winding down of fiscal support measures and more restrictive monetary policy stances in several countries in the region inhibit the rebound in economic activity. A growth rate of 3.1 per cent is expected for 2022 as domestic demand recovers more fully from the economic shock of the pandemic.

The region's largest economy, Kazakhstan, was particularly affected by the drastic reduction in the international price of crude oil, its main export, during the first half of 2020. The subsequent stabilization and recovery in international crude prices, together with the application of substantial fiscal and monetary stimulus measures helped to moderate the economic contraction in 2020, at 2.6 per cent. For 2021, the Kazakh economy is expected to register growth of 3.6 per cent as the rebound in global demand, a gradual uptick in international oil prices and production helps to boost economic activity. UNCTAD expects a moderate acceleration of growth in 2022, to 4.0 per cent, as an increase in production in the country's energy sector and recovering domestic demand will help to drive productive activity.

4. East Asia

East Asia was the region which demonstrated most resilience in 2020, registering a growth rate of 0.3 per cent. Likewise, the region is expected to register the most dynamic recovery in 2021 with 6.7 per cent growth estimated for 2021, moderating to 4.7 per cent in 2022.

East Asia's growth pattern is driven mostly by China, where the imposition of restrictions following the initial outbreak and subsequent mass test and trace programmes proved largely successful in containing

the virus within the country. The Chinese economy is expected to comfortably outperform the minimum target of 6 per cent growth set for this year by the authorities, accelerating to 8.3 per cent in 2021 as a continuing recovery of global demand and the country's role as a key player in the global supply chains of electronics and communications goods as well as healthcare equipment and vaccines will provide a strong boost to the export sector. Similarly, a gradual bounce back in domestic demand is expected, albeit partly contingent on the success of the domestic roll-out of vaccines. For its part, continued support from the government for new infrastructure projects will ensure a healthy expansion of public expenditures.

UNCTAD expects the growth rate to moderate to 5.7 per cent in 2022, as fiscal and liquidity support measures wind down. More stringent macroprudential policies and a tightening of regulations in the financial and real estate sectors, amid elevated debt burdens and rising housing prices, should also restrain growth.

In the Republic of Korea during 2020, containment policies which proved to be very effective without causing excessive disruptions to productive activities helped minimize the negative impact of the pandemic. However, an unexpected rise in infections at the end of 2020 necessitated the introduction of tighter restrictions and social distancing rules, which in turn had a detrimental impact on employment and private consumption. Tempering this downturn in consumption was the positive performance of the export sector which, much like in China, enjoyed buoyant demand, in particular, for electronic and communications equipment. The combination of these factors resulted in only a modest contraction of 0.9 per cent in 2020.

An expansion of 3.9 per cent is expected in 2021, as the country's external sector benefits from strong international demand for its exports of consumer electronics, semiconductors and automobiles. For its part, investment spending remains resilient helped by public outlays on digital and infrastructure in the context of the Korean Green New Deal. Likewise, the fiscal and monetary support measures introduced by the government during 2020 have largely remained in place, along with increased public expenditures targeted towards lower income households and small businesses in 2021. UNCTAD expects a moderation of the growth rate in 2022 to a fairly robust 2.8 per cent, as policy support, an uptick in investment and private consumption, and continued strength of the

export sector drive the expansion in economic activity. However, rising debt levels among households, elevated real estate prices and growing inequality remain policy concerns for the government.

During 2020, Japan experienced a double hit from the two consecutive quarters of contraction in 2019Q4 and 2020Q1, and the ensuing Covid-19 shock, producing an annual contraction of 4.7 per cent, which could have been more severe without the remarkable growth of government spending in goods and services. This stimulus played its role in creating a good momentum in the second half of the year, but was halted due to a severe second wave of the pandemic, leading to a fall in GDP of 1.0 per cent in the first quarter of 2021. The government continued to support the shocked economy but at a more moderate pace. Private sector activity shifted to positive territory from the second quarter onwards, but as restrictions and lockdowns continue to different degrees, growth will only stabilize from the fourth quarter and into the year 2022.

The Olympics, held under lockdown, will have a very marginal effect on effective demand. Net external demand, which has been disappointing since 2019 is expected to play a more favourable role, pulled by the global rebound and assuming that bottlenecks in global value chains are overcome. Given all uncertainties, growth for 2021 is projected at 2.4 per cent. In 2022, external demand will likely gain firmer traction, leading to more private sector activity and consumer demand. By contrast, the fiscal stance will likely shift towards adjustment, responding to pressure to contain the rise of debt. On these assumptions, the economy will yield 2.1 per cent growth, a stronger performance than the pre-Covid-19 average, but barely overpassing at the end of the year the level of 2019.

5. South Asia

South Asia suffered a sharp contraction of 5.6 per cent in 2020, with the region's economic activity brought to a halt thanks to widespread restrictions. Deficient public healthcare systems and high levels of informality magnified the impact of the pandemic in terms of both health and economic outcomes, which was reflected in a stark rise in poverty rates. UNCTAD expects the region to expand by 5.8 per cent in 2021, with the more vigorous recovery signalled at the beginning of the year muted by a rapid surge in infections during the second quarter of 2021. Moreover, the limited progress made in terms of vaccine rollouts continues to leave the countries

of the region susceptible to future outbreaks. For 2022, UNCTAD expects the region's growth rate to moderate to 5.7 per cent.

India, which experienced a contraction of 7.0 per cent in 2020, showed a strong quarterly growth of 1.9 per cent growth in the first quarter 2021, on the back of the momentum of the second half of 2020 and supported by government spending in goods and services. Meanwhile, a severe and broadly unanticipated second wave of the pandemic, compounded by bottlenecks in the vaccine roll out, hit the country in the second quarter, on top of rising food and general price inflation, forcing widespread lockdowns and drastic consumption and investment adjustments.

Income and wealth inequalities have widened, and social unrest has increased. The Central Bank estimates another sharp contraction (quarter-on-quarter) in the second quarter followed by a rebound afterwards. Given the inherent fragilities in coping with the pandemic and restoring employment and incomes, growth in 2021 as a whole is estimated at 7.2 per cent, insufficient to regain the pre-Covid-19 income level. Going forward, assuming away a resurgence of the pandemic to the degree experienced in the second wave, a revitalization of private sector activity, subject still to a slow recovery of jobs, is likely to be matched with a more adverse policy environment, especially on the fiscal front, and with continuing pressures on the trade balance. On these conditions, the economy is expected to decelerate to 6.7 per cent growth in 2022.

6. South-East Asia

South-East Asia registered a contraction of 3.9 per cent in 2020, as several of the larger economies in the region, notably Malaysia and the Philippines, struggled with elevated and persistent infection rates that were met with restrictions on population movements. The economic fallout of these restrictions was predictably severe. In Indonesia, the contraction of output was not as severe as other countries in the region, at 2.1 per cent, as the country benefitted from its relatively limited reliance on external demand and tourism flows, and less-stringent lockdowns. Those countries reliant on tourism (particularly Thailand) were especially hard hit by the widespread travel restrictions that were introduced to limit the spread of the pandemic. One positive note in the region was Viet Nam, which registered an economic expansion in 2020. The country's success in containing the virus helped to ensure a quick bounce back in activity,

while the export sector also performed well as global demand recovered during the second half of the year.

The prospect of a more rapid recovery in 2021 has been interrupted by a resurgence in infection rates throughout the region and the reintroduction of lockdowns (including in Indonesia, Malaysia and Thailand), with a knock-on effect on travel and tourism. Even in the case of Viet Nam, a significant increase in the number of cases was registered towards the end of the first quarter of 2021. Moreover, the slow pace of vaccinations and the prospect of a withdrawal of policy support measures have acted as further drags on growth in the region. In Indonesia, the region's largest economy, although significant public investments in infrastructure will help boost economic activity, the rise in infections will dampen the recovery in household consumption, resulting in growth of 3.6 per cent in 2021, a weak expansion compared to the growth rates observed prior to the pandemic.

UNCTAD expects the region to expand by 3.5 per cent in 2021, increasing to 4.7 per cent in 2022. A significant factor behind the expectation of a somewhat subdued recovery is the prospect of a relatively slow reversal of the numerous job losses suffered in 2020, many of which were low-skilled jobs in the services sector. As such, the bounce back in private consumption is expected to be gradual.

7. Western Asia

Western Asia registered a contraction of 2.9 per cent in 2020, as the oil-exporting countries in the region suffered the simultaneous shocks from the pandemic and the precipitous drop in the demand and price of oil during the first months of 2020. As in the case of other oil exporters, a gradual uptick in crude prices during the second half of 2020 as global demand recovered did drive a partial recovery in oil revenues. UNCTAD expects the region to expand by 3.5 per cent in 2021 as international crude prices continue to return to the levels observed prior to the onset of the pandemic. Virus-related disruptions to economic activity will continue to hamper the recovery, although the economic impact of these outbreaks have proven to be less severe than those observed during 2020. For 2022, the region is expected to grow by 3.2 per cent as domestic demand increasingly gains traction and global demand remains firm.

The economy of Saudi Arabia contracted by 4.1 per cent in 2020 as the government's efforts to provide

budgetary support to households and firms was compromised by the growing pressures coming from the sharp reduction in fiscal revenues due to the drop in oil prices. For 2021, the Saudi economy is expected to register a modest bounce back in growth of 2.7 per cent. The somewhat subdued recovery is explained in part by the relevant authorities' decision to make additional cuts in oil production beyond those agreed in the OPEC+ quota agreement. A reversal of these self-imposed cuts along with a winding down of the production caps from the OPEC+ agreement and the rebound in global oil demand will help growth pick up during the second half of 2021. For 2022, UNCTAD expects the economy to expand by 3.3 per cent as domestic demand recovers more fully and a planned ramping up of public investments coming from the country's sovereign wealth fund takes hold.

Turkey was one of the few countries to register an expansion in 2020, with growth of 1.8 per cent. Despite suffering a deep contraction in the second quarter, a period of record growth ensued during the third quarter as a substantial cut in the Central Bank's policy rate prompted real interest rates to turn significantly negative. At the same time, a change in banking regulations compelled the country's banks to extend credit lines. These moves triggered an unprecedented credit boom and a subsequent sharp uptick in economic activity. For 2021, UNCTAD expects the Turkish economy to grow by 3.9 per cent. Although a resurgence in infections and consequent introduction of restrictions hampered the recovery during the second quarter of the year, the government's response in providing budgetary support to businesses, along with a pickup in the export sector thanks to the rebound in external demand and the sustained resilience of the country's industrial sector will help to boost economic activity during the latter part of the year. UNCTAD expects an expansion of 3.6 per cent in 2022 as domestic demand gains more traction and provides a greater impetus to growth. However, the country continues to face severe vulnerabilities due its outsized reliance on short-term capital flows and the elevated level of foreign-currency denominated debt obligations among its domestic firms.

8. Oceania

Oceania registered a contraction of 2.4 per cent in 2020. The negative result was the first in almost 30 years for the region. However, UNCTAD expects a robust rebound in economic activity in 2021, with an estimated growth rate of 3.1 per cent for this year, followed by 2.8 per cent growth in 2022. The region's

performance is determined to a large degree by that of its largest economy, Australia, which accounts for over 80 per cent of the region's total GDP.

After contracting by 2.5 per cent in 2020, the Australian economy is experiencing a rapid rebound, following the growth momentum that started in the second half of the year thanks to strong fiscal and monetary stimuli. Commodity prices and favourable supply in the exporting sectors also helped. This led to a rapid recovery of household consumption and business investment in the first quarter of 2021, especially as the full border isolation and partial internal lockdowns helped contain the pandemic despite the scarcity of vaccines.

However, new headwinds have emerged. On the domestic front, new partial lockdowns in relatively populated areas were needed, affecting private activity and confidence. On the external front, while the rapid rise of commodity prices continues to boost export earnings, tensions with China, the main export market, present a potential constraint on the rebound. All in all, UNCTAD projects the Australian economy to grow at 3.2 per cent in 2021. Growth will moderately decelerate to 2.8 per cent in 2022, partly as the main private and external growth drivers resume a more 'normal' pace, and partly because of curbs on government spending in goods and services, which have already started in early 2021 and will gather pace going forward.

9. Africa

Most African economies have entered a phase of cyclical recovery in 2021 after the pandemic brought an unprecedented recession of 3.4 per cent, which wiped out years of development gains. In this context, the entire continent is expected to grow 3.2 per cent in 2021, before slowing to 2.9 per cent in 2022. The underlying level of activity, however, remains depressed, and scars will endure. This is particularly unfortunate because several large sub-Saharan African economies – such as Angola, Nigeria, and South Africa – had already been stuck in low growth trajectories since the middle of the last decade. As a result, current estimates predict that the regional GDP per capita will not return, even in the best-case scenario, to its pre-pandemic level before 2024. In particular, South Africa, which experienced a contraction of 7 per cent in 2020, is expected to grow by a moderate 4 per cent in 2021 and by 2.3 per cent in 2022. As tens of millions of African citizens have already fallen back into extreme poverty (World

Bank, 2021a and 2021b), such development will make the SDGs even more elusive.

The economic upturn has in many cases rested on improved external conditions, especially in developed economies and China, which have supported African exports. In parallel, exchange rates have continued to rebound, for example in Botswana, Morocco, and South Africa, after being severely hit in March–April 2020. By mid-2021, exchanges rates of these three economies reached levels that were close to their pre-pandemic ones, if not higher. By contrast, foreign exchanges rates have trended downward in several other countries, notably in Nigeria where acute hard-currency scarcity has forced multiple devaluations since the beginning of the Covid-19 crisis. Fortunately, the terms of trade of major commodity-exporters had reversed after reaching a trough during the second quarter of 2020. PMI indicators for manufacturing activities (and services when available) had been, almost always, above the 50-point mark in Kenya and South Africa during the last quarter of 2020 and the first half of 2021. By contrast, they had mostly remained in contraction territories in Egypt and in Nigeria during this period.

In situations of subdued economic activity and generally low inflation pressures, monetary policies have often been accommodative, despite soaring food prices that have created tensions, especially in Central and West Africa. Nevertheless, several countries have registered double-digit inflation (or even triple-digit in the case of Sudan). These include, inter alia, Zimbabwe, South Sudan, Angola, Libya, Zambia, Nigeria, and Ethiopia, which all face stagflationary threats.

On the fiscal front, pressure has mounted to reduce, or even withdraw completely, the (limited) support that a handful of countries had initially been able to introduce in response to the Covid-19 shock. The fact that many governments had lost control of the public debt trajectory due to the widening budget deficits (sometimes reaching double-digit figures) and growing government debt (often by at least 15 percentage points of GDP) has significantly constrained public demand. Meanwhile, external financial assistance has fallen dismally short of what was deemed necessary to cope with the social, sanitary, and economic needs. Official Development Assistance to sub-Saharan Africa averaged US\$ 27.1 billion in 2018 and 2019 but fell to US\$22.6 billion in (OECD, 2021) In the outlook period, a resumption of tourism and the

rollback of pandemic-induced restrictions should provide some relief to the region. The gradual increase in oil production for OPEC+ African countries will also support export revenues. Yet, these positive elements will fail short of taking many African economies out of their low-growth environment. Moreover, the weak recovery has recently been jeopardized by the third wave of virus infection, starting in June 2021, given the lagging vaccine rollout.¹ Such outbreaks will hamper the situation, especially if fast-spreading variants develop. Though at this stage it remains unclear how strong this negative effect will be, there is no doubt that no serious improvement will be made until vaccination campaigns reach the herd immunity threshold. Prior to that, sectors linked to the hospitality industry, though not only these ones, will remain heavily depressed. The situation will therefore remain dramatic in most of

the tourist-reliant economies, which have already experienced the largest shocks.

In this outlook, two main factors could further damage economic prospects. One is elevated food prices (see Box 1.4.), which have already exacerbated hunger across the continent. The other is renewed social protests and conflicts – which have already escalated in several parts of sub-Saharan Africa, including in Central African Republic, Eswatini, Ethiopia, Mozambique, the Sahel region, and South Africa – as these now threaten to hinder the recovery, with potentially long-lasting economic consequences. Should these factors persist, they will add to Covid-19 related shocks – such as the disruption of education, the worsening of health, and the setback of investment – whose negative effects had already altered the growth prospects for the years ahead.¹⁷

BOX 1.4 Increased food insecurity amid rising food prices

The global goal of achieving ‘zero hunger’ by 2030 (SDG 2) seems increasingly out of reach as the number of people facing acute food insecurity and requiring urgent food, nutrition and livelihoods assistance has been on the rise. In 2020, at least 155 million people, across 55 jurisdictions, faced a situation of food crisis or worse (IPC/CH Phase 3 or above).²⁸ This represents an increase of about 20 million people from 2019 and roughly a 50 per cent increase from 2016. In absolute terms, the situation was particularly acute in Afghanistan, the Democratic Republic of the Congo, the Sudan and Yemen, since in each country, at least 2 million people were categorized in an emergency phase of or worse (IPC/CH Phase 4 or above), requiring urgent action to save lives and livelihoods (FSIN and GNAFC, 2021). The FAO (2021b) estimates that globally 45 countries, including 34 in Africa, 9 in Asia and 2 in Latin America and the Caribbean, will need external assistance due to severe food insecurity.

While conflict is often the main reason behind hunger, climate disruption and economic shocks, aggravated by the Covid-19 pandemic, have further compounded the situation. In this context, international food prices have rising from the second quarter of 2020 after 5 years of relative stability; the FAO Monthly Food Price Index increased steadily by 37 per cent between May 2020 (a 4-year low) and May 2021 (a 10-year high).

On domestic markets, increasing food prices – particularly in import-dependent countries that experienced currency depreciation – weighed heavily on household access to food. In parallel, damaged public finances often constrained governments’ capacity to support vulnerable households as needs increased. In this context, six countries – Argentina, Brazil, Nigeria, South Sudan, Sudan, and Zimbabwe – saw prices of one or more basic food commodity at abnormally high levels in mid-2021 that could negatively impact on access to food (FAO, 2021a).

Overall, food crises are becoming increasingly protracted and the ability to recover from new adverse events is becoming more difficult. Conflicts, the Covid-19 pandemic, and prolonged economic stress are expected to extend food crises beyond 2021.

Notes

- 1 Based on 2015 constant dollars and exchange rates.
- 2 Since the European Union is one of the G20 economies, together with Germany, France, and Italy, we

included Spain as the 20th economy in figure 1 to avoid double counting.

- 3 The full impact of expansionary fiscal measures on income distribution across households is still

- not clear. There is also a growing debate about the impact of monetary policies, although with only a very small percentage of the population directly benefiting from the massive monetary injections by Central Banks that eased liquidity constraints and prevented financial meltdown its magnifying effect on wealth inequality seems more certain (Petrou, 2021).
- 4 Not incidentally, a large proportion of countries are expected to engage in aggressive austerity packages down the road (Ortiz and Cummins, 2021).
 - 5 For a historical account of the concepts see Costantini (2018).
 - 6 See *TDR 1994* and *TDR 1996*, also Storm and Naastepad, 2005; Wade, 2014.
 - 7 Defined, by the IMF, as those economies “that resemble emerging markets with regards to international market access” (IMF 2020, p.46).
 - 8 Other investments conventionally include other equity, currency and deposits, loans, insurance and pensions, trade credits and advances, guarantee schemes as well as Special Drawing Rights (SDRs).
 - 9 This expansion and the changes in the composition of emerging economies’ foreign liabilities and assets have amplified the susceptibility of gross external assets and liabilities and of net foreign asset positions to variations in asset prices and exchange rates, entailing large transfers of wealth and income from emerging economies to advanced economies (see *TDR 2019* and Akyüz, 2021).
 - 10 Haldane A (2014). The age of asset management? Speech by Mr. Andrew G Haldane, Executive Director, Financial Stability. Bank of England, at the London Business School. London. 4 April.
 - 11 UNCTAD secretariat calculations, based on Refinitiv. See also UNCTAD (2021) and IMF (2021).
 - 12 Unless otherwise indicated, figures quoted in the text are UNCTAD secretariat calculations based on World Bank, IMF and national sources.
 - 13 See <https://www.imf.org/en/About/FAQ/sovereign-debt>
 - 14 Between March 2020 and June 2021, Covid-19-related lending by the IMF to 85 countries amounted to \$113 billion (see: <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#REGION>), while the World Bank committed \$104 billion for the period between April 2020 and June 2021. According to the World Bank, this has been as high as the commitments of all other multilateral development banks taken together. See: <https://www.worldbank.org/en/news/factsheet/2020/10/14/world-bank-covid-19-response>
 - 15 The first dip relates to the great lockdown of the spring 2020. The second happened during the first quarter of 2021, reflecting a mixture of new lockdowns in some large economies, together with the traditional seasonal slowdown in international trade which occurs during the first two months of the year.
 - 16 IATA (2021). Airlines Financial Monitor, May. Available at <https://www.iata.org/en/iata-repository/publications/economic-reports/airlines-financial-monitor---may-2021/>
 - 17 World Bank (2021a). Sub-Saharan Africa: Macro Poverty Outlook. Spring Meeting 2021. World Bank. Washington DC. World Bank (2021b). Middle East and North Africa: Macro Poverty Outlook. Spring Meeting 2021. World Bank. Washington DC.
 - 18 In reading the estimated size of the Covid-19 stimuli packages, it is important to take note of the extent of the economic shock in the case of each country. This is particularly so for those countries that are part of the European Union, where, as discussed in section E, the differences in the scale of fiscal stimuli also respond to the disparities in the magnitude of the shock to economic activity in each country.
 - 19 Problems of data availability and comparability did not allow straightforward inclusion of smaller developing economies or LDCs, which would most likely show even greater disparities.
 - 20 The United States stands out among developed economies for its outsized reliance on direct income transfers in its Covid-19 fiscal support measures. As discussed in section B, the dependence on these transfers for providing support to households in the midst of the pandemic points to the inadequacies and poorly calibrated nature of the country’s existing welfare protection systems.
 - 21 United States Bureau of Economic Analysis, GDP (Advanced) Estimate of 2021 second Quarter, Table 8.
 - 22 At the SDR/US\$ exchange rate of 0.7026 on 7 July 2021.
 - 23 Currently, SDRs can be exchanged for US dollars, euros, renminbi, Japanese yen, and pound sterling.
 - 24 The use of SDRs is not entirely cost-free, since when countries use (or reduce) their allocated holdings of SDRs in transactions with the IMF or other member countries, they incur an interest charge at a non-concessional rate. Net interest payments due to the IMF are based on the difference between a country’s cumulative allocation of SDRs and its effective holdings. The same interest rate applies for allocations and holdings, as set by the IMF based on a weighted average of representative interest rates on 3-month debt in the money markets of the five SDR basket currencies. At present, this rate stands at a mere 0.05 per cent per year, reflecting strongly accommodative

- monetary policies in issuer countries of SDR basket currencies.
- 25 The current IMF quota formula is a weighted average of GDP (50 per cent), openness (30 per cent), economic variability (15 per cent) and international reserves (5 per cent). This systematically favours the status quo of the distribution of economic power between developed and developing countries rather than facilitating the use of SDRs for agreed global goals, including inclusive and sustainable development.
 - 26 UNCTAD has been a longstanding advocate of linking SDRs to development finance, see Park, 1973
 - 27 Thus, Plant and Andrews (2021) suggest that proposals limited to the use or recycled ‘standard’ SDRs’ for current Covid-19 responses would require changes to the IMF’s legal and policy framework (including its Articles of Agreement).
 - 28 The scale of the Integrated Food Security Phase Classification (IPC) and the Cadre Harmonisé (CH) ranges between 1 (none/minimal) and 5 (catastrophe/famine).
 - 29 The reader should note that generally T is used to described net or gross taxes, that is transfers from the private sector to the government. Here the definition carries the opposite sign so that the difference dT (as presented above) is interpreted as a fiscal stimulus.
 - 30 Net Transfers from the Government to the Private Sector encompass the sum of government transfers to the private sector (including unemployment benefits and direct income transfers) minus taxes and contributions to government social security.

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Annex: Methodological Note for Box 1.1

The estimates for G and T in Table B1.1 are calculated on the basis of the decomposition of the following two identities. The identities are valid in both nominal and constant values; in this note, unless otherwise specified, constant values (chained) are used:

- (1) $Y_x = C_x + I_x + G_x + NX_x$ with Y_x : GDP, C_x : Private Consumption spending, I_x : Private Investment spending, G_x : Total Government Consumption and Investment spending, NX_x : Net Exports.
- (2) $-NL_{G_x} = T_x + G_x \Leftrightarrow T_x = -NL_{G_x} - G_x$ with NL_{G_x} : Net Lending by the General Government sector, T_x : Net Transfers *from* the Government to the private sector²⁹, G_x : Total Government Consumption and Investment spending.

For the selection of countries in Table B1.1, annual data for G_x is extracted from National Accounts datasets, as expressed in equation (1). Likewise, annual data on NL_{G_x} is extracted from Government accounts or fiscal data for these countries.

In order to estimate dG , that is the additional amount of Government consumption and investment spending relative to the expected level in 2020, first the expected level of Government consumption and investment spending in 2020 (\hat{G}_{2020}) is estimated as the average growth rate of G_x ($\widehat{growth}[G]$) over the last 3 years, 2017 to 2019, applied to G_{2019} :

$$\hat{G}_{2020} = G_{2019} * (1 + \widehat{growth}[G])$$

and dG_{2020} as the difference between the expected and observed value of G_{2020} :

$$dG_{2020} = G_{2020} - \hat{G}_{2020}$$

In order to estimate dT , that is the additional amount of Net Transfers from the Government to the Private Sector³⁰ relative to the expected level in 2020, first the expected level of Net Transfers in 2020 (\hat{T}_{2020}) is estimated as the average ratio of T_x / GDP_x ($\widehat{ratio}[T]$) over the last 3 years, 2017–2019, applied to the value of GDP in 2020 (GDP_{2020}):

$$\hat{T}_{2020} = \widehat{ratio}[T] * GDP_{2020}$$

and dT_{2020} as the difference between the expected and observed value of T_{2020} :

$$dT_{2020} = T_{2020} - \hat{T}_{2020}$$

For simplicity, the variable dG_{2020} is presented as G and the variable dT_{2020} is presented as T in Table B1.1.

THE TROUBLED HISTORY OF BUILDING BACK BETTER: FROM THE 1980s DEBT CRISIS TO COVID-19



A. Introduction

President Ronald Reagan was fond of citing Thomas Paine's declaration, penned at the height of the American Revolution, that "we have it in our power to begin the world over again". Although Reagan did not begin the neo-liberal revolution, which was stirred by disruptive economic and political events during the 1970s, his assuming the reins of the world's most powerful state, in January 1981, was a catalytic moment in the rise of a new policy consensus. The promise was a better future for all, by releasing mobile capital, nimble entrepreneurs and efficient market forces from the dead hand of government oversight and regulation.

UNCTAD's *Trade and Development Report* was launched that same year and has over the subsequent four decades borne witness to the consequences of the new consensus as it spread beyond the Anglo-Saxon world, through many international institutions, to the developing world.

Even in the face of overwhelming evidence that this era has been marked by recurring crises, an unprecedented concentration of wealth and power and growing economic insecurity, too many policymakers remain committed to the idea that markets are naturally competitive and automatically self-righting. To a large degree, this dogma has reflected a reckless disregard, notably among the more fundamentalist proponents of hyperglobalization, of the anarchic impulses of hot money, the predatory practices of big finance and the destructive power of unrestrained movements of capital across borders.

That neglect culminated in the global financial crisis whose origins, in the activities of large Western banks, were impossible to ignore and whose destructive consequences forced policy makers, as much in panic as from conviction, to abandon some of the totems of the policy consensus. Governments promised to build back better. The 2009 meeting of the G20 in London signalled a desire to change course:

We start from the belief that prosperity is indivisible; that growth, to be sustained, has to be shared; and that our global plan for recovery must have at its heart the needs and jobs of hard-working families, not just in developed countries but in emerging markets and the poorest countries of the world too; and must reflect the interests, not just of today's population, but of future generations too.

In the end, the grip of conventional policy wisdom and the gravitational pull of financial markets proved too strong. Any hope of building back better had, by the end of the last decade, faded away.

With lives, as much as livelihoods, under threat, the Covid-19 crisis has exposed just how fragile the world has become; it has also served as a reminder that if we are to build back better this time around, the invisible hand of financial markets will not deliver the money on the right scale, to the right places at the right time. Beginning the world all over again will require a much more collective effort, within and across countries.

The next section positions the analysis provided by the *Trade and Development Report* in response to

the shocks, setbacks and crises that have hampered development during the era of hyperglobalization and underscores its abiding call for an inclusive global economic governance. Section C looks at what might happen if the policy proposals that were widely adopted during that era were to return once the pandemic subsides and sounds an “amber warning” about the supercharged asymmetries that would follow. Section D considers some of the measures that advanced economies, in particular,

have undertaken during the crisis to address inequality, unchecked corporate power and the looming climate crisis; while in the right direction, these have been too tentative and could, given the lack of policy coordination, blowback on developing countries. If a new policy consensus is to emerge it will need to be made of sterner stuff. The final section highlights some broad policy themes that have emerged during the Covid-19 crisis which could provide just that.

B. The Trade and Development Report at 40

1. *Swimming Against the Tide*

In 1981, the advanced economies were still grappling with the stagflationary pressures unleashed in the previous decade. Inflation and unemployment remained at elevated levels. Investment was sluggish or falling. Political tensions added to an atmosphere of anxiety and confusion. Confusion was also apparent at the international level; the consensus agreed at Bretton Woods had already been upended by the release of the dollar from its link to gold, the opening of capital accounts and volatile movements in private capital flows. Some large international banks faced solvency issues due to shaky loans to developing countries.

Against this backdrop, the G7 countries met in Ottawa in July 1981 “to revitalize the economies of the industrial democracies”. Doing so, they insisted, hinged on defeating inflation by cutting government borrowing and controlling the money supply, a signal that the era of Keynesian demand management was over. They also insisted that revitalization would require more fundamental changes in expectations about growth and earnings, in labour relations, in support for industry, in the direction and scale of investment, and in energy use and supply (G7, 1981).

Acknowledging the realities of an interdependent world and “the serious economic problems in many developing countries”, the G7 also confirmed their commitment to strengthen international cooperation and expressed a desire to discuss common challenges at the International Meeting on Cooperation and Development in Cancun later in the year.

During the previous decade, many developing countries had made economic strides thanks to higher commodity prices, above all oil, increased investment and faster growth. With growing economic

confidence fuelling heightened political ambition, negotiations had been launched at the United Nations to fashion a more development-friendly international economic order. However, the structural foundations of many economies were still weak and growth spurts proved ephemeral. The low real cost of debt (in terms of the volume of exports needed to cover interest payments) and high commodity prices had encouraged massive borrowing through syndicated bank loans. With much higher interest rates and much slower growth in advanced countries, financial stresses began to emerge in some heavily indebted economies.

UNCTAD’s first *Trade and Development Report* landed in 1981 amidst these shifting economic currents. The *Report* warned that the global conditions for promoting a long-term development agenda were disappearing and that the deteriorating situation in many countries signalled a pending “development crisis”. Its message, which has become a recurring theme across the subsequent four decades, was that faster growth in developing countries is of mutual benefit to developed countries but achieving “it will require intensified international cooperation and concerted efforts by governments since market forces alone cannot be relied upon to achieve the required transformation and structural reforms”. In 1981, this was a message at odds with the direction of policy in the North.¹

Signs of a changing policy direction, since tagged with a neo-liberal label, were already discernible in the mid-1970s but had moved up a political gear with the election in 1979 of Margaret Thatcher in the United Kingdom and of Ronald Reagan the following year in the United States.² A last hurrah of Keynesian demand management came with the Government of Francois Mitterand in France, elected

a few months before the first *Report* was launched, but a turn to austerity soon came from the pressure of capital flight and a widening current account deficit. Despite the desires expressed in Ottawa, the Cancun Summit proved to be the end of negotiated changes to the international economic order when President Reagan made it clear that the focus of his Administration would be on supporting domestic policies in countries willing to “encourage economic freedom” and not reform of the existing multilateral architecture.

The resulting policy shift extolled the virtues of smaller government and the benefits of freeing markets from regulatory discipline and oversight. As competitiveness trumped employment as the measure of economic success, liberalization moved to the centre of the policy stage with tight monetary policy cast in the sole supportive macroeconomic role. The promise was simple: freed from government intervention, particularly regulation on international capital movements, and wage-price spirals, increased competition would spur entrepreneurship, stimulate investment and bolster wealth creation with the gains trickling down to even the poorest strata of society and spreading globally through free trade and heightened capital flows.

2. A Lost Decade

Economic reality was proving very different; as Paul Volker (1978), Chair of the United States Federal Reserve, pushed interest rates into double figures, a strengthening dollar and falling demand for commodities, turned the liquidity strains and financial stresses in developing countries into solvency crises. Mexico’s default in 1982 cast suspicion on other sovereign borrowers and the flight of private capital triggered debt crises across much of the South. The 1982 *Report* warned that with a further narrowing of the range of “feasible policies open to developing countries to promote their own development” and with “the spirit of international cooperation ... on the wane”, the development crisis was set to intensify.

In the absence of timely concessional multilateral support, stringent retrenchment measures were inevitable. Structural adjustment programmes, backed by a very different development policy paradigm from the one envisaged in the *Report*, and subsequently christened the “Washington Consensus” (Williamson, 1990), became commonplace in developing countries as a condition for renewed access to multilateral financing. The damage these programmes caused along with

their failure to produce a macroeconomic environment that supported long-term investment was extensively documented across subsequent *Reports*.

As the advanced countries began to recover, a very different global economy emerged from what Volker himself, somewhat euphemistically, described as “the controlled disintegration of the world economy” that followed the floating of the dollar. This world economy would require different governance arrangements – “mutual contingency planning” among the monetary authorities of the systemically important economies – from those established at the Bretton Woods Conference (Volker, 1978). These arrangements were underpinned by a new growth regime in the United States led by an expanding financial sector and related service industries, a strong dollar, persistent trade deficits and a drive to boost overseas profits through increased foreign investment flows, tighter intellectual property rights and an incessant search for cheaper sources of labour.

The payments and exchange rate regime became more and more intertwined with the free movement of capital and the international trade regime operating through a mixture of tariff reductions negotiated largely by advanced economies under the GATT and unilateral discretionary trade restrictions adopted by those same countries. The 1984 *Report* anticipated the fault lines and asymmetries that would come to characterize the emerging global landscape: creditors would be favoured over debtors, large producers over small, profits over wages, with the interests of developed countries prioritized over those of developing countries in international fora.

Overcoming the crisis posed by an unsustainable burden of debt would, ideally, have involved a combination of accelerating growth, lower interest rates and increased capital flows on appropriate terms. In their absence, the lack of a well-designed and impartial framework for the timely resolution of external debt problems became increasingly apparent. Ad hoc and creditor-friendly restructuring exercises, beginning with the Baker Plan in 1985, offered some limited rescheduling but with the onus on spending cuts and deflationary adjustment in indebted countries. In response, the 1986 *Report* proposed an alternative approach built around new principles of debt restructuring, drawing in part on the United States Bankruptcy Code, a temporary standstill on debt servicing and the establishment of an independent debt workout mechanism tasked with undertaking debt restructuring on a fair and timely basis.

As the decade came to an end, the 1989 Report concluded that moving beyond the lost decade would require a significant relaxing of the external constraint on growth in developing countries, along with a new social contract (and accompanying fiscal reforms) that could more equitably share the costs of further adjustment and the fruits of any subsequent recovery. A relaxation of sorts had started with commercial banks selectively writing down some of their loans, and the Brady Plan, launched in 1989, offering more extensive debt relief by converting outstanding loans into tradeable bond instruments, paving the way for the return of middle-income Latin American countries to international capital markets. A more equitable social contract, however, was not on the table.

3. *Birth of the Hot*

With the easing of acute economic distress – and the fall of the Berlin Wall in November 1989 – the contours of a hyperglobalized economy became clearer. The deregulation of financial markets and the opening of the capital account gave way to the buying and selling of financial assets, shareholder governance and rising levels of debt. The removal of tariff barriers continued but negotiations turned to agreeing rules in support of deeper integration and the spread of international production networks with heightened protections for the corporations managing them. The drive to privatize state-owned assets gave way to the promotion of public-private partnerships and a business environment that would attract foreign direct investment. Policy makers were told that they had no more grounds to debate these changes than they did the changing of the seasons (Blair, 2005), countries could either “integrate themselves into the international economy or become marginalized from it and thus fall farther and farther behind in terms of growth and development” (Camdessus, 1997).

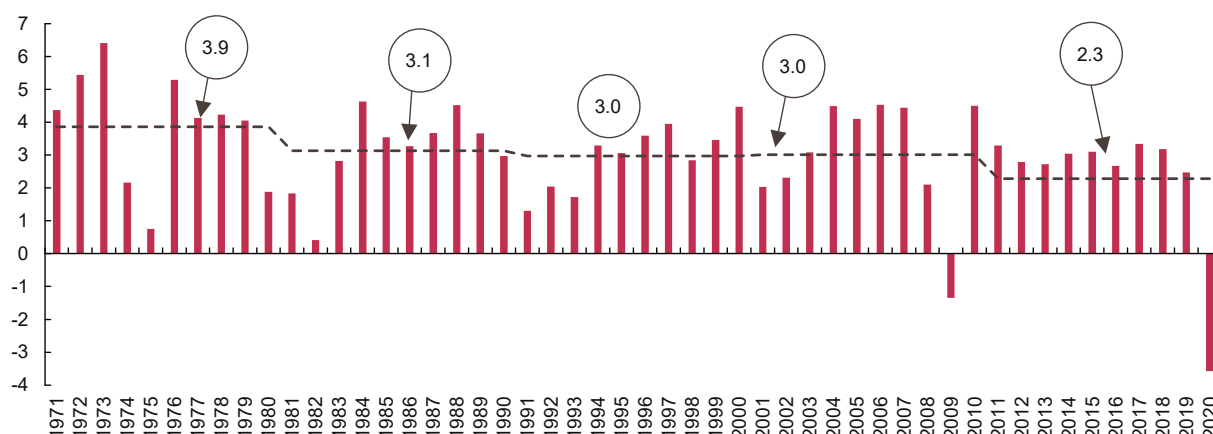
The break-up of the Soviet Union as the new decade got under way opened up a wider front for market-based reforms and at a faster pace described as “shock therapy”. The 1993 Report warned that transition economies had seen more shock than therapy. Still, a new world order was promised which would, according to United States President George H. W. Bush, offer “new ways of working with other nations . . . peaceful settlement of disputes, solidarity against aggression, reduced and controlled arsenals and just treatment of all peoples” (Nye, 1992); on the musings of one enthusiastic observer this signalled “an end to history” (Fukuyama, 1992).

History, it turned out, was not so obliging. The changing face of global interdependence in a world of footloose capital and the new threats this posed, particularly for developing countries, became an abiding theme of subsequent *Reports*. Particular attention was given to how trade and capital account liberalization, combined with pro-cyclical fiscal and monetary policies, could disrupt growth and development. The misalignment of macroeconomic prices, the shortening of investment horizons and the fuelling of asset bubbles which could go bust when sudden shifts in market sentiment triggered rapid capital outflows and heightened payment pressures, led to retrenchment, job losses and rising poverty. And despite the assurances that financial innovation was conquering market risk, the 1995 Report expressed a growing concern about the rapid growth of derivative instruments generating systemic risks which, in the absence of international cooperation, could cause a wider breakdown in financial markets.

Foreign capital did begin flowing back to Latin America from the early 1990s, but many developing countries, particularly in sub-Saharan Africa, continued to struggle with the legacies of the debt crisis. Only with the Highly Indebted Poor Countries initiative (HIPC), launched by the IMF and the World Bank in 1996, did their situation begin to change. At the same time, the dangers of rapid financial liberalization were becoming apparent in some of the most successful developing countries in East Asia. The 1994 Report warned that capital account liberalization there had triggered a surge of short-term inflows (“hot money”), taking advantage of higher local nominal interest rates, that could just as quickly flow out. As investors became nervous about growing current account deficits and turned their speculative antennae to booming markets in the United States, a reversal of flows put pressure on local exchange rates. The collapse of the Thai baht in July 1997 proved highly contagious, dragging Thailand and several neighbouring economies into a vicious financial spiral and triggering a sharp recession. Contagion from the crisis continued to ripple across other emerging markets through the end of the decade.

The 2000 Report concluded that the initial policy response to the East Asian crisis, marshalled in large part by the international financial institutions, had been unnecessarily severe, with the burden carried by wage earners, small and medium sized enterprises and the poor. Recovery only began once austerity measures were reversed and governments allowed to play a more positive role, including, in the case

FIGURE 2.1 The slowdown in global economic growth, 1971–2020
(annual and decadal geometric average, percent)



Source: UNCTAD secretariat, based on UNCTADStat; and World Output series for TDR production.

of Malaysia, through the effective use of selective capital controls. A fundamental lesson drawn from the experience was that even in developing countries with a strong growth record, in a financialized global economy excessive reliance on foreign resources and markets leaves growth prospect vulnerable to external shocks.

Among advanced countries, the 1990s was America's decade. A short-lived recession at the beginning of the decade gave way to stronger growth linked to accommodative monetary policy and the euphoria surrounding the information and communication technology revolution; investment, productivity and employment all picked up while inflationary pressures remained subdued. The stock market rose precipitously leading the Chair of the Federal Reserve to warn of "irrational exuberance" but he showed no enthusiasm to dampen it. The European Union, by contrast, suffered a more prolonged downturn, as it struggled with the newly adopted Maastricht Treaty. A weak recovery from the mid-1990s did, however, inject sufficient confidence in a sub-section of the bloc to launch a currency union under the Euro at the end of the decade. Japan, by contrast, was unable to find a sustainable adjustment path away from the massive financial bust at the end of the previous decade, with short-lived stop-and-go cycles holding back growth over the course of the decade.

Along with these uneven growth performances, the persistence of high unemployment and accelerating deindustrialization were taxing policy makers across advanced countries. Adjusting to market forces was not it turned out quite as smooth as textbooks implied,

leaving residual pockets of poverty and deprivation even as growth picked up. The 1995 Report rejected the suggestion, gaining political traction at the time, that growing trade with developing countries was the main culprit and instead highlighted a combination of weak demand, uneven investment growth and labour market deregulation resulting from policy choices aligned with their increasingly financialized economies. The Report warned that cutting wages in an attempt to boost competitiveness would, by reducing domestic demand, only further weaken employment conditions.

Overall, average annual global growth in the 1990s failed to register a significant improvement over the previous decade despite the surge in capital flows (Figure 2.1). Per capita growth in many developing countries continued to lag advanced economies, signalling their further falling behind (Table 2.1). However, a pick-up of growth in South Asia and continued strong growth in East Asia, now including the rapidly transforming China, was a sign that the international economic landscape was changing.

4. Winners and Losers

While faith in efficient markets continued to dominate economic policy making, governments in advanced economies were beginning to worry about persistent imbalances in the global economy. Trade imbalances and accompanying financial instability caused by inconsistent macroeconomic policy stances both within and across the main advanced countries had been a running concern of the Report during the 1980s. The growing current account surplus of Japan

TABLE 2.1 Average annual per capita growth, by region 1951–2020 (PPP)

	World	Developed (M49 incl. Republic of Korea)	Developing (M49)	Central Asia	East Asia (incl. Japan and Republic of Korea)	South Asia	South- East Asia	West Asia (incl. Israel)	Latin America	North Africa	Sub- Saharan Africa
1951–1959	3.0	3.6	2.8		5.1	1.4	2.5	4.1	2.3	2.6	1.9
1960–1969	3.5	4.4	3.1		5.4	2.8	1.9	4.7	2.6	6.8	1.9
1970–1979	2.6	2.4	3.6		3.9	1.2	4.2	4.6	3.5	2.1	0.9
1980–1989	1.0	2.0	0.8	-0.5	4.0	2.0	3.1	-2.8	-0.3	-1.4	-0.9
1990–1999	1.0	1.1	2.2	-4.7	2.9	3.3	3.4	1.1	1.2	0.8	-0.6
2000–2009	2.4	1.8	4.0	6.9	4.6	4.5	3.7	2.4	1.6	2.5	2.4
2010–2019	2.1	1.7	3.0	4.3	3.5	4.7	4.2	2.1	0.8	0.2	1.4
2020	-4.5	-4.6	-3.9	-2.0	-0.3	-6.7	-4.4	-4.4	-7.9	-5.8	-4.7
2000–2008	2.9	2.5	4.3	7.5	4.9	4.6	4.0	3.1	2.2	2.8	2.6

Source: The Conference Board (April 2021). Total Economy Database. See <https://www.conference-board.org/data/economydatabase/total-economy-database-productivity>.

had provoked particular anxiety in the United States and, in the absence of effective international coordination, triggered a series of ad hoc responses which disrupted international trade. Imbalances widened further in the 1990s, on the back of persistent policy divergences, compounded by the export success of the newly industrialized East Asian economies. The resulting global imbalances exposed the lack of policy coordination in an increasingly interdependent world that, the 2000 Report warned, would most likely be resolved in a disorderly manner and to the disadvantage of developing countries. Subsequent *Reports*, up to the global financial crisis, continued to warn of the danger of a hard landing.

The logic of free trade promised widespread gains for developing countries. However, more than a decade of rapid opening up had seen only a small number of developing countries, mainly from East Asia, posting a strong record of catch-up growth, while elsewhere the lost decade of the 1980s was lengthening into the early years of the new decade. The anomalous success of the “miracle” economies began to raise questions about the policy advice coming from Washington. A major World Bank study, commissioned by the Japanese Government, attributed its success to a tighter embrace of market-friendly policies (implicitly endorsing its own advice to other developing countries). But this account was quickly contested by a growing body of scholarly research which highlighted the key role of strategic trade and industrial policies employed by strong developmental states in promoting structural transformation and compensating for the competitive disadvantages their firms faced in international markets. UNCTAD’s own

research, presented in various *Reports*, confirmed that active policy measures had helped to animate a robust profit-investment-export nexus in the most successful East Asian economies and highlighted the role of effective public institutions willing and able to dialogue with the private sector and with sufficient policy space to support, guide and, where necessary, discipline businesses in order to achieve a fast pace of investment and technological upgrading.

Recognizing that there were losers, within and across countries, as well as winners in a globalizing world went against the trickle-down logic promoted by market fundamentalism. As parts of the international community became concerned that a narrow focus on growth conditions was neglecting the wider challenge of “an enabling environment for people to enjoy long, healthy and creative lives” (UNDP, 1990), “human development” emerged as an important theme during the 1990s. While this approach helped to broaden the policy discussion in international development circles, it concentrated exclusively on the policy challenges posed by extreme poverty and social deprivation. The 1997 Report broke with this line of thinking by shifting the debate from those at the bottom of the economic pyramid (the poverty challenge) to those at the top, recognizing that widening income gaps had become endemic to hyperglobalization and that the behaviour and influence of an increasingly disconnected elite, of both households and firms, was having a disproportionate impact on the direction and prospects of the wider economy.

The Report detailed the trend of rising inequality in countries at all levels of development with a

hollowing out of the middle-class in the North while middle-income countries in the South were falling further behind. This, the Report argued, was best explained by a combination of policy decisions, particularly tight macroeconomic policies and rapid liberalization, and the new rules of the international economy that favoured footloose capital and put downward pressures on wages.

The flip side of these trends was a rising share of profits in national income, but rather than delivering the promised boost to productive investment this was instead leading to a shortfall in aggregate demand, rising levels of debt and slower growth, with investors shifting attention from the productive economy to the buying and selling of existing assets. The rentier economy had emerged. The Report warned that if left unchecked the resulting economic fragilities and political tensions would eventually produce a backlash against globalization. Violent demonstrations at the WTO meeting in Seattle in November 1999 were an early sign of growing discontent.

5. Growth Picks up; Imbalances Widen

As had been predicted in previous *Reports*, not only were liberalized financial markets becoming a greater source of volatility, but the increasing integration of the global economy also meant that shocks (both real and financial) were being transmitted much more rapidly across sectors, countries and regions. Meanwhile, developing countries were still being strongarmed into dismantling capital controls on the promise of increasing market efficiency. The possibility that financial instability could spread from “emerging markets”³ was signalled by the so-called Tequila crisis which hit the Mexican bond market in 1994, while the collapse of Long-Term Capital Management in 1998 – overexposed to the Russian bond market – brought the role of hedge funds, as conduits of contagion, to the attention of policy makers. In both cases, swift bailout operations by monetary authorities in the United States proved successful. However, the dotcom bust in 2000, persisting through 2001, provoked a more active response from the Federal Reserve (amplified by the terrorist attack on New York and Washington), along with other Central Banks, who rapidly reduced interest rates and injected liquidity on a large scale and for a prolonged period, in an effort to stabilize and revive financial markets.

These large-scale injections also spilled over to developing countries through increased capital inflows

as investors became less risk averse in their search for higher yields. A sense of returning economic optimism was given a further boost with the confirmation of China’s membership to the WTO, along with a recovery in global trade. For the first time since the 1970s, growth across the South exhibited a simultaneous pick up and poverty numbers finally began to fall, albeit dominated by their rapid drop in China. High and rising commodity prices – that became known as a “super-cycle” – fed growth across developing countries; and with growth in advanced economies on a slower trajectory, the long-promised convergence – narrowing income gaps between developed and developing countries – finally looked like it would happen.

As interest rates dropped and financial markets picked up, policy makers in advanced countries convinced themselves that they had discovered the holy grail of macroeconomic stability. Economists (retrospectively) announced the arrival of “a great moderation” (Bernanke, 2004), with some announcing the end of economic depressions (Lucas, 2003). The Chair of the Federal Reserve, Alan Greenspan (2005), suggested that a combination of financial innovation and Central Bank foresight had finally given Adam Smith’s invisible hand the room to deliver stability and vibrancy across the entire global economy.

The big question was whether these trends were sustainable. With policy making becoming ever more closely tied to the calculations of unregulated financial markets and the ever-shortening investment horizons of footloose capital, there were reasons to be doubtful. As outlined in the 2001 Report, various initiatives pursued in different forums in the hope of finding a system of international governance compatible with flexible exchange rates and large-scale capital flows had failed to make meaningful progress. In the absence of a multilateral system to match the reach of global financial markets, a dualistic system had emerged where heightened surveillance and disciplines on developing countries coexisted with a *laissez-faire* approach towards the policies of systemically important advanced countries, whose domestic financial systems, including private international creditors, were left to be governed through voluntary arrangements. Such a system, the Report concluded, was both crisis prone and skewed against the needs of developing countries.

Picking up on previous reform proposals aimed at making international finance work for development, the Report called for improved multilateral

surveillance and coordination of economic policies in the major economies; stronger regulation and supervision of international capital flows; increased official financing, including on concessional terms; new ways to manage and restructure debts in a fairer and timely fashion; greater coherence in the formulation of policies relating to finance and development, including a significant pruning of policy conditionalities attached to adjustment programmes.

Concerns were also growing over the governance of international trade. The ambiguous outcome of the Uruguay Round had been discussed in the 1996 Report and the 1999 Report concluded that the predicted gains for developing countries had been exaggerated due to a combination of non-tariff barriers restricting access to Northern markets and various trade-related measures that reduced their policy space. The gap between what the 2002 report called “the rhetoric and reality of a liberal international economic order” was even more apparent with the spread of international production networks. While opening up new export opportunities for developing countries, participation in these networks depended on a significant increase in imported intermediate inputs and the sacrifice of policy space to the large corporations managing these networks – a privatization of governance, making it increasingly difficult for participating countries to diversify into higher value-added activities.

The 2002 Report concluded that while developing countries were now trading more than before, many were earning less from doing so. Manufacturing enclaves with few links to the wider domestic economy did little to boost employment, investment, value added and productivity growth, and in some cases, as examined in the 2003 Report, the rapid pace of liberalization had led to “premature deindustrialization” as countries experienced declining shares of manufacturing employment and output at relatively low levels of income and a downgrading to less technology intensive activities.

On a more positive note, the East Asian growth story had demonstrated potential benefits from closer regional trade and investment flows, raising the possibility that replicating such arrangements, along with closer south-south cooperation and integration, could help sustain the growth momentum in the South. The opportunities and challenges were examined in various *Reports*, while insisting that they should not be taken as a substitute for effective multilateral arrangements and a warning that their impact would be compromised

if these arrangements continued to squeeze policy space through badly designed trade and investment agreements, excessive lending conditionalities and the further encouragement of pro-cyclical capital flows.

6. A Feature not a Flaw

In 2007 the Report again raised concerns that persistent global imbalances combined with the outsized presence of highly leveraged institutional investors in a position to benefit from and, up to a point, influence, macroeconomic price movements across countries, were posing a systemic risk to the global economy. Combined with complex financial instruments that promised to spread the impact of risky investments and the search for yields well in excess of growth in the real economy, the danger of “irrational exuberance” had become a permanent feature of financialized economies, along with the limits of self-regulating markets to discipline such behaviour.

The warning proved prescient, the optimism of the new millennium was shattered by the financial crisis that had been building since August 2007 and broke across the global economy with the collapse of Lehman Brothers in September 2008. While the crisis was incubated in the increasingly reckless practices of the United States mortgage market, it was the culmination of a highly leveraged financial system which had become untethered from the productive economy. The impact was as swift as it was devastating, with investors resorting to panic selling in the hope of minimizing losses. As financial contagion crisscrossed markets and continents, the global economy went into recession for the first time since the Second World War.

Judgement was swiftly forthcoming. A distressed Alan Greenspan told a congressional hearing that he had discovered “a flaw” in his thinking about the virtues of free markets while a group of eminent economists in the United Kingdom informed the Queen that there was “a failure of the collective imagination of many bright people”. The head of the IMF, Dominic Strauss Kahn, concluded, more correctly, that the crisis had “devastated the intellectual foundations of the last twenty-five years”.

Recognizing that a global crisis on this scale required collective actions beyond the efforts of a small club of Western economic powers, the response was broadened to include key emerging economies with the new G20. At its London meeting in April 2009, the G20 called for large-scale coordinated fiscal expansion to

stem the crisis. The new United States Administration had already announced a three-year \$720bn stimulus package – 1.6 per cent of GDP annually – prior to the meeting but the real gamechanger was China's two-year \$586bn spending package, some 4.3 per cent of its GDP annually. The sense of a shifting geo-political landscape was given further expression with the first summit of the BRICS countries in June 2009.

The London meeting promised a series of ambitious reforms to prevent a repetition of the crisis, restore growth and build back better (G20, 2009). Its ability to deliver, however, proved underwhelming. Once the balance sheets of the big international banks at the centre of the crisis had been cleaned up and financial markets had regained their nerve, the advanced economies made the turn, in varying degrees, to austerity. The revealed preference of policy makers in Europe and the United States in particular was for global financial stability; global prosperity mattered less.

The Report in 2011 warned that with a concerted shift to fiscal consolidation while the private sector was still deleveraging, neither a further loosening of monetary policy nor a rehabilitated financial sector, would, separately or together, produce a strong recovery. Moreover, given the likelihood of subsequent financial shocks, not only would the poverty challenge be set back in many developing countries but the growing calls for a transition to a more climate friendly economy would go unheeded.

A year before President Obama pronounced inequality “the defining challenge of our times”, the 2012 Report returned to the issue of rising inequality and its links to economic stagnation. Confirming that the policy factors and structural forces that had been identified in the late 1990s continued to make for a highly unequal world, the Report also noted that there had been some regional improvements, particularly in Latin America, since the opening years of the new millennium, as a boost to job creation (in both the public and private sectors) from rising commodity prices and accelerating growth was amplified by a new policy turn which supported public spending on social services and income support schemes. Still, in the absence of reforms to international governance, continuing vulnerability to shocks and high levels of economic informality would, the Report concluded, continue to pose significant barriers to tackling inequality in many developing countries.

What eventually emerged from the crisis was a new variant of hyperglobalization in which new forms of

non-bank finance were allowed to flourish beyond the (limited) regulatory oversight of banks introduced after the crisis⁴, Central Banks would continue to prime financial markets through their balance sheet transactions, and new sources of rent extraction were created through monopolistic practices in concentrated markets and on digital platforms.

In the United States, the stock market soared as large corporations used their profits to buy back their own shares and acquire rival companies, while budget cuts, weak domestic investment and wage stagnation held back a strong recovery and generated growing precarity. Similar polarizing pressures were visible elsewhere albeit with remaining welfare provisions in some countries softening more extreme outcomes.

The exception to post-crisis austerity and malaise was China. Its unprecedented fiscal stimulus in response to the global financial crisis shifted the impetus of growth towards domestic demand, particularly investment, which rose to \$6.2 trillion by 2019 from \$2.8 trillion in 2010 (compared to \$4.5 and \$2.8 trillion respectively in the United States), and continued to underpin a strong export performance, despite an appreciating currency and the targeted tariff increases adopted by the Trump Administration. While China's trade surplus did begin to fall after 2014 it remained in positive territory while overseas lending, including to other developing countries, began to rise, linked, in part, to its Belt and Road Initiative launched in 2013. However, the deceleration of growth over the course of the decade and the continued build-up of domestic debt, particularly at the provincial and corporate levels, along with growing inequality brought a threat of unspeculative bubbles. Turbulence on the Shanghai stock market in 2015 and 2016 was a warning to policy makers that financial balance sheets needed a clean-up.

7. A New Normal versus a New Deal

The failure to deliver the promised reforms after the global financial crisis raised uncomfortable questions about the effectiveness of the multilateral system in a hyperglobalized world of footloose capital, growing market concentration, sluggish global demand, weak investment and mounting indebtedness. Still, 2015 saw the launch of the Agenda 2030 and agreement in Paris on reducing carbon emission levels to mitigate the climate crisis, which together offered an ambitious and transformative agenda for the global economy. However, in the absence of a programme

of systemic reforms to address the entrenched asymmetries of hyperglobalization and to provide the financial support needed for a big investment push to meet the agreed goals and targets, the odds of their timely delivery were soon lengthening.

Taking lessons from the efforts of the Roosevelt Administration in the United States to build back better from the Great Depression of the 1930s, the 2017 Report, argued that a Global New Deal was needed to end austerity and create decent jobs, rein in the rentier economy and harness finance to serve wider social interests. “Effective internationalism” the report concluded “continues to rest on responsible nationalism and finding the right balance remains at the heart of any meaningful multilateral agenda”.

As the decade ended, advanced countries had failed to find significant new resources for the IMF or to deliver the (even limited) funding promised a decade earlier for the Green Climate Fund, had abandoned the multilateral trade negotiations launched in Doha, focusing instead on bilateral and plurilateral deals, and had made little progress on global tax reform. The limited attempts at financial regulation (including through the efforts of the Financial Stability Board and the, delayed, third stage of the Basel Accords) had done little to rein in the predatory activities of a new generation of private creditors, leaving many highly indebted developing countries struggling against an unforgiving legal system, with some already in default.

The IMF in its final *World Economic Outlook* of the decade expressed concerns about the danger of policy missteps against a backdrop of downside global risks. UNCTAD also worried about policy missteps, but the bigger problem was the rules of the international economic game which constrained productive investment, generated intolerable levels of inequality, and indulged, if not actively encouraged, predatory corporate behaviour. A deepening sense of insecurity continued to permeate the lives of too many people across the global economy. The potential dangers coming from an emerging rentier class, that the Report had warned about at the end of the 1990s, had now become a fully-fledged rentier economy that had acquired global reach. In the face of weak and unstable growth, persistent financial fragility, growing economic polarization and rising geo-political tensions, the 2019 Report warned that a global recession was a clear and present danger.

8. Back to the Future

Covid-19 was the straw that broke this sclerotic camel’s back. The immediate response to the shock, following the policy playbook of previous crises, was to cushion the blow to financial markets with a new round of quantitative easing. But governments in advanced economies soon found themselves in unfamiliar territory, as lockdowns to contain the pandemic triggered an economic blowback that required concerted and targeted measures to protect lives and livelihoods. Central Banks kept the money tap open, but governments also increased their spending to levels not seen since wartime, abandoning, in the process, previously uncontested policy positions. Even so the drop in output during the second and third quarters of 2020 was unprecedented and even as economies began to unlock and confidence return, the bounce back was marked by considerable unevenness across sectors, income groups and regions. Moreover, the income and wealth inequalities that emerged over the last four decades have, if anything, intensified, with the owners of financial and digital assets reaping the biggest gains from recovery.

Lockdowns hit developing countries hard triggering a series of interconnected shocks which generated vicious economic cycles that on top of existing debt vulnerabilities, tipped most regions in to a deep recession and some countries into default. Despite the fiscal squeeze and increased debt burden, developing countries were left to manage the crisis largely on their own, forcing deep cuts in public employment and services.

A faster than expected reflux of capital flows and recovery in commodity prices, as lockdown in the advanced economies were lifted, prevented a worst-case scenario emerging. Still, as discussed in the previous chapter, growth in most parts of the developing world remain weak, large debt overhangs have grown even larger, while variants of the virus are threatening to revive new waves of the pandemic that will derail fledgling recoveries in more vulnerable economies.

But even if the virus is contained, the fear of higher interest rates is again stalking development prospects with the threat of another lost decade a possibility. In response, last year’s Report, much like the first, called for a coordinated global recovery plan based on a change of policy direction in the advanced economies which would sustain recovery and build resilience and reforms to the international

architecture that could better coordinate those efforts and support developing countries in adopting similar measures. So far, the international community has failed to deliver.

In an odd sense of *déjà vu*, this year's Report coincides with the G7 countries again talking of the need to revitalize western democracy and build a new partnership with developing countries around infrastructure investment, including through an initiative for clean and green growth. Their call for a "building back better world" has struck a hopeful note. A promise to treat health and education as global public goods, a commitment to a sufficiently financed green revolution, an infusion of liquidity through a new allocation of SDRs, and the announcement of a minimum global corporation tax are all welcome departures from recent practice.

However, with a development crisis looming, the climate crisis a reality for many countries and the Agenda 2030 in trouble even before Covid-19 hit, the willingness to acknowledge the scale of the challenge facing developing countries is still missing. The G7 countries provided little detail on their proposed reform agenda and even less on the resources they would commit to lift all boats out of the immediate crisis and launch a just transition to a decarbonized world by 2050. The call from developing countries to waive the TRIPs agreement in the WTO as a necessary first step to enabling the local manufacture of vaccines has, despite belated backing from the United States, been resisted by other advanced economies, whose defence of large corporate interests is causing new fissures in the global economy, based on access to vaccines and freedom of movement. Furthermore, a general reluctance to bring private creditors to the negotiating table gives little hope that the debt burden weighing on developing countries will be sufficiently eased to allow them to invest

their way out of the multiple crises they currently face.

What is missing is a bold, human-centred narrative that breaks out of the technocratic, finance-influenced tropes about economic growth and connects shared global policy challenges to improvements in the everyday lives of people in Bogota, Berlin, Bamako, Busan or Boston. Policy should address worries about not only their job security but whether the job they have will guarantee a secure future for themselves and their families, whether the taxes they pay will deliver the public services that they want and the social protection they need if things go awry, whether the debts they acquire to put a roof over their head, food on the table or their children through school will be a lifelong burden and whether the planet itself will continue to sustain a meaningful life for their children and grandchildren.

Forty years on, the conclusion of the first *Trade and Development Report* still rings true:

The present situation thus appears to require a new development paradigm, and this paradigm will need to take explicit account of the fact that issues concerning the management of the world economy, on the one hand, and long-term development objectives, are intermingled.

The big differences between then and now in linking long-term development objectives to the management of the global economy are the widening income and wealth gaps in countries at all levels of development and the looming climate crisis. Whether or not a new policy paradigm emerges to help guide a just and inclusive transition to a decarbonized world is an open question. That a building back better world for people and the planet hinges on that new paradigm is, quite simply, no longer in doubt.

C. Living in the Past

In the wake of any crisis, reverting to pre-crisis practices is a temptation for policymakers, in advanced and developing countries alike. But, as discussed in the previous section, the economic policy wisdom that has prevailed in recent decades has not played out well for the vast majority of countries, and particularly since the global financial crisis. Even when successful performers appear,

their achievements often come under very specific circumstances, making generalized policy choices unclear. Moreover, as has again been demonstrated this year with the emergence of new strains of the virus and extreme weather events, there are many imponderables that can upset projected economic trends. Even the immediate future is uncertain and beyond that, more so.

In this section, and with these caveats in mind, we examine the risks of a return to pre-crisis “normalcy” as a target of post-pandemic recovery for policy makers. The UN Global Policy Model (GPM)⁵ is employed to map out the plausible impact of a pre-defined set of policies on economic performance, assuming away exogenous shocks. The policy assumptions made in the scenario period draw on data from previous post-crisis periods over recent decades, as well as current and ongoing policy debates and announcements by governments, central banks and other relevant players. The scenario assumes that policy responses in the post-pandemic period will be oriented to: (a) tightening fiscal spending aiming at cutting deficits below 3 per cent of GDP; (b) labour market deregulation leading to continuing pressures on wage shares, so that wages rise at a slower pace than productivity until the unemployment rates approaches pre-covid levels; (c) continuing injections of liquidity by central banks aimed at inducing private investment; (d) continuing measures to liberalize capital markets (including through advancing trade and international investment agreements).

Whether such a configuration of policies will materialize is a matter of political conjecture. The intent here is to provoke a rigorous ex-ante reflection on the risks inherent in a return to policy normalcy.

1. The growth picture

Table 2.2 presents the estimated growth rates to 2030 in the main regions of the world if the return to

policy normalcy is adopted. It shows that the world economy is likely to slow down after the rebound of 2021 continues in 2022 (see Chapter I). The deceleration is such that the average rate of growth for the period 2023–2030 will be lower than that of the post-GFC of 2007–09, and lower still than the post ‘dot.com’ crisis of 2000–01.⁶ We call this deceleration in recovery growth rates **growth loss**. We calculate the loss of growth comparing the growth rates in this simulated scenario of post-Covid recovery with these earlier periods of recovery from 1980 onwards. We show that post-Covid growth loss compared with the earlier periods is substantial for all regions, albeit with variation among them.

Our scenario suggests that Developed America will exhibit a narrower growth loss than other developed regions by virtue of what appears to be a relatively more proactive approach to macroeconomic management. The striking outcome of the policy scenario is the more severe projected growth decelerations for developing economies. The scenario yields a narrower growth loss in Latin America than in other developing regions, due, in part to its historically lower growth performance, but also to economic ties with the relatively better performing Northern neighbours, and to the resurgence of more proactive governments in some countries. The nearly 5 percentage points shortfall in China is not, however, a sign of economic malaise but rather, a continuation of its policy-driven restructuring, incorporated in the scenario design. At this level of aggregation, the resulting growth average for China will still outperform the rest of the world.

TABLE 2.2 Economic growth of world regions, 2001–2030
(annual per cent, based on constant dollars at market rates)

	2019	2020	2021	2022	2025	2030	"average 2001–07"	"average 2010–19"	"average 2023–30"	growth loss relative to past recoveries
World	2.45	-3.67	5.33	3.59	2.54	2.44	3.54	3.13	2.54	-0.80
Developed America	2.14	-3.69	5.67	3.03	2.29	2.04	2.53	2.28	2.22	-0.18
Europe	1.46	-6.93	4.46	2.88	1.21	1.19	2.53	1.67	1.28	-0.82
Developed Pacific	0.94	-3.46	2.84	2.35	1.45	1.33	2.24	1.97	1.45	-0.65
China	6.11	2.30	8.34	5.75	4.73	4.34	10.96	7.80	4.59	-4.79
East Asia excluding China	3.17	-3.57	3.72	4.48	3.17	3.08	5.15	4.76	3.15	-1.80
South Asia	3.49	-5.57	5.68	5.62	3.43	3.65	6.72	5.89	3.64	-2.67
Western and Central Asia	1.81	-2.72	3.69	3.07	2.34	2.18	5.15	4.02	2.34	-2.25
Latin America and Caribbean	-0.87	-6.70	5.46	2.53	1.94	1.80	3.36	1.83	1.93	-0.67
Africa	3.50	-3.58	3.16	2.70	2.54	2.38	5.30	2.70	2.51	-1.49

Source: United Nations Global Policy Model. Historic data compiled from United Nations Secretariat and IMF databases; projections 2021 to 2030 are estimated.

Note: Regions as defined in Table 1.1 (for modelling purposes, the Republic of Korea is included in ‘Developed Pacific’).

2. The triggers of the slowdown

The domestic policy conditions that contribute critically to the growth outcomes presented above are aggregated at global level in Figure 2.2(a). As it is known, the ratio of government spending in goods and services on GDP has been subject to a marked fall since the 1980s (*TDR 2013, 2017*; Izurieta et al., 2018), ascribed to the doctrine of small government. Expansionary policies have occasionally swung into action to counter recessions, as with the GFC (and even more so with the Covid-19 shock) but were followed by tighter budgets, particularly through declining government spending, as policy makers confronted the inevitable rise in government debt caused by recession (Costantini, 2015; Lavoie and Seccareccia, 2017). Cutting the fiscal budget is not the only means to reduce debt ratios, is ineffective in most cases and undermines growth (Jayadev and Konczal, 2010; Storm and Nastepaad 2012; Blanchard et al., 2015). But it has, nonetheless, been the preferred policy option adopted after recent crises.

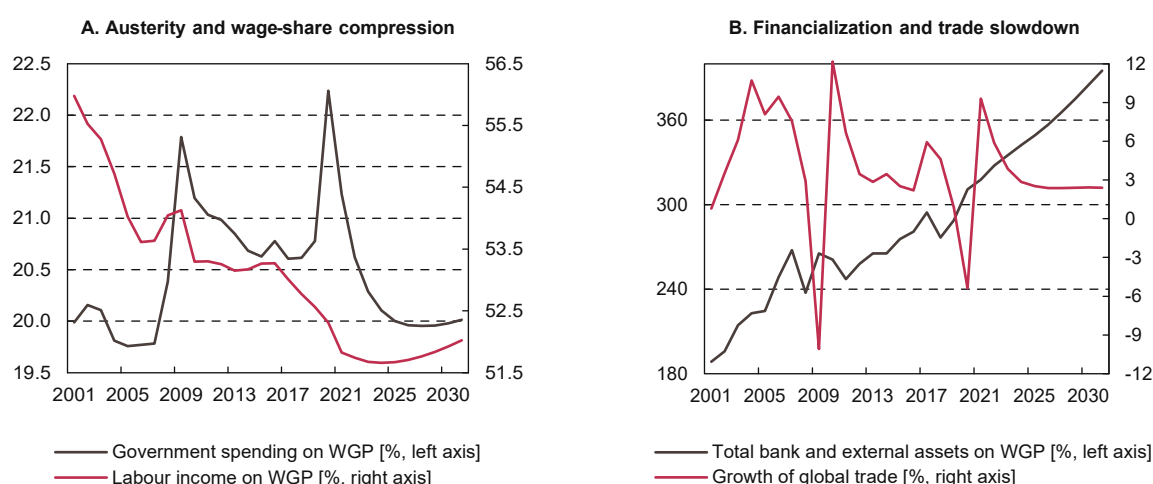
The scenario starts from the assumption of a general return to tighter fiscal stances, recognizing that in some instances (China, the European Union, North America, and a handful of developing countries in East Asia and Latin America) the resort to austerity points to a relatively softer line. Yet, in most of the mentioned cases the expected magnitudes of direct injections to the flow of expenditure in goods and services are marginal (see Chapter I). At the same time, the current ratios of government

debt are unprecedented and there is little to suggest the adoption of a sustained policy prescription to reduce debt burdens by fiscal expansion (see also *TDR 2019*). Thus, fiscal policy in the scenario is modelled to cut fiscal deficits to less than 3 per cent of GDP by the end of the decade, resulting in the pace of government spending shown in the Figure 2.2 (a).⁷

Figure 2.2 (a) also shows the historic pattern of global wage shares. As discussed in previous *Reports*, wage share compression has been the norm in most countries since the 1980s. From 2000 to 2019 the decline was nearly 4 percentage points of World Gross Product (WGP). As discussed in the next section, wage shares appear to have fallen further after the Covid-19 shock. Our scenario assumes that wage shares will keep falling moderately, at a pace similar to that experienced in the post-GFC, especially until the pre-crisis rate of employment is restored, which will take a few years.⁸ This is because policy-makers, facing a weakening of aggregate demand due to induced fiscal tightening, and being wary of excessive demand push by the private sector (for fear of inflationary pressures or financial fragility), would tend to privilege the option of increasing export competitiveness to gain market share. In the current policy paradigm, a weakening of labour's bargaining power appears as the default option to induce lower unit costs.⁹

The combined set of domestic policy conditions is mirrored in a continuing acceleration of the pace of financialization, highlighted by the rising trend of the

FIGURE 2.2 Main drivers of the scenario: global aggregates, 2001–2030



Source: United Nations Global Policy Model. Historic data compiled from United Nations Secretariat and IMF datasets; projections 2021 to 2030 are estimated.

ratio of external and bank financial assets on WGP (figure 2.2(b))¹⁰. This, in part, reflects policymakers' preference to gain net export demand through opening up to external markets by deepening trade and financial agreements (Kohler and Cripps, 2018). But it is also partly the result of continuing reliance on monetary easing and liquidity creation to support productive investment (Dow, 2017; Epstein, 2019; Gabor, 2021). As is well-known, would-be investors in productive activities facing sluggish aggregate demand would rather seek profitable investment opportunities in the financial sector (Bhaduri et al., 2015). The line showing the growth of import demand is not an assumption but an endogenous result of the policy stances. As indicated in the graph, pronounced cyclical fluctuations of trade growth follow the rhythm of the major economic crises. The model captures the sensitivity of import volumes to global conditions of demand, the weak impact of reducing tariffs barriers, and the negative effect of an accelerated pace of financialization that diverts funds away from credit for production and employment creation (see also *TDR 2016*).

3. Unfavourable conditions for most developing regions

The key assumptions of a return to normal policies play out under the current structure of global governance. This structure includes the heightened power of corporate players and the growing burden of (public and private) debt worldwide, which impose deeper vulnerabilities for most developing economies that do not issue currencies traded on international markets. As discussed in Chapter I, the structure of private finance generates waves of inflows and outflows beyond the control of policymakers, amplifying the worst aspects of current governance.¹¹

Thus, developing economies are increasingly forced to aim at securing the needed foreign exchange to meet their external commitments by exporting. Depending on initial conditions, availability of resources, externally determined price fluctuations, etc., few of them can become successful (net-) exporters. And even then, they will need to rely on deflationary policies to contain the growth of imports and related financial leakages. Most other developing economies will likely remain in structural deficit and facing greater costs of external finance (McCombie and Thirlwall, 1994; Barbosa-Filho and Izurieta, 2020). Regarding developed economies, the self-inflicted limits to growth brought about through wage-share compression, inadequate public sector

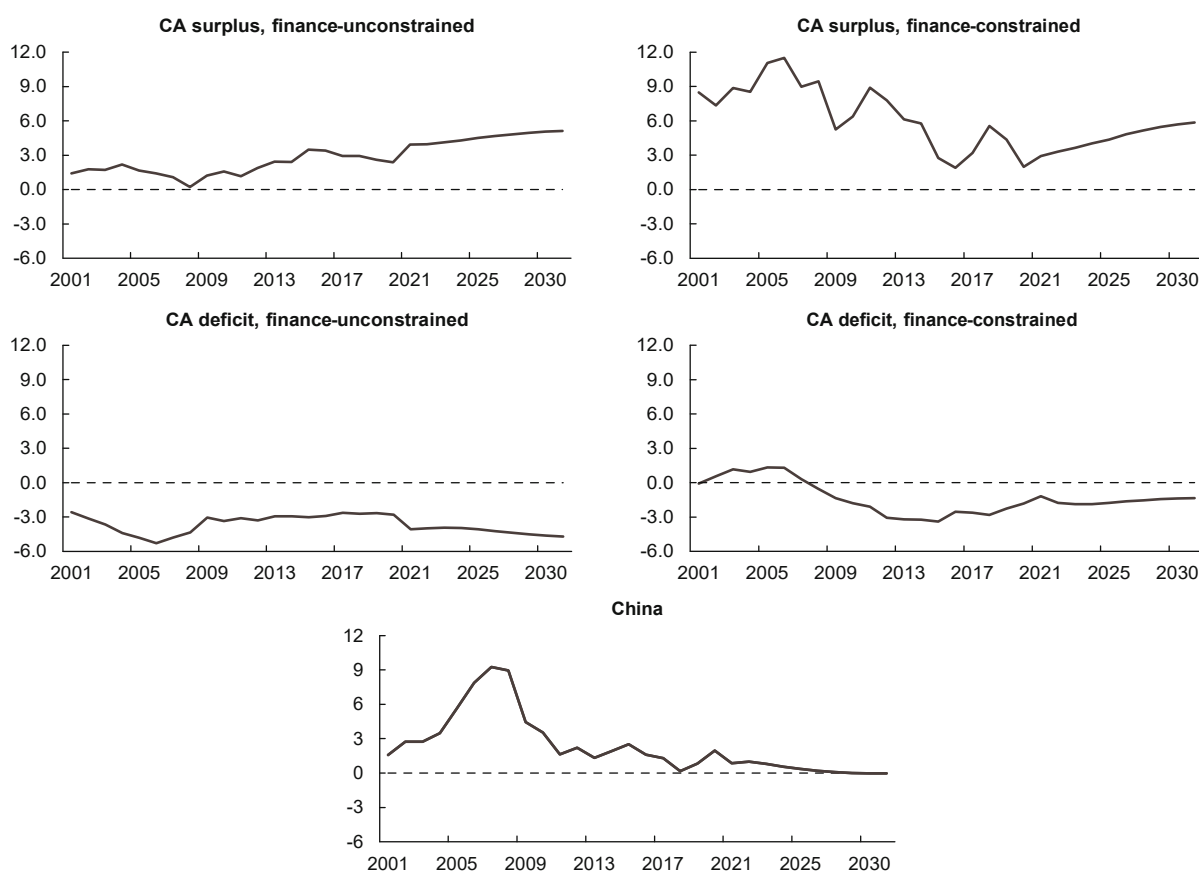
demand and accelerated financialization are likely to amplify the trend towards rising macro-financial imbalances.

On this basis, macroeconomic patterns can be mapped as either finance-constrained (most developing economies) or financed-unconstrained (developed economies). Within each category surplus-biased and deficit-biased economies can be further distinguished. China is presented separately as it no longer matches the conditions of surplus economies (with growth depending increasingly on domestic demand), nor of financially constrained economies (given advances in the international use of its currency as well as the abundance of held reserves). Their current account configurations are shown in Figure 2.3.¹²

The current account performances of these groups in the scenario period are the endogenous result of the interplay of the assumed domestic policies, the financial constraints mentioned above, and the expected behavioural responses of the private sector in each of the economies under exam. These elements, discussed below, will help explain economic growth patterns.

Current account positions are, by accounting, exactly equal to the combined public and private sector net lending positions (shown in Figure 2.4 for each set of countries). As all lines represent ex-post flows of savings (disposable income of either public or private sectors minus current and investment expenditure), movements downwards indicate injections to effective demand and conversely movements upwards represent leakages. The graphs per se do not reveal whether the shrinking of a deficit (movement upwards) results primarily from reductions of spending or increases of income. But a general observation that can be made of 'normal' periods of growth is that government revenues hold a stable relation with national income. Thus, movements upwards of the net-lending position of public sectors (reductions in the deficits) in the scenario period capture mostly the extent of expenditure cuts resulting from the assumed shift to fiscal austerity.

A pattern from past experience, which is extended to 2030 by design of the scenario, is the bias in current account surplus economies for small public sector deficits. In the process of moving from larger to smaller deficits, expenditures do not rise at the pace of revenues. Thus, by withdrawing public sector demand from the flow of income generation, *unless* corresponding additional spending is done by their

FIGURE 2.3 Current account, selected groups, 2001–2030
(Per cent of GDP)

Source: See Figure 2.2.

Note: Current account surplus, finance-unconstrained economies include the European Union and other economies of Western Europe, Israel, Japan and the Republic of Korea. Current account deficit, finance-unconstrained economies include Australia, Canada, New Zealand, United Kingdom, and the United States of America. Current account surplus, finance-constrained economies include major developing economies of East Asia (excluding China), of Western Asia (excluding Israel) and the Russian Federation. Current account deficit, finance-constrained economies include all other developing economies.

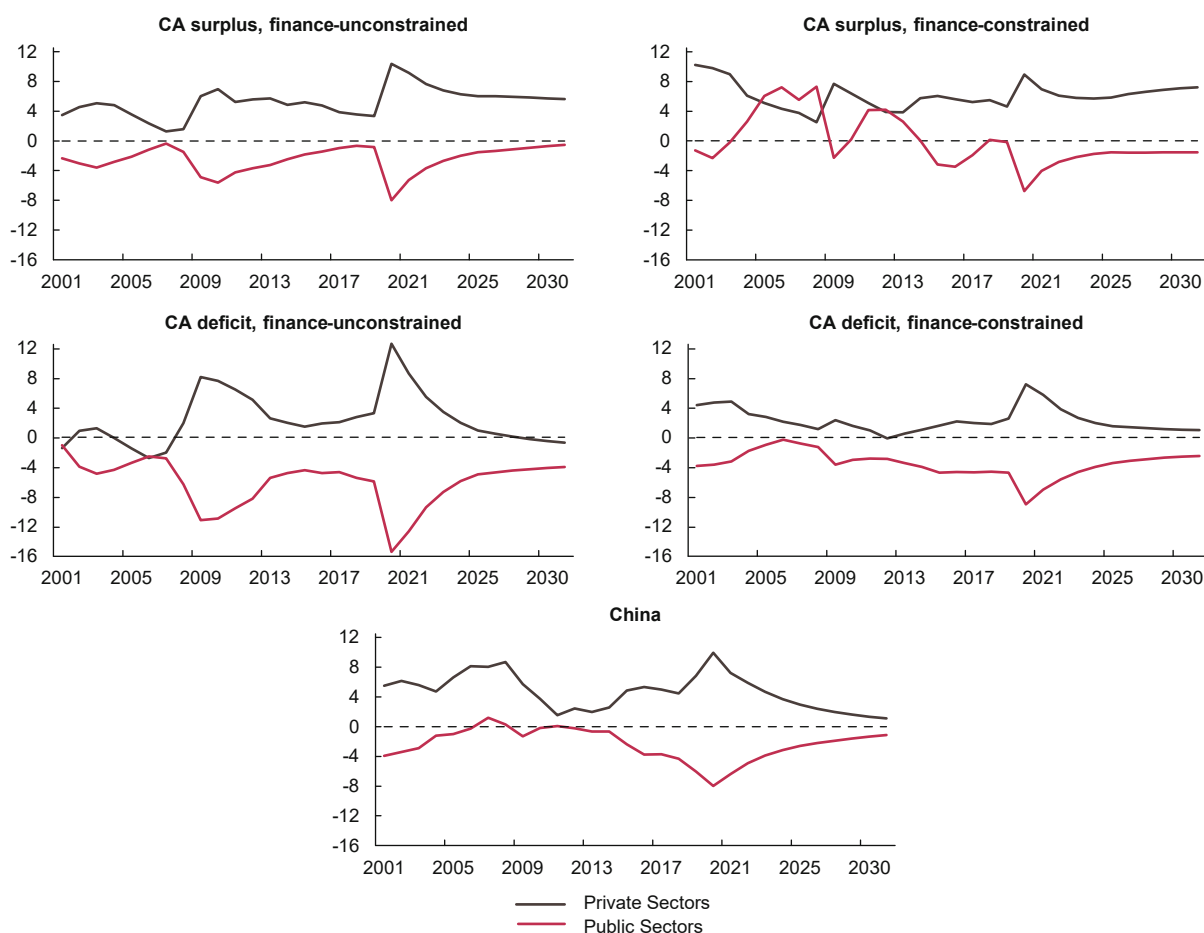
private sectors, these economies would be imposing deflationary pressure on the rest of the world. In other words, the resulting net withdrawal of spending relative to income by surplus economies implies a reduction of income potential in partner economies.

Thus, given the assumed shifts towards fiscal austerity, growth performance would mostly depend on private sector behaviour, which, in turn, is affected by financial conditions. To illustrate this, it is worth recalling the post-GFC responses in China. As in all other groups, the global shock of 2008–09 was met with a sudden increase of the fiscal deficit. But the sharpest injection to aggregate demand came from the private sector (movements downwards of the net-lending position). This was facilitated by financial conditions created to support investment. And such conditions were extended far into the post-GFC period with the double effect of generating fast growth

domestically and contributing to global demand. A similar configuration is extended into the post-Covid recovery, with the notable difference that it is expected that there will be greater emphasis on supporting household demand than on business investment. Needless to say, liquidity provisions to sustain private sector spending carry financial risks (*TDR 2020*), but to the extent that the Chinese economy does not issue a currency that can be easily traded in global financial markets, and flows of capital are carefully managed, those risks can be closely monitored.

In the other surplus economies, the large fiscal deficits in 2021 shrink relatively quickly in the scenario period. In the first four years, finance-unconstrained economies cut 71 per cent of the public deficit, while finance-constrained economies 62 per cent. Meanwhile, the export-bias of these economies, which also contributes to a continuing

FIGURE 2.4 Private and public sectors net lending, 2001–2030
(Per cent of GDP)



Source: See Figure 2.2.

Note: For country groupings, see Figure 2.3.

compression of wage-shares, results in cuts of the large surpluses of their private sectors, but by only 30 per cent (finance-unconstrained economies) and 16 per cent (finance-constrained economies). In sum, considerably greater cuts in public spending than additions to private spending induce growth decelerations, domestically and abroad. This behaviour turns out to be very similar to that of the post-GFC.

Among these surplus economies, the central difference is referenced by financial conditions. Finance-unconstrained (developed) economies have induced considerably large private sector net lending positions (savings) during the Covid-19 shock,¹³ and maintain moderately large private savings levels in the post-Covid period, by expanding liquidity (generated electronically by Central Banks) which make domestic and international portfolio investment attractive on the back of asset appreciations.

Meanwhile, private sector savings behaviour in surplus finance-constrained (developing) economies is more dependent on international financial conditions than domestic monetary stimuli. The allocation of private savings into financial assets is typically biased in favour of investments abroad, denominated in reserve currencies, while the flows of borrowing are mostly dependent on external 'push' factors. And especially in conditions of growth slowdown and potential global financial instability, private sector savings in these economies tend to increase and to divert more assets abroad¹⁴. This, in turn, forces governments to assume higher costs (interest rate premium) to finance their budgets. As costs add to the fiscal deficit, greater shares of expenditure cuts have to be enacted to achieve degrees of fiscal 'consolidation' similar to those of the finance-unconstrained economies. Thus, the domestic deflationary impact of similar paces of fiscal austerity are greater for developing economies. In the policy conditions postulated in

this scenario, finance-constrained surplus economies will likely experience a combination of growth slowdown (where both domestic and external sources of demand weaken) and greater volumes of domestic private capital shifting abroad, especially as growth decelerates.

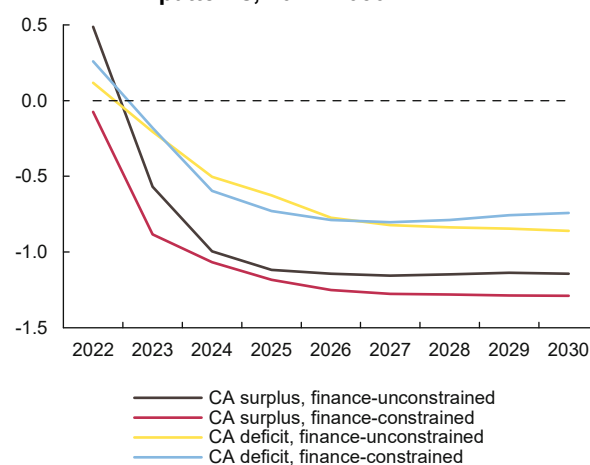
In economies tending to current account deficits, the main growth drivers rest on domestic demand. For finance-unconstrained (developed) economies, while fiscal austerity may predominate, the targets of fiscal adjustment seems to be more moderate than elsewhere, in part because of the privilege conferred on economies that can issue internationally accepted currencies without severe market pressures, and in part because their economic structure is geared to partially rely on public sector injections to demand ('soft-budget constraint', as per Galbraith, 2008). What is more, domestic creation of liquidity has proven to be an effective and powerful means to accelerate the pace of private sector demand (reducing or eliminating their net-lending positions), backed by asset appreciations (Godley and Lavoie 2007: 74–77; Costantini and Seccareccia, 2020). By virtue of the international status of their currencies (which may even trigger more inflows from abroad when international conditions falter), they are able to feed, via credit booms, increasing private sector spending.

By contrast, deficit finance-constrained (developing) economies cannot pursue a meaningful relaxation by domestic liquidity creation; public sector deficits shrink through the adoption of austerity measures and while private sector surpluses may shrink (contributing effectively to aggregate demand), private consumption or investment are likely to depend heavily on foreign inflows, which are (i) beyond the control of local policy makers, and (ii) costly, risky and volatile. Furthermore, in these economies which are structurally constrained and subject to boom-bust cycles, a significant portion of their private expenditure involves imports of manufacturing goods that cannot be generated domestically because industrialization requires affordable and stable financing. Thus, effective demand may not weaken as much as in surplus finance-constrained economies but keeping growth going induces an increasingly greater risk of financial instability.

4. Overcoming the dilemmas of interdependence

Given the current macro-financial structure of the world economy, a return to pre-Covid-19 policy

FIGURE 2.5 Projected growth performance according to macro-financial patterns, 2022–2030



Source: See Figure 2.2.

Note: For country groupings, see Figure 2.3.

normality marked by fiscal austerity, wage constraint and loose monetary and financial policy, will impose heavy burdens on developing countries.

Just as in the period leading to the GFC, this policy mix seems to deliver robust growth for as long as financial risks are kept in check. It may be tempting to think that reinstating similar policy stances in the post-Covid period may speed up growth for long enough so that the benefits outweigh the potential losses of, say, another global financial crisis. But this would be wishful thinking. By replicating similar policy triggers and analysing the world economy in a model that takes into account the configuration of external imbalances and financial constraints, we have shown that a marked slowdown of growth is the more likely outcome, and sooner, rather than later.

Policymakers in surplus economies have typically justified this set of policy options by offering reassurance that their emphasis on financial resilience and fiscal prudence warrants their economic growth performance. But it will not be so this time around. Figure 2.5 shows the timeline of growth losses of the four types of economies in the scenario period.¹⁵ The series measure the losses in economic growth of these groups, in per cent terms each year, relative to the average of economic growth of the same economies along all the recovery periods since the 1980s. The two sets of surplus economies are likely to lose the most, of around 1.2 percentage points of growth each year. Between these two groups, the finance-constrained (developing) economies will experience relatively sharper hits. Current account

deficit economies will also exhibit considerable slowdowns, to the tune of about 0.8 percentage points of growth each year, provided that systemic shocks from the build-up of financial vulnerabilities are averted. Needless to say, in the event of a significant financial collapse under current global conditions, neither deficit nor surplus economies will be spared considerable pain.

The rationale for this adverse outcome for surplus, financially well-off economies,¹⁶ is fairly straightforward. First, this time around, in most parts of the world, wage-shares have reached rock-bottom levels. Employees, small farmers and informal workers are remunerated at levels far below their historical contributions to output generation. This creates unprecedented pressures for either underconsumption or overborrowing.

Second, a return to fiscal austerity aimed to cut deficits is likely to trigger an acceleration of effective demand shortfalls. This is because, on the one hand, the predominance of global finance will raise the costs of public debt implying greater cuts in real public sector spending, as noted earlier. On the other, fiscal multipliers are higher at lower levels of aggregate activity, which in turn implies that austerity cuts will have a greater negative impact on aggregate demand.

Third, public sector spending in goods and services relative to national income has been declining

through the last decades. As clearly explained in Minsky (1982), and widely corroborated by decades of observation after the Great Depression, smaller public sectors make it harder to counter cyclical fluctuations of demand, which makes economies more vulnerable to private sector shocks.

Fourth, financial innovation and deeper globalization make it considerably easier and more attractive to shift resources potentially available for spending and investment into speculative activities with no direct effect on global demand (Nesvetailova, 2007).

Finally, as demonstrated in earlier *Reports*, the combination of wage share compression, austerity and smaller public sectors, and greater financialization impose further constraints on import growth, weakening global trade.

Therefore, the global deflationary impact of this combination is likely to be severe and will affect most dramatically economies which rely relatively more heavily on external demand than on domestic conditions, and most especially developing economies among them. The slow growth predicament facing surplus economies in the event of a widespread return to past policies should serve to motivate policymakers to seek more effective ways to sustain growth by combinations of injections to demand and tighter reins on speculative finance. And to the extent that growth is a globally intertwined outcome, policies to achieve it ought to be internationally coordinated.

D. From Economic Recovery to Building Back Better

Avoiding the policy mistakes of the past is necessary but not sufficient to recover from Covid-19. A better world will only emerge from the pandemic if strong economic recoveries are supported and coordinated in all regions of the global economy, if the economic gains from recovery are skewed towards middle and lower-income households, if health provision, including ready access to vaccines, is treated as a truly global public good and if there is a massive investment push across all countries into carbon-free sources of energy.

These are all demanding challenges in their own right, made all the more so because they are also closely interconnected. With the need for simultaneous progress on all fronts, moreover, policy makers can no longer disregard the complexity of the challenge by

offering a simplistic narrative about things falling in to place if prices are right. As the previous section showed, reverting to business-as-usual will by the end of the decade leave an even more fragile and fragmented world. That world now needs planning, not platitudes.

Thinking about how to make connections on all these fronts can help concentrate minds and actions on some of the basic elements of a successful strategy, and, in the process, make the challenge facing policy makers less daunting. In particular, with success on all fronts depending on boosting productive investment, creating decent jobs and narrowing wealth and income gaps, this section considers some of the policy responses adopted in the advanced economies since Covid-19 with respect to reducing inequality,

countering corporate rent-seeking and advancing green investments.

1. Avoiding separate development

After decades of growing inequalities and polarization pressures (*TDR, 2017, 2020*) and a pandemic that has destroyed jobs on an unprecedented scale, the economic recovery provides an opportunity to rebalance the distribution of income within and between countries. But, in spite of calls by G7 leaders for “building back a better world”, separate economic worlds may in fact be rising from the ashes of 2020, with little chance of them being unified without concerted reform measures at the national and international levels.

A full spectrum of the impact of the Covid-19 crisis on inequality, within and across countries, will not emerge for some time (Ferreira, 2021). But with vaccines still a distant hope for the majority of the world’s population, the gap in living standards between the developed and developing economies, which narrowed for some years from the start of the new millennium, is likely to widen again. In most developing countries, fiscal and monetary expansion has been constrained largely by external factors: the limited appetite of financial markets for debt issued in local currencies, the risk of being forced into an austerity program, should the need for IMF assistance arise, and the ebb and flow of international capital movements. As discussed in the previous section, failure to address these constraints will see a repetition of the lopsided recoveries of the past. Moreover, developed countries have been reluctant to agree on a multilateral mechanism for orderly debt workouts, clinging, instead, to the belief that a mixture of enlightened market responsibility, ad hoc reprofiling exercises and fiscal discipline will eventually alleviate the stress from undue debt burdens (see Chapter I sections B and D).

Most importantly, many of the policies developed countries are relying on for immediate relief and longer-term growth – including fiscal and monetary expansion, support for their high-tech sectors and protection for traditional sectors and trade in intangibles – could, without effective international coordination and compensating measures, impede the ability of developing countries to recover from the Covid-driven recession. In fact, historically low interest rates in developed countries combined with the speculative appetite of investors for high returns have led to large capital inflows into some emerging

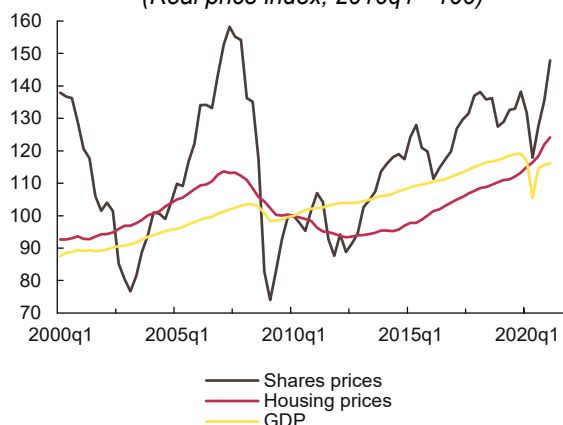
and commodity markets, including food, with adverse consequences for food security in the rest of the world (see Chapter I section C). Moreover, without scaled-up multilateral financial support for investments in climate mitigation, the foreign exchange constraint is likely to tighten further on many developing countries as their exports become the target of carbon adjustment taxes. Meanwhile, the health emergency in developing countries is ongoing. As a result, developing countries are, more than ever, likely to come under pressure to cut labour costs and public services, in a futile attempt to export their way to recovery, further exacerbating inequality at home.

In contrast, a budding recovery in developed countries has been driven by a fiscal expansion, which has supported household incomes, and by monetary policies that made sure financial breakdown was avoided when the economy was at its most vulnerable and that firms had access to cheap credit to remain sufficiently liquid during lockdowns. Going forward, growth is set to continue as long as the current policies are maintained and could even gain more momentum, at least to the extent that concerns about climate change encourage investments in green technologies to accelerate (see next section).

However, underlying structural problems that predate the pandemic continue to cast a shadow over future stability. The danger of separate recovery paths among countries has its counterpart in a K-shaped recovery across households and which reflect existing patterns of domestic inequality. On the one hand, as noted in Chapter I, CEO compensation rose by over 18 per cent during 2020 and an astounding 1,322 per cent since 1978. On the other, a large section of the American labour force on the minimum wage of \$7.25 per hour actually earned a higher weekly income being unemployed during the pandemic from the \$300 federal benefits than they did working (Matthews, 2021). In this context, the monetary measures employed during the crisis have been double-edged: these undoubtedly prevented a financial crash but have helped also to fuel massive asset appreciations, contributing significantly, in the process, to income and wealth inequality.

As discussed in the previous section, as financialization has become a ubiquitous feature of the global economy, and a spur to rent-seeking behaviour, an unbalanced macroeconomic policy mix has been present in virtually all developed countries since the bursting of the dotcom bubble in 2000, but similar trends can also be found in some emerging

FIGURE 2.6 Housing, shares and output in developed countries, first quarter 2000 to first quarter 2021
(Real price index, 2010q1 =100)



Source: OECD and IMF data.

Note: Average indices weighted by nominal GDP. Data available for 42 countries: AUS, AUT, BEL, BRA, CAN, CHE, CHL, CHN, COL, CZE, DEU, DNK, ESP, EST, FIN, FRA, GBR, GRC, HUN, IDN, IND, IRL, ISL, ISR, ITA, JPN, KOR, LUX, LVA, MEX, NLD, NOR, NZL, POL, PRT, RUS, SVK, SVN, SWE, TUR, USA, ZAF.

economies. If ignored by policy makers, a separate recovery for the financial sector compared to other parts of the economy, extending the disconnect already visible from before Covid-19, will pose an obstacle, and probably an insurmountable one, to building back better. Figure 2.6 which shows how, since the global financial crisis, house and share prices have, worldwide, become closely correlated with each other on a sharply upward trend and increasingly disconnected from a more sluggish output trend, provides a measure of the policy challenge (see also Annex Figure 1).

If a pattern of separate development is to be avoided, much is likely to depend on policymakers in advanced economies confronting the inequality challenge head on. In the United States, Covid-19 caused, cumulatively, the largest number of deaths per thousands of inhabitants among developed countries with a disproportionate number of women and minorities, and low-income families. The shock hit an already fractured economy split between “lead” sectors, with high wages and high productivity, and “lagging” sectors with low wages and low productivity (TDR 2020; Taylor, 2020). By 2019, decades of wage repression, weak social protection and industrial offshoring had left half the labour force (80 million workers) in precarious conditions, often in debt and with limited access to health care.

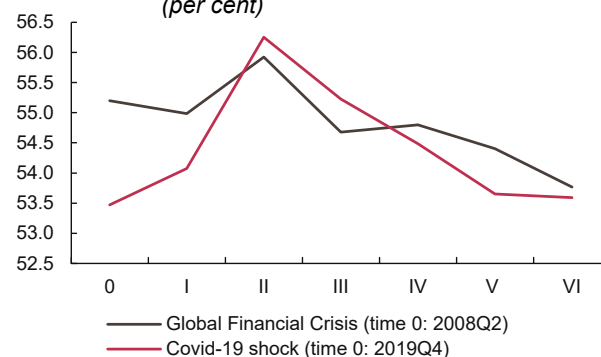
Against this already polarized economy, changes in income distribution during the pandemic have

followed a familiar script: as the recession wiped out profits, the labour share initially increased, in part thanks to discretionary government interventions, such as stimulus checks and increased unemployment benefits, only to decrease again as a result of layoffs. With small oscillations, five quarters after the recessions first hit, the labour share appears set on a downward trend. The timing is very similar to the one registered during the global financial crisis in 2008 and 2009, with the impact somewhat harder (Figure 2.7).

Sector level data are still incomplete but aggregate data already provide clear indications of rising inequality: While unemployment soared in 2020 and remains 2 percentage points above its 2019 level, total wage payments have already recovered. In fact, they surpassed pre-recession levels in the fourth quarter of 2020, when unemployment was still at 7 per cent. This suggests that some of the workers who remained employed during the pandemic saw their incomes increase. As this is unlikely the case for essential workers, it probably reflects income gains for workers in the prime economy who worked remotely in high productivity, high wage sectors including high-tech and pharmaceuticals (BIS, 2021; Gould and Kandra, 2021). In other words, economic recovery in the United States has not yet happened for a large share of the labour force.

In 2020 and the first half of 2021, government payments and discretionary relief measures including stimulus checks, mortgage forbearance and a moratorium on evictions staved off a deeper social and economic crisis, helped alleviate the plight of

FIGURE 2.7 Labour share in the United States in the aftermath of recessions
(per cent)



Source: US Bureau of Economic Analysis. National Income and Production Accounts (NIPA), Table 1.10; released 29 July 2021.

Note: i. The wage share is the proportion of ‘Compensation of Employees’ over Gross Domestic Income (GDI).
ii. The wage bill of Q2 2021 is the officially published (preliminary) figure. GDI for 2021Q2 was generated assuming the same trend of GDP.

those at the bottom of the income ladder – with a significant drop in the poverty rate in 2021 on some estimates, (Parolin et al., 2021) – and could possibly make the United States economy more efficient in the longer run. However, reversing decades of wage repression requires more than temporary measures and discussions from early 2021 about direct government intervention by raising the minimum wages seem to have faded.

The large cash transfers contributed less to GDP growth and employment creation than direct spending in goods and services would have because a portion of the transfer has been saved. This is a well-known effect of cash transfers and in the initial phase of the crisis, it was probably consistent with the objective of keeping people at home. But the increase in personal savings was massive in 2020, in excess of 12 per cent of GDP. To what extent this was fuelled by saved stimulus checks is still unclear, but it seems realistic that most of the increase was caused by capital gains on existing assets. Regardless, the combination of financial transfers to the private sector and expansionary monetary policy has fuelled growth of financial and real estate prices driving up wealth inequality further.

The path of the recovery, and whether it will be inclusive or not, hinges on the deployment of investment and labour market policies, which are articulated in legislative proposals currently under discussion. The recent social protection measures are mostly set to expire in 2021. As measures are phased out and pressures to reduce the public debt mount, fiscal policy may revert to austerity counteracting the impact of the recovery plans.

Avoiding this path will be key to ensuring an inclusive recovery. One challenge for the government going forward is how to persuade households to spend some of the savings accumulated during the pandemic. If most of the savings are held by the middle class, what is holding them back from spending them is probably insufficient confidence in future economic security or excessive confidence in financial returns. This can be addressed with policies that strengthen job security and wage growth, public investment and less expansionary monetary policy. If most of the savings are held by the wealthy, channeling them to real spending likely requires increasing marginal tax rates to transfer part of the wealth to the government, which can make productive use of it. A wealth tax, paid on total assets in the manner that homeowners pay property taxes, would break

new ground in ensuring equitable taxation, and help reverse existing inequalities.

A broad plan would include enhancements of physical infrastructure – with public investment programs and incentives for private investment aiming at decarbonizing the economy – and of “social infrastructure” such as the introduction of free childcare and higher education, which aim at generating wage and productivity growth. The plan also recognizes the importance of manufacturing as a driver of productivity growth and outlines a vision in which offshoring is partially reversed and corporate concentration reined in. With \$4.5 trillion in spending¹⁷ over a time span of eight years, the proposal would amount to 2.5 per cent of GDP annually starting in 2022, enough to have an initial impact on the long-standing problems of inequality and underinvestment.

As discussed in the previous chapter, the European Union suffered a more severe recession than the United States largely because of widespread and extended lockdowns. Although the private sector curbed its spending, employment did not contract as much as in the United States thanks to stricter dismissal regulations. Extensive social protection systems helped sustain disposable income but consumers’ willingness to spend is still at historical lows, as signalled by a saving rate of 21 per cent of disposable income (mid-2021), compared to 12 per cent in the United States (long-term rates are similar).

This may, in part, be owed to insufficient financial support offered by governments in 2020. But it is also likely to reflect a skewed recovery of incomes in 2021, which privileges the highest earners, who save proportionally more. Data are not yet conclusive on this issue but a major challenge in achieving an inclusive recovery in the European Union is posed by increasing inequality as a result of widening economic dualism.

In the European Union’s three largest economies – France, Germany and Italy – productivity growth has been low or negative for two decades, with wages in low-productivity sectors losing substantial ground to wages in high-productivity sectors (Capaldo and Ömer, 2021). Labour shares have decreased substantially but most of the loss has been borne by workers in already low-wage occupations. In Italy a severe deterioration of productivity growth has offset the decline of the labour share but a large share of workers has nonetheless suffered decades of wage repression. Research indicates that a major factor

of these developments has been the combination of austerity and emphasis on export competitiveness (Capaldo, 2015; Capaldo and Izurieta, 2013), which has undermined two key components of aggregate demand – public spending in goods and services and household spending.

In this context, an inclusive recovery in the European Union depends on restoring dynamism to consumption and investment, which requires sustained wage growth, public investment and continued commitment to strong social protection systems. Current fiscal rules and the emphasis on export competitiveness present serious hurdles which recently adopted recovery plans have not yet addressed.

As discussed in the next section, the “Next Generation European Union” plan is a good starting point to revive public investment and make sure it occurs in strategic sectors such as renewable energies, transport and agriculture. But to accomplish the targeted transformation and an inclusive economic recovery, member states would have to add substantially more to it at the national level. However, European Union rules foresee a return to austerity in 2023, after a temporary suspension of the deficit reduction mandated by the Stability and Growth Pact, which could prevent member states from effectively ramping up spending to bolster the recovery. At the same time, continued emphasis on trade expansion and cost cutting reforms (affecting government spending as well as wages) threaten to widen the gap between workers in lead sectors and those in the lagging sectors, adding to widening income gaps and further undermining the prospects for an inclusive recovery.

2. Taming the rentiers

As discussed above, an abiding theme of past *Reports* is the link between hyperglobalization and the rise of a rentier economy dominated by large corporations. Their control over key strategic assets and long global reach affords them a dominant market position from which abusive, and oftentimes predatory, business practices proliferate. Considerable evidence has accumulated over the last two decades indicating the growing extent of abusive market power and its distortionary impact, at both the national and global levels. The pandemic has, if anything, extended these practices, particularly through intellectual property rights and the control of digital technologies.

In both developed and developing countries, the perception that the benefits from globalization have

been unfairly skewed to large conglomerates is reinforced by their ability to pay little or no tax on the rents they extract.

A stark example is the increasing share of corporate profits – oftentimes classified as FDI – that passes through empty corporate shells rather than being invested in productive activities in the receiving economies (Damgaard et al., 2019). This type of transaction can be used for intra-company financing or to hold intellectual property and other assets. For tax-optimization purposes, it is concentrated in a few tax havens (Delatte et al., 2020), depriving many countries of a fair share in the benefits of globalization. Evidence on the exploitation of loopholes and tax havens or low-tax jurisdictions shows, for example, that companies from the United States generate more investment income from Luxembourg and Bermuda than from China and Germany (*TDR 2018*).

The origins of such practices can be traced back to the very foundations of the regime of international business taxation, whose broad principles were agreed during the early years of the 20th century and have remained intact until very recently. These principles assigned the taxation of active business income to source jurisdictions – where the business was located – while passive income such as investment income or rent fell to the jurisdiction where the investors resided.¹⁸ The concept of source taxation, which has been the mainstay of international business taxation, had both technical and political flaws. Since a large portion of global trade takes place in the form of intra-firm trade between subsidiaries within the same company (*TDR 2015*), companies often transfer large portions of profitable activities to subsidiaries in low-tax jurisdictions, also known as tax havens, so that the income appears to originate there.

The fallout from the GFC of 2007–2009 prompted renewed attempts, at both national and international levels, to target tax abuse and the secrecy jurisdictions that facilitate these practices (*TDR 2014*: chap. VII). Policymakers in leading economies have been focusing their attention, in particular, on the abusive practices of large digital corporations. During the pandemic, several European Governments, along with the European Commission, have pushed for improved surveillance of these corporations and stronger antitrust enforcement. The new United States Administration has also set out to strengthen antitrust laws and enforcement with the clearly stated aim of rewriting the rules of corporate behaviour more generally (*Financial Times*, 2021).

The main multilateral response was the launch in 2013 of the Base Erosion and Profit Shifting (BEPS) project by the OECD (see *TDR 2019*: Chapter V). It was given a boost in 2020 with the launch of the Inclusive Framework to deliver a multilateral, consensus-based solution to the tax challenges arising from the digitalization of the economy (OECD, 2021a).

The latest step forward was the agreement in early July 2021 by 132 member jurisdictions out of the 139 entities for a two-pillar solution to address those tax challenges with respect to taxing rights between jurisdictions and the losses of public revenues due to profit shifting activities (see OECD, 2021a: Annex A for the details). Subsequently, G20 Finance Ministers endorsed the key components of the Inclusive Framework agreement. These include the reallocation of profits of multinational enterprises under Pillar One and an effective global minimum tax of at least 15 per cent under Pillar Two. G20 also called on the Inclusive Framework to swiftly address the remaining issues, finalize the design elements within the agreed framework and provide an implementation plan for the two pillars by October 2021. Meanwhile, it invited the Inclusive Framework member jurisdictions that have not yet joined the agreement to do so (G20, 2021).

This achievement has been presented as a gamechanger for several reasons. Technically, it reaffirms the need to consider MNEs as unitary businesses, displacing the ineffective arm's length principle. Moreover, by applying a minimum tax rate to all multinational groups with consolidated revenues over €750 million (not only the ones linked to the digital economy), it simplified the scope of negotiations and narrowed the room for further delays.

Politically, the deal should help reinvigorate multilateralism, including by deescalating trade tensions between some key G20 members after several advanced economies announced that they would pursue their own path to tax major tech giants, which led the previous United States Administration to threaten retaliatory trade measures. Economically, the two-pillar package also promises to bring much needed tax revenue (OECD, 2021a), with estimates up to \$275 billion per year (Cobham, 2021), and to dent, if not eliminate, the global race to the bottom on corporate taxation.

As is often the case in the issue of taxation, the devil is in the details, and the details of implementing the

latest agreement are yet to be finalized. However, since, according to some calculations, corporate tax avoidance through profit shifting in low-tax countries 'saves' these firms from \$500-\$600 billion dollars in tax payments world-wide (Shaxson, 2019), one would expect the new system to affect companies' bottom line. However, despite the publicity surrounding the proposals for the new global tax, share prices have failed to register significant change. This suggests that business analysts are not persuaded that the new tax regime will change much.

There are at least three areas of concern about the global efficacy of the reform. First, there is a risk that it would still be possible to game the system (de Wilde, 2021). The more complex the system, the greater the probability of creating loopholes. Moreover, Devereux and Simmler (2021) find that this reform would affect only 78 of the world's 500 largest MNEs, because, under Pillar One, the tax applies only to companies with revenues above \$20 billion that earn a rate of return on revenue above 10 per cent. Their study reveals that reducing the revenue threshold for MNEs from \$20 billion to €750 million (the threshold of Pillar Two) would increase the number of companies affected by a factor of 13, even though the authors acknowledge that the relative gain of reducing the threshold below \$5 billion is small relative to the increase in the number of companies involved.

Second, there is a risk that developing countries will gain very little from this reform, because major grey areas and other contentious issues remain to be addressed. These include: the complexity of the new rules creating a significant burden for tax administrations around the world, especially in developing countries who face a shortage of highly-trained tax experts in their public administration; the low level of the tax rate; the limited reallocated tax-base under Pillar One with special carve-outs already promised for extractives and regulated financial services; the timing of the implementation with legal and political haggling shift the start date to well beyond 2023; the final allocation of taxing rights between firms' home and host countries currently based on MNE sales in each country (as favoured by the OECD and its members) and giving headquarter countries the first right to top up the tax on undertaxed profits, which would see G7 countries receiving more than 60 per cent of additional revenues (Cobham, 2021).

Third, a number of unresolved problems specifically concern the United States system of taxation. The United States has traditionally adhered to the principle of capital export neutrality (CEN), which is based on the idea that system of business taxation should be neutral about a resident's choice between domestic and foreign investments. For that purpose, the United States introduced the principle of tax deductions, so that United States firms could deduct losses generated abroad from their domestic taxation. A number of large companies have taken advantage of the system of tax deductions to reduce their tax to the minimum; Amazon, for instance, is paying nearly no tax at all world-wide by taking advantage of this system (Fair Tax Mark, 2019; Phillips et al., 2021).

It is not, as yet, clear how the existing United States system of deductions of taxation will work with the new multilateral proposals, and how it will affect the operation of global corporate structures. Furthermore, the United States also needs to address the inconsistency between the G7 proposal and its so-called Global Intangible Low-Taxed Income tax (GILTI), introduced by the previous Administration. In an attempt to prevent United States companies from moving their intangible assets, the 2017 Tax Cuts and Jobs Act had set the GILTI tax rate in a range of between 10.5% and 13.125%.

In the absence of an agreement that would have resolved all the above-mentioned risks and uncertainties, a group of leading tax experts have devised a more equitable, far less complex, and more practical proposal for a global anti-base erosion tax (Cobham et al., 2021; Picciotto et al., 2021). This relates to a minimum effective tax rate (METR), which could be introduced by a coalition of willing countries, whether they are home to MNEs, host of MNEs, or both. As the authors stress, this would still not be a complete solution. Changes would be needed to tax treaties to ensure a taxable nexus for significant economic presence and to allow a switch-over rule. However, in their view, progress on ensuring a minimum effective tax rate should not depend on securing signature and ratification by all States of a multilateral treaty – as is necessary for Pillar Two – because such a ratification process would in practice give all States a veto on implementation, which would be fatal. By contrast, the METR provides a practical and pragmatic basis for a feasible consensus of willing States to create a critical mass for progress toward effective reforms, since its adoption would contribute to, rather than impede, momentum for a more comprehensive multilateral agreement in a more distant time horizon.

3. Making green recovery packages work

Nothing highlights the importance of connecting policies adopted today to the prospects of a better future tomorrow than the dangers posed by rising global temperatures. Keeping the rise in global temperatures to below 1.5C is, arguably, the preeminent challenge facing the global policy community (IPCC, 2021), albeit one that is inseparable from the redistribution of economic resources within and across countries.

The *Trade and Development Report 2019* laid out a global strategy that could mitigate the threat of global warming whilst simultaneously addressing the inequities and fragilities of a financialized world. Climate protection requires a massive wave of new investments to rewire energy systems and other carbon-emitting sectors. Such a wave of green investment, the *Report* showed, could be a major source of jobs and income everywhere but the existing constraints on developing countries would mean that new sources of finance are required, including a significant scaling up of support from the international community in line with its commitment to common but differentiated responsibilities, along with the policy space needed to tailor industrial policies to the local demands of a just transition.

Given the uneven global economic landscape, rapid progress in this direction will, however, hinge on the immediate actions of the largest players, particularly China, the United States and the European Union. The United States and the European Union account for close to half of the stock of CO₂ emissions in the atmosphere. China, which is still a developing economy, accounts for much less than either (the more so on a per capita basis) but is now the world's largest emitter. Together, these three economies account for well over half of the 34 billion metric tons of emissions being pumped into the atmosphere each year (Table 2.3).

As Table 2.3 also shows, over the 20-year period 1999 – 2018, all three economies managed to lower their emissions relative to GDP, and by similar amounts—a 2.5 per cent average annual decline in China, a 2.2 per cent decline for the United States and 2.1 per cent decline in the European Union. Of course, the broad economic trajectories were distinct over this period. China's economy grew rapidly, at 9.0 per cent per year, so that the country's absolute level of emissions rose at a 6.5 per cent average annual rate, even while its emissions/GDP ratio declined. Economic growth was much slower in the United States and European Union over this period and, as a result, the absolute

level of emissions did decline, by 0.1 per cent per year in the United States and a slightly larger 0.8 per cent per year in the European Union. However, and unlike China, in both cases, investment levels have been moving in the wrong direction, particularly in the public sector.

Despite the differences between the three big economic blocs, the fundamental requirement for advancing climate stabilization remains the same for all: to cut their absolute emissions levels, regardless of their respective economic growth rates. All three economies face formidable challenges to accomplish this. This is because the single most important action required for eliminating CO₂ emissions is to phase out the consumption of oil, coal, and natural gas to produce energy since burning fossil fuels is responsible for about 70–75 per cent of global CO₂ emissions. Correspondingly, it is imperative to build a new energy infrastructure in all three economic areas, as well as throughout the global economy. The cornerstones of this new global energy infrastructure will need to be high efficiency and clean renewable energy sources, primarily solar and wind power.

In terms of policy design, a critical first question to ask is: what will be the investment spending requirements for transforming the energy infrastructures in China, the United States and European Union and, more generally, throughout the global economy? Estimates, including the 2020 *Report*, converge around a finding that, on a global basis, total clean energy investment spending in the range of 2–3 per cent of GDP per year will be necessary for this project to succeed. This figure can be somewhat lower or higher in individual countries, depending on the extent to which a country's clean energy infrastructure has advanced to date. For China, the United States and European Union, it is likely that investment spending will need to be sustained at this roughly 2–3 per cent of GDP level.¹⁹

With economies other than China, the United States and the European Union currently generating about 48 per cent of global emissions, it follows that the clean energy transition will have to advance throughout the rest of the global economy as well. The climate programs for China, the United States and European Union will therefore also need to be evaluated in terms of how much they contribute toward achieving the IPCC targets on a global basis, not simply within their own national or regional economies. However, in this regard, the principle of common but differentiated responsibilities places

TABLE 2.3 CO₂ Emissions and Economic Growth for China, United States and the European Union, 1999–2018 (per cent)

	CO ₂ emissions in 2018 billions of metric tons	Share of 2018 global CO ₂ emissions	CO ₂ emissions and GDP annual growth, 1999–2018		
			Growth of emissions/GDP	GDP growth	Emissions level growth
China	10.3	30.2	-2.5	9.0	6.5
United States	5.0	14.7	-2.1	2.0	-0.1
European Union	2.9	8.5	-2.2	1.4	-0.8

Source: <https://data.worldbank.org/indicator> for CO₂ emissions and emissions/GDP figures; <https://fred.stlouisfed.org/> for real GDP growth figures. Emissions growth figures derived from GDP growth and emissions/GDP ratios.

the onus for concerted international action on the developed economies.

The two basic ways through which government policy can advance a clean energy transformation are through either direct public-sector investments or a range of regulations and incentives to encourage private-sector investment. These regulations/incentive policies for private investment include carbon taxes or carbon caps, long-term contracts for clean energy suppliers with guaranteed prices (i.e. “feed-in tariffs”), and various forms of subsidized financing.

Achieving the right mix between public and private investment will be critical to the success of the overall project. The *TDR 2019* argued that public investment should take the lead given that achieving the required spending levels by private investors faces very high sunk costs, political risks, illiquidity and uncertain returns. Private investments depend on the calculations of expected profitability by private business owners and financial markets. As a recent IMF Working Paper has noted, closing the resulting gap between private and social returns is, under these conditions, difficult using market-based instruments. On the other hand, the advantage of higher levels of private investment for the clean energy transition is that they will relieve pressures on public-sector budgets to deliver the overall spending amounts required.

There will be large-scale job creation resulting from both the public and private-sector investments to build clean energy infrastructures. Climate stabilization projects in China, the United States and European Union and throughout the world should

therefore include measures to establish high job quality standards and to ensure that these newly-created jobs are fully available to women and other disadvantaged population cohorts. At the same time, it is unavoidable that workers and communities that are currently dependent on the fossil fuel industry will face significant economic losses as that industry is phased out. For China, the United States and the European Union, and throughout the global economy, fair and effective transition policies for these negatively impacted workers and communities should also be incorporated into their overall clean energy transition projects.

A transition led by public investment and jobs rich, to a decarbonized future underpins the calls, already heard before Covid-19 hit, for green new deals. The massive mobilization of fiscal and monetary resources in advanced countries to respond to the pandemic has suggested that there is an opportunity to globalize this idea. Under the banner of “a building back better world” there has been much talk by G7 economies of launching the kind of green recovery that was promised in response to the global financial crisis but was quickly abandoned in the face of austerity measures adopted in the advanced economies.

A premature resort to austerity appears less likely at the current moment than it did after the GFC. However, a survey of the initial recovery packages adopted in the world’s 50 largest (mainly advanced) economies found that only 2.5 per cent of the spending went to greening the recovery (UNEP, 2021). The challenge ahead will, therefore, be maintaining a public investment drive over the coming decade and beyond whilst scaling-up the climate component. In this context it is important to understand the current policy positions, and the respective strengths and weaknesses, of the major economic players.

(a) Policies of the United States

Between 2017–2020, under the Trump Administration the federal Government undertook no new climate initiatives and weakened most existing federal regulations and reduced sources of financial support to address climate change. The United States also withdrew from the Paris Climate Agreement in 2017. One of the first acts of the Biden Administration in January 2021 was to rejoin the Paris Agreement and has since then advanced a range of further initiatives aiming to put the United States economy onto a viable climate stabilization path. Most broadly, in alignment with the IPCC’s global emissions reduction targets,

the new Administration has committed to reducing United States CO₂ emissions by 50 per cent as of 2030 and to become a net zero emissions economy by no later than 2050.

In terms of specific measures to achieve these broad goals, the most significant initiative to date is the proposed 8-year, \$2.7 trillion American Jobs Plan, introduced in March 2021. Between 35–40 per cent of the total spending allocation, or about \$130 billion per year, would be allocated to investments that can directly contribute to reducing CO₂ and other greenhouse gas emissions. The American Jobs Plan would also provide significant support for R&D on climate issues as well as just transition initiatives for workers and communities that are currently heavily dependent on the fossil fuel industry. In separate proposals, the Biden Administration also advocates financial support, in unspecified amounts, for climate stabilization measures in developing economies.²⁰

This level of federal Government funding for climate stabilization would be unprecedented for the United States. But even if something close to this measure does become law, it is still not clear that the proposed funding levels would be adequate for achieving the Administration’s stated climate goals, i.e. of a 50 per cent emissions reduction by 2030 and net zero emissions by 2050.

In line with the estimates noted above that 2–3 per cent of GDP will be needed to finance the clean energy transformation, overall clean energy investments in the United States—including both public and private investments—should range between \$450–\$500 billion per year to reach the 50 per cent emissions reduction target as of 2030. The American Jobs Plan would provide about 25–30 per cent of the total investment required. Public funding from state and local governments can also contribute, but, for the most part, the amounts are likely to be much smaller than what the federal Government provides. This raises the question of the prospects for mobilizing most of the remaining 75 per cent of the needed funding from private investors.

Private clean energy investment spending in the United States has been on an upward trajectory for over a decade. But to date, the level of private clean energy investment spending remains far below the required level. For 2019, the year before the onset of the COVID-induced recession as well as the most recent year for which full data are available, total private sector clean energy investments amounted

to about \$60 billion in renewable energy and \$40 billion in energy efficiency.²¹ This total of \$100 billion therefore could contribute about 20 per cent of the amount that is required.

To mobilize private funds at the level required will depend on a strong set of incentives to support clean energy and energy efficiency and disincentives to discourage fossil fuel consumption. The most impactful such measures would be some combination of carbon taxes and carbon caps. Carbon taxes or caps do presently operate in 12 United States states that account for a quarter of the population and one-third of United States GDP.²² These states have achieved lower emissions levels relative to the United States average. But they have not succeeded in inducing private clean energy investment spending to a level close to the amount required. Part of the problem is that neither carbon tax or carbon cap policies have been designed in the United States states to avoid the significant problems that can accompany these measures. One major problem is that increasing the price of fossil fuels affects lower-income households more than affluent households, since energy costs account for a higher share of lower-income households' consumption. An effective solution to this problem is to rebate to lower-income households a significant share of the revenues generated by the tax to offset the regressive distributional impacts of such taxes. But such rebate policies have not yet been enacted in any state.

Overall, for the United States to transition onto a viable climate stabilization path will require some combination of significantly greater levels of public investment as well as stronger and more effectively designed regulations of private investment than those operating at present or are under current discussion within either the Biden Administration or at the United States state level.

(b) European Union policies

The European Union is advancing the world's most ambitious climate stabilization program, what it has termed the European Green Deal. Under this plan, the region has pledged to reduce emissions by at least 55 per cent as of 2030 relative to 1990 levels, a more ambitious target than the 45 per cent reduction set by the IPCC. The European Green Deal then aligns with the IPCC's longer-term target of achieving a net zero economy as of 2050.

Beginning in December 2019, the European Commission has been enacting measures and

introducing further proposals to achieve the region's emission reduction targets. The most recent measure to have been adopted, in June 2021, is the Next Generation EU Recovery Plan, through which €600 billion—one-third of the overall €1.8 trillion euro investment seven-year budget—will be allocated toward financing the European Green Deal.²³ In July 2021, the European Commission followed up on this spending commitment by outlining 13 tax and regulatory measures with these major features:

- Expansion of carbon taxes within the European Union Emissions Trading System;
- A Carbon Border Adjustment Mechanism through which importers will pay fees for importing carbon-intensive products such as steel, cement or aluminium;
- Tighter alignment of overall taxation policies with the European Green Deal objectives;
- Raising energy efficiency levels and expanding renewable energy supplies;
- A faster rollout of low-emissions transport modes and the infrastructure and fuels to support them;
- Tools to preserve and grow forests and other natural carbon sinks;
- A socially fair transition aiming to spread the costs of tackling and adapting to climate change.²⁴

In terms of the mix of public investments, regulations and other incentive to promote private investments, the European Green Deal apparently aims to rely primarily on regulations and other private-sector inducements. The €600 billion allocated over seven years through the NextGenerationEU Recovery Plan would amount to an average of about €85 billion per year. This is equal to less than 0.6 per cent of European Union GDP over this period (assuming that the European Union grows at a modest 1.5 per cent per year over this period). Private spending levels to transform the region's energy infrastructure, as well as forestry and agricultural practices, would therefore need to provide the remaining roughly €250 billion per year—or 75 per cent of total spending—to be on a viable stabilization path both for 2030 and 2050.²⁵

As noted above, considerable uncertainty is, unavoidably, associated with relying on private investments

induced by regulations and incentives as opposed to direct public investment spending for building a clean energy infrastructure. Thus, one recent study concluded that achieving the European Union's 55 per cent emission reduction target as of 2030 would require a tripling of the carbon price as of 2030 relative to what would be needed to reach a 40 per cent emissions cut by 2030.²⁶ Implementing this steep of a carbon price increase would undoubtedly face stiff political opposition, especially in the absence of rebates to counteract this new tax burden on lower- and middle-income people.²⁷ The 2018 Yellow Vest Movement in France emerged precisely in opposition to President Macron's proposal to enact a carbon tax without including substantial rebates for non-affluent citizens

As such, as with the United States case, the prospects for the European Green Deal to succeed as a climate stabilization program will almost certainly entail much higher levels of public investment support than has been proposed to date through the NextGenerationEU Recovery Plan.

(c) China policies

Unlike the United States and the European Union, China has not yet committed to achieving the IPCC's emission reduction targets for 2030 or 2050. However, in his September 2020 address to the United Nations General Assembly, President Xi was the first world leader to set out a set of targets for his country: emissions would continue to rise until they peak in 2030 and then begin declining to reach net zero emissions by 2060. commitment was the trigger for others to increase their ambition (Tooze, 2020). In addition, China has stated its endeavour to reduce its reliance on coal; emissions from burning coal are currently about 30 per cent greater than those from oil and 70 per cent greater than from natural gas.

China's position is that its situation, as both an historically low emitter and a developing country, is distinct because it is proceeding along a much more rapid economic growth trajectory than either the United States, European Union or other advanced economies.

China, as a fast-growing developing economy, does, undoubtedly, face more formidable challenges than either the U.S or European Union in achieving major emissions reductions. But it is still the case that if China does not achieve the IPCC's targets within

its own economy, these targets will be unattainable on a global scale. It follows that the risks the IPCC describes as resulting from failing to meet these targets — intensifying heat extremes, heavy precipitation, droughts, sea level rise, and biodiversity losses — will become increasingly severe, including in China itself.

China does, moreover, have a record of overachieving in advancing climate stabilization projects. As a major case in point, following the 12th Five-Year-Plan (2011–2015) in which solar and wind manufacturing were listed as strategic industries, the Government implemented a series of industrial policies, including public financing, feed-in-tariffs, local content requirement, and R&D support, which enabled China to become a leading global manufacturer of solar and wind power. When low domestic demand for solar energy became a bottleneck for this project, the Government responded by facilitating the growth of a domestic solar market. As a result, China managed to install over 130 GW of solar capacity by 2017. This exceeded by 24 per cent, and three years ahead of schedule, the Government's solar installation target of 105 GW by 2020 (Finamore, 2018). Primarily as a result of this and related initiatives by Chinese policymakers, the average global price of solar panels has also fallen by about 80 per cent since 2009.

China has been active in financing clean energy investments in developing economies through its Belt and Road Initiative, including in collaboration with international partners.²⁸ By contrast, the G7 economies did not commit to significantly raising their own global green financing commitments at their 2021 Cornwall meeting in the United Kingdom.²⁹

China has also implemented extensive programs for transitioning workers out of the fossil fuel industry and into other occupations. In 2016, it was estimated that roughly 1.8 million coal and steel industry workers needed to be relocated into other occupations when various coal and steel operations were closed. China's central Government announced in February 2016 a series of policy measures to support the reemployment for laid-off workers including an earmarked fiscal package of 100 billion RMB (about 15.4 billion USD).³⁰

In short, China has successfully mounted a highly ambitious set of industrial and financial policies to move its economy onto a viable climate stabilization path. At the same time, China is likely to remain as

the primary source of global CO₂ emissions over the next 20 to 30 years unless it substantially accelerates its emissions reduction program.

For different reasons, China, the United States and the European Union all need to mount significantly more ambitious climate stabilization programs in order for their respective initiatives to provide the necessary leadership for achieving the IPCC's emission reduction targets. In particular, these economic blocks need to commit higher levels of public investment to the global clean energy investment project. Of course, policies to induce private clean energy investments are also critical. But, as with private investment activity more generally, there will inevitably be high levels of uncertainty associated with achieving the increases in private investment at the scale necessary to reach a viable global climate stabilization path.

A basic constraint with increasing public investment is how to find significantly greater sources of public funding. The need to raise additional public revenues through more progressive tax systems, should be considered in all countries, conscious of local demands and pressures. But in fact, most of the funds needed to bring global clean energy investments to scale can be made available without a

significant increase in taxes, by channelling resources from other sources, including:

- Transferring funds out of military budgets;
- Eliminating fossil fuel subsidies and transferring a significant proportion of these funds into clean energy investments;
- Mounting large-scale green bond purchasing programs by the United States Federal Reserve, the European Central Bank, and the People's Bank of China.
- Leveraging the lending power of public development banks, at the national, regional and international levels

A great deal of analysis and program design will, no doubt, need to be accomplished in order to make these proposals workable, and with countries opting for different mixtures of these potential sources of finance.³¹ But one critical starting point for this work will be to raise levels of cooperation between China, the United States and the European Union, both on specifics of public financing for clean energy investments as well as more generally across all aspects of the global climate stabilization project.

E. Towards a new economic settlement

Speculating on the future direction of economic policy after Covid-19 is complicated by the extemporaneous nature of the response to the pandemic in many countries, as well as the high degree of uncertainty at the current juncture. Moreover, the global financial crisis stands as a warning that directions taken under the pressures of a particularly stressful moment may not persist once those pressures ease.

Under the circumstances, it is perhaps not surprising that a good deal of attention has been given to the actions and pronouncements of the new Administration in the United States with some already anticipating “the dawn of a new economic era” (Tooze, 2021) and others a “new variant” of capitalism (Elliot, 2021).

The President's Council of Economic Advisors (2021) has been forthright in acknowledging the need for a policy reset both to fix the damage caused by past policies and to address new challenges:

For the past four decades, the view that lower taxes, less spending, and fewer regulations would generate stronger economic growth has exerted substantial influence on United States public policy. Over this period, the United States has underinvested in public goods such as infrastructure and innovation, and gains from growth have accrued disproportionately to the top of the income and wealth distribution.

The economic theory underlying President Biden's American Jobs Plan and American Families Plan is different. These proposed policies reflect the empirical evidence that a strong economy depends on a solid foundation of public investment, and that investments in workers, families, and communities can pay off for decades to come.

A nascent break with past policy prescriptions – and the emergence of a new consensus (Sandbu, 2021) – is

detectable in the multilateral financial institutions, with their endorsement of big spending programmes, taxing the rich and curtailing the market power of big business (Georgieva et al., 2021), their acknowledgement that capital flows need to be more effectively managed including, under some circumstances, through capital controls (Adrian and Gopinath, 2020) and their endorsement of a strongly interventionist policy agenda to backstop a green investment push (IMF, 2020). Another bastion of neo-liberal policy thinking, the OECD, has also encouraged its members to spend big and protect jobs (Giles, 2021) and has recognized that socially inclusive and cohesive outcomes will require “a fundamental reappraisal of the relationship between state, society, the economy and the environment” (OECD, 2021b).

Others, however, have warned that the death of neo-liberalism is exaggerated (Galbraith, 2021), stressing its adaptability to changing circumstances (Slobodian, 2021) and pointing to new strains that will extend the power and influence of under regulated financial markets (Gabor, 2021). Some have also pointed to the policy continuities attached to the lending programmes of multilateral financial institutions during the pandemic (Ortiz and Cummings, 2021) and by the call from G7 trade ministers for deeper liberalization and a further narrowing of policy space (Davies et al., 2021). A greener variant of neo-liberalism has also been observed determined to ensure that the transition to a low-carbon high-digital future remains market-centred and capital-friendly by getting the price of carbon right, promoting a new generation of financing instruments that abide by ESG standards, greening corporate social responsibility and harnessing the wealth of billionaires and the power of big data to save the planet.

To date, most of the talk of a new consensus has been delivered by voices from the North and often with an eye on the 10-point policy checklist synthesized into the previously mentioned “Washington Consensus”. While Williamson never endorsed all the policy recommendations enshrined in that Consensus, he did support its claim that there was no alternative to “outward-oriented market economies subject to macroeconomic discipline” (Williamson, 1993) and its underlying mission to abandon the “intellectual apartheid” that had restricted the application of some policies to particular categories of countries (Williamson, 2004).

Whatever the record of this one size fits all policy agenda, it is not the approach needed by policy

makers facing the multiple and intertwining challenges that will shape development outcomes over the coming decade. If there is to be a genuine break with the past 40 years, governments must not only confront the vested interests that have built up considerable economic and political capital from the skewed distribution patterns under hyperglobalization but also acknowledge the deep structural constraints and vulnerabilities that have continued to obstruct sustainable growth and development prospects. Doing so will have to allow for greater flexibilities in the setting of policy priorities by developing countries and ensure sufficient policy space for the measures needed to manage ambitious goals and resulting trade-offs, along with differential treatment in support of their efforts to mobilize the resources needed to pursue the 2030 Agenda.

That said, the Covid-19 crisis has already opened the door to taboo breaking approaches to policy making that could help countries, at all levels of development, navigate towards a better future. These would include a recognition that:

1. *Governments are not households.* The Covid 19 crisis has not only seen advanced country governments spend on an unprecedented scale it has forced them to abandon the idea that budgets should always be balanced and instead to embrace, whether implicitly or explicitly, a functional approach to government finance which allows governments to spend first and tax later, and under certain conditions to spend solely with state-issued money (TDR 2020). Recognizing this opens up a discussion on the determinants of fiscal space, particularly in developing countries, where external factors have a much greater influence on the spending capacity of governments and where reforms to the multilateral financial institutions, as well to the domestic tax system, can help provide greater room for both counter-cyclical and social expenditures.
2. *Revisiting Central Bank independence.* Central banks have, since the last crisis, moved away from a singular focus on inflation targeting into economic fire-fighting through their balance sheet operations. This approach has continued in the current crisis including, in some cases, direct lending to the private sector. Accepting that Central Banks are the lynchpin of a credit making machine, necessarily extends their regulatory authority, including over the shadow

banking system, taming boom-bust credit cycles and more broadly extends their risk horizon to include wider threats to financial stability, such as from climate change and rising inequality. Given such wider responsibilities, greater democratic oversight is appropriate.

3. *Resilience is a public good.* The idea that “no one is safe until everyone is safe” clearly extends to challenges beyond the immediate health crisis and while some elites appear desperate to find ways to isolate themselves from economic, health and environmental shocks, Covid-19 has reinforced the idea that resilience is a public good, in the sense that it is both non-excludable and non-rivalrous, and one with global dimensions. Resilience is, no doubt, the responsibility of the state, delivered through a robust public sector with the resources to make the necessary investments, provide the complementary services and coordinate the multiple activities that building resilience involves. Countries need universal systems of basic services and social protection, but this imperative also raises specific challenges for developing countries over how to adapt the goals of a developmental state to the challenges, including financial challenges, posed by protecting citizens against shocks. In this respect, funding world-wide resilience will require new and ambitious thinking on the mobilization and dispersion of financial resources.
4. *Finance is too important to be left to markets.* Wall Street, and its counterparts elsewhere, has not been good at providing long-term, affordable finance even as its indulgence of speculative excess has undermined resilience at country and community levels; rates of capital formation have been too low in many countries and at all levels of development. Equally, the willingness to allow parts of the financial system to operate in the shadows, beyond regulatory oversight, has proved damaging, along with the discredited idea that they are disposed to regulate themselves. A financial system that accords a more significant role to public banks, breaks up and guards against the emergence of megabanks, and exercises stronger regulatory oversight is less likely to generate speculative excesses and more likely to deliver a healthier investment climate.
5. *Minimizing wages is bad for business.* The idea, grounded in microeconomic logic, that wages are no more than a cost of production has underpinned the drive to make labour markets as flexible as possible. But not only are wages a critical source of demand, their growth can stimulate productivity. Moreover, decent wages are a key component of a strong social contract. Consequently, healthy labour markets require that wages are embedded in robust arrangements of voice and representation and supported through minimum wage and related labour legislation that provides appropriate protection against abusive practices. In the case of developing countries, where underemployment remains an abiding feature of the labour market, targeting measures to tackle informality is of particular importance.
6. *Diversification matters.* No country has made the difficult journey from rural underdevelopment to post-industrial prosperity without employing targeted and selective government policies that seek to shift the production structure towards new sources of growth. The stalled industrial transition in much of the developing world, or worse still “premature deindustrialization”, has reinforced their peripheral position in the international division of labour, left them more vulnerable to external shocks and perpetuated high levels of informality. Industrial policies are even more urgent where meeting the climate and digital challenges imply structural and technological leaps and a just transition requires the effective management of stranded activities that ensures new jobs are created in the right locations.
7. *A caring society is a more stable society.* The question of care work is becoming an integral part of any policy agenda for recovering better including transforming paid care work into decent work with the wage levels, benefits and security typically associated with industrial jobs in the core sector of the labour market. But more generally, the design of proactive transformational social policy must go beyond offering simply a residual category of safety nets or floors designed to stop those left behind from falling further. Effectively designed social policies can also be used to accelerate and manage structural transformation, helping to foster technological upgrading and productivity gains underscoring the importance of an integrated approach to policy making for recovering better.

It is clear, as argued more forcefully in previous *Reports*, that policy programmes that build on these broad precepts will need a supportive multilateral system if they are to succeed, with a set of guiding principles aimed at ensuring “prosperity for all” by providing the space for necessary actions at the national level and galvanising global support for collective actions that rest on cooperation across all countries.

The call for reform of the multilateral system, made four decades ago in the first *Trade and Development*

Report, to avert an impending development crisis, went unheeded. The imbalances, inequities and insecurities that were beginning to emerge in 1981 have since, with the unleashing of the furies of hyperglobalization, spread further and deeper so that today’s crises are now truly global in their reach and impact. With debt levels having risen exponentially over the last four decades, and again during the pandemic, and the climate edging ever closer to a catastrophic tipping point, the urgency of reforming the system has become fiercer than ever.

Notes

- 1 It was, of course, also the message of the international New Dealers at Bretton Woods, typified by Morgenthau’s recognition that “the Bretton Woods approach is based on the realization that it is to the economic and political advantage of countries such as India and China, and also of countries such as England and the United States, that the industrialization and betterment of living conditions in the former be achieved with the aid and encouragement of the latter”, Morgenthau, 1945.
- 2 On the intellectual, bureaucratic and political origins of neo-liberalism and its evolution, see Mudge, 2008.
- 3 While the term was coined by the World Bank in 1981, its more widespread use stems from the establishment of an Emerging Markets Index by the investment bank Morgan Stanley in the late 1980s.
- 4 The rapid rise of the private capital industry with assets under management of over \$7 trillion in 2020, a more than three-fold increase in the decade after the GFC, was indicative of this trend, see Wigglesworth, 2021.
- 5 The UN Global Policy Model (GPM) is an empirical modelling framework for the analysis of domestic and global interactions between economic variables and policy stances, based on econometric causal-effect relations and a tight stock/flow world accounting framework (<https://unctad.org/debt-and-finance/gpm>).
- 6 By design, an economic or financial crisis was not modelled, even though financial fragilities and economic vulnerabilities are clearly emerging that can resemble conditions that triggered crises in the past.
- 7 This will not mean that government debt ratios will necessarily fall by these means.
- 8 As with fiscal policy, the scenario has given due consideration to calls to wage protection, job promotion and income support made in some of the same countries where also a softer approach to fiscal austerity seems to emerge. But as before, the analysis of what is actually in the recipes is, at best, consistent with the view that at some point wage shares may stop from falling but will not significantly rise to catch up with the declining trend.
- 9 Like with fiscal tightening to reduce debt burdens, the prescription tends to fail, especially on a global scale (Capaldo and Izurieta, 2013).
- 10 To generate the figure for total external assets, the accounts of financial derivatives were included in net terms. Not doing so would have increased the levels significantly but not changed the trend in a meaningful way.
- 11 See also Akyüz, 2021.
- 12 Current account surplus, finance-unconstrained economies include the European Union and other economies of Western Europe, Israel, Japan and the Republic of Korea. Current account deficit, finance-unconstrained economies include Australia, Canada, New Zealand, United Kingdom, and the United States of America. Current account surplus, finance-constrained economies include major developing economies of East Asia (excluding China), of Western Asia (excluding Israel) and the Russian Federation. Current account deficit, finance-constrained economies include all other developing economies.
- 13 See Chapter I, Box 1.1.
- 14 This observation resonates with the accounts of the period of buildup of ‘petrodollars’ during the 1970s and early 1980s, overborrowing and capital flights, especially in commodity and oil exporters (Vos, 1989).
- 15 As explained in the previous section.
- 16 It was less visible in earlier episodes where such set of policies were implemented.
- 17 This includes an agreed bipartisan plan of \$1 trillion on physical infrastructure and an additional

- \$3.5 trillion budget proposal on limited physical infrastructure, childcare, paid leave, health services, and climate-related investments. At the time of writing, the fate of the budget proposal is not yet clear.
- 18 Since then, most of the leading countries save the United States have abandoned the system of passive taxation (Matheson et al., 2013). Among the major OECD countries only the United States and the Netherlands hold on to the principle of resident taxation – although even that is in some doubt (Avi-Yonah, 2019).
 - 19 Recent studies include IEA (2021), IRENA (2021), Pollin (2020) and, specifically for the U.S., Williams et al., 2020.
 - 20 <https://www.whitehouse.gov/briefing-room/state-ments-releases/2021/04/22/executive-summary-u-s-international-climate-finance-plan/>
 - 21 The energy efficiency estimate is from: <https://energyefficiencyimpact.org/>. The renewable energy figure is at <https://www.bloomberg.com/graphics/climate-change-data-green/investment.html>
 - 22 <https://www.c2es.org/document/us-state-carbon-pricing-policies/>
 - 23 https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en.
 - 24 https://ec.europa.eu/info/publications/delivering-european-green-deal_en
 - 25 It is still notable that the most current public spending proposal is significantly higher than what had been budgeted previously. Thus, in 2020, the EC projected a total budget of €1 trillion over 2021–2030 for everything, including clean energy investments as well as just transition programs. This included funding from all public and private sources, with about half of the money coming from the EU budget, and the other half provided by a combination of national governments and private investments (https://ec.europa.eu/commission/presscorner/detail/en/qanda_20_24).
 - 26 <https://reader.elsevier.com/reader/sd/pii/S0306261921003962?token=898AD8E008D-08C848C1C66228819C4FDE743799A3B9A66947B82EAB740587B680DE3E2DB11EE3DF96AE99ACA78C1BB5C&originRegion=us-east-1&originCreation=20210715214704>
 - 27 <https://www.ft.com/content/5e1e5ba5-5b95-445d-9de6-034ad3568d2f>
 - 28 In 2018, China and the United Kingdom jointly launched the Green Investment Principles (GIP) for the Belt and Road Initiative.
 - 29 <https://www.carbonbrief.org/daily-brief/g7-reaffirmed-goals-but-failed-to-provide-funds-needed-to-reach-them-experts-say>
 - 30 <http://www.xinhuanet.com/fortune/caiyan/ksh/137.htm>
 - 31 Pollin (2020); see also *TDR 2019*.

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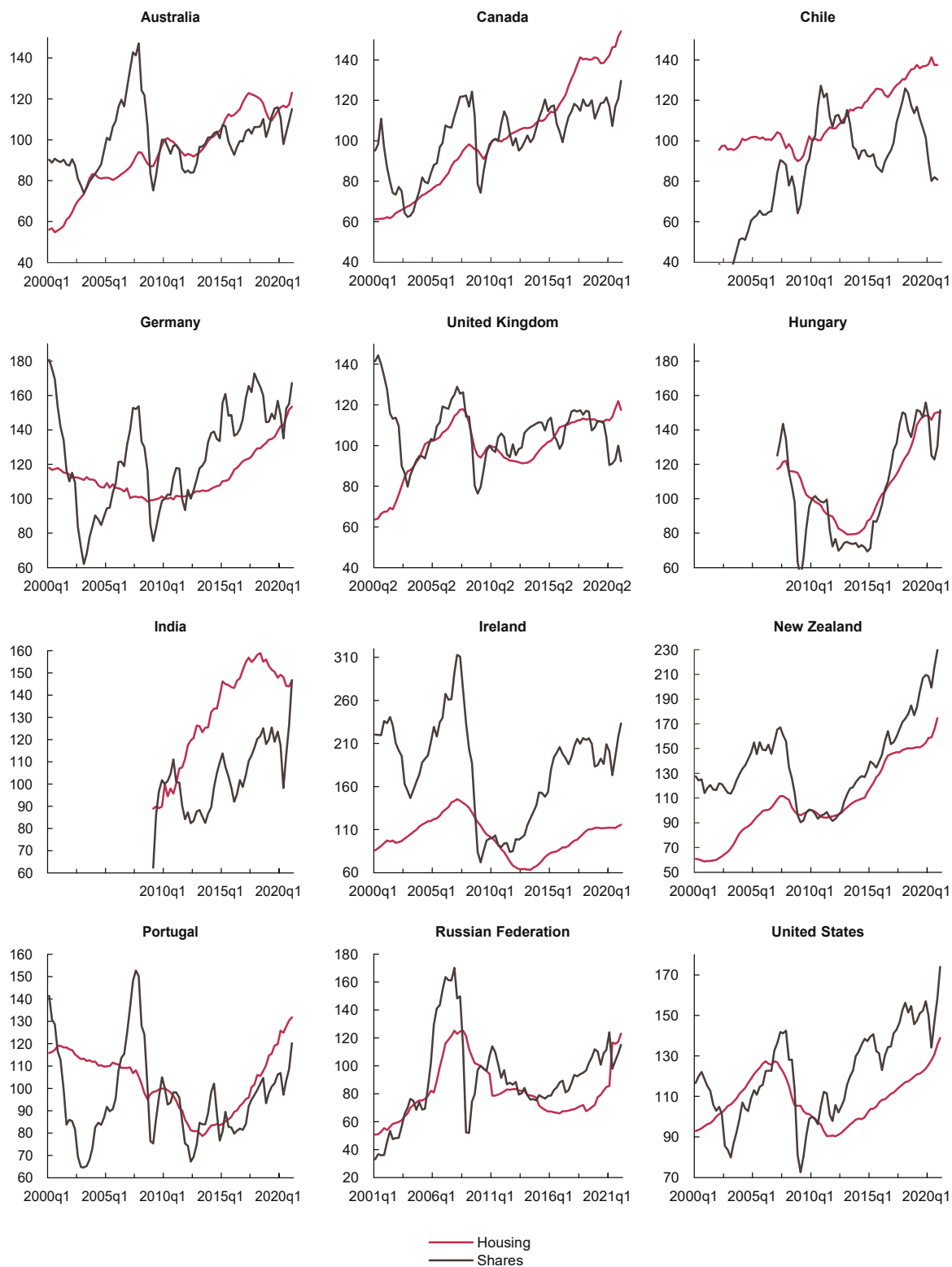
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Annex

FIGURE 2.A.1 Stock and housing appreciations in selected countries, first quarter 2000 to first quarter 2021
(Real price index, 2010q1 = 100)



Source: OECD data.