UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

TRADE AND DEVELOPMENT

REPORT 2021

FROM RECOVERY TO RESILIENCE:
THE DEVELOPMENT DIMENSION

OVERVIEW

UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

TRADE AND DEVELOPMENT REPORT 2021

FROM RECOVERY TO RESILIENCE:
THE DEVELOPMENT DIMENSION

OVERVIEW

UNITED NATIONS
Geneva, 2021

This publication has been edited externally.

United Nations publication issued by the United Nations Conference on Trade and Development.

UNCTAD/TDR/2021 (Overview)

OVERVIEW*

Introduction

Every crisis brings with it an opportunity. As the world economy recovers from the economic paralysis of the pandemic, there appears to be the chance to rethink the model of global governance that has guided the world economy for the past forty years but has largely failed to deliver on the promise of prosperity and stability.

There are some signs that 2021 could mark the beginning of a fairer, more resilient global economy, able to withstand interacting shocks and crises, and founded on a new consensus about the balance between the state, market, society and the environment. In the United States, the President's Council of Economic Advisors has acknowledged the need for a policy reset, both to fix the damage caused by past policies and to address new challenges, with a solid foundation built on investments, public as well as private, in workers, families, and communities.

The move away from simple market dogmas has also been apparent at the level of multilateral financial institutions. Both at the IMF and the World Bank, there has been a recognition that the economic thinking of the past would not deliver a more resilient system for the future. There has been an endorsement of big spending programmes, initiatives to tax the rich and curtail the power of monopolies, recognition of the role of targeted capital controls, an endorsement of a strongly interventionist policy agenda to backstop a green investment push.

It appears, in other words, that a new, global political economic consensus is emerging out of the crisis induced by the Covid-19 pandemic. But it would be premature to call time on belief in an unregulated free market.

---

* The Overview contained herein is also issued as part of the *Trade and Development Report 2021* (UNCTAD/TDR/2021).

The year 2021 marks the 40th anniversary of President Regan's inaugural speech that set the tone for the economic doctrine which prioritised private interests and markets over society and the state. Having gone global, the doctrine was institutionalized in the policies of national governments and international organizations where it retains its supporters. Even during the pandemic, austerity continued to guide the multilateral lending programmes to many developing countries; the G7 trade ministers called for deeper liberalization which would further narrow policy space for the state, while a good deal of the discussion of transitioning to a low-carbon economy has been focused on getting prices right.

What, then, is the likely path of post-Covid recovery? Will the world return, through a premature reversal to austerity, to a pre-pandemic state of affairs, marked by deepening and multi-faceted inequality, fractured economies, financial asset bubbles, corporate non-liability and environmental degradation? Will a more activist policy agenda persist but with only cosmetic efforts to address these underlying conditions? Or can a new way towards a fairer, balanced, resilient and climate-conscious development be found in the policy space opened by the pandemic?

Most advanced economies are rebounding in 2021 from the recession conditions, induced to stem the pandemic. Their key challenge is the medium and longer-term direction and nature of economic growth, both in terms of avoiding the policy reversals that marred the decade following the global financial crisis and making a definitive shift to a zero-carbon energy system, in line with the aims of the Paris Agreement.

The challenge facing developing countries is more immediate, with a combination of diminished fiscal space, increased indebtedness and limited vaccine roll out, holding back recovery and triggering divergence with advanced economies. Behind this divergence, however, lie decades of deepening economic and social divisions, an unstable insertion into global financial markets subject to mercurial flows of capital and diminished policy space. In many countries, these structural obstacles

to a balanced recovery are compounded by shocks linked to warming global temperatures.

In the advanced economies, the initial response to the Covid-19 shock, following the policy playbook used in 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 triggered an economic blowback that required concerted and targeted measures to protect lives and livelihoods. Central Banks kept the liquidity injections going, but, unlike in 2007-09, governments also increased their spending to levels not seen since wartime, abandoning, in the process, previously sacrosanct policy positions. Even so, the drop in output during the second and third quarters of 2020 was unprecedented; even as economies began to unlock and confidence returned, 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.

Developing countries were hit particularly hard by the global lockdown of economic activity. It triggered a series of interconnected shocks which generated vicious economic cycles that came on top of existing debt vulnerabilities, tipping most regions in to a deep recession and some countries into default. Despite the fiscal squeeze and increased debt burdens, 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, growth in most parts of the developing world remains weak, large debt overhangs have grown even larger, while variants of the virus threatening to revive new waves of the pandemic would derail fledgling recoveries in the more vulnerable economies. Even if the virus is contained, the fear of higher interest rates already undermines development prospects with the threat of another lost decade now a possibility.

As was the case with the first Report in 1981, 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 debt 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. There has been scant detail on the proposed reform agenda and even less on the resources available 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 – 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 deference to corporate interests is causing a new division in the global economy based on access to vaccines and freedom of movement. Furthermore, a general reluctance to pressure 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.

Forty years on, the conclusion of the first *Trade and Development Report* published in 1981 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 governance of the world economy, on the one hand, and long-term development objectives, are intermingled.

The big difference between then and now in linking long-term development objectives to the management of the global economy is 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 it is no longer in doubt.

Growth divergence, inflation fears and new variants

Assuming no further shocks, global growth is projected to reach 5.3 per cent in 2021, decelerating somewhat to 3.6 per cent in 2022. These figures are the result of demand stimulus in advanced economies and economies issuing global currencies, but still reflect incomplete reactivation of the productive capacity idled in the recession of 2020. Growth performance by region is very uneven. Only developed countries show the expected growth spurt, while many developing economies will remain below pre-pandemic averages.

The unevenness reflects the different degrees of policy independence enjoyed by developed and developing economies. Most developed countries used the strong financial firepower afforded by the privileged status of issuers of international-reserve currencies. This was a necessary response, but it did not lead to the recognition that other countries, especially developing economies, needed support to implement similar policies.

The expansion of SDRs allocations, necessary to ease some policy constraints in developing economies, was agreed late and to an insufficient degree. A few developing countries, including Brazil, Indonesia and Turkey, did adopt strong fiscal and monetary responses, similar to those by developed countries, but recent developments suggest they are vulnerable to financial repercussions, including through currency markets. Also in the advanced economies, public money allowed the development of vaccines at record speed and the cornering of supplies. Manufacturers, who have struggled to produce enough doses

for the developing world, have so far resisted calls to share technology, delaying the start of low-cost production in developing countries, and share technological know-how. By slowing down immunization, this stance aggravates the loss of life, facilitates the spread of new variants and makes booster doses necessary, compounding vaccine scarcity. This failure is even more dramatic than the inadequacies of the financial system because health infrastructure in developing countries is far weaker in comparison to most developed countries, and 'lockdowns' to contain the virus spread are futile, given widespread informality of jobs and inadequate social protection.

It is still unclear whether (or when) the current performance of the world economy will by sufficiently strong to recover pre-Covid trends (which in turn, were considerably lower than pre-2008 trends). In 2020-22, the global economy faces a cumulative income loss of about USD 13 trillion. If the global economy were to grow as in the early 2000s (approximately 3.5 per cent per year) it would return to its pre-pandemic trend only by 2030. Considering that global growth in 2017–2019 was already insufficient to reach the Sustainable Development Goals, reaching them in the current conditions requires unprecedented action, both in terms of degree and of multilateral coordination.

Prospects for maintaining the demand stimulus and advancing transformative public investment programmes over the longer term are clouded by the returning spectre of inflation, in both developed and developing economies. The facts, however, do not support the fears of inflation so often mentioned in some policy circles. Recent inflation spikes in the Euro Area will likely remain below target. In the United States, where inflation has recently surpassed the 2 per cent target, accelerating prices have been a common occurrence, especially in recovery years.

Evidence points to supply shortages as the main cause of the recent inflation spikes in commodity and energy exporting countries, as well as those that provide manufacturing inputs into global supply chains. Where inflationary shortages affect the labour market, establishing

better working conditions, including wages and social protection, can help ease the shortage by attracting more workers and contain costs by stimulating productivity growth (which is positively correlated to high wage growth and good working conditions). This stands in stark contrast with the standard response, which attempts to contain inflation through wage repression but effectively drives down productivity, leading to higher real unit labour costs. Instead, in cases where inflationary shortages affect other inputs or commodities, as is often the case in developing economies, sensible responses should focus on engineering a strong recovery of investment, incomes and of production worldwide. This distinction of causes and the respective responses, however, are absent from policy discussions, which have focused on demand stimulus packages. Yet in many countries, slowing demand growth by terminating the stimulus packages would not stop inflation, since its source is imported inputs, including commodities.

Debt vulnerabilities: Kicking the can down the road

Indebtedness has been growing across most regions since the start of the pandemic. With the exception of China and some oil exporting economies, debt burdens are too high and export revenues too low across the developing world. For almost all developing countries commodities are not a reliable source of income because their export revenues fluctuate due to frequent price swings. However, the frequently adopted approach of enhancing export potential by requiring developing countries to enter bilateral or plurilateral trade and investment agreements is no solution. One reason is that these agreements are not negotiated in the WTO, the functioning of which at least allows developing countries to form a united front.

Another reason is that the way these agreements regulate intellectual property rights and dispute settlement limits real technology transfer, preventing developing economies from competing with countries that are already industrially developed. Furthermore, the type of liberalization promoted by these agreements makes the global economy

more vulnerable as it is mostly geared towards extreme financialization running counter the strategic need to manage finance, especially for developing countries.

Building protection against the vagaries of global finance is critical for developing countries. It should start with a proper evaluation of sovereign and private debt burdens and repayment profiles, which affect development strategies but also crisis response.

External debt sustainability is set to remain high over the coming years, as many developing countries face a wall of sovereign debt repayments in international bond markets. Excluding China, servicing existing sovereign debt in developing countries will generate payments of almost $1 trillion by 2030, the year earmarked for achievement of the Sustainable Development Goals (SDGs), including $571 billion in repayments of principals and $365 billion in interest. The total amount far exceeds the estimated investment target of 2 per cent of GDP required for the green transition. Debt reprofiling and relief, including debt cancellation, are necessary. But so far agreed measures have been mostly symbolic. The only lasting multilateral relief was provided by the IMF through the cancellation of debt service obligations in 29 countries, amounting to $727 million between April 2020 and October 2021.

The contrasting pre-pandemic experiences with debt management in the advanced and developing countries have carried over to the current crisis. Even with similar debt ratios, developed economies, especially those that issue reserve currencies, have continued to function smoothly and have seen growth pick up. Developing countries, in contrast, face the risk of a lost decade. The pandemic offered an important test-case, in which governments of developed countries were able to enact larger spending measures than developing countries with similar or even lower debt burdens. In the latter, domestic liquidity creation does not necessarily improve access to foreign currency, while fiscal deficits act as a deterrent to private foreign investors driven by short-term and speculative interests.

In terms of fiscal policy too, not only were developed countries able to provide much larger stimulus than developing countries, even though the actual stimulus in the former was often much smaller than initially announced. Yet developed countries were not chastised by the bond markets for their spending announcements as developing countries were. How stringent the constraints to fiscal policy really are in all countries becomes clear when we consider the prevalence in the stimulus packages of transfers compared to direct government spending. In many cases, government spending on goods and services contracted during the pandemic. While cash transfers have provided a critical lifeline, especially in the absence of robust social protection systems (as in most developing world), austerity in direct spending continued to affect policy decisions even during the pandemic.

The perils of normalcy

The biggest threat to global recovery is a possible repeat of the post-2008 playbook, and a return to 'normalcy' in economic policymaking. In the wake of any crisis, reverting to pre-crisis ways of doing things is the easiest approach for policymakers, in advanced and developing countries alike. Even though the macroeconomic policy wisdom that has prevailed in recent decades has not played out well for the vast majority of countries, the pressures to contain government direct spending (and thus intervention in economic activities) remain strong.

Calls to enact new cuts have already returned, generally with the stated intention of reducing debt burdens. Commentary about the threat of inflationary pressures also contributes to the bias against fiscal spending. Meanwhile, calls to contain prices by increasing labour market flexibility have resumed. Fiscal austerity and downward pressure of labour income shares are supposed to help countries tap global demand with more competitive exports, hence the reignited attention to trade and investment agreements. Yet as previous Trade and Development Reports have argued, three decades of experiments in this direction have amply demonstrated just how faulty this strategy has

been. No significant attempt has been made to support development, to reorient the global financial and payments system towards productive investment, to establish a debt workout mechanism, and to make trade more conducive to sustainable development.

Projections reflecting the continuation of these conditions into 2030 point to insufficient growth across the board. All economies would slow down, with the growth loss ranging between 0.6 and 1.2 percentage points, while the deflationary measures in each country would establish a global deflationary bias with negative feedbacks on all. Moreover, economies that typically recover thanks to exports and fiscal prudence will be the main losers since global trade will decelerate due to sluggish global demand, greater financialization and weaker wage growth, further constraining productivity growth.

The faster pace of financialization and the growth of speculative investment would raise the cost of government borrowing, especially in finance-constrained economies, thus deepening the pro-austerity measures. Disappointing growth aside, in this context developing economies will experience the greater vulnerabilities: both deficit economies subject to external bottlenecks and forced to rely on commodities, and surplus economies subject to double boom-bust cycles of commodity prices, exchange rate and domestic price shocks. Finally, these trends in trade and finance run counter to the climate stabilization goals, undermining the prospects of actual decarbonization of the global economy, which requires international cooperation for sustainable and efficient management of natural resources and therefore, alternative source of income for resource- abundant developing countries.

These projections invite a long overdue reflection on effective ways of sustaining growth and promoting structural transformation and economic development by internationally coordinated injections of effective demand, promotion of productive capacities and investment, enhancement of physical and social infrastructure and curbs to speculative finance. Global challenges clearly require multilateral responses.

The growing urgency of climate adaptation

July 2021 was the hottest month ever recorded on the planet, following on from the hottest year in 2020 which, itself, came after the hottest decade on record. Intense heatwaves, increasingly powerful tropical cyclones, prolonged droughts, rising sea levels, spreading diseases are just some of the threats accompanying the unrelenting rise in global temperatures, bringing with them ever greater economic damage and human suffering. And worse is to come. Even if we get our mitigation efforts together within this decade and manage to keep the global average temperature rise to 1.5°C above pre-industrial levels by the year 2100, the extreme climate events in 2021 serve as a foretaste of what an additional 0.4°C to the average global temperature has in store for communities and countries across the planet.

The consequences of rising global temperatures reflect, and are amplified by, existing structural inequalities within and across countries. The historical responsibility for global greenhouse gas emissions (the principal cause of global warming) lies squarely with the developed nations, which account for around two-thirds of the cumulative total of emissions in the atmosphere compared with just 3 per cent for Africa. Between 1990 and 2015, the wealthiest one per cent of the world`s population added more than double the carbon emissions of the bottom 50 per cent. And while some developing economies like Brazil, China, India, and South Africa have rising emissions, on a per capita basis they are still behind advanced countries and even the consumption-related emissions of their richest citizens are below counterparts in advanced economies.

For many developing countries rising global temperatures are compounding a vicious development cycle that has been constraining resource mobilization, widening income gaps and weakening state capacities for decades. Economies with underfunded health care systems, mal-developed infrastructure, undiversified production base and missing state institutions are more exposed not only to potentially large-scale environmental shocks but also a more permanent state of economic stress as a result of climate impacts.

Rising temperatures will hit growth prospects in developing regions the hardest; and all the more, the higher the increase above the 1.5°C target. But the nature of the adaptation challenge will vary across regions and sectors of the economy, making a one-size-fits-all response inappropriate. Extremely hot days are expected to primarily increase in the tropics, where temperature variability across years is lowest. Dangerous heatwaves are forecast to occur earliest in these regions, and they are expected to become widespread at 1.5°C global warming rise. As the most food insecure region with the largest rural population, Sub-Saharan Africa is likely to face deepening challenges. For scenarios ranging from a 1 °C to a 4 °C increase in global temperatures relative to pre-industrial levels, the continent's overall GDP is expected to decrease by 2.25 per cent to 12.12 per cent. In South Asia, more intense and frequent tropical cyclones, accelerated heatwaves and a rising sea level will continue to generate adverse impacts on the region. Middle East and North African countries face acute water shortages, where as many as 60 per cent of the region's inhabitants already experience a serious lack of water. East Asia and the Pacific, which have a quarter of the world's population already suffering from the most severe storms, cyclones and inundation globally, and will likely face the highest levels of climate-induced displacements.

Large portions of populations in low-lying coastal zones – 84 per cent in Africa, 80 per cent in Asia, 71 per cent in Latin America and the Caribbean and 93 per cent in the least developed countries can be especially affected. Critical infrastructure assets and networks like ports, airports, railways and coastal roads will also face devastation by rising sea levels which will cause permanent or even repeated damage and will impede access to food, materials, and other income-generating supplies to people and businesses.

The risks of a risk-based approach

To date, the global policy response to the climate crisis has been divided between mitigation and adaptation measures. *Climate mitigation* focuses

on slowing down and reducing emissions of greenhouse gases (GHG), through a mixture of more efficient energy use and the replacement of fossil fuels with renewable sources of energy. *Climate adaptation* centers on harnessing resilience and protection mechanisms to minimize the negative impact of climate change on lives and livelihoods. In practice, the two sets of measures are often difficult to separate, and in much of the agenda-setting discussion on climate, adaptation has remained a poor cousin of mitigation efforts. This is proving short-sighted and increasingly costly, particularly for developing countries, where adaptation challenge is both widespread and connected to a wider set of deep-seated social and economic vulnerabilities that have emerged in recent decades.

Conventional measures towards more resilient systems – across the economy, society and ecology- have borrowed from the available methodologies of risk management used in the financial system. Consequently, at all levels of development, governments have been told to strengthen their resilience to shocks by improving their data gathering and risk assessment techniques to better protect existing assets and by providing temporary financial support when shocks materialise. This approach has been appealing because no new methodologies and frameworks were necessary. Adopting and adapting already operational approaches was seen to deliver speedy response to the threat to lives and livelihoods.

In this traditional risk-management perspective, the problem of climate adaptation is not distinguished from most other types of risk and is being dealt with through disaster risk assessment and early warning systems, improved ecosystem management, and stronger social safety nets. The extension of this approach to the adaptation challenge can be more explicitly traced to the Sendai Framework for Disaster Risk Reduction that the United Nations General Assembly adopted in 2015 as a blueprint for disaster-related resilience and reacting to human-made hazards. The 2015 adoption of the Paris Agreement also stressed this approach with its focus on the reduction of risks related to climate change.

There is a problem, however, with this practice of climate risk management: it is retrospective, not forward-looking. The measures may provide partial resilience *now*, but by using scarce resources for adaptation to current climate hazards, these interventions preclude other future-oriented interventions and lock in path-dependent dynamics which reproduces current vulnerabilities. There is no guarantee that adapting to current climate variability would automatically reduce the vulnerability to future climate change.

The weakness of extending a risk-resilient approach to the adaptation challenge is its reliance on pricing and other market-assessment techniques which bias the approach towards what is predictable and incremental in nature, rather than what is uncertain and systemic. Given its roots in financial risk management, the approach privileges a return to (pre-crisis) normality and stability over a dynamic vision of change and new trajectories. In the case of many communities, this 'normality' means a return to persistent inequality. Preservation and coping therefore, take priority over transformation.

In the case of climate crisis, it is not simply insufficient, but counterproductive, leading to maladaptation. Application of conventional risk-resilience approaches are especially problematic in the current political context, where new social contracts are needed to regain citizens' trust in public policies and multilateral efforts. Tackling current global challenges like climate adaptation requires a new vision of common goals rather than emphasizing the avoidance of risks and worst-case scenarios that emerge from current circumstances.

A transformative approach to risks of climate change is required. The only lasting solution is to reduce the dependence of developing countries on a small number of climate sensitive activities through a process of structural transformation that can establish more resilient economies. It should move away from the core priority of de-risking and centre instead on an integrated, system-based vision that can deliver socio-economic resilience and diversified economies. This, in turn, requires the institutional capacity of a developmental State,

equipped with greener industrial policies that are critical to advancing such an agenda.

From de-risking to diversification

The success of today's advanced economies, as well as the catch-up economies of East Asia, rests on sustained economic growth closely tied to structural transformation. At its core, this involves two sets of combined and cumulative processes: a vertical shift in the production structure from the primary sector to manufacturing (and on to high-end services) on the one hand, and a more horizontal shift of resources from lower- to higher-productivity and more capital-intensive activities within and across both sectors. Together, these processes have, in almost all successful development experiences, facilitated a more diversified structure of economic activity, raised productivity and led to an improvement across a broad set of social indicators, including poverty reduction.

More diversified economies are also less vulnerable to external shocks which are likely to disrupt the growth and transformation process. This has, in recent years, been apparent with the heightened vulnerability of primary export-dependent economies to economic shocks that originate elsewhere in the global economy but it is also the case with climate shocks. Indeed, in many developing countries, particularly those located in tropical and sub-tropical regions, vulnerability to economic and climate shocks is compounding one another, locking countries into an eco-development trap of permanent disruption, economic precarity and slow productivity growth. Breaking out of that trap implies that the climate adaptation challenge in the developing world needs to be approached from a developmental perspective.

Not all past experiences, no matter how attractive, can, however, be easily adapted to contemporary realities. Today, developing countries confront the dilemma of having to pursue economic development while keeping emissions and resource consumption within the ecological

limits of the planet. This challenge necessitates new strategies that pursue structural transformation in a climate constrained world. As that world wakes up to rebuilding economies after the Covid-19 shock, an opportunity to formulate, agree and implement a set of new policy choices that combine developmental and ecological concerns should not be missed.

Developing country policymakers face this challenge from a position of structural weakness in today's hyperglobalized economy and in terms of institutional weaknesses in their ability to mobilize domestic resources. One potentially offsetting advantage of economic latecomers is being able to draw on technologies already developed in more advanced economies to help speed up their transformation. This, however, is easier said than done, because developing countries face a number of obstacles to technology transfer, which are becoming more pronounced in the face of binding environmental constraints.

Macroeconomic priorities necessary in order to overcome those constraints will need to be based on pro-investment policies, as well as strategic collaboration and coordination between the private sector and the government. The former means abandoning austerity as the default policy framework to manage aggregate demand, the latter is needed to monitor the interdependence between investment and production decisions. These decisions concern identifying the areas where the most significant constraints to investment are; how effectively to channel public and private investment to the high-productivity activities; and monitor whether these investments are managed in such a way as to sustain a high-wage future for citizens and to increase long-term productivity. Such disciplining of investment is ensured through monitorable performance standards and a withdrawal of governmental support that fails to achieve its objective within a given period of time, as well as thorough checks on rent-seeking on the part of authorities and entrepreneurs.

One major benefit of green fiscal expansion is higher employment benefits. This is because expanding low-carbon sectors tend to be

more labour intensive than shrinking high-carbon sectors. A recent study estimated that renewable energy, energy efficiency and grid enhancement will create around 19 million new jobs worldwide by 2050. As the job losses in the fossil fuel sector will be around 7.4 million, the net addition will be 11.6 million jobs. The greater job-generation capacity of a green path towards structural transformation may be of particular importance for economies where labour migration resulted in an expanding urban informal sector, including because existing technologies were too capital intensive for these economies' structural conditions, as for instance, in parts of Africa.

While climate-related investments on a global scale are needed to transform the global energy system to mitigate the rise in global temperatures, targeted national policies (and resources) are needed to address the adaptation challenge countries are facing from the rising temperature already baked into current patterns of growth. Aligning these global and national challenges is neither straightforward nor automatic. It requires strategic planning and policy intervention.

Retrofitting the developmental State

Structural transformation, characterized by a shift in the production structure from the primary sector to manufacturing, has traditionally been the most successful way of achieving sustained economic growth and rising living standards. This avenue was followed by the now advanced economies, as well as a few successful late industrializers in East Asia. Their traditional fossil fuel-intensive model, however, cannot satisfy the aspirations of the many other developing countries that are trying to upgrade their national incomes through industrialization because it would take emissions and resource consumption beyond the limits of the planet's ecological capacity.

The answer to this problem is not to forsake industrial development in developing countries. Rather, it is to build a diversified low-carbon economic system, powered by renewable energy sources and green

technologies, and where economic activities within and across sectors are interconnected through resource-efficient linkages. Such a solution maintains manufacturing as a central objective because important elements of structural transformation towards a more resilient low-carbon economy will, in most developing countries, continue to depend on the diversification into high-productivity high-wage activities. The energy transition, along with an emergent circular economy, can provide opportunities for a reduction of the carbon footprint of traditional manufacturing, as well as for the manufacturing of devices for a low-carbon economy.

The transition to renewable energy and progress with the circular economy can increase the scope for industrialization for a broad range of developing economies because they decouple economic activities endowed with natural resources. Sources of renewable energy – such as sun, wind and water – are more equally distributed than economically exploitable deposits of fossil fuels, and the circular economy allows extracting resources from used products and waste, thereby reducing the required quantity of new resources.

Many activities related to renewable energy production and the circular economy can economically operate at low scale, opening business opportunities for small firms and rural areas. This will not only help to diversify economic production structures and reduce many countries' dependence on the production of a narrow range of primary commodities, but it can enlarge developing countries' tax bases and foster domestic resource mobilization as a source of development finance. These activities can also help to relax countries' balance-of-payments constraints. Relying on domestic production of energy and food requirements, thereby reducing the import of raw materials, may allow for a sizable reduction of imports, what will liberate scarce foreign exchange for imports of capital goods for industrialization and economic catch-up.

None of these transformations are likely to occur without a developmental State. Successful structural transformations have generally relied on

proactive government policies and effective regulations. In addition to undertaking large-scale public investment and financing the investment push required for green structural transformation through green financial instruments, it will involve green industrial policy and state-society relations that not only break existing fossil-fuel interests but also establish clear rules, the enforcement of which can govern the new green investment trajectories and ensure a legitimacy base that can rely on a wide range of societal groups.

Retrofitting the developmental State to deal with adaptation (and mitigation) challenges can still draw lessons from previous success stories. First, there is the need for strong administrative and institutional capacities for the state to formulate industrial policy and lead structural transformation. Experience with the Covid-19 pandemic and the uncertainties associated with climate adaptation suggest that governments should also possess dynamic capabilities to handle partial and at times contradictory evidence; build synergies from multiple tiers of governance; quickly repurpose existing infrastructure; and learn from other governments.

A second lesson concerns the importance of *mechanisms of accountability* of policymakers and implementation agencies, such as through reporting requirements and other obligations to disclose information, combined with more general checks through auditing, independent courts and the press.

A third lesson involves embeddedness – the close relationships between private actors and government officials that can ensure a mutual exchange of information and common understandings. Embeddedness will be particularly important for green industrial policies because societal transition will involve a broad set of stakeholders and reflect broad societal consensus. Combined, the second and third lessons constitute reciprocal control mechanisms.

A final, and related, lesson concerns the state not being too close to private interests and willing to employ disciplining devices to sanction

abuse of its support and to discontinue failing projects and activities. Disciplining abusive practices requires clearly defined objectives, measurable performance indicators, appropriate monitoring and evaluation routines, and government autonomy in deciding where and when to apply disciplining devices, as well as where and what experimental approaches to apply, and where and when to change course if something goes wrong.

Given the scale of adaptation needs and the fact that those who suffer the most are the least responsible for the cause of the problem and least able to pay for them, it is clear that advanced economies will be the main source of finance. However, domestic resource mobilization will need to be strengthened, including through more active Central Banks and dedicated public banks.

A climate conscious developmental State must catalyse a public investment-led strategy of diversification. Locally-led climate finance efforts need to be driven by principles that ensure the most effective way of responding to governance and climate challenges and risks, including: i) community-led planning that is anchored within and is supportive of existing devolved institutions, and that promotes ii) social inclusion of climate marginalized people; iii) a process that is flexible and adaptive management towards the creation of resilience investments, with iv) an emphasis on public goods provisioning.

The complexity of systemic risks requires the state to become a regulator and coordinator of private green finance and not simply "de-risk" the opportunity for others to make profit and take more than their share of the benefit. These should be seen as a means to avoid the destructive tendencies of today's ultra-liquid financial sector, where the embedded search for yield is inconsistent with the global needs of climate mitigation, let alone the more localized needs of adaptation.

As central banks around the world were able to help support governments directly during the Covid pandemic, the post-Covid recovery period provides an opportunity to consider how they could also follow this

path to support climate-related investments. At the very least, central banks could do more to discontinue support for carbon-intensive and maladaptive activities which means a change in the current programmes that continue to give financial support to fossil fuel industries. In addition to properly regulating the financial sector, Central Banks should also use a fuller range of tools to create and guide finance to green activities. Collateral policy is one of the main tools towards greener central banking: central banks should adjust their collateral regulations and accept financial institutions' green bonds as collateral.

Reforming adaptation governance I: International finance

At the most basic level, addressing climate change makes structural transformation a global task, in which the advanced economies should take the lead in undertaking profound changes in their patterns of production and consumption but where significant structural and technological changes are also necessary even in the least developed countries. A climate-conscious developmental State must be able to combine the challenges of climate adaptation and mitigation with the longstanding goals of higher productivity jobs, rising living standards and closing the economic and technological gaps with more advanced economies.

The imperative of scaling up climate investment and directing it to where it is needed, requires that the international trade and financial systems are geared to supporting structural transformation, particularly in developing countries. This is currently not the case, particularly when it comes to the adaptation challenge. Aligning ambition and action will require a concerted reform effort at the multilateral level.

In the run up to the Copenhagen COP in 2009, the UNFCCC estimated that annual worldwide costs of adapting to 2 degrees of warming would be between $49 to 171 billion by 2030, with developing countries facing a $34 to 57 billion bill. A decade later, the delay in responding has been costly. Annual adaptation costs in developing countries is now estimated

at $70 billion, reaching $140–300 billion in 2030 and $280–500 billion in 2050. Current funding reaches less than a half of current needs and will not reach the 2030 target without a fundamental change of track.

At present, assistance from the international community for climate adaptation continues to rely on an ad hoc combination of official development assistance, multilateral lending and self-insurance schemes against catastrophic risk. This, however, is woefully insufficient to address the systemic impact of recurrent and increasingly frequent climate change-related shocks. For many countries, the result has been an endless cycle of punctuated development and rising indebtedness.

From a development perspective, the challenge of climate adaptation puts the onus on grant-based finance or highly concessional lending mechanisms as key to meeting the adaptation challenge. Two levels of reform for financing the adaption challenge can be identified at the international level: first, steps in support of the climate conscious developmental State to mobilise financial resources for mitigation and adaptation investments, and second, reforming the approach to climate governance internationally.

The first set of reforms should focus on the following:

- **ODA commitments** and pledges need to be met and go further, to increase the proportion of additive finance designated for climate change adaptation and resilience building. *Grants and extremely concessional loans* are essential for adaptation. These could be financed by a green bond and a tax à la Tobin tax, or through the repurposing of fossil fuel subsidies. This must take account of specific country requirements in least developed countries and lower-middle income countries and fossil-fuel exporting economies that need a gradual restructuring of these carbon-intensive industries and an appropriate safety net system to meet climate debt.
- **Debt relief and debt restructuring** for developing countries should be put firmly on the climate agenda. An obvious starting point

would be the debt of the V20 countries but linking the climate and debt crises highlights the need for more systemic reforms to the international debt architecture.

- **The multilateral development banks** need additional capital to support more green investments and less fossil fuel or polluting activities and their activities aligned with the Paris Agreement and their "build forward better" commitments, withdrawing from oil, coal and gas and building in transition processes that support people and those industries to make the leap. Policy conditionalities will need to be pruned back and their AAA straitjacket should be relaxed to support experimental or new green technologies and enterprises. G7 countries should use their shareholder power to guide MDBs in this direction. *Regional Development banks* and multilateral development banks could also buy developing countries' green bonds, guaranteeing a more stable demand for such bonds and easier access to long-term capital for developing countries. This could also have a favourable impact on their yields and, consequently, help to mitigate the external service burden, to an extent.
- **Green bond markets** are one way to help raise long-term financing. Yet regulatory standards lag behind the growth of these markets and greenwashing is rife. Given the scale of the challenge, the regulatory framework for the green bond market needs to be supported by *corresponding levels of financing and staffing*, at national and international levels.

The second step would be declaring the adaptation challenge a global emergency and establishing appropriate mechanisms to govern what is effectively, a global public good. This would reflect the reality already experienced by the developing economies struggling to fund climate adaptation needs, help establish a framework to enable them to access finance on appropriate terms and adapt green technologies to their national growth trajectories.

Some seventy-five years ago, the Marshall Plan helped deliver shared prosperity among the war-torn economies. Today, climate change is a challenge to humanity that requires a similarly integrated, anticipatory

and strategic approach. Several pathways are discussed in this Report. However, a global, green-oriented structural fund would support realignment of developing countries and deliver funding for both adaptation and mitigation initiatives as an urgent priority. This would generate dividends not only for the developing countries, but for advanced economies too.

Reforming adaptation governance II: International trade

Many of the initiatives that are gaining momentum in the context of reforming the multilateral system continue to adhere to a view of free markets and capital flows that bears little resemblance to the deep divisions and asymmetries that structure the contemporary global economy. This agenda has done little to advance inclusive development, nor is it likely to provide meaningful support to meeting global emission targets. Pursuing it further is, instead, likely to jeopardize any notion of a just transition for developing countries, by adversely impacting existing export capacities and reducing their policy and fiscal space at a time when it needs to expand to build resilience against future shocks.

Liberalization of trade in environmental goods and services is being pushed at the WTO. While there is no consensus on what goods should be included in the list of environmental goods, most developing countries are net importers of environmentally related goods as identified in the combined list of environmental goods (CLEG). Tariffs on these environmentally related goods are on average 5 to 6 per cent in developing countries with maximum tariffs exceeding 100 per cent on some products, while these tariffs are below 1 per cent in most developed countries. In 2019, tariff revenue collected on these goods by developing countries amounted to USD 15 billion. Trade liberalization in these products will therefore entail a substantial loss of tariff revenue for developing countries.

Environmental services were already classified under a limited range for the negotiations on the General Agreement on Trade in Services (GATS).

However, there are attempts to widen the scope of environmental services to include services like engineering, architecture, design, general management, construction. Any resulting commitments in these services will take away the flexibility that the positive list approach in the GATS offered to the developing countries in terms of liberalizing their services trade. Furthermore, there is a risk that forcing the liberalization of vital public utilities would lead to negative development outcomes. This will create an environment of conflicted interests, because public goods will then be delivered for profits. This will further restrict developing countries' ability to use public procurement as a policy tool to achieve social objectives.

Trade liberalization agenda is also being pushed in the context of the circular economy, on the grounds that trade restrictions in the form of export bans may hinder related activities to reuse, repair, refurbish, remanufacture and recycle. However, the calls for the liberalization of trade in remanufactured or recycled goods and waste, dating back to 2004 in the WTO have been rejected by many developing countries, worried that second-hand, refurbished, or remanufactured goods may lock their economies into outdated and less efficient technological solutions and therefore would delay the achievement of environmental goals. Concerns were also raised over liberalizing trade in waste and scrap as that would put additional pressure on the waste management systems of developing countries, especially those which lack a sound regulatory framework for waste management and the associated infrastructure capacities. Furthermore, imports of second-hand clothes and footwear were found to have significant negative impacts on the revamping of the textiles and leather industries, especially in Africa, and on consumer health, human dignity, and culture.

Greenhouse gas emissions in traded goods and services account for around a quarter of of global carbon emissions. This suggests that trade policy, and in particular international trade rules, will play a secondary role in reshaping the climate agenda. Rather than building a trade and environment agenda which pushes trade liberalization, such an agenda should focus on facilitating green technology transfers and

providing climate finance to developing countries. Given that structural transformation in a climate constrained world requires a shift from high- to low (and no) -carbon technologies, it can only be achieved when it is approached in an integrated manner by an effective developmental State, with technological change occurring alongside productivity growth, expanding employment opportunities, and rising living standards.

In today's interconnected global economy, the organization of global production through global value chains (GVCs) has caused many carbon emitting production activities to be shifted to developing countries, while associated low-carbon pre-production and post-production activities have been retained by the lead firms and mainly based in the developed countries. The comparative energy efficiency in the North therefore cannot be de-linked from the energy inefficiency in the South. This implies that measures such as Cross Border Adjustment Mechanisms (CBAM), which impose carbon tariffs on imports from developing countries into developed countries, cannot be evaluated independently of these structural conditions. Such mechanisms impose on developing countries the environmental standards that developed countries are choosing. This goes against the principle of common but differentiated responsibility enshrined in the Paris Agreement. Achieving coherence between special different treatment (SDT) and the UNFCCC principle of 'common but differentiated responsibilities' (CBDR) can offer a better point of departure for a development-oriented approach to the trade-climate nexus.

A first step in aligning SDT and CBDR would be to widen non-reciprocal SDT measures to expand policy space for climate and development initiatives. Legal tools such as waivers and peace clauses can help to diminish the number of restrictive rules and extent of regulatory chill, as well as to expand the policy space for developing countries. Advanced economies can provide supportive incentives, such as optional preference schemes that provide ringfenced climate financing additional to ODA or preferential market access in exchange for progress towards nationally determined contributions (NDCs), which could accelerate climate action without resorting to measures with anti-developmental effects.

As a step towards such an arrangement, the international community could support initiatives to transform rules governing intellectual property rights, such as through a WTO Ministerial Declaration on TRIPS and Climate Change, with a view to expanding TRIPS flexibilities for developing countries in relation to climate-related goods and services. This could provide a basis for innovative mechanisms for promoting access to patent-protected critical green technologies. Other initiatives that could support this agenda include the open-sourcing of key green technologies as global public goods and South-South cooperation on low-emission research and design.

Conclusion

After decades of growing inequalities, polarizing pressures 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 better world will only emerge from the pandemic if strong economic recoveries are promoted and supported 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 coordinated big investment push across all countries into carbon-free sources of energy.

Printed at United Nations, Geneva – 2115797 **(E)** – November 2021 – 1,901 – **UNCTAD/TDR/2021 (Overview)**