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 Volcker 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 (Volcker, 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).

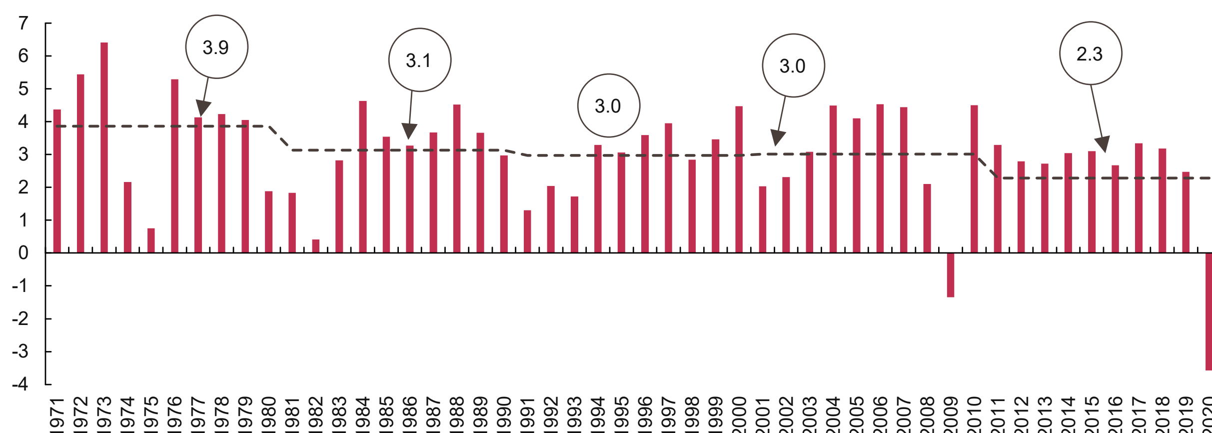
The break-up of the Soviet Union as the new decade got under way opened up a wider front for market-based reforms and at a faster pace described as "shock therapy". The 1993 Report warned that transition economies had seen more shock than therapy. Still, a new world order was promised which would, according 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 laisser-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 crisis[4], 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

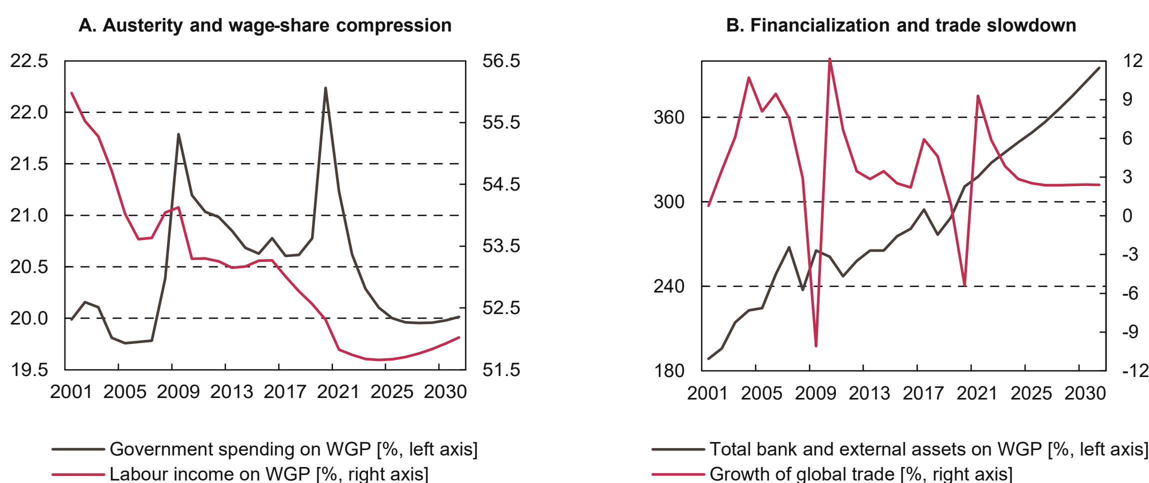
The domestic policy conditions that contribute critically to the growth outcomes presented above are aggregated at global level in Figure 2.2(a). As it is known, the ratio of government spending in goods and services on GDP has been subject to a marked fall since the 1980s (*TDR 2013, 2017*; Izurieta 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.

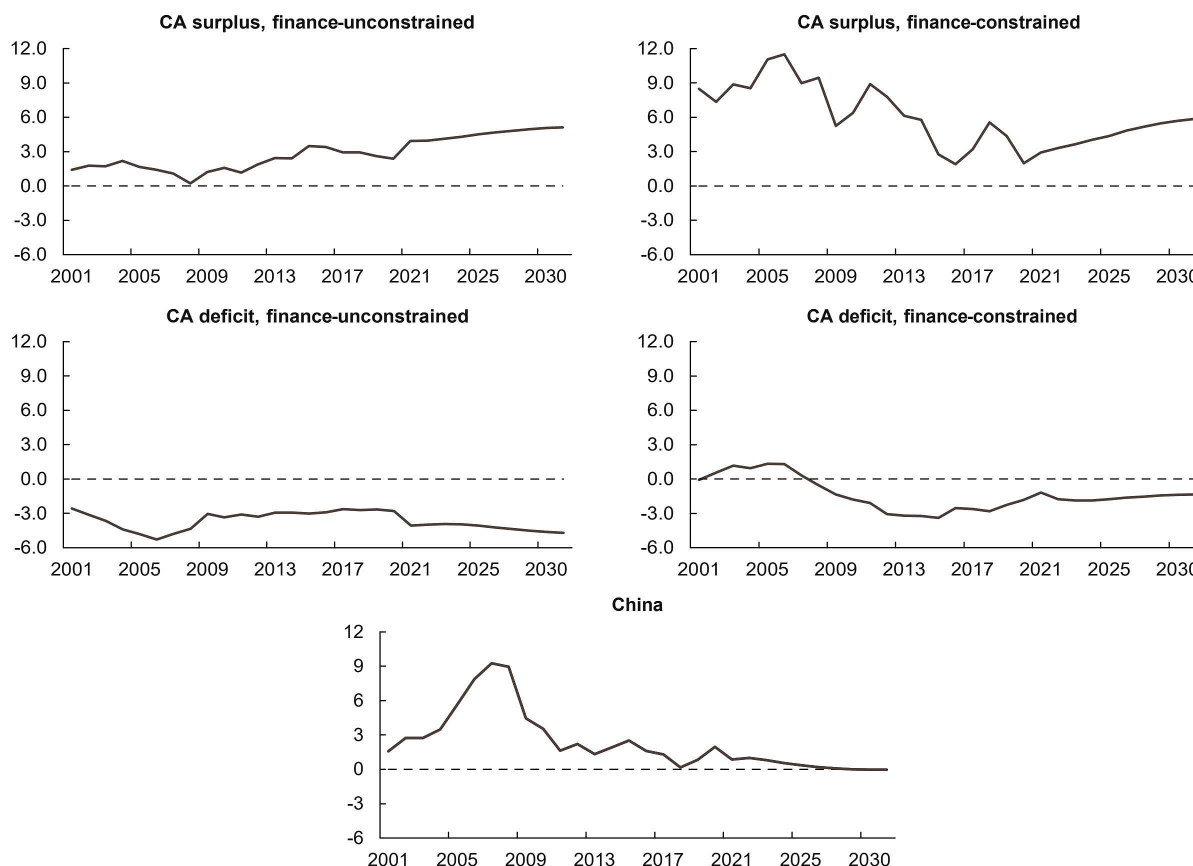
On this basis, macroeconomic patterns can be mapped as either finance-constrained (most developing economies) or financed-unconstrained (developed economies). Within each category surplus-biased and deficit-biased economies can be further distinguished. China is presented separately as it no longer matches 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)



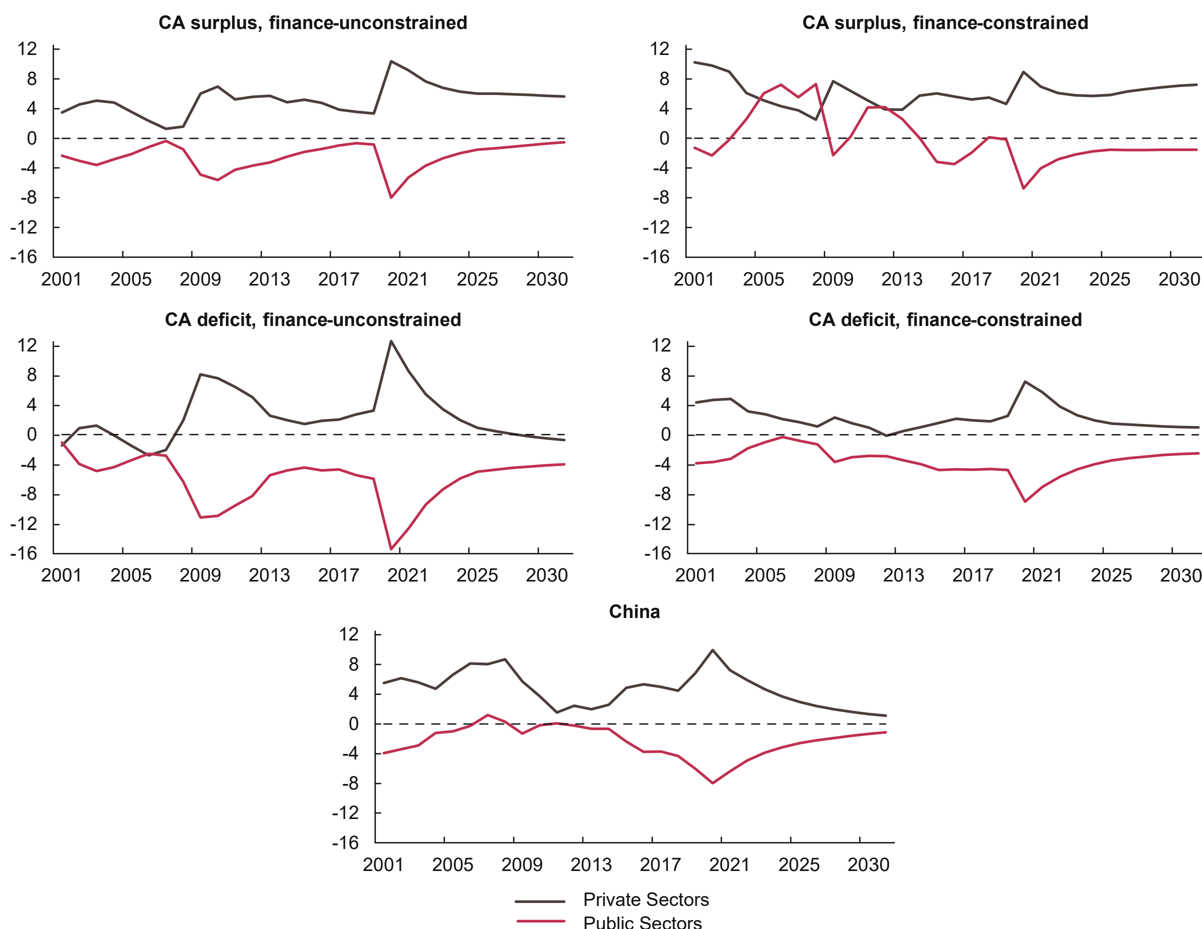
Source: See Figure 2.2.
Note: Current account surplus, finance-unconstrained economies include the European Union and other economies of Western Europe, Israel, Japan and the Republic of Korea. Current account deficit, finance-unconstrained economies include Australia, Canada, New Zealand, United Kingdom, 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 abroad[14]. 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.

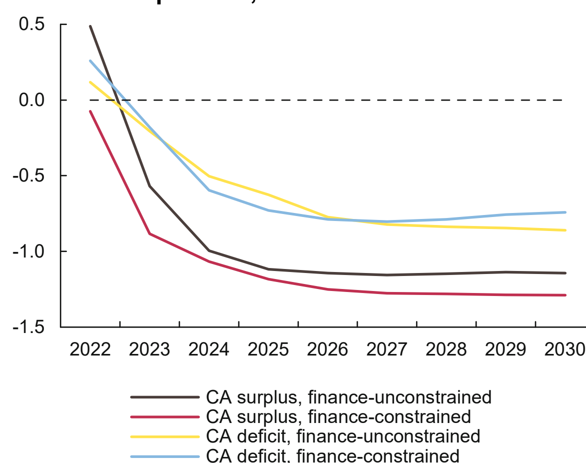
In economies tending to current account deficits, the main growth drivers rest on domestic demand. For finance-unconstrained (developed) economies, while fiscal austerity may predominate, the targets of fiscal adjustment seems to be more moderate than elsewhere, in part because of the privilege conferred 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 normality marked by fiscal austerity, wage constraint and loose monetary and financial policy, will impose heavy burdens on developing countries.

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.

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).

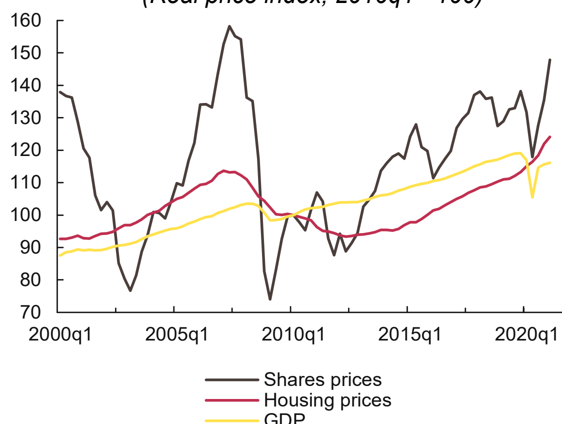
Most importantly, many of the policies developed countries are relying on for immediate relief and longer-term growth – including fiscal and monetary expansion, support for their high-tech sectors and protection for traditional sectors and trade in intangibles – could, without effective international 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).

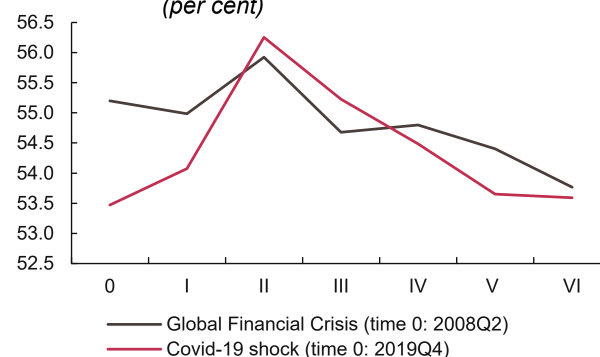
If a pattern of separate development is to be avoided, much is likely to depend on policymakers in advanced economies confronting the inequality challenge head on. In the United States, Covid-19 caused, cumulatively, the largest number of deaths per thousands of inhabitants among developed countries 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, channelling 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 spending[17] 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 CO_2 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 CO_2 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 CO_2 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 the onus for concerted international action on the developed economies.

TABLE 2.3 CO_2 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 CO_2 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 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 CO_2 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 CO_2 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 CO_2 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 alos 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 casual-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/statements-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=898AD8E008D08C848C1C66228819C4FDE743799A3B9A66947B82EAB740587B680DE3E2DB11EE3DF96AE99ACA78C1BB5C&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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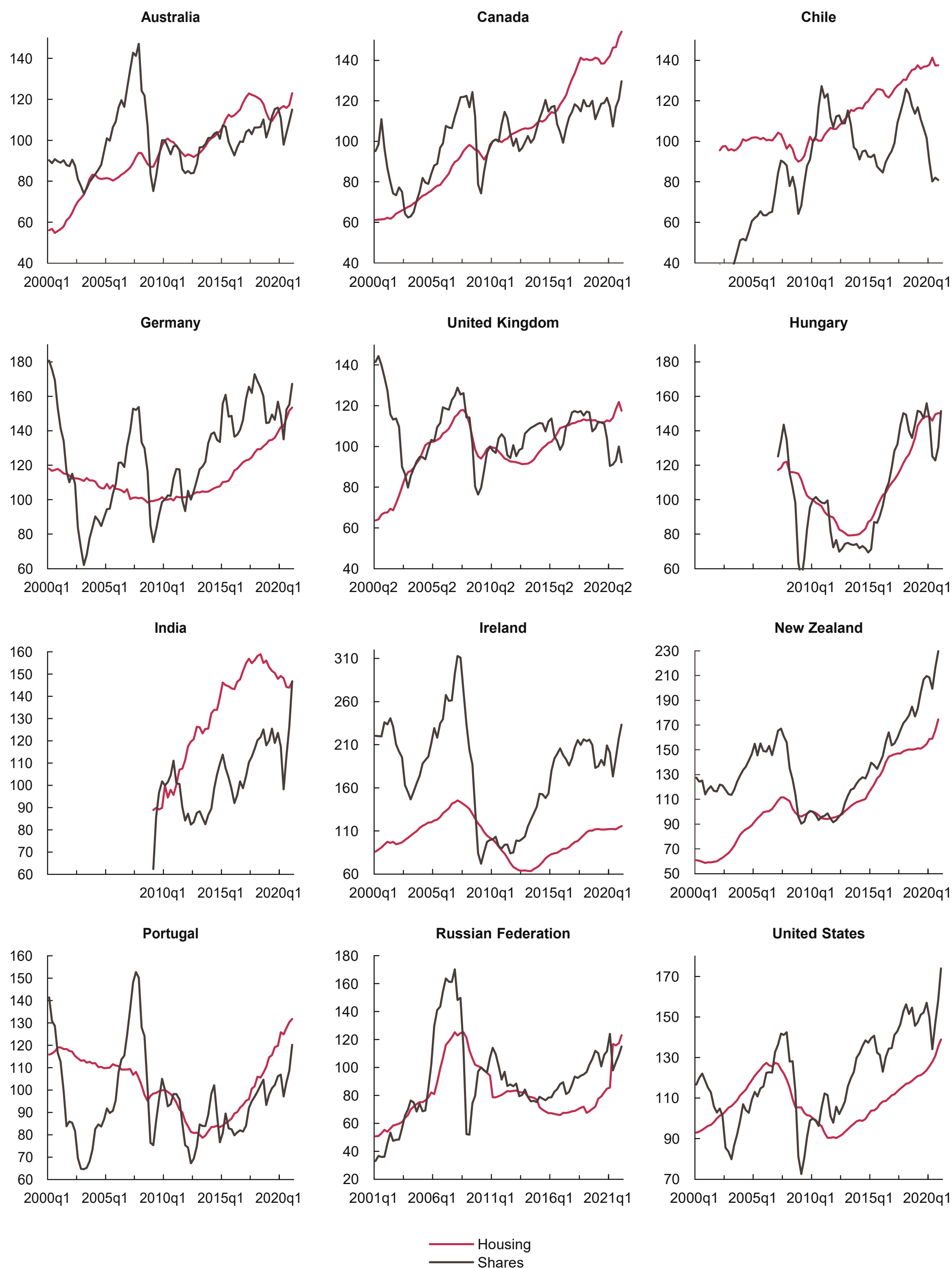
Annex

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.