Chapter 1

Introduction

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Chapter 1
Introduction

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While the coronavirus disease (COVID-19) seems to be behind us now, the scarring effects on employment, poverty, and education will last forever. The unemployment rate reached 6.3% in 2021, with 33 million more people unemployed worldwide than before the pandemic. Women, youth, and less educated groups of the population have been disproportionately affected. Poverty incidence has also increased, with extreme poverty rising by 0.9% in 34 mostly low-income and lower middle-income countries. By the end of 2022, 860 million people could be living in extreme poverty, while simultaneously the world's poorest countries must repay US$43 billion in debt this year.

Moreover, the current war in Ukraine and rising global tensions have placed additional pressures on the world economy. The supply shortage will magnify inflationary pressures through increases in the price of energy, food, and metals. Inflation is expected to remain elevated for much longer, both in advanced and emerging market and developing economies (EMDEs). The fact that now, countries, particularly low- and middle-income countries, have limited fiscal space, has worsened the inequality and the recovery process.

We believe the G20 could be an effective international forum to foster a coordinated global response to establish and deliver commitments for resilient, sustainable, and inclusive growth. This report consists of three main sections: economic recovery, digital transformation, and sustainable development.

Chapter 2, written by Chatib Basri, Lili Yan Ing, and Günther Schulze, discusses the urgency of global efforts in mitigating the scarring effects of the pandemic. It starts with an explanation of how the prolonged COVID-19 pandemic has increased uncertainties in various domains, including health, economy, and social aspects. Governments around the world have strived to optimise the use of fiscal and monetary measures to mitigate the effects of the pandemic. The fiscal interventions have helped countries to survive during the pandemic but have increased debt burdens significantly. Monetary interventions have also been implemented since 2020 by lowering interest rates and providing additional liquidity. While the pandemic is not over yet, the war in Ukraine has escalated major economic shocks and affected the world's recovery path. It is even more challenging because of the fact that the economic recovery is uneven.

The authors propose three main policy recommendations. First, it is crucial for the G20 to reinforce its commitment to provide vaccines and medical supplies to low-income countries. Second, the G20 needs to take steps to mitigate the risk of debt distress by implementing the

Debt Service Suspension Initiative (DSSI) as well as ensuring that the Common Framework for Debt Treatments (CFDT) works effectively. For most developing countries with limited fiscal capacity, efforts are needed to improve tax revenue through reforms to tax administration as well as improving the quality of spending. Third, while developed countries have started to tighten their liquidity, low- and middle-income countries still need stimulus to grow. It is important that the exit strategy chosen in developed countries does not cause instability for emerging and developing economies. The G20 forum is an avenue for developing and developed nations to exchange information on policy in an honest and transparent manner that will create greater certainty in the market.

Chapter 3, by Maurice Obstfeld, highlights specifically the role of monetary policy in the post-pandemic strategy. Obstfeld provides evidence that the world economy has yet to return to pre-pandemic growth paths, and that the repercussions due to the war in Ukraine are an additional drag on the global recovery. Emerging and developing economies are generally projected to stay farther from pre-pandemic growth paths for longer than the advanced economies. At the same time, inflationary pressures are worryingly strong throughout the world. Without appropriate economic policies and more effective multilateral cooperation on global public health in particular, the scarring effects of COVID-19 may result in permanently lower levels and long-run growth rates of real gross domestic product (GDP) than those expected in January 2020, especially for EMDEs.

Fiscal policy must ensure public solvency over time without a premature withdrawal of macroeconomic support or harm to the most vulnerable, already battered by the pandemic. Monetary policy must keep inflation expectations well anchored while stopping short of inducing deep recessions. With all countries facing pressures of fiscal and monetary credibility, they must coordinate policy responses to avoid a jointly excessive response to their shared challenges, with due regard to national conditions. That effort must include rejecting food export restrictions despite high food prices. Spillovers from tighter monetary policy could impact EMDEs most powerfully, especially frontier markets with high debts. To help, the G20 should endorse enhancements to the global financial safety net, EMDE policy approaches that reduce the impact of the global financial cycle, and, in cases of likely insolvency, enhancements to the current haphazard landscape of sovereign debt restructuring. Directed evolution of the G20 Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative could produce less costly ways of handling future sovereign debt problems.

Chapter 4, by José Antonio Ocampo, points out the importance of ensuring global financial stability. The current financial stability issues facing the global economy are the result of the high public sector debt levels inherited from the COVID-19 crisis, and of the rising inflation and slower economic growth that has been evident since late 2021 but aggravated by the economic effects of the Russian invasion of Ukraine. The major challenges are associated with the increase in interest rates, which is already under way. Despite high debt ratios, the risks are not severe for advanced economies, where public sector debt ratios are expected to decrease moderately in the next few years but are important for emerging and developing countries, which will have to confront not only the rising costs of financing but also a possible reduction in international private capital flows.

Capitalising and increasing financing from multilateral development banks (MDBs) and official development assistance, as well as a new allocation of special drawing rights (SDRs), could mitigate these problems. Debt relief and better debt workout mechanisms should also play a role for countries facing high debt ratios. Existing mechanisms for low-income countries should be maintained and strengthened, and new ones should be put in place for middle-income countries facing severe debt problems. Stock market corrections may also generate financial stability issues in advanced economies, but they are less important than those faced by emerging and developing countries. The liabilities of private sector firms that were strongly affected by the COVID-19 crisis also generate problems and may require improvements in restructuring and solvency systems in some countries, but there is no evidence of risks of significant banking crises. Finally, action is needed to manage the risks associated with the growth and high volatility of crypto assets, and the financial risk that climate change is generating.

Chapter 5, by Taiji Furusawa and Lili Yan Ing, highlights the importance of maintaining resilient global supply chains. The pandemic and current geopolitical tensions have put supply chains under pressure, resulting in increased onshoring. More than two-thirds of all international trade flows involve trade in global value chains (GVCs), and the value of worldwide intermediate goods trade has risen to more than US$10 trillion annually in the past 2 decades. However, the pandemic and its measures, such as lockdowns and limited economic activities, caused global demand and supply shocks and halted production and trade. The pandemic did not only disrupt firms' direct intermediate supplies, but also about 40% of their tier 2 suppliers and beyond.

The authors discuss five types of shocks in this chapter and argue that the heavy reliance on sole suppliers for a variety of critical inputs and products might not be the optimal solution. The pandemic showed firms that their just-in-time strategy is highly prone to disruptions affecting the suppliers. In parallel, the pandemic and current geopolitical tensions increased the use of export restraints as many countries struggled to secure their domestic supply. The world needs to restructure GVCs and there are two broad policy suggestions to increase GVC resilience: reshoring/nearshoring or diversification of suppliers and markets. The G20 needs to play a key role in the effort to improve GVC resilience as well as ensuring the stockpiling of essential goods and critical inputs to mitigate other shocks or disruptions in the future.

Chapter 6, prepared by Gordon Hanson, emphasises the importance of the G20 in fostering trade and investment in the economic recovery agenda. The uneven globalisation has left many countries riven by regional economic disparities, especially in the developing economies. Workers in low-wage and low-employment rate regions are not leaving in sufficient numbers to improve the large difference in earnings and living standards across regions. The ongoing trade war between China and the United States has increased global geopolitical tensions, and the ongoing pandemic has severely disrupted both global supply chains and the movement of people across borders. Moreover, as the ability of the World Trade Organization (WTO) in resolving disputes has eroded, countries have increasingly turned to bilateral or regional solutions, making it more complicated to revive multilateral cooperation on trade. G20 members must find ways to foster trade and investment as many countries have grown increasingly sceptical about globalisation.

The chapter provides three principles that policymakers should keep in mind: focus on helping displaced workers regain employment, policy needs attuned to change and helping workers move across sectors, and better cooperation amongst governments to avoid tax and subsidy competition. Restoring global trade will require global efforts and coordination amongst countries, especially within G20 members.

Chapter 7, by Lili Yan Ing, Gene Grossman, and David Christian, brings to the fore one of the most crucial changes of our time – digital transformation (DX) – that massively reduces the cost of sharing information. The pandemic has accelerated the development of DX, including digital trade. Despite the fact that DX helps businesses to improve productivity and drive economic growth, it has consequences for employment and wages, particularly for less skilled workers. DX potentially raises labour market polarisation and inequality between countries. Moreover, the key challenges embedded in DX and digital trade include privacy, cybersecurity, competition, and digital divide.

The G20 must play a leading role in overcoming these challenges and ensure DX 'development for all'. First, the G20 needs to implement what it has already committed to in the fields of industrial robots, automation, and artificial intelligence (AI). This includes (i) cooperation and support for digitalisation enablers, comprising the development of digital infrastructure and connectivity; (ii) protection of data privacy and the mitigation of digitalisation risks from a consumer protection standpoint; and (iii) the development of mapping and statistical measurement of the digital economy. Second, to reduce the adoption costs of industrial robots, automation, and AI for businesses and make them commercially viable, G20 members should cooperate and promote incentives for technological adoption by developing countries. Third, the G20 should improve the quality of key digital enablers for the adoption of industrial robots, automation, and AI. This includes digital infrastructure and the necessary technologies. Last, the work of implementing and adapting to the massive changes that go along with DX falls on *human capital*. DX is ultimately a people issue. The G20 should continue to promote efforts to improve preparedness for digital and AI technologies, both amongst the workforce and firms (especially micro, small, and medium-sized enterprises; women; and youth) to reduce the digital divide and ensure more inclusive digital participation. It is crucial for the G20 to further facilitate partnership between the private and public sectors to raise the pool of funds that can be used to reduce digital gaps and improve digital skills worldwide to ensure 'development for all'.

Chapter 8, by Haroon Bhorat, Caitlin Allen Whitehead, and David de Villiers, focuses on technology gaps in developing countries. They propose three key measures to assess technology gaps across countries: technology adoption, technology production, and human capital accumulation. Using individual indicators for each of the measures, ranging from internet usage rates and patent applications to the quality of science, technology, engineering, and mathematics (STEM) tertiary institutions, the chapter presents empirical evidence on the technology gap in the world economy during 2000–2020. They provide estimates of the rates of change in the technology gap and the growing global inequality of technology adoption, production, and human capital accumulation. They synthesise these measures into a single Alkire-Foster technology gap index, which yields evidence on the incidence of the technology gap and the evolving nature of technology gaps in the regions of the world.

To close the technology gaps, Bhorat et al. propose improving internet usage, closing patent gaps, and developing strategies for higher education in technology adoption. Improving internet usage requires a pricing strategy to attract private investment rather than just developing infrastructure, especially in low-income countries. Governments need to focus on pricing of the internet from the providers to offer cheaper packages for poor households. To close the patent gap and increase patent applications, governments can also introduce an innovation policy package and focus on higher education institutions, microenterprises, small and medium-sized enterprises (SMEs), and high-productivity export-oriented firms. Finally, for higher education institutions, this chapter points out that expenditure on research and development (R&D) should be extended to universities for research and innovative ideas in STEM fields. As a support, governments can build well-funded technology and innovation centres, particularly in developing countries. To reduce the cost of technology adoption, governments should consider giving subsidies to microenterprises and SMEs, while large and export-oriented firms need more nuanced support from governments.

Chapter 9, written by Paul Collier, emphasises the importance of inclusive growth. To illustrate the distribution of poverty, this chapter classifies countries into three groups: the bottom billion (poor countries), the advanced countries (Organisation for Economic Co-operation and Development (OECD) countries), and the emerging market economies. Recent evidence shows that the growth rates of GDP per capita for the bottom billion are less than those of the emerging market countries, and that they diverge from the rest of humanity. To escape from mass poverty, countries will depend on the generation of productive jobs that directly raise workers' incomes and opportunities for society to get access to health, education, and public services. However, the poorest countries cannot provide a good environment for business, thus have a low number of formal firms. With high uncertainty in these countries, they also face problems financing their businesses.

Collier argues that the G20 can be a promising international cooperation mechanism for achieving inclusive growth in the world. G20 members can show leadership in facing the challenges of the poorest countries. Collier proposes five practical new mechanisms for what the G20 can and should do: (i) a public commitment to reverse the divergence of the poorest countries, (ii) a debt moratorium, (iii) pioneering investments by the development finance institutions of the G20 and G20 aid agencies, (iv) responding to the African COVID-19 crisis, and (v) closing safe havens for corrupt fortunes.

Chapter 10, by Justin Yifu Lin and Yan Wang, assesses the overall need for investing in infrastructure bottlenecks and offers a strategy for financing the infrastructure. They begin with the argument that economic development is a process of 'continuous structural transformation' in an economy. Infrastructure is essential for making this transformation feasible and sustainable. It is also critical for people's livelihood and a country's survival. The G20's Global Infrastructure Hub projects that US$97 trillion will be needed in infrastructure investment globally by 2040 to support economic development and the achievement of the United Nations Sustainable Development Goals (SDGs), leaving a financing gap of US$18 trillion or 3.7% of global GDP. The gap has widened due to the war in Ukraine and the fragmentation of global supply chains.

Given this huge financing gap, the G20 should encourage countries and international development finance institutions to prioritise infrastructure investment that addresses country-specific structural transformation bottlenecks and that is consistent with the nationally determined contributions (NDCs) for reducing carbon emissions in the Paris Agreement and plans to achieve the SDGs. The G20 should play a leadership role in proposing new initiatives and coordinating global efforts, including the use of part of the US$650 billion in special drawing rights (SDRs) to establish a global green finance fund for green infrastructure; strengthening G20 support for multilateralism – including multilateral development banks and funds, as well as newly established development finance institutions (DFIs); and encouraging innovations in both debt relief and green transformation, e.g., debt-for-bond swaps and debt-for-nature swaps, as well as asset+ based refinancing.

Chapter 11, by Ishac Diwan and Homi Kharas, argues that sustainable development requires countries to prioritise green finance. They recommend that the G20 enhance green finance along two parallel tracks: a short-term track that underlines the urgency of the situation and the need to accelerate now, and a medium-term track that recognises that green finance must be sustained over decades and therefore requires reform in the international financial architecture. There are many promising evolving innovations in green finance, some of which are highlighted in this chapter. At this stage, they recommend that the G20 develop a process for advancing green finance that is credible and consistent with the scale and urgency of the challenge.

On the short-term track, the G20 should (i) monitor progress towards the US$100 billion climate finance pledge in the G20 Sustainable Finance Working Group annual report and bring to leaders' attention any gaps, including in disaggregated areas such as adaptation; (ii) encourage dialogue amongst advanced economy members on a sub-target for additional concessional finance for climate by 2025; and (iii) reallocate, on a voluntary basis, surplus special drawing rights (SDRs) in a way that permits countries to expand the fiscal space for the implementation of nationally determined contributions (NDCs) in a leveraged way.

On the medium-term track of reforming the international financial architecture, the G20 could (i) encourage MDBs to scale up their NDCs, including by helping to scale up country-owned, country-led green country platforms; (ii) establish a long-term, forward-looking strategy of MDB capital adequacy, and encourage innovations to free up capital, such as backstop credit facilities, guarantees to reduce single borrower risks, and asset sales, along with a process for considering paid-in capital increments; (iii) review the principles of debt restructurings, so that official and mobilised private green finance are not bound by the same comparable treatment rules as other forms of debt; (iv) assess ways of de-risking privately mobilised green finance, including through the use of guarantees; (v) review the regular issuance of SDRs to expand the fiscal space for NDC implementation; and (vi) review the potential for expanding and integrating carbon offset markets.

The last chapter, **Chapter 12** written by Richard Baldwin and Dmitry Grozoubinski, closes our report by urging the G20 to strengthen the multilateral trading system in the face of 21st century challenges of climate change, the pandemic, and persistent economic and social inequalities, which threaten untold millions of lives. The World Trade Organization (WTO) deserves top-of-mind attention from G20 leaders, as it is hobbled by entrenched disagreements and a lack of resources. While trade alone cannot solve these threats, this chapter argues that viable solutions require more trade as well as stronger multilateral trade governance. Therefore, G20 leaders must reimagine the WTO as critical to saving lives, not just livelihoods – a vital tool in the struggle against humanity's existential threats – and grant it the status and resources it needs to rise to the challenges.

They recommend that the G20, together with WTO leadership, prepare the ground for climate-related disputes and ultimately develop a new infrastructure for mediating, negotiating, discussing, and adjudicating them, breaking down the walls between global trade policy discussions and global climate discussions. A concrete step would be to create a meeting – co-chaired by the WTO Director-General and the United Nations Framework Convention on Climate Change (UNFCCC) Executive Secretary – aimed at coordinating trade and climate efforts; and to establish a diverse and inclusive 'eminent persons' group to think ahead about trade and development in a world where services trade is growing much faster than goods trade, especially for developing and emerging economies, and a world where service-led development is increasingly the pathway to prosperity for many developing nations.