

Chapter 1: Fiscal Policies to Address the COVID-19 Pandemic

The COVID-19 pandemic and associated lockdowns have prompted unprecedented fiscal actions that amounted to \$11.7 trillion, or close to 12 percent of global GDP, as of September 11, 2020. Half of the fiscal actions consisted of additional spending or forgone revenue, including temporary tax cuts, and the other half liquidity support, including loans, guarantees, and capital injections by the public sector. This forceful response by governments has saved lives, supported vulnerable people and firms, and mitigated the fallout on economic activity. However, the consequences of the crisis for public finances, combined with the revenue loss from the output contraction, have been massive. In 2020, government deficits are set to surge by an average of 9 percent of GDP, and global public debt is projected to approach 100 percent of GDP, a record high. Under the baseline assumptions of a healthy rebound in economic activity and low, stable interest rates, the global public debt ratio is expected to stabilize in 2021, on average, except in *China* and the *United States*. Yet, more needs to be done to address rising poverty, unemployment, and inequality and to foster the economic recovery.

Chapter 1 of this edition of the *Fiscal Monitor* reviews the state of public finances across the world in this unprecedented time and examines the scale, scope, and effectiveness of fiscal policy responses to the COVID-19 crisis. It then offers a roadmap for the overall fiscal strategy to promote a strong recovery.

Although the global fiscal response has been unparalleled, the pandemic has laid bare major differences in the ability of countries to finance emergency spending to protect their people. That ability has been determined in part by countries' fiscal space, and by public and private debt levels, heading into the crisis. In many advanced economies and some emerging markets, massive liquidity provision and asset purchases by central banks have facilitated fiscal expansions. However, in many emerging markets and especially in low-income developing countries—more than half of which are at a high risk of debt distress

or in debt distress—financing constraints have been binding. Official support to alleviate such constraints has been overwhelmed by financing needs. Based on the projected fall in per capita incomes, 100–110 million people globally would be expected to enter extreme poverty, reversing the decades-long declining trend. Additional social assistance—supporting directly the poor and cushioning the recession—is expected to have a modest impact reflecting limited support and capacity constraints in some countries, containing the increase in poverty to 80 million to 90 million people.

With limited fiscal space, countries need to assess the benefits, costs, and risks of support measures. Early insights suggest that public health policies that quickly contained the spread of the disease also allowed for an earlier and safer reopening, restoration of confidence, and economic recovery, reducing overall social and fiscal costs. Targeted cash transfers were vital for poor individuals, who spent them on necessities. Likewise, unemployment benefits supported necessary consumption for people who lost their jobs. Many policies that provided essential support in the short-term have longer-term implications. For example, wage subsidies preserved employment relationships but may slow labor market reallocation when new vacancies emerge. Temporary tax deferrals and cuts have supported liquidity but risk becoming permanent at the expense of government revenues. Equity injections have often been necessary to prevent bankruptcies, particularly in hard-hit strategic firms, but they could delay sectoral reallocation that is crucial for the recovery. Direct or guaranteed loans have so far had low take-up, reflecting some success in restoring confidence, but also administrative constraints and conditionality, as well as the private debt overhang.

Fiscal risks are also unprecedented. They stem from uncertainty about the course of the pandemic, the shape of the recovery, the extent of scarring and the required resource reallocation, the outlook for commodity prices and global financial conditions, and the contingent liabilities from implicit and explicit guarantees. It is crucial to ensure the full transparency, good governance, and costing of all fiscal measures, especially given their size, exceptional nature, and speed of deployment.

A Roadmap for Fiscal Policies during the Different Phases of the Pandemic

Global efforts to develop and ensure universal access to an affordable and effective vaccine or treatment are the highest priority to contain the human, economic, and fiscal costs of the pandemic. National actions are also vital to address the health crisis, including smart, well-informed, and localized containment policies. High levels of precautionary savings by households and limited private investment in an uncertain environment imply that interest rates will remain low for a long time in advanced and some emerging market economies. These factors provide the scope and motivation for fiscal policy to remain a crucial and powerful tool to foster the recovery. Other emerging market economies and low-income developing countries facing tighter financing constraints will need to reprioritize expenditures and deliver more with less by enhancing efficiency, and will need further official financial support and debt relief.

Policymakers need a toolkit of flexible fiscal measures to navigate lockdowns and tentative reopenings, and to facilitate structural transformation to the new post-pandemic economy. In the acute outbreak phase, when lockdowns are pervasive, fiscal policies should be geared to do whatever it takes to save lives and livelihoods. As lockdowns ease and become more selective, governments should ensure that lifelines are not withdrawn too rapidly. Improvements in the ability of social protection systems to reach, target, and deliver benefits to vulnerable people should be preserved. When health risks diminish and a durable recovery is foreseeable, support should shift from protecting employee-firm relationships to helping workers find

new jobs, helping viable but still-vulnerable firms reopen, and supporting structural transformation toward the post-pandemic economy.

When the pandemic is under control through effective vaccines or treatments, governments will need to foster the recovery while addressing the legacies of the crisis—including elevated private and public debt levels, high unemployment, and rising inequality and poverty. The scope for stimulus or the appropriate pace of fiscal adjustment is country-specific, depending especially on the depth of a country's recession, how many people are unemployed, and how easy it is to access financing. Countries with fiscal space and major scarring from the crisis should provide temporary stimulus, including through public investment, as discussed in Chapter 2. Measures to support low-income households—including good-quality jobs—will be critical to reducing poverty. Countries with limited fiscal space and less access to financing should protect public investment and transfers to lower-income households while increasing progressive taxation and ensuring highly profitable firms are appropriately taxed, aiming at a growth-friendly and equitable adjustment.

Policies for the new post-pandemic economy should focus on tackling poverty and inequality to ensure social peace and sustainable growth, and on building resilience against future epidemics and other shocks. This includes policies to ensure that all people have access to basic goods (for example, food) and services (for example, health and education). Finally, reducing emissions will remain a core long-term challenge after the pandemic. This will call for policies to increase carbon prices and catalyze investment in low-carbon technologies.