EXECUTIVE SUMMARY

Chapter 1: Tailoring Fiscal Responses

The race to vaccinate against COVID-19 continues, but the pace of inoculations is widely different across countries, with access unavailable for many. Global vaccination is urgently needed. Global inoculation would pay for itself with stronger employment and economic activity, leading to increased tax revenues and sizable savings in fiscal support. Until the pandemic is brought under control globally, fiscal policy must remain flexible and supportive of health care systems, households, viable firms, and the economic recovery. The need and scope for support varies across economies, depending on the effect of the pandemic and the ability to access low-cost borrowing. Many governments in advanced economies are implementing sizable spending and revenue measures in 2021 (6 percent of GDP, on average). Support in emerging market economies and especially in low-income developing countries has been smaller and front-loaded, with a large share of measures expiring.

Fiscal support has prevented more severe economic contractions and larger job losses. Meanwhile, such support, along with drops in revenues, has raised government deficits and debt to unprecedented levels across all country income groups. Average overall deficits as a share of GDP in 2020 reached 11.7 percent for advanced economies, 9.8 percent for emerging market economies, and 5.5 percent for low-income developing countries. Countries' ability to scale up spending has diverged. The rise in deficits in advanced economies and several emerging market economies resulted from roughly equal increases in spending and declines in revenues, whereas in many emerging market economies and most low-income developing countries, it stemmed primarily from the collapse in revenues caused by the economic downturn. Fiscal deficits in 2021 are projected to shrink in most countries as pandemic-related support expires or winds down, revenues recover somewhat, and the number of unemployment claims declines.

Average public debt worldwide reached an unprecedented 97 percent of GDP in 2020 and is projected to stabilize at around 99 percent of GDP in 2021. Despite higher debt, average interest payments are generally lower in advanced economies and many emerging markets, given the trend decline in market interest rates. In pursuit of their mandates, central banks have lowered policy rates and purchased government bonds, thereby facilitating the fiscal responses to the pandemic. For low-income countries, however, financing large deficits continues to be challenging, given limited market access and little scope to raise revenue in the near term. These countries need assistance through grants, concessional financing, or, in some cases, debt restructuring. Over the medium term, fiscal deficits are projected to shrink in all income groups as recoveries increase pace and fiscal adjustments resume. As a result, the debt-to-GDP ratios in most countries are projected to stabilize or decline, although public debt will continue to increase in a few countries because of factors such as aging and development needs.

Uncertainty concerning the fiscal outlook is unusually high. On the upside, faster-than-expected vaccinations could expedite an end to the pandemic, boosting revenue collections and reducing the need for additional fiscal support. On the downside, a more protracted economic downturn, an abrupt tightening of financing conditions amid high debt, a surge in corporate bankruptcies, volatility in commodity prices, or rising social discontent could inhibit the recovery. In general, the longer the pandemic lasts, the larger the challenge for the public finances.

Against this backdrop, fiscal policy priorities include continuing support as needed while vaccinations proceed and the recovery strengthens; promptly implementing the announced fiscal measures with upgraded project execution capacities and procurement procedures; pursuing a green, digital, and inclusive transformation of the economy; tackling long-standing weaknesses in public finances once the recovery is firmly in place; developing medium-term fiscal strategies to manage fiscal and financing risks; and renewing efforts to achieve the Sustainable Development Goals. To meet these priorities:

- Global cooperation must be scaled up to contain the pandemic, especially accelerated vaccination at affordable cost in all countries. In an upside scenario in which the pandemic is controlled sooner in all countries (see the April 2021 *World Economic Outlook*), stronger economic growth would yield more than $1 trillion in additional tax revenues in advanced economies, cumulatively, by 2025, and save trillions more in fiscal support measures. Vaccination will, thus, more than pay for itself, providing excellent value for public money invested in ramping up global vaccine production and distribution.

- The targeting of measures must be improved and tailored to countries' administrative capacity so that fiscal support can be maintained for the duration of the crisis—considering an uncertain and uneven recovery. Given the low-interest environment, a synchronized green public investment push by countries with fiscal space can foster global growth.
- Policymakers need to balance the risks from large and growing public and private debt with the risks from premature withdrawal of fiscal support, which could slow the recovery. Credible medium-term fiscal frameworks are critical for attaining such balance, setting a path for rebuilding fiscal buffers at a pace contingent on the recovery. This effort could be supported by improving the design of fiscal rules or recalibrating their limits to ensure a credible path of adjustments or legislation such as "preapproving" future tax reforms. Improving fiscal transparency and governance practices can help economies reap the full benefits of fiscal support.
- To help meet pandemic-related financing needs, policymakers could consider a temporary COVID-19 recovery contribution, levied on high incomes or wealth. To accumulate the resources needed to improve access to basic services, enhance safety nets, and reinvigorate efforts to achieve the Sustainable Development Goals, domestic and international tax reforms are necessary, especially as the recovery gains momentum.

Chapter 2: A Fair Shot

The COVID-19 pandemic has exacerbated preexisting inequalities and poverty and has demonstrated the importance of social safety nets. It has also laid bare inequalities in access to basic services—health care, quality education, and digital infrastructure—which, in turn, may cause income gaps to persist generation after generation. In the months ahead, universal access to vaccines and progress in vaccination will be decisive. For the recovery period and beyond, policies will need to aim at giving everyone a fair shot at lifetime opportunities by reducing gaps in access to quality public services. For most countries, this will require mobilizing additional revenues and improving the delivery of services while fostering inclusive growth.

This chapter documents how large preexisting inequalities have worsened the effect of the COVID-19 pandemic, while the crisis, in turn, has escalated those inequalities. For example, countries with better access to health care have had lower mortality rates, considering the age of the population and the number of cases. Countries with higher relative poverty have had more reported infections, especially where urbanization is more extensive. Some effects on labor markets will be long lasting, as will be the impact on education. The unprecedented scale of school closures has resulted in education losses equivalent to about one-quarter of the school year in advanced economies and one-half in emerging market and developing economies. The largest losses have accrued to children from poorer and less-educated families. Moreover, in 2021, net school enrollment rates in emerging market and developing economies could drop by 1 percentage point (or about 6 million children dropping out of school). Children who drop out of school will experience major learning losses.

Policy responses should recognize that various aspects of inequality (income, wealth, opportunity) are mutually reinforcing and create a vicious circle. Interventions thus need to combine predistributive policies (which affect incomes before taxes and transfers) and redistributive policies (which reduce market income inequality, mostly through transfers and to a lesser extent through taxes, especially in advanced economies). Policy responses should thus include the following:

- *Investing more and investing better in education, health, and early childhood development.* Additional spending on education, for example, can reduce the enrollment gap between children from poor and rich households. Inefficiencies should also be tackled. In emerging markets and low-income developing countries, the difference between a country's spending efficiency and that of best performers ranges from 8 percent to 11 percent for health care and 25 percent to 50 percent for education.
- *Strengthening social safety nets by expanding coverage of the most vulnerable households, and increasing adequacy of*

benefits. Beyond making more resources available, these objectives can also be attained by reallocating spending to the most effective programs and by improving identification of and delivery to beneficiaries.

- *Mustering the necessary revenues.* Advanced economies can increase progressivity of income taxation and increase reliance on inheritance/gift taxes and property taxation. COVID-19 recovery contributions and "excess" corporate profits taxes could be considered. Wealth taxes can also be considered if the previous measures are not enough. Emerging market and developing economies should focus on strengthening tax capacity to finance more social spending.
- *Acting in a transparent manner.* For most countries, these reforms would be best anchored in a medium-term fiscal framework as early as possible. Strengthening public financial management and improving transparency and accountability, not least for COVID-19 response measures, will reinforce trust in government.
- *Supporting lower-income countries that face especially daunting challenges.* Meeting the Sustainable Development Goals—a broad measure of the access to basic services—by 2030 would require $3 trillion for 121 emerging market economies and low-income developing countries (2.6 percent of 2030 world GDP). Support from the international community is needed to aid reform efforts, with the immediate priority being affordable access to vaccines.

The COVID-19 pandemic has focused attention on governments and their ability to respond to the crisis. Popular support for better public services, already significant before the pandemic, has likely risen. Cross-country surveys administered before the pandemic suggest that respondents in advanced and emerging market economies have long expressed favor for more tax-financed spending on education, health care, and old-age care, and more progressive taxation. A recent survey suggests that, if a household member becomes ill with COVID-19 or loses employment, the probability of favoring progressive taxation rises by 15 percentage points. Meeting the rising demand for basic public services and more inclusive policies is crucial for policymakers to strengthen public trust and support social cohesion.