



Financing for Sustainable Development Report 2020

Inter-agency Task Force on Financing for Development



United Nations

This report is a joint product of the members of the Inter-agency Task Force on Financing for Development. The Financing for Sustainable Development Office of the United Nations Department of Economic and Social Affairs serves as the coordinator and substantive editor of the Financing for Sustainable Development report.

The online annex of the Task Force (<http://developmentfinance.un.org>) comprehensively monitors progress in implementation of the Financing for Development outcomes, including the Addis Ababa Action Agenda and relevant means of implementation targets of the Sustainable Development Goals. It provides the complete evidence base for the Task Force's annual report on progress in the seven action areas of the Addis Agenda (chapters III.A–III.G). The report is by necessity more concise and selective and should thus be read in conjunction with the online annex.

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The production of this report and the online annex of the Inter-agency Task Force are generously supported by the Federal Ministry for Economic Cooperation and Development of Germany.

How to cite this report:

United Nations, Inter-agency Task Force on Financing for Development, *Financing for Sustainable Development Report 2020*. (New York: United Nations, 2020), available from: <https://developmentfinance.un.org/fsdr2020>.

United Nations publication
Sales No.E.20.1.4
ISBN 978-92-1-101422-8

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THE GLOBAL ECONOMIC CONTEXT AND ITS IMPLICATIONS FOR SUSTAINABLE DEVELOPMENT



Chapter I



The global economic context and its implications for sustainable development*

1. Introduction

In early 2020, the Inter-agency Task Force on Financing for Developing (Task Force) members lowered their already tepid growth forecasts due to rapid worldwide spread of COVID-19. Even in the most benign scenario, global growth is now expected to slow further in 2020, with a substantial risk of a global recession, significantly below the decade-low growth of 2.3 per cent in 2019.¹ The baseline outlook is subject to downside risks and uncertainty, including a renewed escalation of trade disputes and a further rise in geopolitical tensions could also affect global growth in the short to medium term. Beyond these risks, the climate crisis continues to pose a rising threat to economic prospects. Without decisive policy action, there is a distinct possibility of a prolonged sharp slowdown in global economic activity.

These challenges pose extremely serious risks to the timely implementation of the Sustainable Development Goals (SDGs). Subdued global growth was already setting back progress towards higher living standards. Before the outbreak of COVID-19, one in five countries—many of which are home to large numbers of people living in poverty—were likely to see per capita incomes stagnate or decline in 2020. This number will likely be higher due to economic disruptions from the pandemic.

Existing economic vulnerabilities are being further aggravated by the impact of COVID-19 and related factors. Disruptions

in industrial production are affecting global value chains and putting additional pressure on already weak trade and investment growth. Economic insecurity and job losses are impacting consumer demand. Rising volatility in financial markets could expose vulnerabilities in some economies with systemically important financial sectors. Risks of debt distress in public and private debt—both of which were already at record-high levels relative to gross domestic product (GDP) in developed and developing economies before the crisis—are increasing. The related fall in commodity prices (particularly oil prices, which have been aggravated by political tensions) is putting further pressure on debt sustainability in some countries. In Africa, six countries with high oil exports could experience significant shocks, while the fall in tourism will hurt small island developing States and other tourism-dependent countries.

To date, monetary policy easing in many systemically important countries has helped support near-term activity. During periods of high uncertainty, monetary policy can boost liquidity to ensure continued functioning of markets, and support lending. However, monetary policy will be insufficient to mitigate the economic impact of a global pandemic and restore medium-term robust growth to the world economy.

Swift and forceful policy action is needed in response to COVID-19, drawing on the full policy toolbox—that is, fiscal policy,

* This chapter is based on the following reports: *World Economic Situation and Prospects 2020* (United Nations publication, Sales No. E.20.II.C.1); *World Economic Outlook, October 2019: Global Manufacturing Downturn, Rising Trade Barriers* (Washington, D.C., IMF, 2019); IMF, “World Economic Outlook Update” (January 2020); *Trade and Development Report 2019: Financing a Global Green Deal* (UNCTAD, United Nations publication, Sales No. E.19.II.D.15); and *Global Economic Prospects: Slow Growth, Policy Challenges* (Washington, D.C., World Bank, 2020).

supported by monetary, macroprudential and capital flow management policies—according to countries’ fiscal positions and financial vulnerabilities. Given the interrelated nature of the global economy, rapid response measures should be coordinated at the global level to ensure maximum impact and signal global resolve to maintain economic and financial stability, promote trade and stimulate growth. Over the medium term, structural and regulatory reforms, public and private investment, and strengthened social protection will be important to rekindle growth, address the rapidly changing technological landscape, and boost sustainable development prospects—all of which is discussed throughout the rest of this report.

2. Outlook and risks for the global economy

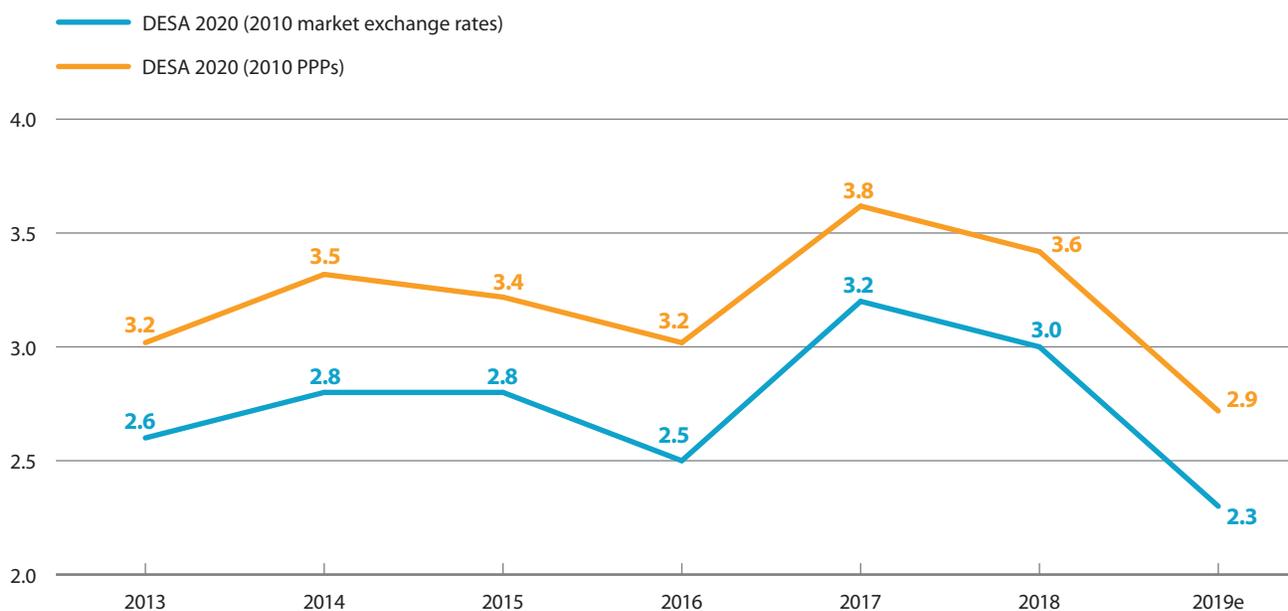
2.1 Growth trends

According to the *United Nations World Economic Situation and Prospects 2020*, global growth decelerated to 2.3 per cent in 2019, its slowest pace since the 2008 world financial and economic crisis, amid weakening trade and investment activity (figure I.1). The growth downturn was broadly based across geographic regions, with about two thirds of countries worldwide recording weaker GDP growth in 2019 compared to 2018. The global economy is projected to slow further in 2020, owing to the economic impact of COVID-19 (see box I.1 on COVID-19), before potentially rebounding in 2021 (with 2021 forecasts highly dependent on the course of the pandemic and policy response).

In per capita terms, the global economy grew at a moderate pace of 1.2 per cent in 2019. This aggregate figure masks stark differences in economic performance across regions and countries (figure I.2). As economic growth remains highly uneven across regions, many developing countries have continued to fall further behind. Before the outbreak of COVID-19, average incomes in one out of five countries (predominantly in Africa, Latin America and the Caribbean, and parts of Western Asia) were projected to stagnate or decline, with more countries expected to see per capita income declines due to COVID-19. Many of these countries are commodity exporters. For commodity-dependent developing countries as a group, average annual growth of GDP per capita fell from 2.9 per cent during 2010-2014 to 0.5 per cent in 2015-2019. In one third of these countries (home to 870 million people), average real incomes are lower today than they were in 2014. These countries are also likely to be significantly hit by the pandemic outbreak and related commodity price drops. Global prices for soybeans and copper fell approximately 8 and 15 per cent, respectively, between January and March, while oil prices collapsed in the first half of March (with political issues exacerbating the impact of falling demand). A sustained drop in commodity prices would severely compound debt and financial vulnerabilities.

Progress towards poverty reduction has slowed in recent years and might slow further due to the impact of COVID-19. The number of people living in extreme poverty has risen in several sub-Saharan African countries, where poverty rates are already high. Poverty rates have also edged up in parts of Latin America and the Caribbean and Western Asia. Growth in most least developed countries (LDCs) remains significantly below levels needed to eradicate extreme poverty by 2030. Only 15 per cent of LDCs are growing at

Figure I.1
Growth of world gross product
(Percentage)



Source: UN DESA.
Note: e = estimate.

Box 1.1

COVID-19: economic impact and policy options

On 11 March 2020, the World Health Organization declared a global pandemic^a due to the spread COVID-19. At the time of writing, the situation continues to unfold at rapid speed, making it difficult to forecast the global economic impact. Nonetheless, a review of some of the effects on supply and demand, as well as financial and other transmission channels, can help identify critical areas for policy intervention.

Unlike typical financial crises, where instability in the financial sector may impact the real economy, COVID-19's most direct impact is on health and human well-being, with immediate effects on economic activity and jobs, which then feed into the financial sector.

COVID-19 affects both the supply and the demand side of the economy, through direct effects (cost of health care, morbidity and mortality) and indirect effects (restrictions of movement and voluntary social distancing). The crisis has already had a significant impact on the economy, including through a disruption of global supply chains; a collapse in travel and tourism; rising unemployment and a decline in consumer demand, a sharp rise in fear and insecurity; and financial market volatility. The pandemic will also strain social systems. Managing the crisis will be particularly difficult for countries with limited fiscal space and weak social protection. Together, these effects are compounding existing financial and debt vulnerabilities (see section 2.4 below).

On the supply side, plant closures and a restricted labour supply are impacting global supply chains, trade, investment, and commodity prices. Investment is also likely to fall, as companies delay capital expenditures. For example, China's manufacturing output and investment contracted significantly in early 2020, with exports falling 17.2 per cent and investment falling 24.5 per cent year on year during January-February.^{b c}

On the demand side, restrictions of movement and the cancellation of public events, together with social distancing are affecting the services industry, to date most notably in tourism and hospitality, which will impact a range of countries, including small island developing States. Heightened economic insecurity, including loss of income due to reduced working hours or layoffs (particularly for those without access to a strong safety net), and rising financial losses are likely to dampen consumer spending, in turn further impacting business expectations and investment.

Commodity exporters are also expected to be among the countries most affected by the slowdown due to the concurrent fall in commodity prices, particularly oil prices, raising the risk of debt distress for some highly indebted countries. In Africa, six countries with high oil exports could experience significant shocks.^d

Small and medium-sized enterprises (SMEs) that do not have financial cushions to rely on may struggle to adjust to the demand shock.^e There was a significant increase in borrowing by SMEs in the period prior to the crisis in some developed countries. Without relief, there is a high risk of increased defaults by SMEs, as well as by individuals losing that have mortgages or student loans.

In early March, global financial markets witnessed large losses and elevated levels of volatility not seen since the onset of the 2008 world financial and economic crisis. Given the highly leveraged nature of the global economy, margin calls may trigger additional sales, leading to a further fall in prices and contagion across asset classes. Developing countries are already experiencing capital outflows, with portfolio outflows from emerging market already surpassing levels observed during the global financial crisis.

Policy options

Given the global nature of the pandemic and its economic impacts, the international community needs to take swift concerted actions. Rapid response measures should be coordinated at the global level to ensure maximum impact and signal global resolve to maintain economic and financial stability, promote trade and stimulate growth. In addition, the global community will need to support vulnerable countries that may have limited fiscal space and weak health systems, including through technical support in countries where the virus has not yet manifested. The Group of Seven and Group of Twenty Finance Ministers and Central Bank Governors have signalled their readiness to cooperate.

At the country level, increased public health spending, including on screening, supplies, and treatment capacities, can help slow the spread and impact of COVID-19, and have a multiplier effect on the economy. Additional fiscal policy measures can include paid family sick leave, wage subsidies and cash transfers. These are particularly important for the poorest, those without access to health care, and those with precarious employment. Countries may also need to support concessional lending programmes for SMEs.

After an initial emergency phase, fiscal policies can also help economic recovery by supporting demand and promoting medium- and long-term sustainable development trajectories (see section 4). This could include increasing public investment and incentives for private investment in sustainable development, to help offset the expected fall in investment due to COVID-19. Short-term policies today also affect future outcomes, so even immediate crisis measures should be aligned with and supportive of sustainable development. The policy response should be sustained, sustainable and equitable, to avoid a rerun of the protracted and slow recovery from the 2008 crisis.

In terms of monetary policy, central banks do not have tools to help restore the global supply chains that COVID-19 has disrupted, or support services demand in countries that significantly limit personal mobility. Monetary policy can help counter tighter financial conditions, including through policy

rate cuts or asset purchases. For example, the ECB has announced a €750 billion Pandemic Emergency Purchase Programme of private and public sector securities, while the Federal Reserve has established additional Dollar-Swap lines with nine more countries to support US dollar funding markets around the globe. Central banks can also provide additional liquidity to financial institutions, particularly by making support conditional on lending to SMEs.

Some commercial banks are also developing programmes that allow flexibility or “breathing space” on loan payments for SMEs and individuals feeling financial stress (including for mortgage payments), similar to banks to showing forbearance during natural disasters. And policymakers should consider offering similar flexibilities (e.g. on student loans) along with concessional broad-based lending programmes.

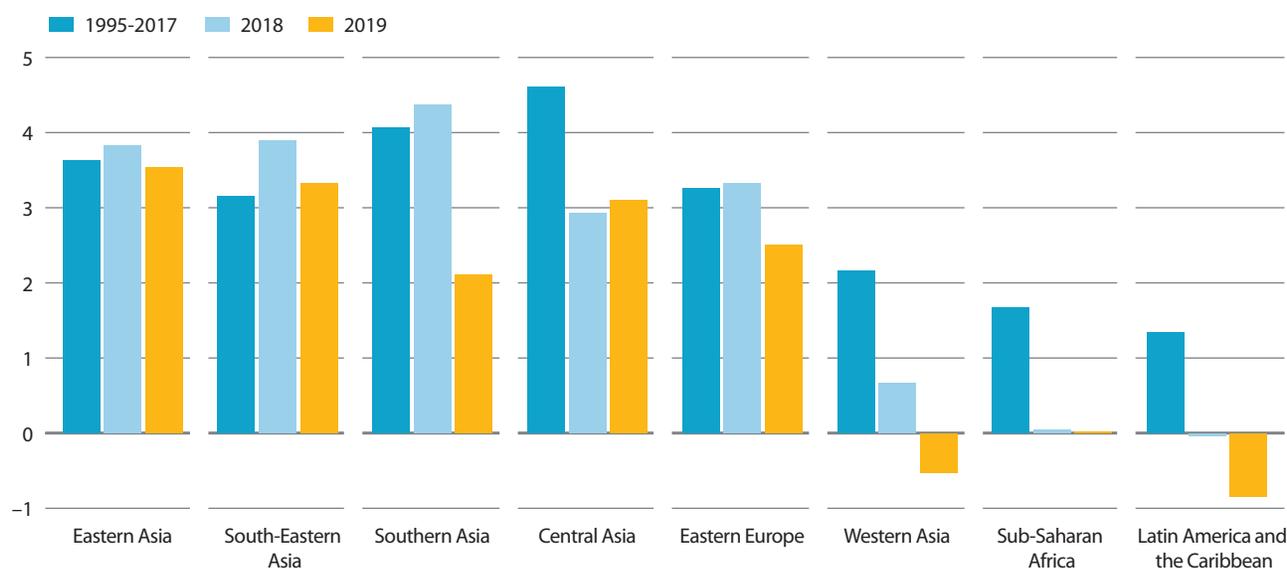
Measures should be coordinated at the global level to ensure maximum impact and signal global resolve. Governments will need to eliminate trade barriers and restrictions that affect supply chains.

The international community will also need to support countries most in need, which may include a targeted COVID-19 fund, both for humanitarian purposes and to help stop the spread of the global pandemic. The World Health Organization has issued an emergency response plan and donor appeal (see chapter III.C). The IMF is making about \$50 billion available through its rapid-disbursing emergency financing facilities, out of which \$10 billion are available at zero interest for low-income countries. The Catastrophe Containment and Relief Trust provides eligible countries upfront grants for relief on IMF debt service.^f The World Bank also has a number of facilities that countries can potentially access during crises and has announced a \$14 billion package of fast-track financing to assist companies and countries affected by COVID-19 (see chapter III.C of this report). These actions will have impact, but more needs to be done. Official bilateral creditors should immediately suspend debt payments from LDCs and other low-income countries that request forbearance, and other creditors should consider similar steps or equivalent ways to provide new finance (see chapter III.E).

Source: UN DESA.

- a WHO, “Coronavirus disease (COVID-2019) situation reports.” Available at <https://www.who.int/emergencies/diseases/novel-coronavirus-2019/situation-reports/>.
- b UNCTAD, “Impact of the coronavirus outbreak on global FDI”, Investment Trends Monitor, Special Issue (Geneva, UNCTAD, March 2020). Available at https://unctad.org/en/PublicationsLibrary/diaefinf2020d2_en.pdf.
- c Reuters, “China January-February exports tumble, imports down as coronavirus batters trade and business.” Available at <https://www.reuters.com/article/us-china-economy-trade/china-january-february-exports-tumble-imports-slow-as-coronavirus-batters-trade-and-business-idUSKBN20U05R>.
- d United Nations Economic Commission for Africa, “Economic Impact of the COVID-19 on Africa.” Available at https://www.uneca.org/sites/default/files/uploaded-documents/stories/eca_analysis_-_covid-19_macroeconomiceffects.pdf.
- e Blinder, Alan, et. Al., “What can US fiscal and monetary policy do to limit the economic harm from COVID-19?”. Available from: <https://www.brookings.edu/blog/up-front/2020/03/10/what-can-u-s-fiscal-and-monetary-policy-do-to-limit-the-economic-harm-from-covid-19/>
- f Kristalina Georgieva, “IMF Makes Available \$50 Billion to Help Address Coronavirus.” Available at <https://www.imf.org/en/News/Articles/2020/03/04/sp030420-imf-makes-available-50-billion-to-help-address-coronavirus>.

Figure I.2
Average GDP per capita growth by region
(Percentage)



Source: UN DESA.

a pace close to the SDG target of at least 7 per cent per annum. Eradicating global poverty by 2030 will not only require much faster income growth, but also steep reductions in inequality. For example, even if per capita income growth for the LDCs were to strengthen to an average annual rate of 6 per cent, income inequality would still need to be reduced by half to eradicate poverty by 2030.

2.2 Impact of trade tensions

COVID-19 is also expected to compound already weak international trade and global manufacturing activity (see box I.1).

Rising tariffs and shifts in trade policies have dampened trade and investment in most regions. The “Phase 1” trade agreement that was reached between China and the United States of America in January 2020 has provided some short-term relief for businesses and investors. Nevertheless, as many of the issues underlying the trade disputes remain unresolved, there is a possibility that trade tensions could re-escalate across countries, although it is unclear whether and how COVID-19 will affect such disputes. Moreover, as more countries resort to unilateralist strategies to resolve their trade disputes, the World Trade Organization and its rules-based multilateral trading system are increasingly being undermined, making multilateral dispute settlements more complex, increasing inefficiencies in global trade and weakening the positions of small and developing countries (see chapter III.D).

Renewed pressure on trade would further hurt growth prospects around the world both directly and indirectly. Global value chains could experience more severe disruptions, raising costs and extending the weakness in exports. Persistent high trade policy uncertainty could also prolong the investment slump in many countries.

2.3 Subdued investment growth

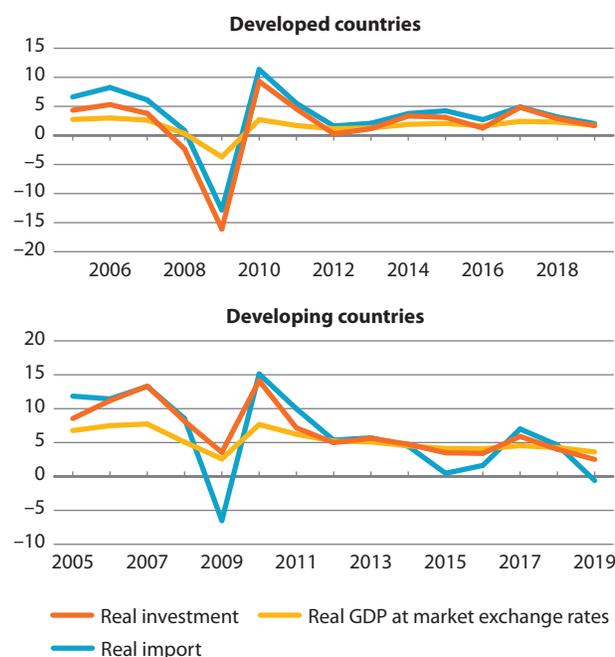
COVID-19 is also expected to exacerbate already low investment growth prior to the outbreak (see box I.1). Global investment fell in 2019, in tandem with the slowdown in trade flows and industrial production. The fall in investment is most pronounced in developing economies, reflecting trends in China as well as other large developing countries (figure I.3). A prolonged slump in investment activity could also dampen productivity growth, thus affecting both short-term output and medium-term potential growth (see section 3.1).

In developed countries, the decline in investment was, on average, greatest in machinery and equipment, and residential real estate. Investment growth in intellectual property products held up relatively better and witnessed a strong increase in the United States, possibly reflecting the growth of the digital economy (figure I.4). A related trend in some developed countries may be an increase in market concentration, which would lead to lower competition and possibly reduced investment and innovation (see chapter II).

In developing countries, the pace of investment growth varied significantly between regions (figure I.5). Trade weakness discouraged export-oriented investment. In a few large emerging countries (e.g., Argentina and Turkey), the sharp decline in domestic investment reflected ongoing adjustments to severe macroeconomic imbalances. For commodity exporters, including several economies in Africa, Western Asia and Latin America and the

Caribbean, subdued commodity prices continued to weigh on capital spending and public investment. The fall in commodity prices in early 2020, if sustained, is expected to continue to hinder investment in these countries. In contrast to developed countries, investment in digitalization has remained relatively low in most countries for which data is available (with the exception of China).

Figure I.3
Global GDP, investment and trade growth, 2005–2019
(Percentage)



Source: UN DESA, based on IMF, *World Economic Outlook*, October 2019.

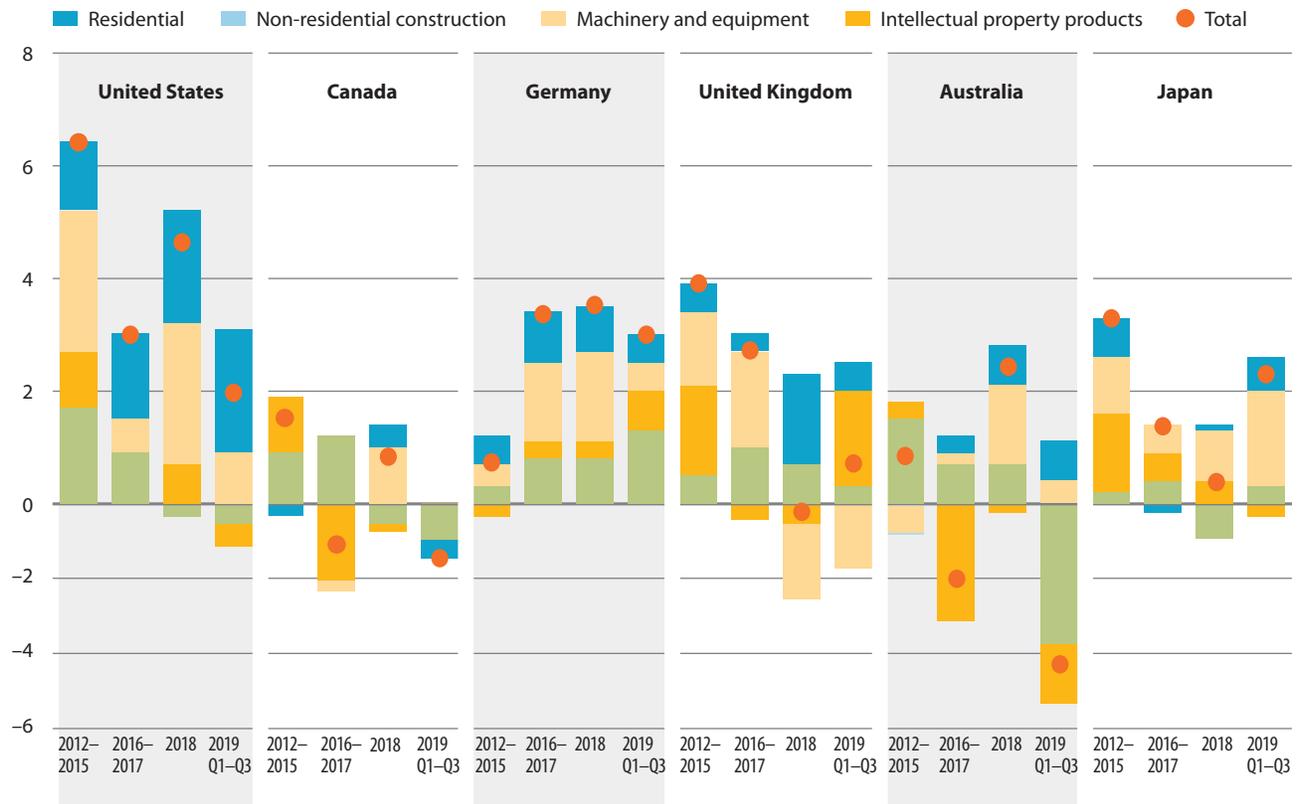
2.4 Monetary policy, leverage, and vulnerabilities

On its own, monetary policy cannot address the supply shock related to COVID-19 as central banks do not have the tools to restore disrupted supply chains or directly support services demand. Monetary policy can help counter tighter financial conditions, but its efficacy is further challenged by the low interest rate environment already in place prior to the outbreak.

Among major developed economies, policy rates have fallen to near zero or negative. In 2019, 67 central banks worldwide lowered their key policy rates (figure I.6), marking the broadest shift in monetary policy since the 2008 world financial and economic crisis. According to IMF estimates, without this stimulus, global growth would have been 0.5 percentage points lower. There are, however, growing concerns that monetary policy has reached its limits, particularly in some developed economies.

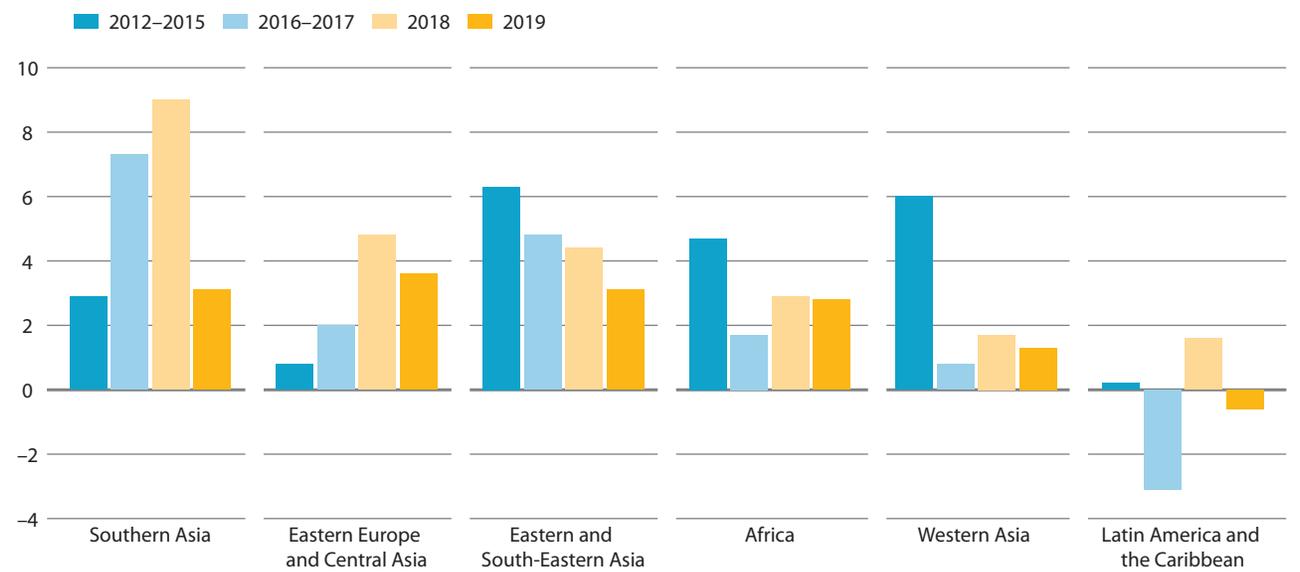
There are indications of increased financial vulnerability outside the banking sector relative to historical standards in several large economies with systemically important financial sectors.² As illustrated in figure I.7, fewer countries show high vulnerabilities in their banking sectors relative to the elevated risk during the 2008 world financial and economic crisis, partly reflecting more stringent regulation (see chapter III.F). However, the share of countries with vulnerabilities in non-bank financial institutions increased

Figure I.4
Investment growth in developed economies
 (Percentage)



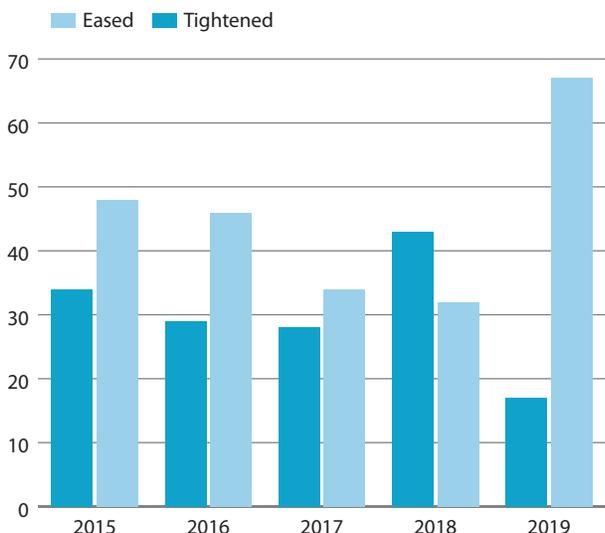
Source: UN DESA, based on data from national authorities.
 Note: Data for Germany, Japan and the United Kingdom are total investment, data for Australia, Canada and the United States are private investment.

Figure I.5
Growth of gross fixed capital formation in developing regions
 (Percentage)



Source: UN DESA, based on data from national authorities.

Figure I.6
Monetary policy shifts
 (Number of central banks)



Source: Central Bank News
 Note: Sample covers 95 central banks.

by almost 20 percentage points during the second half of 2019 alone, to reach levels similar to those before the crisis. Also, significantly more countries than before the crisis show high levels of vulnerability of sovereigns and of the non-financial corporate sector (figure I.7) (see chapter III.E).

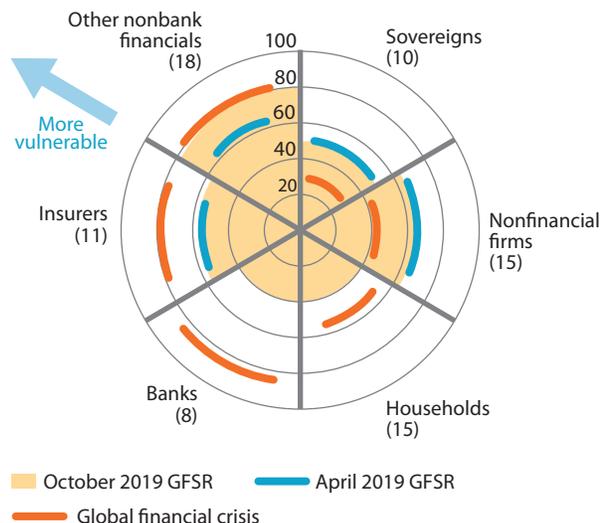
Public and private debt have risen to record-high levels relative to GDP in both developed and developing economies (figure I.8). High sovereign debt could be a growing source of risk to financial stability for some developing countries. Between 2010 and 2019, interest payments as a share of government revenue increased in more than 70 per cent of developing countries—despite historically low yields—and 44 per cent of least developed and other low-income countries are currently considered to be in debt distress or at high risk of falling into debt distress (see chapter III.E).

In developed countries, corporate debt has increased since 2011, surpassing pre-crisis levels (after an initial decline following the 2008 world financial and economic crisis). In large developing countries and emerging economies, the ratio of corporate debt to GDP has risen by 31 percentage points since 2011, with government and household debt ratios each growing by over 15 percentage points. Yet, much of the financing raised by corporate borrowing has been used for share buybacks, to pay out dividends and boost short-term investor returns, or to fund mergers and acquisitions, rather than for productive investments.³

While the growth in corporate debt in some countries (e.g., China) is concentrated in larger firms, including state-owned enterprises, in others (e.g., the United States) it is more pronounced in smaller and medium-sized companies (SMEs). As COVID-19 is expected to have a particularly large impact on SMEs (see box I.1), the risk of corporate default has increased significantly in these countries.

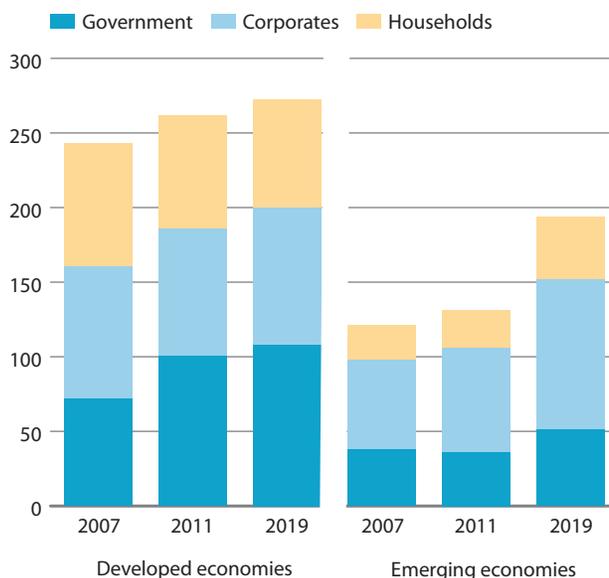
“Lower for longer” interest rates also create incentives that lead to riskier behaviour in the financial system. For example, institutional investors that

Figure I.7
Proportion of systemically important economies with elevated financial vulnerabilities, 2007–2008 and 2019
 (Percentage of countries with high and medium-high vulnerabilities, by GDP [assets for banks]; number of countries in parentheses)



Source: IMF, Global Financial Stability Report, October 2019

Figure I.8
Breakdown of non-financial sector debt of developed and emerging economies
 (Percentage of GDP)



Source: Bank for International Settlements, Total Credit Statistics.
 Note: 2019 refers to outstanding debt data as of 2Q 2019. Advanced economies comprise Australia, Canada, Denmark, the euro area, Japan, New Zealand, Norway, Sweden, Switzerland, the United Kingdom and the United States. Emerging market economies comprise Argentina, Brazil, Chile, China, Colombia, the Czech Republic, Hong Kong SAR, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Poland, Russia, Saudi Arabia, Singapore, South Africa, Thailand and Turkey.

are less risk averse increasingly purchased high-yield bonds. At the same time, the average credit quality of debt has fallen. In the United States, even for corporate bonds rated “investment grade,” the share of triple-B rated bonds (the lowest “investment grade” bonds) in outstanding debt has increased. Potential sell-offs in the case of downgrades and rising credit spreads—which could arise from the COVID-19 pandemic—could have systemic implications, as the mandates of many investors forbid them from holding bonds with sub-investment grade credit ratings. These effects can be exacerbated if the investments were initially funded through borrowing (see also box I.2).

Box I.2

Rising leverage and loosening underwriting standards

As shown in figure I.7, vulnerabilities are elevated in the non-bank financial sector in a number of countries (what was formerly called “shadow banking”). For example, “leveraged loans” (loans to higher risk corporate borrowers usually syndicated to multiple lenders, most of which are then packaged into “collateralised loan obligations”) have doubled in volume since the crisis, to reach \$1.2 trillion in 2019.^a In addition, financial institutions have loosened underwriting standards and issued loans with fewer covenants that have traditionally protected lenders in loan contracts. More than 80 per cent of new leveraged loan issues in the United States of America have been “covenant-lite”.^b Business development companies—closed-end investment companies that invest in small- and medium-sized enterprises (SMEs)—have also experienced a weakening in covenants. As discussed in the chapter III.B of this report (private finance), if well structured, diversified and regulated, such instruments could support the Sustainable Development Goals by raising new financing for SMEs. However, there are also some inherent risks in many of these types of structures (see chapter III.B) that tend to have additional leverage built in to enhance their yield. Perhaps one of the biggest is the tendency for underwriting standards and covenants to weaken during periods of high liquidity. As these loan instruments are traded internationally, there is a risk of systemic implications on global financial markets and spillovers, depending on the nature of their international financial linkages. This underscores the need to continue to strengthen regulatory frameworks for non-bank financial activity (see chapter III.F of this report).

Source: UN DESA.

^a Based on S&P/LSTA Leveraged Loan Index.

^b S&P Global, “US leveraged loan default rate hits 9-month high as market distress rises.” Available at <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/55929866>.

The systemic impact of this credit growth depends in large part on the interlinkages of the investment products and portfolios and the financial system. Risks can be amplified due to leverage, as fund managers might be forced to sell other assets to raise money to cover their losses and repay debt, leading to contagion across markets with systemic implications. There is a risk that financial market volatility associated with COVID-19, including widening credit spreads and falling asset prices, could trigger such sales, putting further pressure on financial markets. Developing countries are also facing the risk of capital flight triggered by increasing

global risk aversion and widening credit spreads due to the impact of COVID-19 (see box I.1).

2.5 Risks from other non-economic factors: climate change

While it is hard to predict the further spread and duration of the COVID-19 pandemic, its economic impact is being felt strongly across the globe.

Beyond the immediate threat, climate change and other natural hazards are posing an increasing risk to the short, medium and longer-term economic outlook. Between 2014 and 2018, the number of weather-related loss events worldwide is estimated to have increased by over 30 per cent compared to the preceding five years.⁴ Climate shocks inflict significant and long-lasting damage, including loss of income, destruction of physical and human capital, and widening inequalities.

While the estimated overall cost of disasters in 2019 (\$150 billion) was lower than in the preceding three years, there were many events with losses in the low billions. This highlights the volatile nature of annual losses, as statistics are often dominated by large individual events.⁵ Nonetheless, an estimated 68 per cent of losses during 2005–2017 were caused by small and medium, localized and frequent disasters.⁶ Although rebuilding efforts provide a temporary boost to economic growth, they also divert scarce resources away from other development needs. Debt levels inevitably rise as governments borrow to finance recovery efforts, driving up borrowing costs and further burdening public budgets.

Climate-related risks are also increasingly affecting the financial sector. As risk evaluations of assets change, insurers and banks may be exposed to large losses that could impact financial stability. While addressing climate change will take a wide range of policy measures, an increasing number of central bank governors have acknowledged the need to respond to the risks it poses to the financial sector. In 2019, the Network of Central Banks and Supervisors for Greening the Financial System published a set of guidelines that urges peers to price climate change risk when regulating financial companies, and to invest with sustainability goals in mind for their own portfolios (see chapter III.F).⁷

Some central banks governors do not consider climate change to be as relevant for monetary policies, since they expect only limited effects on their own countries’ GDP growth and inflation in the near term. There is also no consensus on the role of central banks’ own portfolios in supporting green investment. For instance, the US Federal Reserve and the Bank of Japan consider this outside their mandates, while the Bank of England and the European Central Bank have indicated strong interest in such policies.⁸ The Bank for International Settlements launched a green bond fund in 2019, as an option for central banks to include environmental sustainability objectives in their reserve management.⁹

3. Medium-term challenges: productivity and equity

3.1 Recent trends in labour and total factor productivity

The recent investment slump has caused a slowdown of capital deepening,¹⁰ reinforcing a longer-term trend of slowing productivity

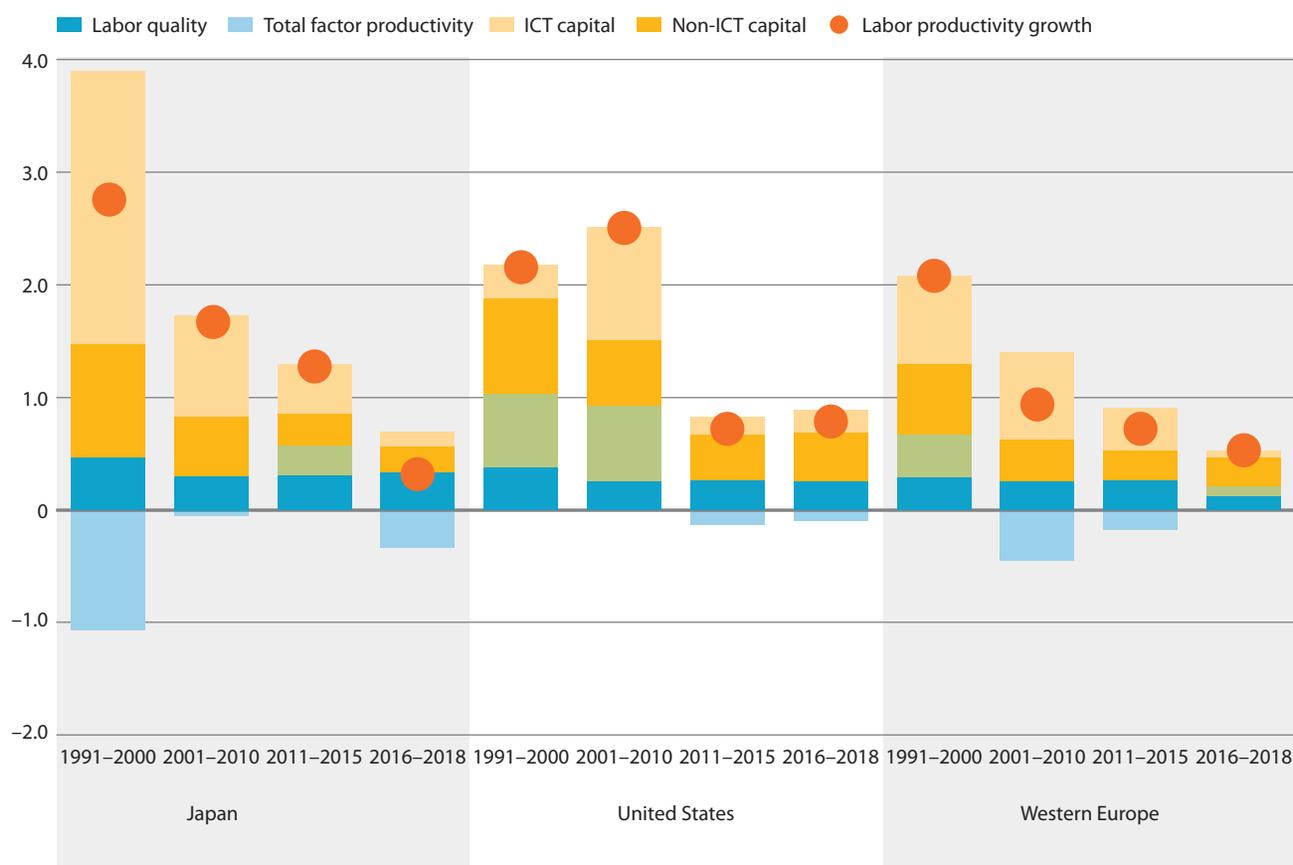
growth in many developed and developing countries. Indeed, all major developed economies have experienced a downward trend in labour productivity growth over the past three decades (figure I.9). The growth of total factor productivity (TFP) (the efficiency with which capital and labour are used together for production) has also slowed. Notably, productivity growth from ICT investment seems to have resisted the overall downward trend over the past two decades, albeit without significantly boosting total productivity (see also chapter II).

Both structural and near-term factors may explain why expectations of rapid productivity gains from new digital technologies have not yet materialized at an economy-wide scale in developed economies (box I.3). Structural factors that have affected productivity growth since the late 1990s and early 2000s include demographic shifts, relative growth of the service sector, slowing gains in education and gender equality, a slower pace of trade integration and innovation,¹¹ and a slowing rate of technological diffusion (the speed at which technological innovations spread within and across economies).¹² These longer-term factors have been exacerbated by the decline in investment since the 2008 world

financial and economic crisis, and more recently the increase in global trade tensions and policy uncertainty.

Although average labour productivity continues to grow significantly faster in developing economies, most have also experienced a marked slowdown compared to the decade before the 2008 world financial and economic crisis. This has been mainly due to a sharp downturn in total factor productivity growth, suggesting less dynamic economic transformation processes and slowing gains from trade integration. Aggregate figures mask stark differences among the various regions; notably, as illustrated in figure I.10, there is a large gap between East Asia and South Asia and the other developing regions. Weak investment and slow productivity growth in Western Asia, Latin America and the Caribbean, and sub-Saharan Africa do not bode well for medium-term economic development prospects. Without strong structural policy measures to boost productivity, including large-scale infrastructure investment, improvements to the quality of education and promotion of innovation capacity, rapid progress towards the SDGs will remain elusive in many countries.

Figure I.9
Labour productivity growth in developed economies
 (Percentage)



Source: UN DESA, based on data from The Conference Board Total Economy Database.
 Note: Regional growth rates are weighted by real GDP.

Box I.3

Slow productivity growth in times of rapid technological advances: the productivity paradox

High expectations for the transformational potential of digital technologies contrast sharply with the downward trend in productivity growth in developed economies over the past few decades. Neither the digital revolution that began in the 1980s nor the more recent advancements, including progress in artificial intelligence and machine learning, have fundamentally changed this trend. This apparent disconnect between rapid technological advancements and slowing productivity growth is known as the “productivity paradox”.

Many potential explanations, which are not mutually exclusive, have been put forward:^a (i) output, and therefore productivity, may be undercounted in national statistics; (ii) technological progress and its diffusion may be slower than expected; and (iii) increasing market concentration due to the nature of the digital economy has weakened investment and, therefore, productivity. In addition, spending patterns and employment have also been moving away from tangible goods to services (childcare, health care, education), where productivity growth tends to be slower.

National accounts may undercount output for two main reasons: First, many new technology firms provide “free goods”—such as free navigation systems or social media networks—and “better goods”—such as better phones, media and communications services, and software. Without prices that reflect the value of these “free” and “better” goods, national accounts will continuously underestimate their contribution to economic output. Second, national accounts may severely underestimate investments, as the capital stock is increasingly shifting towards intangible assets—such as patents, branding and managerial knowledge, which are much harder to quantify than tangible assets. Nonetheless, these measurement problems are not new and do not seem to have become significantly larger over time. They are thus unlikely to account for a large part of the observed productivity slowdown.^b

Regarding the nature and speed of technological progress and its diffusion, some recent studies have raised doubts about whether the current wave of innovations will have the same economy-wide effects as technological breakthroughs of the past. Some argue that the age of great invention may be essentially over, and the pace of technological progress will likely continue to slow.^c Others stress that new ideas are simply harder to find and that an ever-increasing number of researchers are required to maintain a given rate of growth in productivity.^d

As discussed in chapter II, increasing market power may have also contributed to the observed productivity slowdown by reducing competition and, with it, the need to invest and innovate. Where this is due to the “winner take most” nature of the digital economy, technical progress would be self-defeating, as potential productivity gains would be undermined by its effects on market concentration.^e However, others argue that the rise in market power is mainly due to higher entry barriers in many sectors as a result of mergers and acquisitions, lobbying, and regulatory capture.^f

Other economic and structural factors have also contributed to current productivity headwinds, as discussed in chapter II. While no single narrative can provide a full explanation, a better understanding of the productivity puzzle in different country contexts can help improve policies to support future productivity growth, as a key contributor to sustainable development.

Source: UN DESA.

^a See for example Gustavo Adler and others, “Gone with the Headwinds: Global Productivity”, IMF Staff Discussion Note 17/04 (April 2017); and Ian Goldin and others, “The Productivity Paradox: Reconciling Rapid Technological Change and Stagnating Productivity”, Oxford Martin School Programme on Technological and Economic Change (April 2019).

^b David Byrne, Stephen Oliner and Daniel Sichel, “Prices of High-Tech Products, Mismeasurement, and Pace of Innovation”, NBER Working Paper No. 23369 (April 2017); Chad Syverson, “Challenges to Mismeasurement Explanations for the US Productivity Slowdown”, *Journal of Economic Perspectives*, Volume 31, Number 2 (Spring 2017), pp. 165–186; Ian Goldin and others, “The Productivity Paradox: Reconciling Rapid Technological Change and Stagnating Productivity”, Oxford Martin School Programme on Technological and Economic Change (April 2019); and Thomas Philippon, “How America Gave Up on Free Markets” (Cambridge, The Belknap Press of Harvard University Press, 2019).

^c Robert J. Gordon, “The Rise and Fall of American Growth: The U.S. Standard of Living since the Civil War” (Princeton, Princeton University Press, 2016).

^d Nicholas Bloom and others, “Are Ideas Getting Harder to Find?”, NBER Working Paper No. 23782 (September 2017).

^e David Autor and others, “The Fall of the Labor Share and the Rise of Superstar Firms”, *Quarterly Journal of Economics*, 135-2 (Forthcoming, 2020).

^f Thomas Philippon, “How America Gave Up on Free Markets”.

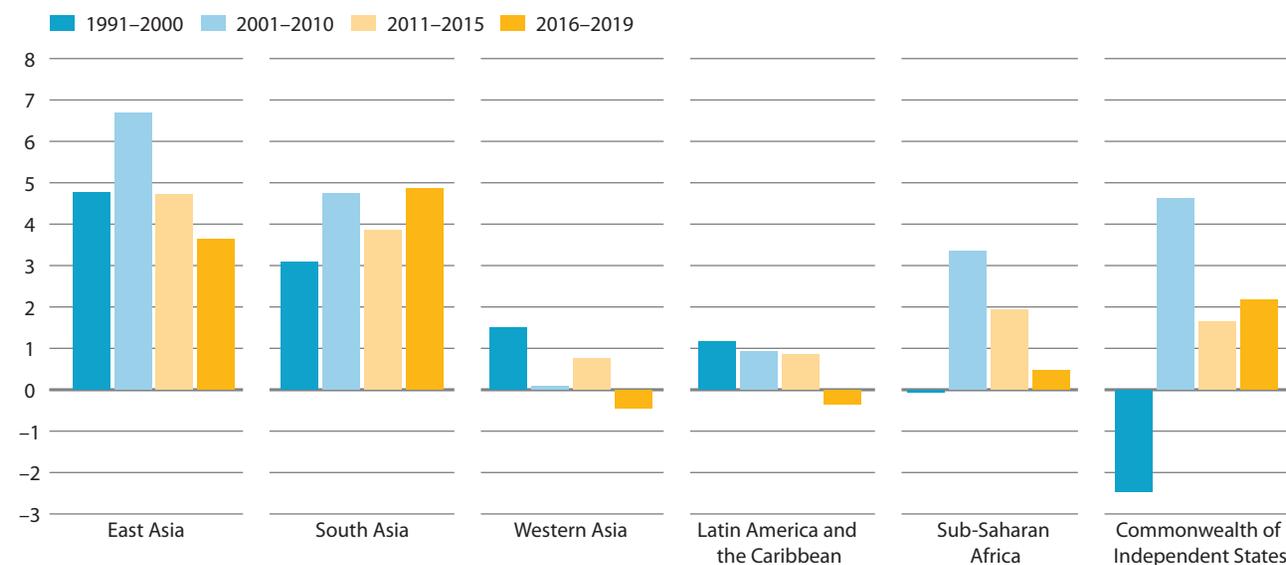
3.2 Impact of technological changes on wages and profit shares

The documented slowdown in average labour productivity growth—particularly visible in developed economies—has hurt workers by limiting the potential for real wage growth. This trend has often been accompanied by two other developments: (i) a decline in the labour share of income, reflected in a growing gap between labour productivity growth and real *average* wage growth; and (ii) rising wage inequality, reflected in a growing gap between real *average* wage growth and real *median* wage growth.¹³

While a decrease in the labour share has been documented for a majority of countries since the early 1980s,¹⁴ trends in wage inequality vary by countries and regions. Wage inequality has risen significantly in most developed countries over the past decades, with the bulk of the increase occurring in the 1980s and 1990s, driven mainly by a widening gap between top and median wage earners. Among developing regions, wage inequality has risen in many East Asian countries, while Latin America and the Caribbean and parts of Africa have experienced some decline in wage inequality in recent decades.

Although not as prominent in developing countries, there is also a risk of future job losses or job polarization, owing to automation and digital

Figure I.10
Labor productivity growth in developing and transition economies
 (Percentage)



Source: UN DESA, based on data from The Conference Board Total Economy Database.

Note: Regional growth rates are weighted by real GDP.

technologies (see chapter II). Up to now, technological progress has been identified as an important driver of the growing gap between productivity and median wages. In developed economies, a technology-driven decline in the price of investment goods has induced firms to substitute capital for labour, thus lowering the labour share.¹⁵

Technological change has also contributed to the rise in wage inequality, as it is a complementary input to the work of highly skilled workers but a substitute to that of low- or medium-skilled workers. The latter may be made redundant or receive relatively lower wages. However, other factors have also played an important role—from increasing trade integration and expansion of global value chains, which has particularly hurt some lower-skilled workers in developed countries, to losses in the bargaining position of workers, owing to declining labour union membership and a shift towards more non-standard employment.

3.3 Gender equity

Wage inequality also continues to be an important aspect of gender inequality. Globally, the gender pay gap—which measures the percentage difference in pay between men and women—is estimated at about 20 per cent, with important differences across country groups.¹⁶ In developed countries, the gap is generally more pronounced at the upper end of the income distribution, as effective minimum wage policies reduce the gap at the lower end. In developing countries where a large share of female employment is in the informal sector, the gap is larger at the bottom. These differences in pay for the same work are further exacerbated by opportunity gaps, with women often encountering challenges to move to more senior roles.

As highlighted by several recent reports, the world is not on track to achieve the gender goals of the Addis Ababa Action Agenda and the 2030 Agenda

for Sustainable Development, and overall progress in reducing gender gaps has been slowing.¹⁷ While women have been catching up in basic capabilities—through access to education, voting rights, and the removal of legal barriers—progress has been much slower when it comes to more enhanced capabilities that involve greater power and responsibility as well as political and economic leadership.¹⁸ Women account for about 60 per cent of contributing family workers worldwide (generally not receiving monetary compensation). COVID-19 may further impact gender equity—for example, through mass school closures that lead to additional childcare work, and other unpaid care work that is still predominantly carried out by women.¹⁹ Women make up only a very small part of the highest-paying jobs,²⁰ and only about 18 per cent of firms worldwide are led by women.²¹

Eliminating gender inequalities requires a wide range of policy measures, in both developed and developing countries. In many countries, there is still room for further legal reforms, as well as increased transparency, financial incentives (e.g., linked to cash transfer programmes) and programmes aimed at changing women’s and men’s attitudes.²² Trade unions, together with Governments, business, and employers’ organizations can take a number of actions to tackle gender pay gaps—such as mainstreaming the principle of equal remuneration, awareness-raising, and targeted action, in addition to increased representation of women in decision-making bodies.²³

4. Policies for sustainable development

Policymakers need to mitigate the short-term risks of COVID-19, without losing sight of medium- and long-term structural issues. This will require

an immediate, concerted, global response to the crisis (see box I.1), along with a balanced policy mix for the medium term that draws on the full toolkit of economic policies.

Short-term actions also affect medium-term outcomes, so it is important that any crisis response take into account longer-term impacts and be aligned with sustainable development. Task Force members have called for fiscal policy to play a more proactive role in supporting demand, particularly in countries where fiscal space exists. Macroprudential policies will also be important, especially in countries with high financial vulnerabilities. Capital flow management can help countries with large balance sheet mismatches mitigate the impact of capital flow volatility (see chapter III.F). In addition, strengthened social protection systems, improved risk management (see chapter III.C) and structural and regulatory reforms can support medium- to long-term growth prospects—taking into account the growing importance of the digital economy (see chapter II).

In many developing countries (outside East Asia), high levels of debt and ongoing fiscal pressures limit the room for countercyclical policy measures. However, fewer countries have been tightening fiscal stances in the past

two years (figure 11) and the imperative of the current economic and public health crisis caused by COVID-19 requires significant and widespread short-term fiscal easing. The experience after the 2009 fiscal stimuli is a lesson for a more measured pace and content of fiscal adjustment after the COVID-19 crisis eases. Fiscal expenditures and revenues have an important role to play in the structural transformation of developing countries. Sustainable development requires prioritizing public investment in sustainable and resilient infrastructure, enhancing redistributive policies, and strengthening social welfare systems. Public investment, along with incentives for private investment, will also be needed to help counteract the fall in investment due to COVID-19. These should be aligned with sustainable development.

Integrated national financing frameworks can help national policy planning by supporting resource mobilization and allocation within the context of an enabling international environment. Rapid technological innovation creates new opportunities for both domestic and international finance to support the achievement of the SDGs. Public policies can contribute to harnessing these opportunities, while mitigating risks, as discussed in chapter II.

Figure I.11
Fiscal policy stances
(Number of countries)



Source: IMF, World Economic Outlook Database October 2019.

Note: Small easing/tightening is defined as a change in the structural fiscal balance of less than 0.5 per cent of GDP. Large easing/tightening is greater than 0.5 per cent of GDP.

Endnotes

- 1 *World Economic Situation and Prospects 2020*, p. viii. The 2.3 per cent growth in 2019 is based on at-market exchange rates. When adjusted for purchasing power parity (PPP), global output is estimated to have risen by 2.9 per cent. These figures are broadly in line with the estimates by other Task Force members. The *Global Economic Prospects reports* global growth of 2.4 per cent based on at-market exchange rates, and the “World Economic Outlook Update”, which uses PPP, reports 2.9 per cent.
- 2 *Global Financial Stability Report: Lower for Longer* (Washington, D.C., IMF, 2019), p. 6.

- 3 Ibid.
- 4 Munich Re, NatCatSERVICE analysis tool. Available at <https://www.munichre.com/en/solutions/for-industry-clients/natcatservice.html>.
- 5 Munich Re, “Tropical cyclones cause highest losses: Natural disasters of 2019 in figures.” Available at <https://www.munichre.com/topics-online/en/climate-change-and-natural-disasters/natural-disasters/natural-disasters-of-2019-in-figures-tropical-cyclones-cause-highest-losses.html>.
- 6 UNDRR, “Global Assessment Report on Disaster Risk Reduction” (Geneva: UNDRR, May 2019), p. 251. Available at <https://gar.undrr.org/report-2019>.
- 7 Network for Greening the Financial System, “First comprehensive report: A call for action,” (April 2019). Available at <https://www.ngfs.net/en/first-comprehensive-report-call-action>.
- 8 Willem H. Buiter, “When central banks go green.” Available at <https://www.project-syndicate.org/commentary/central-banks-go-green-by-willem-buiter-1-2020-01>.
- 9 BIS, “BIS launches green bond fund for central banks.” Available at <https://www.bis.org/press/p190926.htm>.
- 10 The term “capital deepening” refers to an increase in the proportion of capital to labour. It is often measured by the rate of increase in capital stock per labour hours worked.
- 11 Gustavo Adler and others, “Gone with the Headwinds: Global Productivity”, IMF Staff Discussion Note 17/04 (April 2017); and *Global Economic Prospects: Slow Growth, Policy Challenges*.
- 12 Dan Andrews, Chiara Criscuolo and Peter N. Gal, “Frontier Firms, Technology Diffusion and Public Policy: Micro Evidence from OECD Countries”, *The Future of Productivity: Main Background Papers*, (Paris, OECD, 2015).
- 13 OECD Economic Outlook 2018, Issue 2, Chapter 2: *Decoupling of Wages from Productivity: What Implications for Public Policies?* (Paris, OECD, 2018) shows that while there are large cross-country-differences, such a decoupling occurred in two thirds of the 24 countries examined.
- 14 Loukas Karabarbounis and Brent Neiman, “The Global Decline of the Labor Share”, *The Quarterly Journal of Economics*, Volume 129, Issue 1 (February 2014), pp. 61–103; and *World Employment and Social Outlook: Trends 2020* (Geneva, International Labour Organization, 2020).
- 15 A decline in relative investment prices will only reduce the labour share if the elasticity of substitution between capital and labour is greater than 1. Recent empirical evidence suggests that this has generally been the case for developed economies in recent decades, but not for developing economies.
- 16 *Global Wage Report 2018/19: What Lies Behind Gender Pay Gaps* (Geneva, International Labour Organization, 2018).
- 17 *Global Wage Report 2018/19: What Lies Behind Gender Pay Gaps; Human Development Report 2019: Inequalities in Human Development in the 21st Century* (UNDP, United Nations publication, Sales No. E.20.III.B.1); *Global Gender Gap Report 2020* (Geneva, World Economic Forum, 2019); and *World Social Report 2020: Inequality in a rapidly changing world* (United Nations publication, Sales No. E.20.IV.1).
- 18 *Human Development Report 2019: Inequalities in Human Development in the 21st Century*.
- 19 Rosamond Hutt, “The coronavirus fallout may be worse for women than men. Here’s why” World Economic Forum, (March 2020). Available at <https://www.weforum.org/agenda/2020/03/the-coronavirus-fallout-may-be-worse-for-women-than-men-heres-why/>
- 20 In many developing countries, a large share of female employment is in the informal sector.
- 21 *Global Gender Gap Report 2020*.
- 22 Seema Jayachandran, “The Roots of Gender Inequality in Developing Countries”, *Annual Review of Economics*, Vol. 7:63-88 (August 2015).
- 23 Jill Rubery and Mathew Johnson, “Closing the Gender Pay Gap: What Role for Trade Unions?”, ILO ACTRAV Working Paper (April 2019).