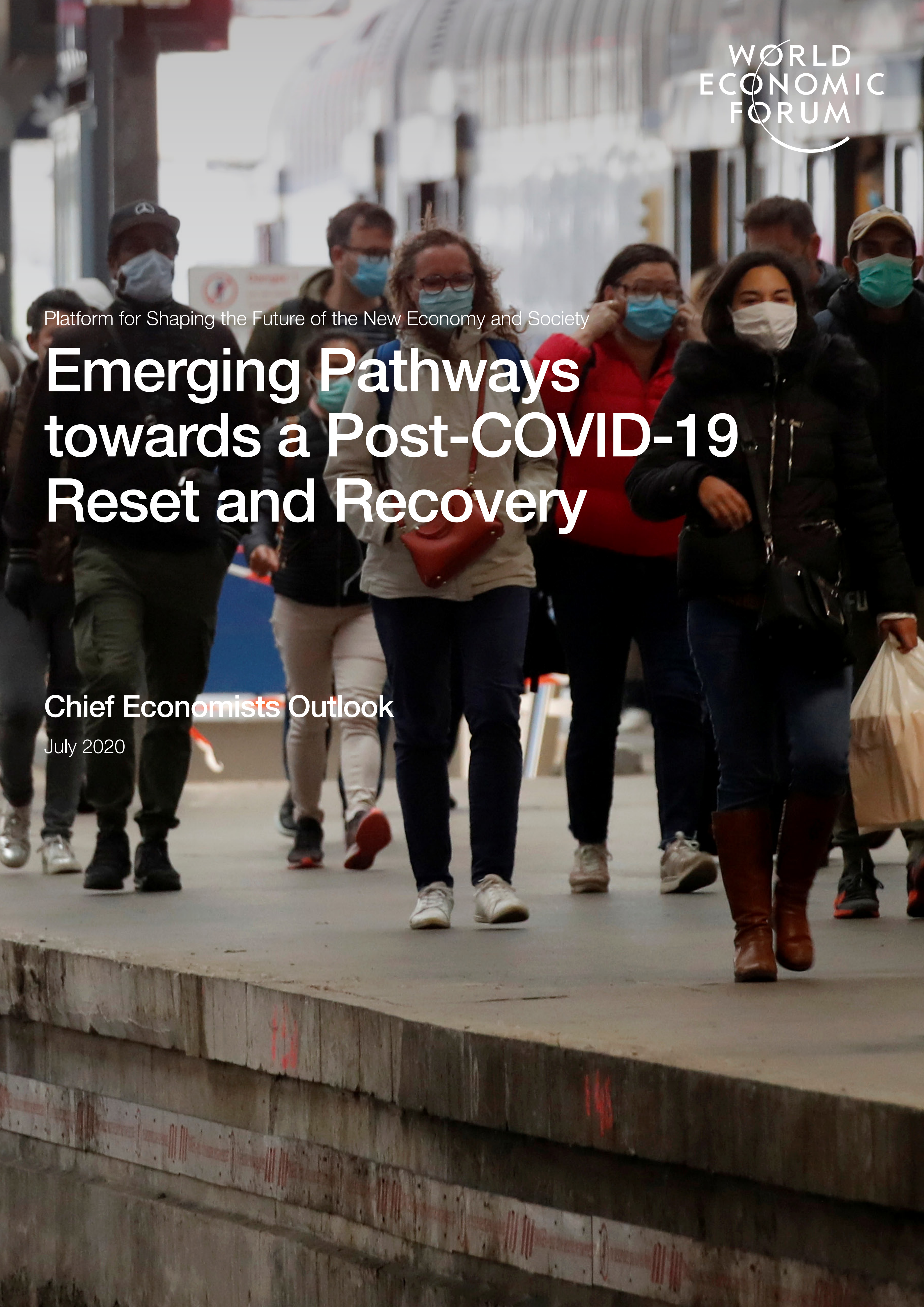


Platform for Shaping the Future of the New Economy and Society

Emerging Pathways towards a Post-COVID-19 Reset and Recovery

Chief Economists Outlook

July 2020

Emerging Pathways towards a Post-COVID-19 Reset and Recovery

Chief Economists Outlook

This briefing is part of the series of the World Economic Forum's Chief Economist Outlooks and builds on the latest economic policy research as well as regular consultations with a growing community of close to 40 leading chief economists from both the public and private sectors, organized by the World Economic Forum's Platform for Shaping the Future of the New Economy and Society.

It aims to summarize the emerging contours of the current global economic environment and to identify priorities for further action by policy-makers and business leaders in response to the economic crisis triggered by the COVID-19 pandemic.

Contents

Global context

The COVID-19 crisis and the political, economic and social disruptions it has caused have exposed the inadequacies of our current economic systems. Amid global concern for lives, livelihoods and the planet, leaders find themselves at a historic crossroads for shaping the recovery, and have a window of opportunity to reset economies on a new trajectory of more inclusive and sustainable growth.

The first phase of the economic policy response to the crisis was marked by speed and relative consensus, despite lack of coordination. There was broad agreement that initial monetary and fiscal measures were well-calibrated in terms of size and speed; and that the single most effective government intervention would be to boost the capacity of the healthcare sector, most importantly for testing, tracking and tracing, and to provide direct support to businesses and households. In addition, when low- and middle-income countries were hit particularly hard by compounding financial, health and economic crises, international consensus on the need for debt moratoria and debt relief formed quickly, which now need to be implemented.

However, as economies enter the rebuilding phase amid ongoing uncertainty about the spread of the virus, policy options are becoming more diffuse. Following a brief review of the most recent developments, this edition of the World Economic Forum *Chief Economists Outlook* sets out a high-level agenda for a path forward on three key emerging challenges: retooling economic policy to reduce inequality and improve social mobility; identifying new sources of economic growth; and aligning on new targets for economic performance.

As the contours of the global economic environment evolve, upcoming editions of the *Chief Economists Outlook* will continue to explore forward-looking topics, including an in-depth look at the themes covered in this publication.

Post-COVID-19 economic outlook: What we know so far

Uncertainty about the future trajectory of the global economy continues to be high as the spread of the virus and the effect of containment measures remain challenging to predict. The crisis compounds volatility from trade tensions and lower international cooperation which marked 2019. The most recent forecasts by the International Monetary Fund (IMF)[1] and the European Commission[2] revised significantly downward their initial projections for 2020 growth made during the first quarter of the year.

Available data on the impact of the pandemic show dramatic collapses in output, most pronounced in services sectors, and in some cases bigger in magnitude than the economic contraction at the time of the Great Depression. Output dropped by as much as 20%-30% during lockdowns in some OECD countries.[3] The ILO estimates that the global drop in hours worked between the last quarter of 2019 and the first quarter of 2020 adds up to 130 million full-time jobs; the loss is projected to be equivalent to 305 million full-time jobs for the second quarter of 2020.[4]

Both the health and economic impact of the pandemic have been very uneven across different populations, often reinforcing historical patterns of disadvantage. The crisis has been disproportionately more severe for women as well as low- and middle-income households.[5]

Impact in the US has also been shown to vary significantly by ethnicity; for example, small businesses with Black, Asian or Hispanic owners have suffered disproportionately.[6] For low- and middle-income earners in the US, the crisis comes at the tail-end of 10 years of wage and wealth stagnation following the 2008 financial crisis, which started with a collapse of the US mortgage market. It wiped out housing wealth for many and the slow recovery that followed left no margin to rebuild savings, leaving households with no reserves when the COVID crisis hit.[7]

Early signs of a global recovery have become discernible in high-frequency data, such as measures of mobility, as well as retail sales and business sentiment measures (Purchasing Managers Indices or PMIs).[8] Indicators even point to consumer behaviour returning to pre-crisis trends in some countries; for example, OpenTable bookings in Germany are back to pre-pandemic times. US jobs numbers are also starting to improve, albeit very slowly. With uncertainty remaining high, it is still too early to tell whether these are the beginnings of a real recovery or only an initial reaction to re-openings, which may yet cause the virus to spiral further out of control.

1 IMF, 2020
2 European Commission, 2020
3 OECD, 2020
4 ILO, 2020
5 IMF, 2020, Brussevic et al., 2020
6 JP Morgan Chase Institute, 2020
7 Serwer, 2020
8 Citi, 2020

There is a stark contrast between the measured real economy impact of the pandemic and US equity market expectations for the medium-term outlook. The optimism of financial markets seems to be based on extrapolations on early partial recoveries in retail sales and industrial production. These have indeed been steep, but they remain far below past levels.

Investors may also feel they can continue to rely on central banks to continue supplying markets with near-unlimited liquidity. Markets further seem to assume that the health crisis will be contained in 2020, warranting solid earnings forecasts for 2021. However, this reasoning may fall short if earnings are secured by reductions in workforces and investments, which, at the macro level, could add up to a significant deterioration in unemployment, innovation and consumer spending in 2021.[9]

For this Outlook, we asked the World Economic Forum's Community of Chief Economists two sets of questions, one focused on the current economic outlook and another on the policy options available (see Box 1 for questions). Possible answers were on the scale of strongly disagree – disagree – uncertain – agree – strongly agree.

Box 1: Questions put to the Chief Economists for this report

Assessment of the current outlook:

1. Current unemployment figures are more informative about the medium-term outlook for the global economy than financial market valuations.
2. In my country/region, efforts to expand social safety nets have been sufficient to offset the deterioration of labour market conditions accelerated by the crisis.
3. The ESG agenda will emerge strengthened from the crisis despite the current contraction in resources.
4. The drive for greater resilience in supply chains will lead to a reversal in international economic convergence.
5. The pace of innovation will be negatively affected by contractions in public and private R&D budgets.
6. The crisis is causing a reversion to a narrow focus by policy-makers on GDP growth recovery over broader well-being targets.

Policy options:

1. The depth of the economic transformation needed will require reform and institution building on a post-WWII scale.
2. Tax architectures will need to be adapted in order to address distributional dynamics accelerated by the crisis.
3. Unconditional basic benefits should remain part of the social policy toolkit beyond the crisis.
4. Government support should protect all jobs, rather than taking sides on structural change.
5. Government direction for innovation will be critical in creating the new growth markets of the future.
6. A dashboard of internationally agreed income, wealth and inequality metrics is needed to widen policy-makers' focus beyond GDP growth as a core policy objective.

[9] Citi, 2020

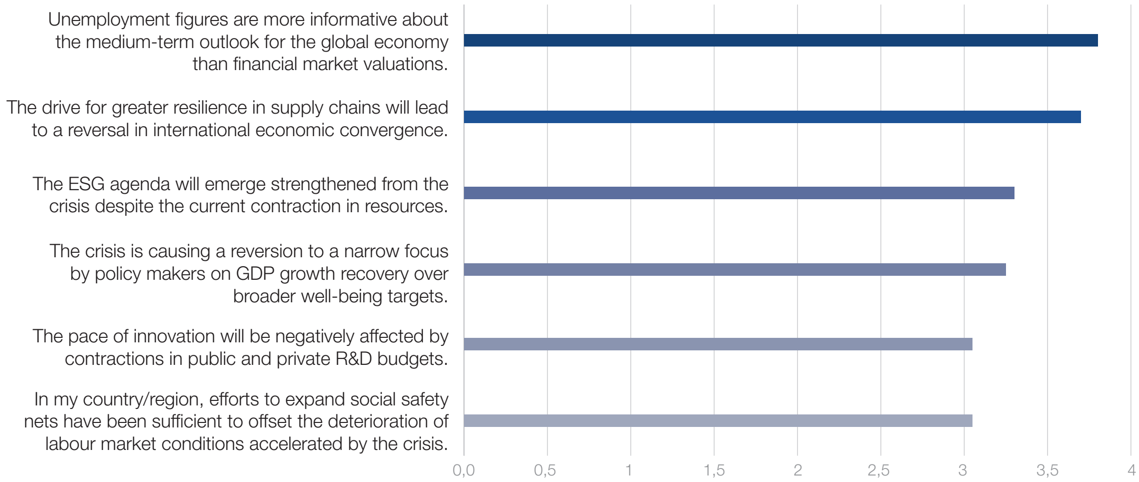
In terms of the current economic outlook, most respondents see today's unemployment figures as more informative about the medium-term outlook for the global economy than current financial market valuations (see Figure 1). However, respondents also found the safety nets made available to workers to be relatively sufficient at present to offset the deterioration in the labour market.

Respondents confirmed a fairly high likelihood of transformations in supply chains to lead to a reversal in international economic convergence and obligate developing economies and emerging markets to reconsider their growth models. This was complemented by concern for a contraction of public and private R&D budgets further hampering the innovation needed to foster future growth.

Finally, there was a mixed picture when it comes to non-financial measures of micro and macro metrics for success. The ESG agenda is more likely than not to emerge strengthened from the crisis in the opinion of respondents, yet policy making currently runs the risk of focusing too narrowly on GDP recovery targets, with some room for a broader focus on the quality and direction of growth.

Figure 1

Average Score: 1 = strongly disagree, 2 = disagree, 3 = uncertain, 4 = agree, 5 = strongly agree



Post-COVID-19 economic outlook: Three emerging challenges

The results of the survey and the deliberations among the Chief Economists Community point to three key emerging challenges faced by governments and business leaders as economies begin to enter the recovery phase.

1. Retooling economic policy to reduce inequality and improve social mobility
2. Identifying new sources of economic growth
3. Aligning on new targets for economic performance

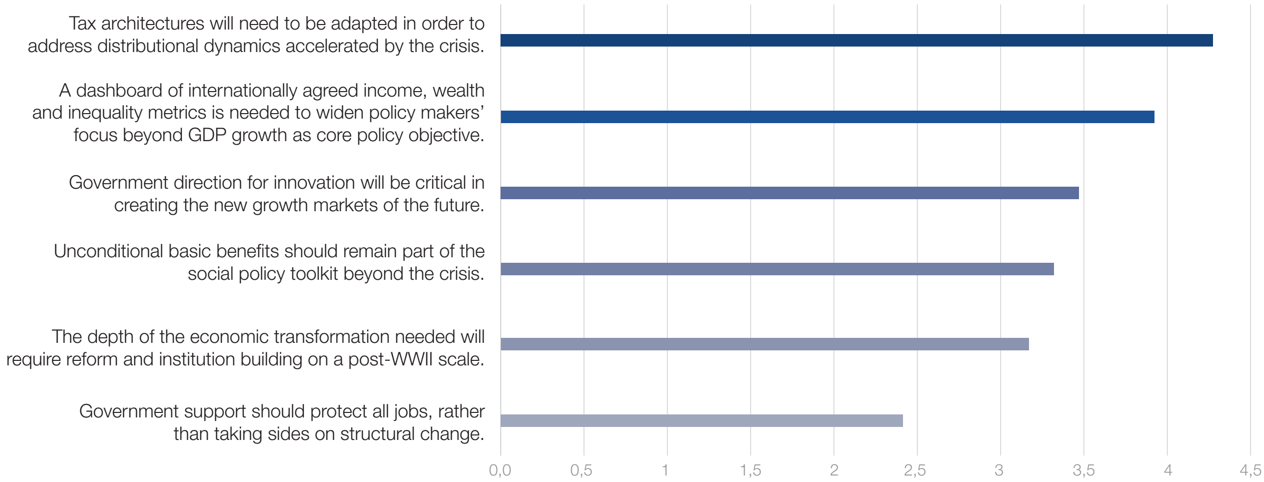
However, in line with current levels of global uncertainty, we found limited consensus on the order of magnitude of reforms needed. Responses to the Chief Economists Survey range from agreement that the necessary economic transformation will require reform and institution building on a post-Second World War scale to more cautious perspectives (Figure 2). The question of the scale of these challenges and the responses to them warrants further exploration in subsequent editions of the Outlook.

Respondents were in strong agreement that the inequality dynamics which the crisis has accelerated need to be urgently addressed through an adaptation of tax architectures. They should also be more systematically monitored by governments along with other targets, such as evolutions in natural, social and other types of capital. A slight majority of respondents also felt that some form of unconditional basic benefits should remain part of the social policy toolkit beyond the crisis, however, there was no consensus.

When it comes to identifying new sources of growth, views were sharply divided over the role of governments in the innovation process. There were voices both strongly in favour of governments proactively setting a direction for innovation and strongly against. For the process of structural change within economies, most respondents felt that government support in this current phase of the crisis should be targeted more towards the growth sectors of the future rather than protecting all jobs.

Figure 2

Average Score: 1 = strongly disagree, 2 = disagree, 3 = uncertain, 4 = agree, 5 = strongly agree



1. Retooling economic policy to reduce inequality and improve social mobility

Inequality has been accelerating in recent years, in part as technological change has driven a wedge between high- and low-skilled workers and given rise to network effects that have unleashed winner-take-all dynamics across a number of industries.[10] In the case of high-income economies, the broad adoption of digital technologies has compounded country-level inequality patterns shaped by the forces of global integration.

The hiatus imposed by the pandemic provides a unique moment to introduce far-reaching systemic change that will stop inequality from spiralling further out of control and focus on measures that will enhance social mobility. In the wake of the crisis, which has fallen squarely on the shoulders of the most vulnerable, how the future burden is shared will be critical. Equally important will be an upgrade of social protection measures to provide broader safeguards for future shocks and provide support to developing socio-economic mobility in the new economy.

Transforming tax architectures

Government interventions to keep firms and households afloat and stimulate demand during the recovery phase will likely push debt-to-GDP ratios to over 120% on average for advanced economies, according to the IMF. In the case of the US, the debt-to-GDP ratio is on track to surpass that accumulated by the end of the Second World War.[11]

Governments will need to make complex choices on how these debts will be paid off and by whom, keeping in mind that the impact of the crisis has been deeply uneven. A compounding factor of the crisis is that it is accelerating the inequality dynamics that were already at work, including the polarization of labour markets, as the prospect of any future

[10] Brynjolfsson and McAfee, 2014
[11] Tooze, 2020

workforce disruptions, such as those caused by the pandemic, is making automation ever more attractive.[12] At the industry level, the gulf between market capitalizations of technology companies and the rest of the economy is also expected to grow.

Getting the burden-sharing right is a daunting challenge, yet it also presents a tremendous opportunity for governments to regain the trust of citizens, the majority of whom have seen their chances of advancing economically dwindle for many years.[13]

The Chief Economists Community is in strong agreement that tax architectures will need to be adapted in order to address the distributional dynamics accelerated by the crisis (see Figure 2).

An active debate on international tax architectures was ongoing before the crisis, with governments working under the OECD's Base Erosion and Profit Shifting (BEPS) initiative to find more effective ways to shut down tax evasion. Debate is also ongoing on how to fairly tax activity generated in the digital economy. The acceleration in global inequality had further brought tax instruments, such as wealth taxes and higher marginal income taxes, back into the public discourse.

As pointed out by one expert, "a world in which coronavirus debts are repaid by a wealth tax or a global crackdown on corporate tax havens would look very different from one in which benefits are slashed and VAT is raised." The expert also cautioned that governments may be tempted to service debts with money that would have otherwise gone to education or pensions.[14]

Supporting labour market transitions and social protection

The COVID-19 crisis descended on labour markets at a time when conditions for workers were already under strain from automation and the number of jobs without permanent contracts and benefits was growing. The outlook is challenging: with every recession in the last 30 years, more jobs involving routine tasks have disappeared without being replaced when economic activity returned.[15] A pandemic that shines a spotlight on the vulnerability of human labour can be expected to exacerbate this dynamic.

As the pandemic made high risk any task that requires physical presence, only essential workers in such roles and those able to work remotely continued working. The impact on unemployment has varied widely across countries. Many European governments, including Germany, Denmark, Italy and the United Kingdom, offered support for reduced-hours working schemes with the aim to preserve ties between firms and workers. As a consequence, unemployment in Europe stayed relatively low.[16]

For others without long-term contracts, some governments extended coverage of social safety nets. In other countries, such as the US and India, the number of jobless claims skyrocketed. Yet, even in European countries that put in place strong job protection measures, an increase in unemployment is expected as many of the schemes are due to run out over the course of the summer. Young people will be particularly at risk since they are more frequently employed on short-term contracts.

[12] Frey, 2020
[13] Spence and Brady, 2020
[14] Tooze, 2020
[15] Jaimovich and Siu, 2012
[16] OECD, 2020

The new momentum stemming from fresh thinking and determined policy action during the emergency response stage must now be leveraged for more permanent reform of labour policy and social protection systems. With a view to longer-term developments in labour markets, policy attention needs to shift from jobs alone to consider the full evolution of working lives today, including transitions between employers, continuous retraining, upskilling and life-long learning, as well as support during periods of inactivity.[17]

A far-sighted upgrade of social protection fit for 21st-century structures would also recognize the extent to which horizontal support systems in the form of community-based networks can play an important role for workers.[18]

One policy tool that has been piloted successfully in several contexts is Universal Basic Income or other forms of unconditional cash transfers. A slight majority of respondents to the Chief Economists Survey feels that some form of unconditional basic benefits should remain part of the social policy toolkit beyond the crisis, but views are far from consensus.

2. Identifying new sources of economic growth

The COVID-19 crisis is expected to heavily impact two important drivers of inclusive long-term economic progress: innovation and global integration.

The economic contraction cannot be expected to spare resources allocated to R&D, despite the fact that innovation has never been more critical than at this current juncture to manage climate change and expand opportunity for all. Inclusive and sustainable growth powered by lower resource use will be necessary to pay down unprecedented public and private debt burdens.

The crisis could also result in long-term damage to trading ties between high- and low-income countries, as multinational companies repatriate parts of their value chain and trade finance becomes harder to access for countries with weaker institutions. Both threaten international integration, an important channel of economic convergence between high- and low-income countries.

Co-creating new frontier markets

If economic recovery defaults to a reboot of pre-COVID-19 activities, societies will have missed an important window of opportunity to transition to a more inclusive and greener growth path. As economic policy interventions are transitioning from economic life-support measures to the stimulus phase, governments have a unique opportunity to influence the direction of economic progress through far-reaching innovation and investment strategies.

The ambition will have to be a deep transformation across all sectors of the economy, a feat that will only be possible if public and private actors work in unison. In this endeavour, the role of governments will need to go beyond the traditional remit of government intervention – fixing market failures – and instead entail an active involvement in reshaping existing sectors and co-creating new markets both as regulators and investors.[19]

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[17] World Economic Forum, 2019
[18] Cottam, 2018
[19] Mazzucato and McPherson, 2019

These new frontier markets include a range from green energy, ecotourism and the circular economy, to health, education, training and the care economy. These are all areas where the use of technology and market forces could have a transformative impact on economies and societies through multiplier effects on employment, social capital and environmental returns; yet, some of the necessary preconditions for these markets to function are lacking.

While traditional government interventions, such as taxing negative externalities and subsidizing positive externalities, will always remain part of the policy toolkit, an ecosystem-level approach would further involve providing a long-term direction for innovation through the definition of societal missions, investing in proofs of concept for new technologies, the strategic use of procurement and innovation prizes, as well as risk-sharing instruments such as loan guarantees and grants to crowd in private investment.[20]

Governments have de facto played a more active role in innovation than they are often credited with, for example in laying the foundations of today's IT industry;[21] yet, they have so far mostly stopped short of providing an explicit direction for innovation. Views of the Chief Economists Community are sharply divided on whether governments should be doing so in the post-COVID era, with votes of both strong agreement and strong disagreement on this question.

Finding new paths for economic development and global convergence

Globalization has been among the most important drivers of international income convergence in recent decades. Yet, when the COVID-19 crisis hit, international trade relations were already strained due to a series of policy shocks, including US-China trade disputes and tensions over technology standards.

A longer-term structural trend that has been evolving alongside is the dwindling comparative advantage of low-wage countries in global value chains.[22] As routine tasks could increasingly be automated, it became cheaper to repatriate them to headquarter countries.[23] These developments have been putting severe pressure on the growth model that had proven successful for South-East Asia.

Some low- and middle-income countries have made strides in establishing a digital sector and have leapfrogged high-income countries on applications such as mobile payments; yet, these successes are not yet far-reaching enough to serve as the foundation of a new long-term growth model. In addition, arms-length trade with low- and middle-income countries has been affected by lower trust in cross-border finance since the global financial crisis, in particular for countries with weak institutions. This reduced access to trade finance, in turn, has tilted the playing field in favour of multinational companies at the expense of smaller, national players.[24]

20 Mazzucato, 2013
21 Mazzucato and McPherson, 2019
22 World Bank, 2017
23 Baldwin, 2019
24 Crozet, Demir and Javorcik, 2019

While the sharp drops in physical goods trade due to lockdown measures may be temporary, the COVID-19 crisis could accelerate two structural trends, one of which would hurt international convergence further, while the other could support it.

The first is related to the call for greater resilience in supply chains as governments realized how geographically concentrated suppliers for critical parts and inputs have been. A move towards greater self-sufficiency or parallel supply chains would imply a reduction in capacity for the countries that currently host them. It remains to be seen whether businesses will indeed be ready to give up efficiency in favour of greater resilience.[25] The trade-off may eventually tilt in favour of resilience as uncertainty about the pandemic, geopolitical tensions or climate-change-related events may cause more supply-chain disruptions.

A silver lining is that firms have now crossed the psychological threshold of large-scale remote work. This could turn into an opportunity for emerging markets to offer competitively priced services based on differences in the wages of skilled workers across countries, offering new opportunities for imagining a new future economic development model, one that also entails higher investment in human capital.[26]

The majority of survey respondents felt that the drive for greater resilience in supply chains is indeed likely to lead to a reversal in international economic convergence.

3. Aligning on new targets for economic performance

The severity of the crisis has forced a pause to refocus minds on what is truly of value. As public- and private-sector leaders are tasked with charting a transition to a greener, more inclusive economic system, a consistent set of targets will be critical to creating accountability and assessing progress for both governments and firms.

Efforts to identify relevant business metrics of environmental, social and governance performance (ESG) as well as frameworks to assess multiple dimensions of well-being beyond GDP have proliferated in recent years. There is a need to embed new measures of business performance, to align on new measures of aggregate economic performance, and to align micro and macro frameworks for greater impact.

Embedding stakeholder capitalism in business

Every company will have to play a role in the transition, embedding the ambition of greener and more inclusive growth in their business model, governance and everyday decision-making. This will require the wide adoption of a well-defined, holistic view of firm performance and impact.[27]

Recent experience suggests that companies that have consistently applied the principles of stakeholder capitalism during the crisis – paying attention to the well-being of their employees, suppliers and customers to the same degree as considering the immediate interests of their shareholders – have weathered the crisis better than others.

25 Javorcik, 2020
26 Baldwin, 2019
27 World Economic Forum, 2020

This is a positive reinforcement of the 2019 Business Roundtable Declaration, which reaffirmed the importance of the principles of stakeholder capitalism, first formulated by Klaus Schwab in 1973. Beyond the crisis horizon, more evidence is emerging that companies that follow more narrowly defined ESG standards, on average, outperform the market.[28]

Yet, the implementation of ESG standards, which stretches from the implementation of diversity, equity and inclusion strategies to reduction in carbon emissions, is costly in the short-run. There is thus a danger that the contraction in resources will lead to a side-lining of the ESG agenda despite its urgency. Chief Economist Community views on whether the ESG agenda will emerge strengthened from the crisis despite the current contraction in resources are mixed, with views slightly tilting in favour of the continued momentum for the ESG agenda.

Building consensus on a new set of national economic policy targets

Despite extensive efforts to anchor alternative measures of economic performance, GDP growth today remains a core economic policy objective and is still often treated as both a necessary and sufficient marker of success. In the wake of COVID-19, much of the focus has been on trying to predict whether the economic recovery will be V-shaped, U-shaped or L-shaped. Yet, targeting a recovery in GDP growth alone will not be sufficient to advance the holistic economic and societal transformation that is needed at this moment.

There is strong agreement among the survey respondents that a concise set of targets will be an important signpost to track progress and create accountability as societies build towards a new system. In addition to an updated measure of GDP and different dimensions of inequality, a new dashboard of economic performance should contain targets across the main components of national wealth as proxies for resilience as well as a target regarding access to economic opportunity.

In particular, drivers of resilience will need to be better measured in order to give more weight to future outcomes over immediate economic gain. Systematically tracking different dimensions of a broad definition of national wealth, including financial, physical, natural and social capital, will be important. GDP itself will also need to be updated to reflect value creation in the digital economy, value created through unpaid care work as well as value destroyed through certain types of economic activity.

Recent years have seen several extensive and rigorous efforts to identify related metrics and tackle different dimensions of the measurement question.[29] Given the urgency of the current situation, an accelerated international convergence on a dashboard of core targets building on these metrics to steer consistent, forward-looking economic and social policy and business decisions will be critical.

The longer-term rebuild of the post-pandemic economy requires rethinking our policy approaches and targets defining success. Upcoming editions of the World Economic Forum Chief Economist Outlook will revisit these questions in detail.

[28] Hoffman et al., 2020

[29] E.g. Stiglitz, Sen, Fitoussi, 2009, OECD, 2018

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