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FINANCE AND DEVELOPMENT

SEPTEMBER 2020

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Resilience

Healing the Fractures

INTERNATIONAL MONETARY FUND

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RETHINKING GLOBAL RESILIENCE

The pandemic is straining economic and social fault lines: the only remedy is international cooperation

Ian Goldin

An infected passenger flies from Wuhan to Milan, a computer virus invades an internet connection, subprime defaults in the US Midwest trigger a global economic crisis. The super-spreaders of the goods of globalization—airport hubs, fiber-optic cables, global financial centers—are also the super-spreaders of the bads. This is the "butterfly defect" of globalization, the systemic risk endemic to our hyperconnected world, in which small actions in one place can spread rapidly to have global effects.

My book *The Butterfly Defect* shows why globalization creates systemic risks. It also shows why stopping globalization will not stop global threats but rather will amplify them. There is no wall high enough to keep out climate change, pandemics, and other catastrophic risks. But high walls undermine the potential for cooperation required to manage our shared risks. Protectionism reduces investment, trade, tourism, and technological advances, which create jobs and higher incomes, reducing the capacity of countries to build resilience. The solution is in working together to make globalization safe and sustainable, not in working against each other.

Leadership is required to manage the negative dimensions of globalization and harvest the positive, to ensure progress is not overwhelmed by common threats. Resilient systems are only as strong as their weakest links. Stopping the next pandemic, which could be even worse than COVID-19, must be a priority. This requires reinforcing and reforming the World Health Organization (WHO) to give it the governance, staff, and capacity it needs to be the world's rapid-response fighting force on global health.

In recent decades, globalization has led to revolutionary changes that have outstripped the slower evolution of institutions, causing a widening gap between our increasingly complex systems and our methods for managing their risks. As we saw with the financial crisis and now with COVID-19, systemic risks can quickly overwhelm processes that previously appeared robust. While there is no doubting the pandemic threat, the slower-moving but accumulating dangers posed by climate change require equally concerted action.

The pandemic has highlighted our lack of immunity to natural threats, but also created an opportunity to reset our economies. There is no shortage of ideas regarding green stimulus policies, which offer the potential to build back better and accelerate the transition from fossil fuels. Global protests, from climate to race, have demonstrated the appetite for fresh thinking. And COVID-19 has also demonstrated that citizens are prepared to change their behavior when required to do so. All that remains is for governments to act.

Networked solutions needed

COVID-19 has highlighted the pressing need for better global risk management. So too has escalating climate change. As did the financial crisis. Urgent reform is required to tame the butterfly defect of globalization.

These networked threats require changes in all parts of the system. Action must begin with us as individuals changing our behavior—for example by wearing masks and weaning ourselves off fossil fuels. Resilience cannot be delegated to others. It is everyone's responsibility. Firms should value a prudent level of spare working capital as a valuable investment in resilience, not just as excess fat to be trimmed to maximize leverage. Minimizing the amount of capital or spare capacity tied up through just-in-time or lean management systems can undermine resilience. Regulators should note the lessons from the Eyjafjallajökull volcano, the Tohoku tsunami, Hurricanes Katrina to Maria, and now COVID-19—that widespread leanness can multiply into systemic fragility.

Our financial, digital, trade, and other systems are intertwined through complex networks. The intersecting nodes and hubs are concentrated in specific locations, such as global financial centers and major ports and airports. The concentration of logistic or other nodes in one location makes them vulnerable, as does the concentration of key personnel and information in headquarters buildings. Resilience can be enhanced by greater geographic diversification, but its benefits have not yet found their way into competition policy or risk management strategies.

A growing number of shareholders and managers of forward-looking firms have expressed their desire to improve their companies' resilience to systemic shocks. And politicians are similarly keen to improve the resilience of the public sector. Although welcome, this requires deeper analysis, including to determine how much resilience, and to what; firms and governments do not have the financial or other resources to insulate themselves totally from all possible shocks.

Resilience can be improved by decentralization, so that individuals, businesses, and countries are empowered to make their own decisions. The principle of subsidiarity is, however, a complement not a substitute for higher levels of authority. Overarching principles are necessary for risk management, and for global systemic risks. This requires that countries yield some autonomy to supranational institutions. Countries that have assiduously followed the guidelines of the WHO have done best, whether they are relatively poor, such as Vietnam, or richer, such as Canada. Stark differences in the management of COVID-19 have demonstrated the importance of operating at multiple levels to contain risk and that robust international, national, subnational, and local actions are required.

Multilateral institutions should be at the apex of this layered approach. Yet there remains a set of orphan issues with no institutional home. A number of international agencies provide analysis and information on climate change, such as the International Panel on Climate Change. But there is no global institution with decision-making and enforcement power to coordinate responses. There also is no major global organization working on cybercrime, even though a single computer virus, such as WannaCry or NotPetya—whether produced by organized state agencies or lone-wolf individuals—can spread globally and cause billions of dollars of damage within days. This threat, like that of extremist ideologies and the subversion of democracy or vaccination campaigns through fake news, is spread opportunistically through the digital networks of globalization. While these threats transcend national borders, as do the threats posed by climate change, pandemics, and terrorism, current responses are predominantly national (or regional, in the case of the European Union).

Significant progress can still be made using the Pareto principle (which states that 80 percent of consequences come from 20 percent of causes), since a small set of actors can usually resolve a large part of any problem. And those that contribute the greatest share of the problem have the greatest responsibility to resolve it. A small number of countries and companies account for well over two-thirds of carbon emissions. New York state accounts for more carbon emissions than 45 African countries. It also consumes more antibiotics than all these nations combined. As the Oxford Martin Commission for Future Generations report "Now for the Long Term" argues, a C20-C30-C40 partnership of the largest countries, companies, and cities would include enough key players to make a significant difference in addressing climate change. The success of coalitions that emerged to tackle ozone depletion or reverse the tide of HIV/AIDS provides inspiring insight into the ability of coalitions of committed citizens, companies, and countries to make a difference, bolstering the efforts of the United Nations and multilateral institutions.

Global governance in the 21st century

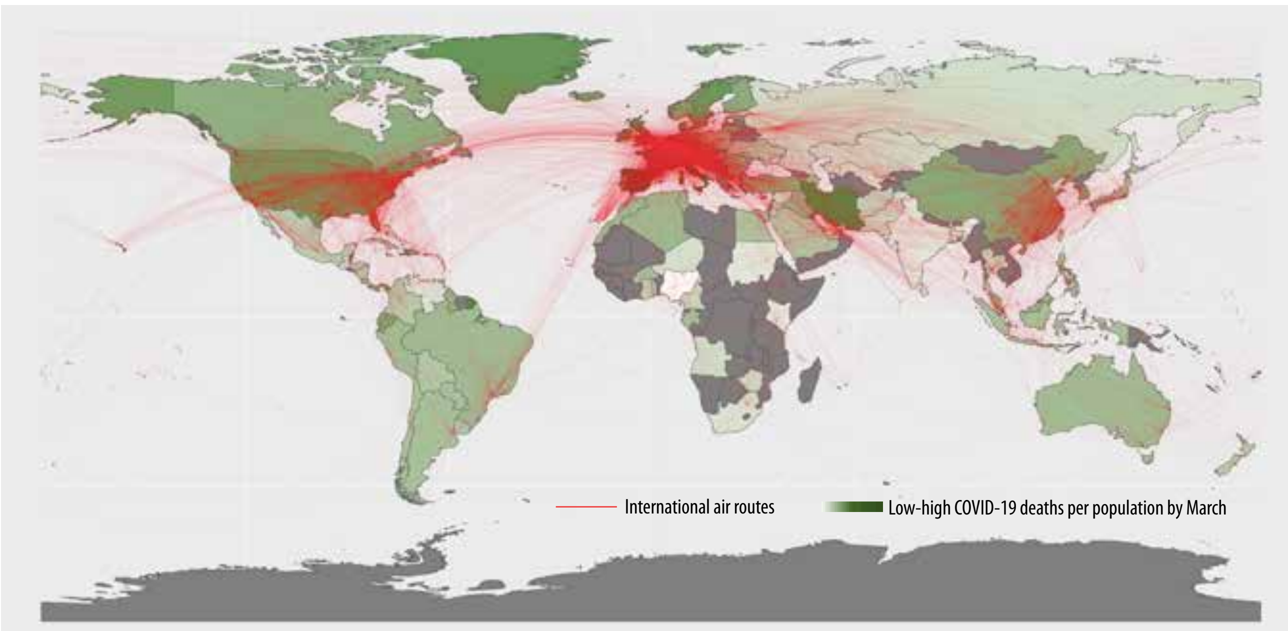
Multilateral institutions can only be as effective as their shareholders allow. In response to the COVID-19 crisis, the IMF has streamlined its processes and provided unprecedented support for its members. But not all institutions have been able to rise to the challenge, and developing economies remain in dire need of additional multilateral support. The WHO should be the world's rapid-response force on global health but has been undermined just when it is needed most. And while global trade could use a shot in the arm, the effectiveness of the World Trade Organization is stymied by trade wars and the blocking of much-needed appointments and reforms.

China-centered institutions are becoming increasingly important, including the Asian Infrastructure Investment Bank and the constellation of bilateral agreements forming the Belt and Road Initiative. Working with these institutions, rather than against them, is essential, as solving global problems requires more firepower and coordination. More diverse personnel also bring greater effectiveness and legitimacy, with broader engagement providing a source of strength rather than anxiety.

In addition to the rise of new powers and the inclusion of more diverse government views, the

Airlines and the Pandemic

The initial spread of the virus was aided by the international flight network.



Sources: Deaths – Our World in Data; Flights – OpenFlights.org.

growing role of private companies needs to be factored into the global architecture. Amazon Web Services and Google Cloud are now systemically important financial infrastructure, while Amazon Marketplace is critical for commerce. Facebook has emerged as a dominant distribution system for public health information, and Alibaba for personal protective equipment; Apple and Google lead Western attempts at app-based contact tracing.

As ever, the next crisis will not conform to our old mental maps; establishing partnerships with those who understand the new landscape is vital to prepare for it. But the private sector is not always benign, and we require independent regulators who are able to control the rising power of superstar firms. A constant renewal of technical expertise is also necessary to ensure that the experience of the financial crisis, when experts and regulators failed to understand credit derivatives, is not repeated with newly emergent threats.

Four meta-horsemen

What are the biggest barriers to reform of global institutions? We can fight pestilence, war, famine, and death—and we have in the past—but to do so we must confront the four meta-horsemen: short-termism, nationalism, cost, and capture. Electorates can prevent governments taking long-term actions and may support protectionist policies, while governments themselves have only limited finances and feel the need to prioritize the urgent issues of the day rather than vitally important looming issues.

COVID-19 shows that where there is a will, all four meta-horsemen can be overcome. Politicians have a limited attention span and focus on the issues of the day, but electorates shaken by COVID-19 will demand long-term solutions. Leaders in the United States, the United Kingdom, Russia, Brazil, and beyond are facing growing criticism over their responses to the pandemic; voters will not forgive governments caught unprepared a second time. Nor will history forgive a generation of leaders who fail to prevent catastrophic climate change. As the inspiring leaders who forged a new world order while fighting World War II taught us, it is possible to focus on both short-term and longer-term challenges simultaneously. The shareholders of global institutions, and of private companies, need to do the same thing.

The next crisis will not conform to our old mental maps; establishing partnerships with those who understand the new landscape is vital to prepare for it.

The COVID-19 health and economic emergencies demonstrate that coordinated global efforts are required. To stop boomerang infections takes international cooperation on vaccines. To overcome chronic shortages of skilled doctors and nurses we need immigrants. And to address climate change, stop future financial crises, and overcome poverty we must harvest the benefits of globalization while resolutely remedying its weaknesses, not least the butterfly defect of systemic risk.

Resources are available in high-income countries—governments and electorates simply need to reorder their priorities. Governments around the world allocate an average 6 percent of their expenditures to the military but less than one one-hundredth of this amount to the prevention of pandemics, despite their much greater threat to the population than war. At the international level, the budget of the WHO is less than that of a single major hospital in the United States. Rapid growth in response to the COVID-19 crisis shows that when the national interest is at stake the resources can be found. These lessons need to be carried forward.

The financial crisis highlighted the risks arising from groupthink and capture of regulatory agencies by lobbies. Ensuring that gamekeepers have the knowledge and independence to keep increasingly agile and well-resourced poachers at bay is essential for resilient systems.

Inertia bedevils institutional reform. Overcoming the capture of organizations by vested interests is vital to ensure that their governance, staff, and activities reflect the needs of the future rather than those of the past. The institutional landscape is littered with well-intentioned reforms that have not been implemented.

Progress is possible, as is evident in the radical changes that many institutions have undertaken. Once a limited technical organization, the European Coal and Steel Community grew into the European Union, which has taken on a wide range of national responsibilities. Crisis can be a catalyst. The United Nations, IMF, World Bank, Marshall Plan, and welfare state were all forged in the fires of World War II. In recent months the IMF has approved a record number of loans in record time, with fewer conditions attached, while its staff was working remotely. National governments have torn up the old rulebooks to provide direct support to workers and firms. What once seemed impossible has been done.

The devastation caused by COVID-19 compels us to redouble our efforts to create a fairer and more inclusive world. This requires that we address the threats that endanger our lives and exacerbate inequality, poverty, and climate change. Building a resilient and sustainable future requires action by all of us, from the individual level up to the global level. International cooperation is vital not only between governments, but through civil society, business, and professional collaboration. The networked problems of our time are amenable to networked solutions. We must use this crisis to build new and stronger bonds, in our communities, in our countries, and globally. FD

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PHOTO: IMF/CORY HANCOCK

Knightmare Uncertainty

In the COVID-19 world, risk has become riskier

Geoffrey Okamoto

THE AMERICAN ECONOMIST Frank Knight theorized about the difference between risk and uncertainty in his classic book *Risk, Uncertainty and Profit*. Risk is "a quantity susceptible of measurement." A precise outcome may not be known, but the probability of a few that are most likely can be calculated. Uncertainty means there is not enough information to even narrow down the possibilities. When a situation is "not susceptible to measurement" economists call it *Knightian uncertainty*.

If this sounds familiar, it is because we are living in the most *unmeasurable* of times. All aspects of life have been disrupted by the simple fact that it is harder to quantify the risk of going to work, shopping for groceries, or having a wedding. Despite necessary optimism, there is great uncertainty about treatments for COVID-19 and a vaccine: when they may be available, how effective they will be, how willing people will be to take them. While it will take years to rebuild the economic devastation and restore jobs and growth, the pandemic will have a lasting impact on how we choose to live our lives. The 1920s economic chaos left many Germans traumatized about inflation to this day; Americans who experienced the Great Depression remained frugal throughout their lives. This pandemic could fundamentally change how we view and manage risk and uncertainty, with lasting consequences on investment decisions, business strategies, government policies, and overall economic productivity.

Individuals may change their risk perceptions permanently after a sharp and sudden loss of income, leading to higher precautionary saving. In the short term, this may mean less debt, but in the long term it could lead to deeper structural changes, such as less willingness to take on a 30-year mortgage. In many countries, home ownership is low because long-term debt is seen more as a risk than an opportunity. Consumption patterns may change if people whose health is at high risk avoid certain activities. Consumers may decide to hold more essential goods in fear of new lockdowns—good news for toilet paper manufacturers, at least! But what about a young woman who has mulled over a transformational business idea night after night at her kitchen table, but whose now-heightened aversion to risk means a business is never started, employees are never hired, and products are never launched? High uncertainty makes it harder still to predict the net impact of so many behavior changes.

Companies also face a new set of uncertainties. US carmakers have experienced parts shortages because the Mexican state of Chihuahua, where many suppliers are based, has limited factory attendance to 50 percent of employees. Such disruptions may lead manufacturers to diversify their supply chains or keep more inventory on hand. Employee health is another new operational risk. Will companies decide to rely more on automation as a result?

Changing suppliers, keeping more inventory, and needing to invest in more advanced machinery all bear costs for manufacturers often operating on thin profit margins. But raising prices in a recession is also difficult. For goods deemed "essential," like medical supplies, countries may change regulations or subsidize domestic production, altering the competitive landscape. Similar to households, companies hit by a sharp drop in revenue may keep higher liquidity buffers. Some changes may be quantifiable once shifts in production stabilize and the impact on earnings becomes clearer, but uncertainty will remain for a long time for many companies.

Market volatility, defaults, and evolving regulation will change the landscape for the **financial sector**. The extreme swings in market conditions and asset prices seen early in the outbreak will change risk management models, with impacts on liquidity and capital buffers held to manage such risks. Regulations may also change, as policymakers seek to prevent a recurrence of the volatility and reduce the need for central bank interventions to preserve market functioning. Moreover, the recession will increase losses.

Economic policymakers are confronted with an intricate new puzzle: how to finance higher spending demands amid falling revenue and ballooning debt. Without a solution to the health crisis, governments will be dealing with unmeasurable variables in trying to plan the future. Private sector interventions through guarantees or direct ownership may have lasting and hard-to-quantify implications for competition and private risk-taking, beyond the immediate impact on public sector balance sheets

What does all this mean for the IMF? We have been called to action like never before, providing emergency support to a record number of countries within a short time frame. We have introduced new support facilities and expanded the borrowing limits on existing ones.

The IMF faces new operational challenges. Many countries have requested financial assistance to weather this storm. Some have challenging debt loads, where sustainability is hard to measure amid elevated uncertainties about growth and trade prospects. And if some countries do need to renegotiate their debts in a post-COVID world, the private sector will have to play a larger role in providing financing assurances to reduce uncertainty, given its increased importance as a creditor. Our members are also asking for policy advice and for help developing the capacity to cope with this severe shock. We must respond while still largely working remotely and unable to travel. Similar operational restrictions have challenged production of one of our key raw materials: timely and accurate country statistics.

In fact, one of our core functions, economic surveillance, has had to reinvent itself. Going back to Knight's concepts, much of our work focuses on measuring and addressing quantifiable risks. We use macroeconomic data to create baseline scenarios and estimate their likelihood. Following the global financial crisis, the approach had already been broadened by developing various scenarios and analyzing their probability so as to better understand the risks around numeric forecasts.

The size and simultaneity of the pandemic shock make for extreme Knightian uncertainty and ever-changing landscapes. We have had to become more agile in that regard. When the infection was still a suspicious pneumonia outbreak in China, we reached out to epidemiologists to learn how to combine their forecasting models with ours. New sources of big data were incorporated to understand consumer behavior changes where traditional statistics fell short. Even before the pandemic, we had started using military-style simulations to study escalating trade tensions. The approach has proved helpful as we attempt to quantify new risk.

Some time ago, I came across an article about how a US epidemiologist teamed up with a German reinsurance company to develop pandemic insurance product. They designed health models and early warning systems, estimated the economic impact for vulnerable industries, and determined how to distribute the risk. The policy became available in late 2018, but potential clients found it too expensive for such an unlikely event. When the catastrophe materialized in early 2020, it was too late to buy insurance.

This cautionary tale shows how much we need to improve risk assessment and management. Manufacturers, for example, must strike a balance in their supply chains between just-in-time (cheaper but inflexible) and just-in-case (more resilient but costlier) methods while factoring in trade, logistics, and sanitary conditions. Going back to the old ways seems reckless; erring too much on the resilience side might decrease the productivity of the economic engines.

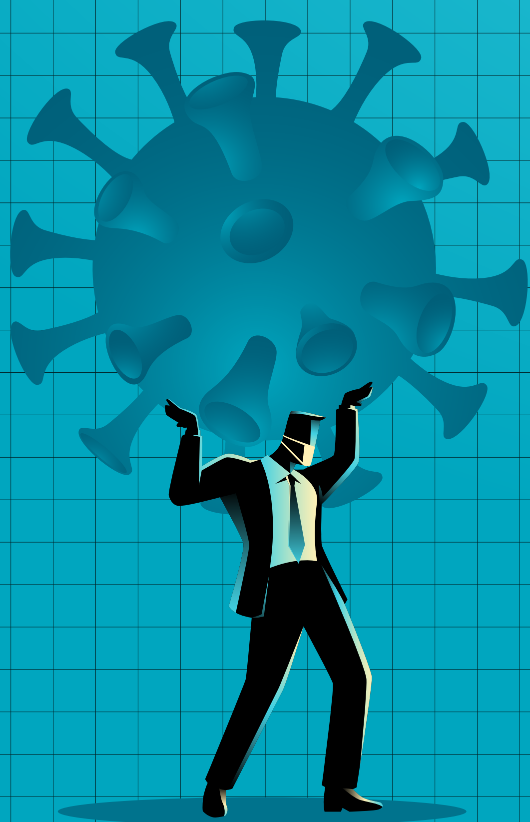
Finding this new equilibrium between risk and resilience when there is so much uncertainty is a challenge we will face far into the future. It will require effort, patience, and innovative thinking. Fundamentally we will need more global cooperation. Everyone will be safe only when each one is safe. Only by working together will we overcome the massive uncertainty and the economic turmoil caused by this mighty microscopic scourge. FD

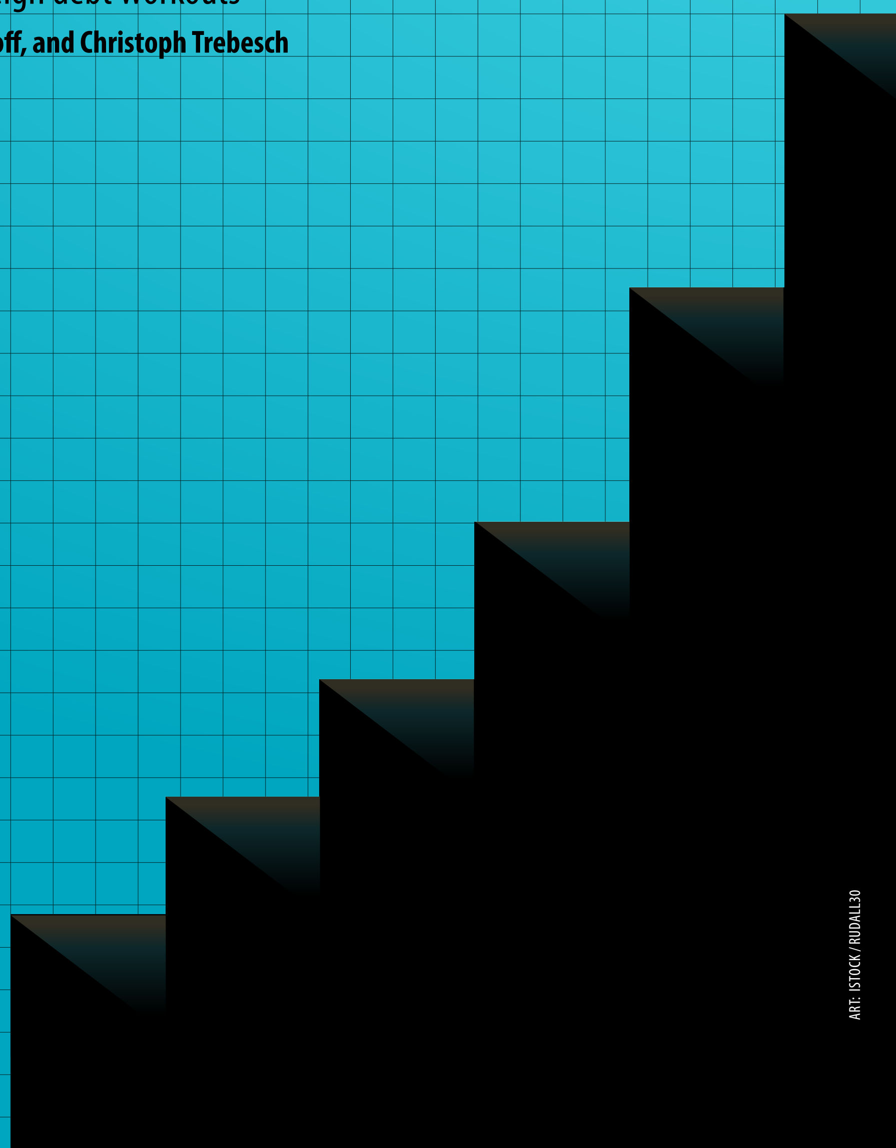
GEOFFREY OKAMOTO is the first deputy managing director of the IMF.

THE DEBT PANDEMIC

New steps are needed to improve sovereign debt workouts

Jeremy Bulow, Carmen Reinhart, Kenneth Rogoff, and Christoph Trebesch





ART: ISTOCK / RUDALL30

The COVID-19 pandemic has greatly lengthened the list of developing and emerging market economies in debt distress. For some, a crisis is imminent. For many more, only exceptionally low global interest rates may be delaying a reckoning. Default rates are rising, and the need for debt restructuring is growing. Yet new challenges may hamper debt workouts unless governments and multilateral lenders provide better tools to navigate a wave of restructuring.

The IMF, the World Bank, and other multilaterals acted quickly to provide much-needed funding amid the pandemic as government revenues collapsed alongside economic activity, while private capital flows came to a sudden stop (see Chart 1). In addition to new loans from multilaterals, Group of Twenty (G20) creditors granted a debt moratorium to the world's poorest countries. They have encouraged private lenders to follow suit—albeit with little success.

So far, the pandemic shock has been limited to the poorest countries and has not morphed into a full-blown middle-income emerging market debt crisis. Thanks in part to favorable global liquidity conditions conferred by massive central bank support in advanced economies, private capital outflows have moderated and many middle-income countries have been able to continue to borrow in global capital markets. According to the IMF, emerging market governments issued $124 billion in hard currency debt during the first six months of 2020, with two-thirds of the borrowing coming in the second quarter.

Yet there are still reasons for concern about sustained emerging market access to capital markets. The riskiest period may still lie ahead. The first wave of the pandemic is not over. Experience from the 1918 influenza pandemic suggests the possibility of an even more severe second wave, especially if it takes until mid-2021 (or later) for an effective vaccine to become widely available. Even in the best-case scenario, international travel will face roadblocks, and uncertainty among consumers and businesses is likely to remain high. World poverty has risen sharply, and many people will not be returning to work when the crisis passes. The political ramifications of the crisis in advanced economies are also still unfolding. The backlash against globalization, already rising before COVID-19, may intensify.

Although many emerging market governments have succeeded in borrowing more in local currencies, businesses have continued to accumulate foreign currency debt. Under severe duress, it's likely that emerging market governments would yield to pressure to bail out their corporate national champions, just as the United States and Europe have done.

On top of the dramatic retreat in private funding, remittances from emerging market citizens working in other countries are expected to drop by more than 20 percent this year. At the same time, borrowing needs have skyrocketed, as emerging market and developing economies contend with the same budgetary stresses as advanced economies. Health systems must be strengthened and support must be provided for citizens whose lives are affected most acutely. Borrowing needs will only rise further as the economic damage mounts.

Rising budget pressures have been accompanied by a new wave of sovereign debt downgrades, surpassing peaks during prior crises (see Chart 2). They have persisted even as major advanced economy central banks have eased credit conditions. Central bank purchases of corporate bonds to provide support for local firms in emerging market and developing economies have also handicapped their debt ratings.

History shows that it is not unusual that countries can keep borrowing even when default risk is high. A review of 89 default episodes from 1827 to 2003 shows the typical experience to be a sharp rise in borrowing, both external and domestic, in the run-up to default (Reinhart and Rogoff 2009). Ideally this time will be different, but the record is not encouraging.

Amid massive and synchronous financing needs across a broad swath of countries, there is brewing in the background a growing need for debt restructurings in numbers not seen since the debt crisis of the 1980s. Official creditors should be prepared to act as needed.

Here they will be impeded by two trends that have been developing independently of the COVID-19 crisis. Call them "preexisting conditions."

First, private creditors are increasingly claiming outsize shares of repayment in debt restructurings. Although theoretically the official sector is a senior creditor to the private sector, much of the historical experience suggests otherwise.

During the 1980s emerging market debt crisis, private creditors were quite successful at pulling out funds as official creditors went in ever deeper (Bulow, Rogoff, and Bevilaqua 1992). Similar developments were at play during the European debt crisis, when investors did take some losses in Greece; a large portion of their funds had been pulled out, with repayments facilitated by large-scale loans by euro area governments (Zettelmeyer, Trebesch, and Gulati 2013). This pattern has recurred over two centuries of private and official lending: when private investors retrench, official lenders often step in (Horn, Reinhart, and Trebesch 2020, cited in Chart 1).

A recent analysis comparing losses (haircuts) taken by official and private creditors raises further doubt about the supposed seniority of official sector loans (Schlegl, Trebesch, and Wright 2019).

These outcomes should not be surprising. After all, governments have a history of protecting domestic creditors who lent abroad (think northern European banks in the case of Greece), and at the same time also care about stability and welfare in the borrowing country. Such altruism, in turn, weakens the official sector's bargaining position—especially vis-à-vis private creditors. Thus, official creditors may be left holding the bag for the bulk of the losses, even when they start with little of the outstanding debt, as in Greece.

A further challenge comes from new **holdout and litigation tactics by private investors** to resist large debt write-downs and restructurings. As the number of restructurings has declined, an increasing share of them have involved lawsuits (see Chart 3, from Schumacher, Trebesch, and Enderlein 2018). While this may not completely explain the private sector's success in maximizing its share in debt restructuring, it is disconcerting.

The second preexisting condition is the length of time debt crises are dragging on. As former Citibank chairman William Rhodes famously said during the debt crisis of the 1980s: "It is easy to get into a debt moratorium. It's tough to get out."

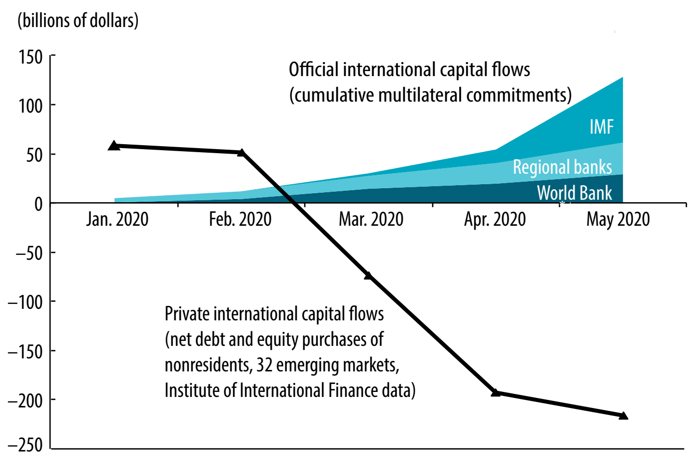
Default episodes have taken, on average, seven years to resolve and typically involve multiple restructurings (see Chart 4). Unfortunately, debt restructurings can become a bargaining game in which the country debtor is often (rightly) willing to exchange higher future debt for lower payments now, fully intending to restructure debt again as necessary. Delay also helps both sides bargain for larger infusions from official creditors (Bulow and Rogoff 1989). And creditors may often be willing to repeatedly renew (or "evergreen") debt in order to temporarily make their balance sheets look better. The COVID-19 crisis could, in the worst case, lead to another "lost decade" in development, with long delays in debt resolution.

What can governments and multilateral lenders do to make sure new funding ends up benefiting the citizens of debtor countries affected by the pandemic rather than lining the pockets of creditors? And how can they make debt restructuring more expedient? Here are three practical ideas:

Chart 1

Multilateral lifeline

Quick funding by multilaterals helped offset a collapse of government revenues and the withdrawal of private capital.



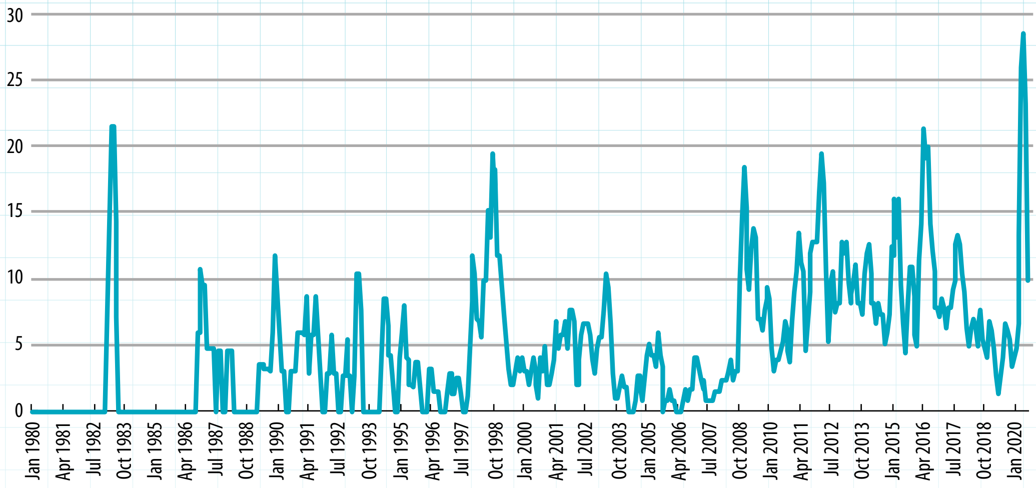
Source: Horn, Sebastian, Carmen M. Reinhart, and Christian Trebesch. 2020. "Coping with Disasters: Two Centuries of International Official Lending," NBER Working Paper 27343, National Bureau of Economic Research, Cambridge, MA.

Chart 2

Sovereign debt downgrades

A surge in rating downgrades in 2020 has surpassed peaks in previous crises.

(three-month sums of share of sovereign downgrades, 1980–2020)



Sources: Fitch; Moody's; Standard and Poor's; and Trading Economics.

- *More transparency on debt data and debt contracts*

It is of utmost importance that the World Bank, the IMF, and the G20 continue to insist on strengthening the transparency of debt statistics.

A new and significant complication in assessing the external indebtedness of many developing economies involves China, which has become the largest bilateral creditor in recent years. Unfortunately, China's lending is often shrouded in nondisclosure clauses, and a full picture is still elusive. More granular data on private sector creditor exposure may facilitate, in case of debt distress, more expedient creditor-debtor negotiations and allow both creditors and governments to identify which bonds are at risk of holdout or litigation tactics. An encompassing transparency initiative would include, for instance, full disclosure on sovereign bond ownership as well as credit default swaps that shift lender composition overnight. Knowing the players involved and the amounts owed would allow the international community and the citizenry of affected countries to better monitor how scarce resources in a time of crisis are being deployed. The accounts for the country itself must become more comprehensive, with improved data on domestic debt and debt owed by state-owned enterprises. Accounting for pension burdens is also increasingly important, as recent debt workouts in Detroit and Puerto Rico vividly illustrate.

- *Realistic economic forecasts that incorporate downside risks*

Realistic growth forecasts are critical to avoid underestimating a country's near-term financing needs and overestimating its capacity to service its debt commitments. IMF historian James Boughton notes that during much of the 1980s debt crisis, overoptimistic growth expectations persisted, especially in Latin America. Realistic forecasts, particularly recognizing the fragility of highly indebted countries, can speed resolution of any crisis. Earlier detection of insolvency and identification of cases in which large write-downs are necessary cannot guarantee a faster resolution but are a step in that direction.

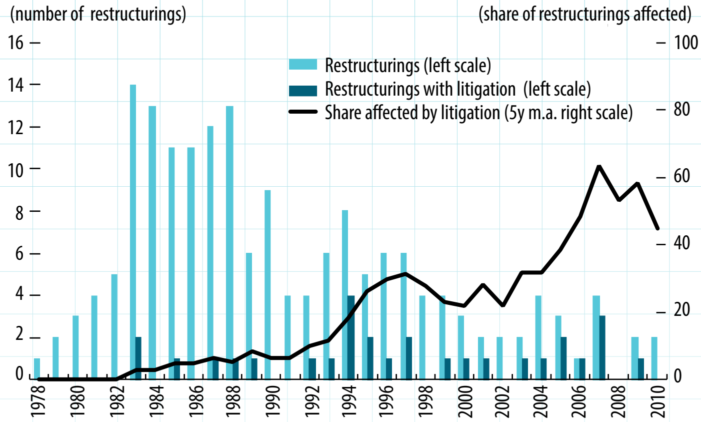
- *New legislation to support orderly sovereign debt restructurings*

Legal steps in jurisdictions that govern international bonds (importantly but not exclusively New York and London) or where payments

Chart 3

Legal risks

An increasing share of sovereign debt restructurings involve litigation.

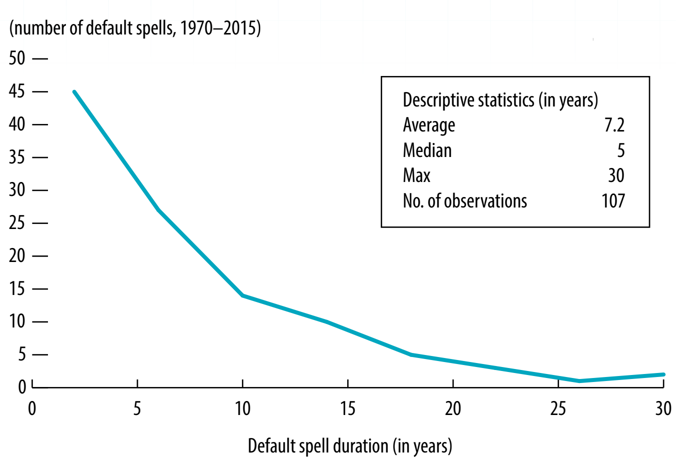


Source: Schumacher, Julian, Christoph Trebesch, and Henrik Enderlein. 2018. "Sovereign Defaults in Court." CEPR Discussion Paper 12777, Centre for Economic Policy Research, London.
Note: 5y m.a. = five-year monthly average.

Chart 4

Long sovereign workouts

Defaults, on average, last more than seven years.



Descriptive statistics (in years)	
Average	7.2
Median	5
Max	30
No. of observations	107

Source: Meyer, Josefin, Carmen M. Reinhart, Christoph Trebesch, and Clemens von Luckner, 2020. "Serial Sovereign Debt Restructurings and Delay: Evidence from the 1930 and 1980s Default Waves." Unpublished, Harvard University, Cambridge, MA.

are processed can contribute to more orderly restructuring by promoting a more level playing field between sovereign debtors and creditors. For instance, national legislation can cap the amounts that may be reclaimed from defaulted government bonds bought at a deep discount. In 2010, the United Kingdom enacted such a law for countries taking part in the Heavily Indebted Poor Countries (HIPC) debt relief initiative, while Belgium in 2015 passed the so-called Anti–Vulture Funds Law, which prevents litigious creditors from disrupting payments made via Euroclear. It would also energize legislation to facilitate a majority restructurings, which would allow a sovereign and a qualified majority of creditors to reach an agreement binding on all creditors subject to the restructurings.

The global pandemic is a once-in-a-century shock that merits a generous response from official and private creditors toward emerging market and developing economies, including preserving the global trading system and helping countries weather debt problems.

Support must be forthcoming, regardless of what progress can be made in better managing debt workouts. However, to make sure as much aid as possible gets through to debtor country citizens, it is essential to ensure inter-creditor equity and fair burden sharing, especially between official and private creditors. The more official aid and soft loans can go toward helping needy citizens around the globe—and the less such assistance ends up as debt repayments to uncompromising creditors—the better. FD

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Conquering the Great Divide

The pandemic has laid bare deep divisions, but it's not too late to change course

Joseph Stiglitz

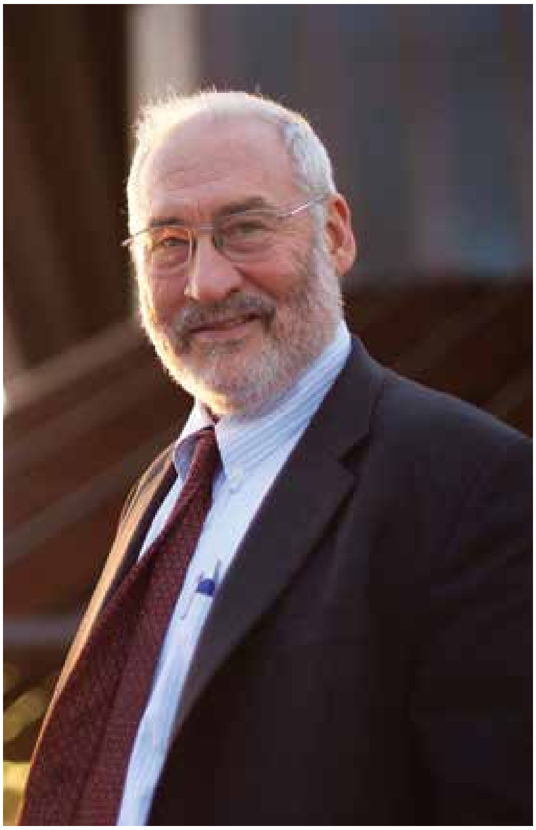

PHOTO: DANIEL BAUD AND SYDNEY OPERA HOUSE

COVID-19 HAS NOT BEEN an equal opportunity virus: it goes after people in poor health and those whose daily lives expose them to greater contact with others. And this means it goes disproportionately after the poor, especially in poor countries and in advanced economies like the United States where access to health care is not guaranteed. One of the reasons the United States has been afflicted with the highest number of cases and deaths (at least as this goes to press) is because it has among the poorest average health standards of major developed economies, exemplified by low life expectancy (lower now than it was even seven years ago) and the highest levels of health disparities.

Around the world, there are marked differences in how the pandemic has been managed, both in terms of how successful countries have been in maintaining the health of their citizens and the economy and in the magnitude of the inequalities on display. There are many reasons for these differences: the preexisting state of health care and health inequalities; a country's preparedness and the resiliency of the economy; the quality of public response, including reliance on science and expertise; citizens' trust in government guidance; and how citizens balanced their individual "freedoms" to do as they pleased with their respect for others, recognizing that their actions generated externalities. Researchers will spend years parsing the strength of various effects.

We need a comprehensive rewriting of the rules of the economy.

Still, two countries illustrate likely lessons that will emerge. If the United States represents one extreme, perhaps New Zealand represents the other. It's a country in which competent government relied on science and expertise to make decisions, a country where there is a high level of social solidarity—citizens recognize that their behavior affects others—and trust, including trust in government. New Zealand has managed to bring the disease under control and is working to redeploy some underused resources to build the kind of economy that should mark the post-pandemic world: one that is greener and more knowledge-based, with even greater equality, trust, and solidarity. There is a natural dynamic at work. These positive attributes can build on each other. Likewise, there can be adverse, destructive attributes that weigh down a society, leading to less inclusiveness and more polarization.

Unfortunately, as bad as inequality had been before the pandemic, and as forcefully as the pandemic has exposed the inequalities in our society, the post-pandemic world could experience even greater inequalities unless governments do something. The reason is simple: COVID-19 won't go away quickly. And the fear of another pandemic will linger. Now it is more likely that both the private and the public sectors will take the risks to heart. And that means certain activities, certain goods and services, and certain production processes will be viewed as riskier and costlier. While robots do get viruses, they are more easily managed. So it is likely that robots will, where possible, at least at the margin, replace humans. "Zooming" will, at least at the margin, replace airline travel. The pandemic broadens the threat from automation to low-skilled, person-to-person services workers that the literature so far has seen as less affected—for example, in education and health. All of this will mean that the demand for certain types of labor will decrease. This shift will almost surely increase inequality—accelerating, in some ways, trends already in place.

New economy, new rules

The easy answer is to accelerate upskilling and training in tandem with the changing job market. But there are good reasons to believe that these steps alone will not suffice. There will need to be a comprehensive program to reduce income inequality. The program needs to first recognize that the competitive equilibrium model (whereby producers maximize profit, consumers maximize utility, and prices are determined in competitive markets which equate demand and supply) that has dominated economists' thinking for more than a century does not provide a good picture of the economy today, especially when it comes to understanding the growth of inequality, or even innovation-driven growth. We have an economy rife with market power and exploitation. The rules of the game matter. Weakening constraints on corporate power; minimizing the bargaining power of workers; and eroding rules governing the exploitation of consumers, borrowers, students, and workers have all worked together to create a poorer-performing economy marked by greater rent seeking and greater inequality.

We need a comprehensive rewriting of the rules of the economy. For instance, we need monetary policies that focus more on ensuring full employment of all groups and not just on inflation; bankruptcy laws that are better balanced, replacing those that became too creditor-friendly and provided too little accountability for bankers who engaged in predatory lending; and corporate governance laws that recognize the importance of all stakeholders, not just shareholders. The rules governing globalization must do more than just serve corporate interests; workers and the environment have to be protected. Labor legislation needs to do a better job of protecting workers and providing greater scope for collective action.

But all of this will not, in the short run at least, create the equality and solidarity that we need. We will need to improve not just the market distribution of income but how we redistribute as well. Perversely, some countries with the highest degree of market income inequalities, like the United States, actually have regressive tax systems where top earners pay a smaller share of their income in taxes than workers lower down the ladder.

Over the past decade, the IMF has recognized the importance of equality in promoting good economic performance (including growth and stability). Markets on their own pay no attention to the broader impacts that arise from decentralized decisions leading to excessive borrowing in foreign-denominated currencies or excessive inequality. During the reign of neoliberalism, no attention was paid to how policies (such as capital and financial market liberalization) contributed to greater volatility and inequality, nor to how other policy changes—such as the shift from defined-benefit to defined-contribution retirement (or pension) plans, or from public to private pensions—led to greater individual insecurity, as well as to greater macroeconomic volatility, by weakening the economy's automatic stabilizers.

The rules are now shaping many aspects of economies' responses to COVID-19. In some countries, the rules encouraged shortsightedness and inequalities, two features of societies that have not managed COVID-19 well. Those countries were inadequately prepared for the pandemic; they built global supply chains that were insufficiently resilient. When COVID-19 hit, for instance, American

While the pandemic has revealed the enormous cleavages across the countries of the world, the pandemic itself is likely to increase disparities.

firms couldn't even provide enough supplies of simple things like masks and gloves, let alone more complicated products like tests and ventilators.

International dimensions

COVID-19 has exposed and exacerbated inequalities between countries just as it has within countries. The least developed economies have poorer health conditions, health systems that are less prepared to deal with the pandemic, and people living in conditions that make them more vulnerable to contagion, and they simply do not have the resources that advanced economies have to respond to the economic aftermath.

The pandemic won't be controlled until it is controlled everywhere, and the economic downturn won't be tamed until there is a robust global recovery. That's why it's a matter of self-interest—as well as a humanitarian concern—for the developed economies to provide the assistance the developing economies and emerging markets need. Without it, the global pandemic will persist longer than it otherwise would, global inequalities will grow, and there will be global divergence.

While the Group of Twenty announced that it would use every instrument available to provide this kind of help, the aid so far has been insufficient. In particular, one instrument used in 2009 and easily available has not been employed: an issuance of $500 billion in Special Drawing Rights (SDRs). So far, it has not been possible to overcome the lack of enthusiasm of the United States or India. The provision of SDRs would be of enormous assistance to developing economies and emerging markets—with no or little cost to the taxpayers of developed economies. It would be even better if those economies contributed their SDRs to a trust fund to be used by developing economies to meet the exigencies of the pandemic.

So too, the rules of the game affect not just economic performance and inequalities within countries, but also between countries, and in this arena the rules and norms governing globalization are central. Some countries seem committed to "vaccine nationalism." Others, like Costa Rica, are doing what they can to ensure that all knowledge relevant to addressing COVID-19 is used for the entire world, in a manner analogous to how the flu vaccine is updated every year.

The pandemic is likely to bring about a rash of debt crises. Low interest rates combined with financial markets in advanced economies pushing loans and profligate borrowing in emerging market and developing economies have left several countries with more debt than they can service, given the magnitude of the pandemic-induced downturn. International creditors, especially private creditors, should know by now that you can't squeeze water out of stone. There will be a debt restructuring. The only question is whether it will be orderly or disorderly.

While the pandemic has revealed the enormous cleavages across the countries of the world, the pandemic itself is likely to increase disparities, leaving long-lasting scars, unless there is a greater demonstration of global and national solidarity. International institutions, like the IMF, have provided global leadership, acting in exemplary ways. In some countries too there has been leadership that has enabled them to address the pandemic and its economic aftermath—including the inequalities that otherwise would have arisen. But as dramatic as the successes have been in some places, just as dramatic are the failures elsewhere. And those governments that have failed internally have hampered the necessary global response. As evidence of the disparate outcomes becomes clear, hopefully there will be a change of course. The pandemic is likely to be with us for a while and its economic aftermath for a much longer time. It's still not too late for such a change of course. FD

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Cultivating
GLOBAL FINANCIAL
COOPERATION

The current crisis highlights the urgency of strengthening the global financial architecture

Barry Eichengreen

The COVID-19 pandemic is the mother of all stress tests for the global economy, and not least for emerging markets and developing economies. Early on, there were hopes that the virus might bypass low-income countries, which have fewer air-transportation links to the rest of the world, or that it could be contained in countries with past epidemic experience—in sub-Saharan Africa, for example. Such hopes were disappointed. We now know that the virus threatens all parts of the world. Moreover, even where countries have been able to avert a full-blown health crisis, the financial effects have been severe.

That financial impact preceded COVID-19's physical arrival in the developing world. Between February and April, more than $100 billion in financial capital flowed out of emerging and frontier markets, five times as much as in the first three months of the global financial crisis. The World Bank forecast that remittances would fall by an additional $100 billion in 2020, four times as much as during that earlier crisis. Global trade was forecast to fall even faster than in 2009. Commodity prices collapsed in response to the global recession, while emerging market and developing economy currencies weakened against the dollar.

This was a shock of unprecedented proportions. Governments responded with emergency spending packages in support of households and firms. Emerging market central banks cut interest rates and in some cases undertook purchases of securities. As a result, the negative impact on economies and financial systems was somewhat less than anticipated initially.

For emerging markets, this policy response was unprecedented. It was the opposite of the actions they were forced to take in earlier crises. The contrast was indicative of progress made in building fiscal space and anti-inflation credibility. One indication lies in the actions of emerging market central banks that adopted a formal inflation-targeting framework as a credibility-enhancing device. Through the first five months of 2020, those central banks were able to cut interest rates by 40 to 50 basis points more than their non-inflation-targeting counterparts.

This is not to deny the existence of financial stress. But the tidal wave of debt defaults, currency crashes, and financial system collapses some had predicted has not come to pass. At least not yet.

Dollar dominance

Having averted the worst does not mean that emerging market and developing economies averted the bad. The financial repercussions of COVID-19 pointed up remaining flaws in the global financial architecture and underscored the need to correct them.

To start, the pandemic is a reminder of how much the global economy—and emerging market economies in particular—relies on the dollar for international liquidity. The international interbank market, in which banks borrow and lend to one another, runs heavily on dollars. The dollar is involved in 85 percent of foreign exchange transactions worldwide. It is far and away the most important vehicle for trade invoicing and settlement. Bonds marketed and sold to foreign investors are disproportionately denominated in dollars.

Countries can shield themselves from sudden liquidity shortages, when banks refuse to lend, by holding dollar reserves. There has been significant movement in this direction by central banks and governments in recent decades, which is one reason there was not a more severe pandemic-induced dollar shortage and greater financial distress.

But a more important explanation for the absence of disruptive dollar scarcity is the extraordinary action of the US Federal Reserve (Fed), which leapt into the breach with dollar swaps and Treasury bond repurchase facilities for foreign central banks. The Fed purchased a wide range of fixed-income assets, flooding financial markets with liquidity and bringing credit spreads back down to precrisis levels. Investors seeking higher-yielding investments had nowhere to look but emerging markets, whose debt was one of the few fixed-income assets the Fed did not buy. This explains much of why capital flowed back to emerging markets after the initial period of strain.

While the Fed's forceful action prevented global financial markets from seizing up, it also pointed to a fly in the international financial ointment. The Fed provided swaps only to a selection of countries,

ART: DAVIDE BONAZZI

and the selection criteria were not transparent. Nor is it obvious that there will be an equally foresightful Federal Reserve Board to do the same in a future crisis.

This has led to suggestions that the Fed, and perhaps other advanced economy central banks as well, should delegate the decision to extend swaps to an impartial arbiter, such as the IMF. Since central banks are not members of the IMF, this would be a decision for governments—which is a problem. Governments, especially the governments of countries that issue key international currencies, are not inclined to cede control of their central banks' balance sheets to the international community.

IMF and World Bank roles

This mention of the IMF points to another source of dollars for emerging market and developing economies: IMF lending facilities. The IMF moved quickly in response to the pandemic to create the Short-term Liquidity Line, a new facility for disbursing liquidity assistance, while enhancing access to existing facilities, including some that allow for lending without a full-fledged program. In the first half of 2020, it received more than 100 calls for emergency funding.

The IMF's overall lending capacity is limited to $1 trillion. This sum may not be enough to deal with the full impact of the pandemic and with whatever comes next. Shrinkage of IMF resources was averted by renegotiation of the Fund's multilateral and bilateral borrowing arrangements, including the New Arrangements to Borrow. However, efforts to augment those resources through an increase in IMF quotas have not produced results. Further, there has not been the requisite agreement of a supermajority of countries on a new allocation of Special Drawing Rights (SDRs), despite widespread calls from the official and scholarly communities. Reforming IMF governance in the context of the General Review of Quotas and enhancing the international role of the SDR are long-standing issues. The COVID-19 crisis is a reminder that these efforts are incomplete, and that their incompleteness weakens the global financial safety net.

The IMF's sister institution, the World Bank, could point to pandemic bonds as its contribution to weathering the crisis. In 2017, in response to the outbreak of Ebola in West Africa, the World Bank, with financial support from a set of advanced economy donor nations, underwrote bonds to be placed with private investors that paid out in a pandemic. Ex ante, this instrument seemed ideally suited to providing poor countries with insurance against health-related shocks.

It didn't turn out that way. The bonds now look to have been overengineered; their documentation was so complex that neither investors nor governments knew what they were getting. The stringent conditions triggering payments were satisfied only 132 days into the outbreak and after more than 2 million cases were identified worldwide. One of the variables triggering payouts was the number of cases identified and reported at the national level, and poor countries were the least able to identify and report cases. Unlike catastrophe bonds, which pay out in response to a hurricane or earthquake affecting one or a handful of countries, pandemic bonds triggered many simultaneous payouts, because the COVID-19 pandemic was global. Investors in these bonds therefore saw their stakes wiped out.

The distaste for this structure for both developing economies and investors became apparent when the World Bank abandoned plans for another pandemic-related issue this year. The notion of some form of financial insurance for pandemics is sound conceptually, but a satisfactory structure has yet to be found.

Dealing with debt

Last, there is the challenge of servicing debt when commodity prices and global trade have collapsed. Acknowledging these realities, in April 2020 the IMF provided debt service relief for an initial six months to 29 low-income countries that were previous loan recipients. In addition, Managing Director Kristalina Georgieva called on governments with bilateral loans to low-income countries and on private sector creditors to suspend repayments. Following a meeting of finance ministers and central bank governors, the Group of Twenty (G20) issued a declaration, the "G20 Action Plan," voicing support for these ideas.

These initiatives faced collective action problems, however. For official bilateral creditors, it made little sense to suspend payments if other governments failed to do likewise. In this case, the debtor would receive only limited relief, and the governments that agreed would end up footing the bill.

Since the 1950s, the official community has addressed this issue through the Paris Club, a group of creditor countries originally made up of Group of Seven governments, whose chair is a French Treasury official. Unfortunately, China, now the source of more official bilateral poor country debt covered by the G20 initiative than all other creditor countries combined, is not a member. China has agreed to match the Paris Club's debt relief terms, but it is not clear whether this commitment extends to loans by state banks and state-owned companies. It is not even clear how much poor-country governments owe to the Chinese official sector overall. All this would have been easier to sort out had China been a full-fledged member of the Paris Club, but it is not—yet another failure to update the global financial architecture to match the realities of the 21st century.

In the case of private debt, the task of setting out terms and organizing negotiations was outsourced to the Institute of International Finance (IIF), the association of institutional investors. This response had something of a fox-in-the-henhouse quality. The IIF cautioned emerging markets that seeking to restructure their debt could jeopardize market access. It warned that institutional investors were responsible to their clients, not to governments or the global community. Early efforts at renegotiating Argentine government bonds got hung up over conflicting contractual terms governing different bonds, reflecting the absence of a single standard for bond covenants. Progress was slowed by obstacles thrown in the way by holdout creditors.

There was no sense that the existing ad hoc machinery had the capacity to deal with a flood of cases. The absence of an international facility or even a standard procedure to deal with a wave of restructurings was glaring.

The agenda

What, then, have we learned about the financial architecture from the COVID-19 crisis? We have been reminded that resilience starts with institution and resource building at home. Governments possessing fiscal space have been able to put it to use. Where inflation expectations are well anchored, central banks have been able to support financial markets and the economy. A surprising number of emerging markets—surprising by the standards of past crises—have been able to implement supportive policies. This capacity reflects their success at building more robust monetary, fiscal, and financial institutions.

Experience at the international level is less heartening. Cross-border financial transactions remain dollar-based. There is reason to think that this will change, but little reason to think that it will change anytime soon. While the demand for dollars is global, the supply remains national: it depends on the policies of the Federal Reserve. There are potential alternative sources of dollars—not least the IMF, which could provide greater access through its existing programs and lending facilities if it had more resources. A new allocation of SDRs is another possibility. Unfortunately, there is as yet no consensus on how to proceed.

We have been reminded that resilience starts with institution and resource building at home.

Although the performance of pandemic bonds has been disappointing, the idea of using financial instruments and markets to insure against these risks is sound. Streamlining the design of such instruments and increasing the subsidy element provided by donors could make them more attractive to both governments and investors. The question is whether this would be enough.

Finally, there is the need to strengthen arrangements for dealing with debt. The structure of the Paris Club should be updated to match the realities of the 21st century. Official institutions should take a larger role in negotiations over restructuring private debt. They can set standards for such negotiations. They can encourage regulatory agencies to mandate institutional investors' adherence to those standards. Governments and regulators can require provisions in loan contracts (so-called single-limb aggregation clauses) that encourage rapid restructuring when a pandemic or other global crisis hits. They can prohibit trading of bonds that lack these provisions. This strategy just might work. If it doesn't, then calls for a more heavy-handed approach, involving some kind of international bankruptcy court for sovereigns, will be back. FD

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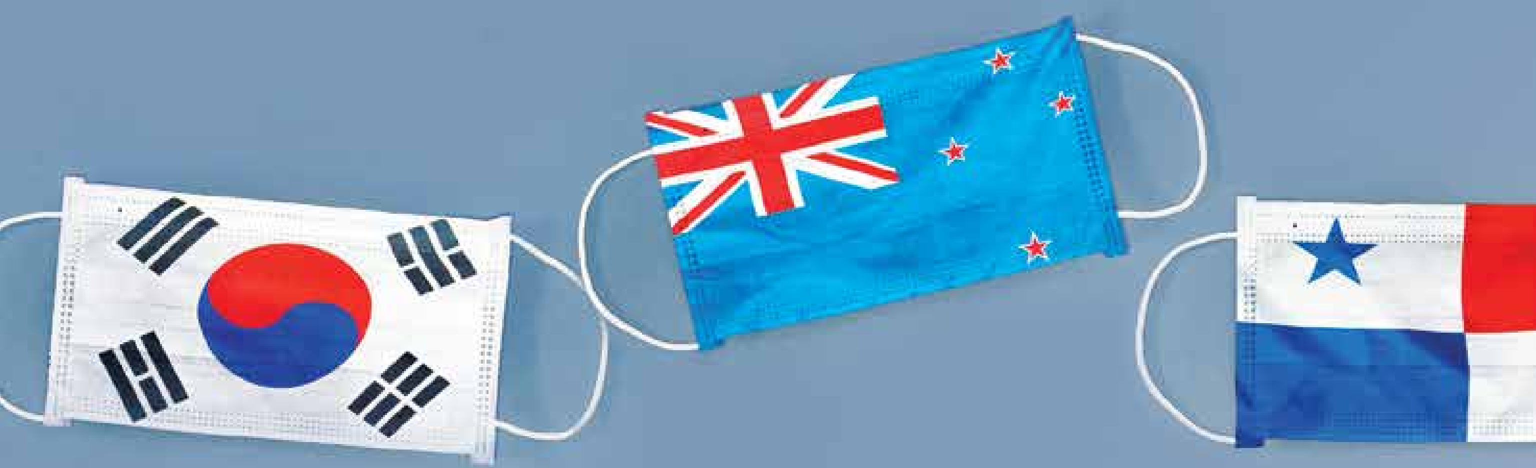

Overhauling HEALTH SYSTEMS

As countries' first line of defense against a crisis, health systems need to be strengthened

Genevie Fernandes

Millions of infections, hundreds of thousands of deaths, and widespread lockdowns. In just six months, the COVID-19 pandemic has changed our world dramatically. As we adapt, we are learning about the virus—especially the possibility that transient immunity could expose people to waves of the virus—and about long-term effects on the lungs, heart, kidneys, and brain among those who recover.

Despite these unknowns, COVID-19 has exposed several well-known and deeply persisting inequalities. People with comorbidities such as cardiovascular and respiratory disease and diabetes are at a higher risk of complications from COVID-19, and these risk factors disproportionately affect those who are socioeconomically disadvantaged.

Women bear the brunt of caring for the sick and children, are at high risk of domestic violence during quarantines and lockdowns, and are affected by disruptions in access to sexual and reproductive health services, as well as by job losses in the informal sector.

This pandemic has also laid bare inequality between rich and poor countries. For the most part, rich countries have better-funded health systems and can afford to temporarily freeze their economies and inject billions of dollars into economic stimulus packages. Yet most poor countries have underfunded and inadequately staffed health systems, weak water and sanitation systems, large populations, mounting debt, colossal unemployment, and limited fiscal capacity for economic relief.

To make matters worse, another pandemic can strike at any time, even as we struggle with the current crisis. Apart from looming global pandemics, there is also the threat of extreme weather events and natural disasters, as well as recurring economic crises, all of which have devastating effects on communities and health systems.

During all of these natural and human-caused crises, it is a country's health system that is the first line of defense, and if the system is not resilient, it will be overwhelmed and collapse, exacerbating the health impact and adding to inequality. Countries such as Germany, New Zealand, South Korea, Taiwan Province of China, and Vietnam—all of which have managed to control COVID-19 better than others—have demonstrated resilience in their health systems.

Resilient health systems

Harvard public health professor Margaret Kruk defines health system resilience as "the capacity of health actors, institutions, and populations to prepare for and effectively respond to crises; maintain core functions when a crisis hits; and, informed

by lessons learned during the crisis, reorganize if conditions require it" (Kruk and others 2015). In the face of a crisis, a resilient health system can cope with the shock, continue to provide services, and return to normal functioning once the crisis settles, thereby delivering positive health outcomes in both good and bad times.

However, a health system does not function in a silo; it operates within a socioeconomic and political context, clearly reflected by the direct and indirect health effects of pandemics and other shocks on vulnerable populations. A resilient post–COVID-19 health system must also address these vulnerabilities and inequalities and sustainably respond to a range of crises in the future.

Based on the growing literature and country experiences of Ebola and COVID-19, we can outline five broad features of a resilient national health system.

First, it must be vigilant. Countries must strengthen their existing disease surveillance systems to routinely collect and analyze information across public and private health care in order to prevent or quell outbreaks. Several simple and effective disease surveillance systems have been developed and adapted in low-resource settings. For instance, in the early 1980s, virologist T. Jacob John established a novel system in south India using a standardized set of symptoms (which would today be called "syndromic surveillance") to detect and limit disease outbreaks (John and others 1998). This national surveillance system must also incrementally build its capacity to routinely monitor such events in neighboring countries and regions and worldwide, which requires capacity building as well as diplomacy.

Second, it must be responsive. Early response is a defining feature of the health systems of Germany, New Zealand, South Korea, and Taiwan Province of China, as well as in states such as Kerala in India—all of which have managed to control COVID-19 effectively. Responsiveness calls for preparedness, which can take years of planning and investment, long before a pandemic hits. Singapore and Taiwan Province of China responded to the deadly 2003 SARS outbreak with elaborate response plans and annual drills in hospitals, while in South Korea, following the 2015 MERS outbreak, the government invested heavily in standard operating protocols and incentivized its biomedical companies to research and develop rapid diagnostic tools. Countries may have emergency preparedness plans and protocols, but these need to be aligned with dedicated individuals and teams with decision-making autonomy to respond swiftly, as well as with investment to strengthen the health infrastructure and a workforce and procedures for emergency procurement and replenishment in the event of shortages.

Third, it must be flexible and adaptable. Hospital staff in several countries have been redeployed to COVID-19 wards. In January and February, nearly 3,000 health workers in Cambodia were trained and deployed to implement rapid detection and contact tracing. In China, Fangcang shelter hospitals were rapidly set up in February 2020—large-scale venues such as stadiums and exhibition centers were converted to temporary hospitals to isolate and care for people with mild to moderate COVID-19 symptoms and reduce the burden on hospitals. Across the world, hospitals have shifted some of their health services to virtual forums such as telephone and video consultations. Such practices show the potential of flexible use of existing resources—whether the workforce or health care facilities—and adaptation to a rapidly changing situation.

Fourth, it is only as resilient as the communities it serves. District public health teams must engage and involve local leaders and community volunteers in structured roles during emergencies; extension of roles during normal times could enhance participatory governance. In Thailand, more than 1 million village health volunteers have monitored communities for COVID-19. In Kerala more the 300,000 youth volunteers were trained and deployed by the government to deliver social services to local communities during the lockdown and support quarantined households (WHO 2020). Local leaders and volunteers are trusted in their communities, and when district health teams partner with such stakeholders it can ensure two-way communication and persuade communities to adopt recommended behavior.

Fifth, and most important, resilient health systems must be equitable. People in both rich and poor countries without effective health coverage have struggled to get tested and seek timely treatment for COVID-19 and other health emergencies. Universal health coverage, regardless of socioeconomic status, geographic location, gender, age, or preexisting conditions, is needed now more than ever (WHO 2010). Countries must invest in universal health coverage, particularly by expanding health insurance coverage and strengthening primary health care services, to ensure early detection and response to COVID-19 and other infectious diseases. This will prevent

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secondary and tertiary health facilities from being overburdened and disrupting the delivery of other essential health services. Most important, universal health coverage will keep families from falling into poverty during such public health emergencies.

Govenments will also have to strengthen three cross-cutting areas to ensure health system resilience. *First, a multisectoral government approach* is urgently needed, whereby mechanisms are built and activated for health policymakers to work closely with their counterparts in other relevant public sectors, including education, social welfare, finance and trade, and the environment.

Partnership with the private health sector is the second cross-cutting task. In several low- and middle-income countries, private facilities are the first health care contact point and deliver the bulk of services. This sector cannot be ignored and must be sustainably engaged under public stewardship.

Third, clear, consistent, transparent, and timely communication is needed through various channels, including credible voices for both internal (public sector departments) and external (public) audiences. These communication channels must include and incorporate feedback. Good communication will build public trust in government and encourage adherence to the behavior needed to disrupt transmission and control outbreaks.

Making it happen

Financing is critical to achieving the above features in cross-cutting areas of health system resilience. Governments must increase domestic financial resources for the public health system through mechanisms such as budget reallocation, tax reform and management, and luxury and sin taxes as well as collaboration with the private and philanthropic sectors. In 2013, within one year of introducing sin taxes on alcohol and tobacco, the Philippines generated $1.2 billion, which made it possible to enroll an additional 45 million citizens in universal health coverage.

Governments can also make a substantial difference by reducing inefficiencies in their health spending. This can be achieved through strategies such as reforming incentive and payment structures to address overuse of services, controlling excessive markups on medicines and promoting generics, pooled medicine purchases, and addressing corruption.

Poorer countries suffering from economic shocks will have a hard time raising money for domestic health financing, which is why we urgently need a coordinated global response. Richer countries, donors, and multilateral agencies must step up development assistance. Institutions such as the World Bank and the IMF have taken initial steps with increased emergency financing, debt relief, and support for debt service suspension. Future support beyond unconditional emergency financing should support broad health system strengthening and resilience and protect social spending and safety nets for the most vulnerable.

Governance holds the key to an effective response for resilient health systems in the face of COVID-19 and future public health emergencies. Effective governance calls for committed leadership across political parties and structures that reflect accountability and transparency, as well as mechanisms for decision-making autonomy and incentives for public health officials across all levels of government.

Worldwide commitment to cooperation on COVID-19 vaccines and therapies starts with collective support for the World Health Organization (WHO). Despite its shortcomings, no other international agency has the technical, normative, and convening capacity to bring countries together at the same table for ensuring equitable access to global public goods for public health emergencies. With the recent US announcement to withdraw from the WHO and threats to overall funding, international cooperation, as demonstrated at the World Health Assembly in May 2020, is more relevant than ever (Sridhar and King 2020).

As former Liberian President Ellen Johnson Sirleaf said, "Coronavirus anywhere is a threat to people everywhere." No government can completely resolve the COVID-19 crisis alone; it takes global cooperation and solidarity. FD

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INVESTING IN A GREEN RECOVERY

The pandemic is only a prelude to a looming climate crisis

Ulrich Volz

This crisis is a rupture. A moment of profound turmoil and disruption. Even more than the 2008–09 global financial crisis—which was most directly felt in the United States and in European countries—this pandemic is affecting almost all of humanity. In countries around the world, rich and poor, the COVID-19 crisis has exposed the vulnerabilities of our health and social systems and the fragility of our economies. It has also highlighted in dramatic ways the need for better disaster preparation. Increasing resilience needs to be one of the main guiding principles when rebuilding our economies and societies after the crisis. We need to ensure we are better prepared to withstand future pandemics but also the other major looming threat to humanity—climate change.

Despite long-standing and plentiful warnings from scientists about the risks of a pandemic, the world was woefully unprepared for this crisis. The same is unfortunately true for climate change. As was the case with pandemics, scientists have long been sounding the alarm about a climate crisis. There can be no doubt that it is here and accelerating. Recent wildfires in Australia and California, the thaw of permafrost in the Arctic, and the increase in the number and intensity of storms, floods, droughts, and other climate-related natural disasters all point to a problem that has already arrived. The earth will soon exceed climate tipping points, presenting a real threat of abrupt and irreversible climate changes.

This pandemic strikes us at a time when—according to the Intergovernmental Panel on Climate Change—we have about a decade left to achieve a low-carbon transition and bring the world economy to a trajectory limiting global warming to 1.5°C above preindustrial levels. The next few years are our last chance to avoid catastrophic global warming. It is imperative that the various crisis response measures amount to a transformative policy response. Short-term crisis responses aimed at protecting jobs

A bush fire rages outside Tuncurry, Australia.

and boosting recovery need to be coupled with longer-term, strategic goals of mitigating climate change and shoring up climate change adaptation and resilience. As much as possible, we need to use economic stimulus and recovery measures to strengthen the resilience of our economies and engineer a just transition. As IMF Managing Director Kristalina Georgieva has said, this is the time to "revive or lose" the Paris Agreement.

Enabling sustainable investment

There is no trade-off between choosing a sustainable recovery and economic progress. Many green technologies have matured, and low-carbon energy is, in most cases, cheaper now than fossil-fuel-based energy. Recent evidence suggests that well-designed green projects can generate more employment and deliver higher short-term returns per dollar spent, compared with conventional fiscal stimulus. Moreover, today's investment in climate change mitigation and adaptation generates substantial long-term returns and cost savings, whereas the cost of inaction or late action on climate change is high. Steps taken now to mitigate climate change represent an investment that will generate dividends into the future, while continued inaction will give way to disastrous global warming and much greater costs down the line. Likewise, failing to invest in making our economies and societies more climate resilient undermines our future growth and well-being. The Global Commission on Adaptation calculated that every dollar invested in building climate resilience could result in between $2 and $10 in net economic benefits.

There is, however, a major problem: Many countries lack the means to finance a recovery and undertake critically needed investments in climate adaptation and mitigation. The COVID-19 crisis has dramatically worsened public finances, which in many countries were already shaky in the run-up to the current crisis. The IMF projects global public debt to increase to more than 100

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THE COVID-19 PANDEMIC HAS SHOWN HOW QUICKLY A NATURAL DISASTER CAN BRING OUR ECONOMIES TO COLLAPSE.

percent of GDP this year, up 19 percentage points year over year. Going forward, many countries will require debt relief to respond effectively to the crisis and undertake meaningful investment to climate-proof their economies. For now, the international financial architecture still lacks an adequate system for addressing situations where sovereign debt becomes unsustainable. Ways need to be found to systematically deal with the coming debt crisis in developing economies.

Moreover, in the face of stretched public finances, it is crucial to align all public expenditures as well as the tax system with the climate goals. Importantly, this should include the phasing out of all fossil fuel subsidies. According to IMF estimates, global fossil fuel subsidies amounted to $5.2 trillion, or 6.5 percent of world GDP, in 2017. Putting an end to these would not only deliver significant public savings, but also lower emissions. Furthermore, as shown in the IMF's October 2019 *Fiscal Monitor*, meaningful carbon taxes—the IMF suggests $75 per ton of CO_2—are a powerful tool to reduce carbon emissions and generate additional environmental benefits, including lower mortality from air pollution. Carbon tax revenues could be redistributed to support low-income households or communities that are hit particularly hard by the transition to a low-carbon economy or the physical effects of climate change. The currently relatively low level of oil prices would provide a good opportunity to levy or increase carbon taxes at a reduced political cost.

Aligning finance

Beyond fiscal policy, it will be imperative to align finance flows with a pathway toward low greenhouse gas emissions and climate-resilient development, as stipulated in Article 2.1c of the Paris Agreement. To this end, monetary and financial authorities need to fully integrate climate risks into their prudential and monetary frameworks. Over the past couple of years, a growing number of central banks and financial supervisors have recognized that climate change represents a material risk for individual financial institutions and systemic financial stability. The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) was established in December 2017 by eight central banks and supervisors and has grown to a membership of 66 central banks and supervisors. In a number of reports, the NGFS highlighted the macroeconomic and financial stability impacts of climate change. It is important that monetary and financial authorities move ahead swiftly in implementing a comprehensive framework for addressing climate-related risks. Such a framework should make the disclosure of climate and other sustainability risks mandatory across the financial sector to help with better risk analysis; require financial institutions to conduct regular climate stress testing that considers multiple transition scenarios; and integrate climate-related financial risks into prudential supervision.

Importantly, central banks and supervisors should also align their current crisis responses to avoid locking in a high-carbon recovery while fulfilling their mandates for financial stability (Dikau, Robins, and Volz 2020). Liquidity-enhancing stimulus measures that are not Paris-aligned can contribute significantly to the buildup of climate-related risks in portfolios of financial institutions and overall in the financial system. Moreover, easing countercyclical and other prudential instruments without considering climate risk can further increase these risks. The implementation of prudential instruments that account for climate risks should therefore not be delayed, but rather strengthened to minimize the potential buildup of additional risks in portfolios.

Supporting vulnerable countries

International financial institutions, many of which have become observers of the NGFS, have a special role to play in helping member countries align their financial systems with sustainability goals. That includes supporting capacity building and leading by example in developing best practices for integrating climate risks in all aspects of their own operations. For multilateral development banks, this also means aligning their own portfolios with the Paris Agreement and completely phasing out any high-carbon lending and investments. In the current crisis situation, multilateral development banks as well as national development banks can also assume an important role by providing countercyclical lending that at the same time supports economic activity and employment in the short term, while contributing to the transition to a more sustainable low-carbon economy.

International financial institutions should also ramp up support to climate-vulnerable countries. The sad truth is that the impact of climate change is the greatest in countries that contributed the least to global warming caused by human industry and agriculture. A rapid scaling up of investment in climate resilience is a matter of life and death for these countries. Unfortunately, climate-vulnerable developing economies are those struggling the most to finance adaptation and resilience. These economies are particularly exposed to climate-related financial risks, and both governments and firms are already facing a climate risk premium on the cost of capital (Kling and others 2020; Beirne, Renzhi, and Volz 2020). There is a real danger that climate-vulnerable developing economies will enter a vicious circle in which greater climate vulnerability raises the cost of debt and diminishes fiscal space for investment in climate resilience.

The financial risk of climate-vulnerable countries is already high and is likely to increase further as financial markets increasingly price climate risks and global warming accelerates (Buhr and others 2018). International support for increased funding in climate resilience and mechanisms to transfer financial risks is urgently needed and could help these countries to enter a virtuous circle. Greater resilience funding could reduce both vulnerability and the cost of debt, providing these countries with extra room to scale up investments to tackle the climate challenge.

The IMF and multilateral development banks will also need to develop new instruments, including extended emergency facilities, to support climate-vulnerable developing economies when they are hit by disasters. Over the past two decades, about 20 countries—most of them small island nations—suffered losses amounting to more than 10 percent of their GDP. The most extreme case is Dominica, where Hurricane Maria caused estimated damage in 2017 equaling 260 percent of GDP. In 2004, Hurricane Ivan wiped out about 150 percent of Grenada's GDP. But even in less extreme cases, disasters can wreak havoc on public finances and make sovereign debt unsustainable. We urgently need a discussion around the treatment of climate debt; that is, public debt incurred as a direct result of climate disasters or necessary adaptation measures.

Avoiding permanent crisis mode

The COVID-19 pandemic has shown how quickly a natural disaster can bring our economies to collapse. Climate-vulnerable countries have been living with this risk for a long time already. If we don't act now and make a concerted effort to significantly strengthen investment to mitigate and adapt to climate change, many more countries will find themselves in permanent crisis mode. The few countries fortunate enough to be spared will not be able to shield themselves from problems elsewhere. Just as the COVID-19 virus has spread across borders, the impacts of climate change will be felt across the world, not least through an increase in migration in the context of disasters and climate change.

The stakes are high. We have a decade to transform our economies and avoid catastrophic global warming. Collective efforts at all levels—locally, nationally, and internationally—and across all sectors—public and private—are needed to tackle climate change and build more resilient societies and economies. The challenges are enormous. But this crisis also provides an opportunity to rethink our economies and societies. As the IMF's Georgieva rightly said, it is upon us to "choose what kind of recovery we want." We'd better choose wisely. FD

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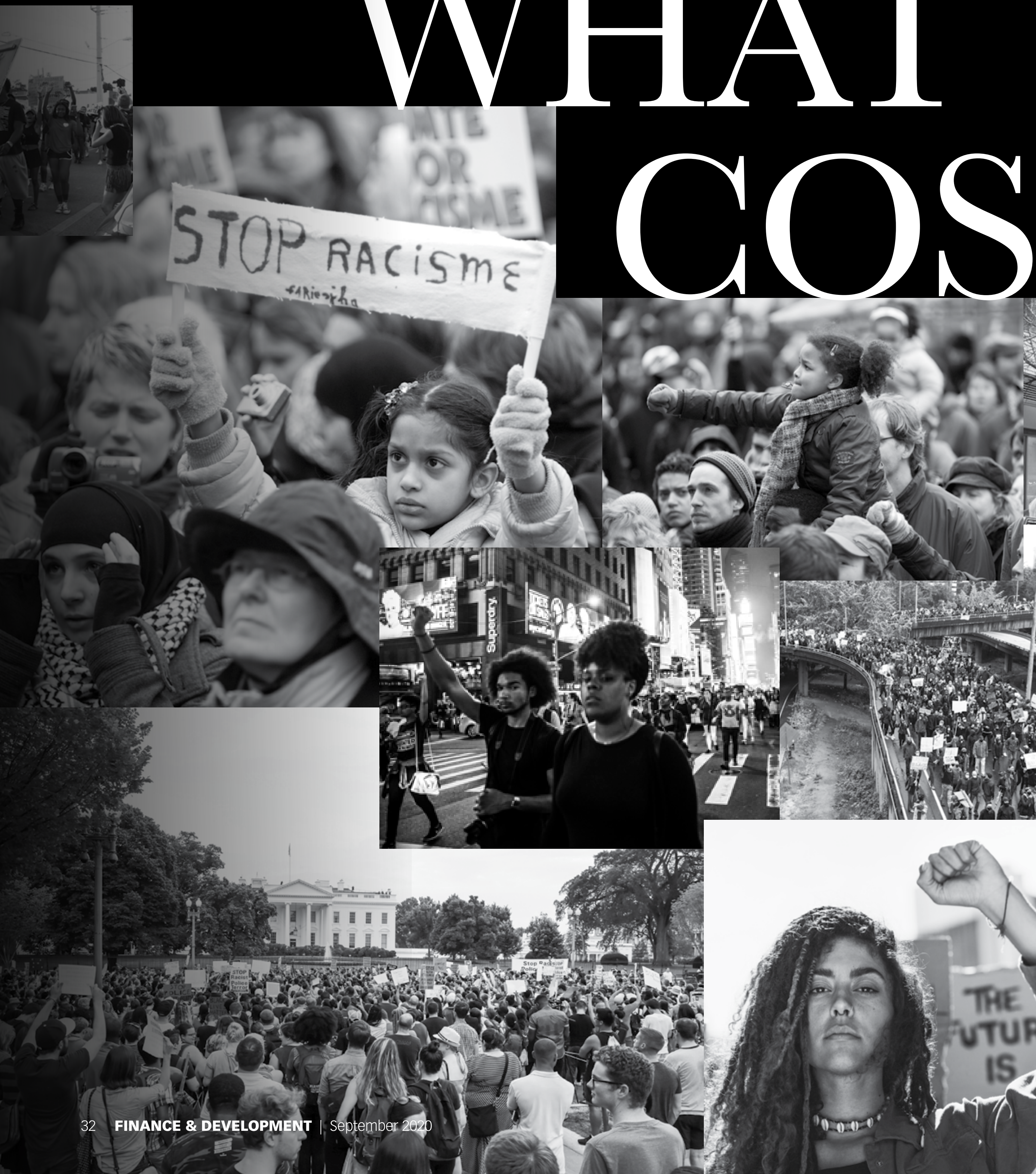

RACISM TS US ALL

Addressing systemic racism is a moral imperative; it can also make economies stronger

Joseph Losavio

George Floyd. Breonna Taylor. Ahmaud Arbery. Three Black Americans killed in acts that reminded the world that systemic racism is still very real in the United States. The early summer protests that followed, though sparked by those deaths, were manifestations of deeper anger and despair at the racism that has plagued the country since its founding.

As protests spread worldwide, many began to shift focus from solidarity with Black Americans to racial injustice within their own countries. Adama Traoré. João Pedro Matos Pinto. David Dungay, Jr. Different names from different countries, but still victims whose deaths have forced reexamination of the global presence of systemic racism and sent demonstrators into the streets to demand better.

Demanding an end to racism, and a remedy for its legacy, is not just morally correct but a boost to economic development. Continuing to deny the existence of racism, and refusing to confront it, will lead to a less vibrant, less cohesive, less prosperous world.

Birth of a nation

A multiracial nation since its independence, the United States has struggled to overcome what many refer to as its "original sin"—slavery—and the de jure and de facto racial discrimination that followed its abolition. Systemic racism continues to burden the United States, and Black Americans have borne the brunt of its legacy.

Racism in local American police departments is a deep-seated problem. According to analysis by the *Washington Post* and the *Guardian*, Black Americans are twice as likely as whites to be killed by police while unarmed. Although this is one of the most widely known forms of systemic racism, the problem runs much deeper.

For example, racism is rampant in medicine—in 2016, the US National Academy of Sciences found that 29 percent of white first-year American medical students thought

that Black people's blood coagulates more quickly than white people's, and 21 percent believed that Black people have stronger immune systems. Such misunderstanding often leads to inadequate preventive care and inferior treatment, resulting in worse health outcomes for Blacks than whites across the board. One study published by the American Heart Association found that racist medical notions contributed to Black women in America being a third more likely to die of heart disease than white women.

Racism has restrained Black economic progress for decades. The benefits of the post–World War II GI Bill, which fueled the growth of the American middle class, were largely denied to Black people at the insistence of white members of Congress from the South desperate to enforce racial segregation—war heroes or not. "Redlining," a Federal Housing Administration policy that refused to insure mortgages in Black neighborhoods, shut Black Americans out of one of the most common avenues for accumulating wealth, home ownership. These factors have all played a role in a persistent Black-white wealth gap. According to a 2019 McKinsey report, median Black families have 10 times less wealth than median white families.

Liberté, égalité, fraternité—pour qui?

Many other countries, such as France, experience similarly entrenched racism, even though that country's national mythology purports it to be a steadfastly color-blind society. The government refuses to compile statistics on faith, ethnicity, or skin color in its census. This universalist outlook masks modern-day racism resulting from historical atrocities. As is true of many countries in Europe, France's role in perpetuating colonial race-based slavery in the Americas is often misunderstood, leading to a belief that racism is a new-world, not an old-world, problem.

As Maboula Soumahoro, a specialist in African diaspora studies at the University of Tours, told France 24, "Because slavery was illegal on the mainland, people in France have the impression that this hyper-racialized history that is characteristic of the modern world only concerns the Americas," adding that "France is not blind to racism. France *thinks* it's blind to racism." This refusal to see race, and the official policy that derives from it, leaves the country unprepared to address systemic racism.

Policing in France may be less lethal than in the United States, but violence and discrimination are targeted far more toward racial minorities than toward French people who are white. Young men perceived as Black or Arab are 20 times more likely to face identity checks. Twenty percent of young Black or Arab French people reported being the victim of brutality in their most recent police interaction—well above the 8 percent of their white counterparts.

As in the United States, however, this systemic racism extends far beyond treatment by police. In a country where religion is often strongly correlated with race, men perceived to be Muslim by employers are up to four times less likely to get a job interview than candidates seen as Christian, according to the think tank Institut Montaigne (Valfort 2015). A 2018 study by the University of Paris-Est Créteil found that job applicants with Arab-sounding names got 25 percent fewer responses than those with French-sounding names.

Racial—or racist—democracy?

Brazil's views on racism are also deeply rooted in its national self-image. For many, the country is viewed as a "racial democracy"—which stems from the belief that Brazil transitioned directly from the 1888 abolition of slavery (the last country in the Western Hemisphere to do so) to participatory, multiracial democracy, avoiding the discrimination enshrined in law in countries like the United States and South Africa. In the minds of many Brazilians, racism and discrimination don't exist in Brazil—after all, Brazil never passed laws like Jim Crow segregation or apartheid, so how could it be truly racist?

Yet in a country where people of partial or full African descent are in the majority, Blacks in Brazil lag far behind whites in major quality of life indicators. Black Brazilians fare far worse in educational attainment. For example, in 2012 fewer than 13 percent of Afro-Brazilians over the age of 16 had received postsecondary education, 15 points lower than whites (Pereira 2016).

Some would ascribe this to class differences, not race; however, one study found that among sets of Brazilian twins in the same household where one was labeled white and the other nonwhite, the nonwhite twin was at a distinct disadvantage in educational attainment, particularly if the twin was male (Marteleto and Dondero 2016).

Black Brazilians also bear the brunt of violence at the hands of law enforcement. In 2018, the police

PHOTOS: ISTOCK / VLIET; STREETMUSE; SCARLETSAILS; OSEPH GRUBER; ALEJANDROPHOTOGRAPHY; JOEL CARILLET; JEDRASZAK; JOEL CARILLET; JACOBLUND; 400TMAX

A less racist society can be an economically stronger one.

killed 6,220 people in Brazil, and despite representing about half of the national population, 75 percent of those killed were Black (Sakamoto 2019).

These systemic factors have widespread socioeconomic consequences. A study by the Brazilian Institute of Geography and Statistics found in 2019 that the average income for white workers was 74 percent higher than for Black and brown workers—a gap that has remained stable for years. Even with the same level of education, Afro-Brazilian men made only 70 percent of comparable white men's income, and Afro-Brazilian women only 41 percent.

Economic costs

Systemic racism is a global problem. It is real, and there is a robust moral argument for addressing it. However, one factor that is often ignored in this critical conversation is the broader economic dimension. Because it prevents people from making the most of their economic potential, systemic racism carries significant economic costs. A less racist society can be an economically stronger one.

For instance, the wealth gap between American whites and Blacks is projected to cost the US economy between $1 trillion and $1.5 trillion in lost consumption and investment between 2019 and 2028. This translates to a projected GDP penalty of 4 to 6 percent in 2028 (Noel and others 2019).

Or think of France, where GDP could jump 1.5 percent over the next 20 years—an economic bonus of $3.6 billion—by reducing racial gaps in access to employment, work hours, and education (Bon-Maury and others 2016). Witness also Brazil, which is losing out on vast sums of potential consumption and investment because of its marginalized communities.

A worldwide scourge

Of course, these three countries are not the only ones to experience racism, its deleterious social and economic effects, and the need for broader acknowledgment of its existence.

For instance, in a poll of Australians taken in the wake of the George Floyd protests, 78 percent of respondents said that US authorities have been unwilling to address racism. Only 30 percent believed there was institutional racism in Australian police forces. This view conflicts with both the lived experience of indigenous Australians in particular and with the A$44.9 billion the Alfred Deakin Institute believes racism cost Australia between 2001 and 2011.

Meanwhile, various racist incidents in China against African immigrants jeopardize the lucrative Sino-African trade and investment relationship. According to Yaqiu Wang, a researcher at Human Rights Watch, this is another case of discrimination denial, "where Chinese authorities claim 'zero tolerance' for discrimination, but what they are doing to Africans in Guangzhou is a textbook case of just that."

Countries should not try to address racism simply because it will help their economic development. It is a debt owed to their own citizens. However, the world should understand that commitment to respecting human rights and racial equity shouldn't be a passive statement of values. It should be a call to action, backed by active measures to acknowledge, understand, measure, and eradicate systemic racism. The world is at an inflection point, and it is up to our policymakers to meet the moment. If not, racism will continue to cost us all. FD

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