Foreword

Following the devastating health and economic crisis caused by COVID-19, the global economy appears to be emerging from one of its deepest recessions and beginning a subdued recovery. Beyond the short term economic outlook, this edition of *Global Economic Prospects* makes clear, policymakers face formidable challenges—in public health, debt management, budget policies, central banking and structural reforms—as they try to ensure that this still-fragile global recovery gains traction and sets a foundation for robust growth and development in the longer run.

Governments, households, and firms all need to embrace a changed economic landscape. While protecting the most vulnerable, successful policies will be needed that allow capital, labor, skills, and innovation to shift to new purposes in order to build a greener, stronger post-COVID economic environment. Some countries already moving toward this type of dynamism and resilience, will need to redouble their efforts. For others, change is especially critical now, when fiscal positions are severely stretched by the pandemic and other drivers of long-term growth have weakened.

Investment, in particular, collapsed in 2020 in many emerging market and developing economies, following a decade of persistent weakness. Investment growth is expected to resume in 2021, but, despite an uplift from advances in digital technology, not add enough to reverse the large 2020 decline. The experience of past crises raises a further concern—without urgent course correction, investment could remain feeble for years to come.

To counter the investment headwind, there needs to be a major push to improve business environments, increase labor and product market flexibility, and strengthen transparency and governance. These can re-kindle investment and help allocate it more effectively, but unsustainable debt burdens are a major obstacle. Already at record levels before the pandemic, both domestic and external debt burdens have become much heavier due to the devastating contraction in incomes across emerging market and developing economies.

To address the external debt burden, a comprehensive set of policy interventions is needed: broader participation by all private and official bilateral creditors in existing debt service relief efforts; deep debt reduction for countries in debt distress to increase the attractiveness for investment; better debt transparency practices that overcome secrecy and restrictions in debt contracts; legislative reforms to expedite the restructuring of private sector debt; and enhanced sequencing of these processes, which may involve countries running arrears with creditors as they work with international financial institutions to achieve debt sustainability.

Complicating the debt sustainability problem is the possibility that contingent liabilities from soaring private debt may be added to already high public debt. During the pandemic, many governments have supported lending to firms to address liquidity constraints, including loan guarantees, payment moratoria, and regulatory forbearance. These interventions highlight the challenge of balancing efforts to increase the availability of credit while maintaining proper regulatory standards to mitigate financial risks. As the health and economic crisis abates, these policies need to be reassessed periodically to ensure asset quality transparency and avoid undermining bank capitalization.

Policymakers also need to enhance supervisory assessments of loan quality and improve resolution and recovery regimes to address the potential challenges associated with elevated corporate debt levels. With non-performing loans likely to rise, more rapid bankruptcy and domestic debt resolution processes will be important in allowing assets to be relieved of litigation and repurposed for new uses. Adding new investment to productive existing assets will be vital for sustainable development.

In both the external and internal debt resolution processes, transparency is critical to bolster accountability, make future investment and debt more productive, and support the economic recoveries that are crucial for poverty reduction. Left unaddressed, the problem of unsustainable debt, and restructurings that do too little, will delay vital recoveries, especially in the poorest countries.

Mounting climate and environmental challenges add to the urgency of policy action, including on debt reduction and an improved investment framework. As countries formulate policies for recovery, they have a chance to embark on a greener, smarter, and more equitable development path. Investing in green infrastructure projects, phasing out fossil fuel subsidies, and offering incentives for environmentally sustainable technologies can buttress long-term growth, lower carbon output, create jobs, and help adapt to the effects of climate change.

Making the right investments now is vital both to support the recovery when it is urgently needed and foster resilience. Our response to the pandemic crisis today will shape our common future for years to come. We should seize the opportunity to lay the foundations for a durable, equitable, and sustainable global economy.

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