Centre for the New Economy and Society

Chief Economists Outlook

June 2021

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This quarterly briefing builds on the latest policy research as well as consultations and surveys with leading chief economists from both the public and private sectors, organized by the World Economic Forum's Centre for the New Economy and Society.

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

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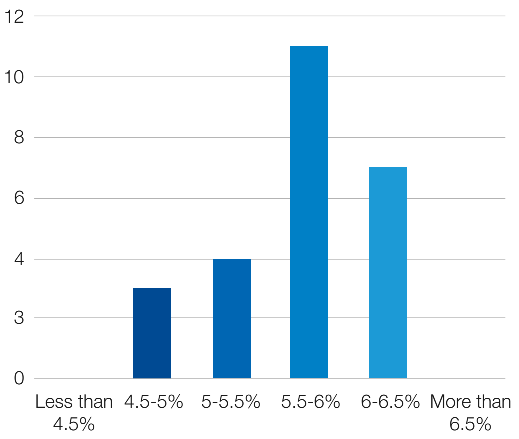
1. Shaping the recovery momentum

The June edition of the Chief Economists Outlook comes out amid improving aggregate recovery momentum, yet in a profoundly uncertain environment with widely diverging trajectories. Across countries, differentiated paths are opening up, determined to a large extent by access to vaccines and the financial resources available to governments. Soaring stock markets and rising commodity prices give the impression that the fortunes of the global economy are looking up. And yet, behind these numbers, some countries are experiencing dramatic new waves of the virus; people are still processing 18 months of ill health, grief and stress; millions of workers have dropped out of the global labour force; and job openings are going unfilled across advanced economies.

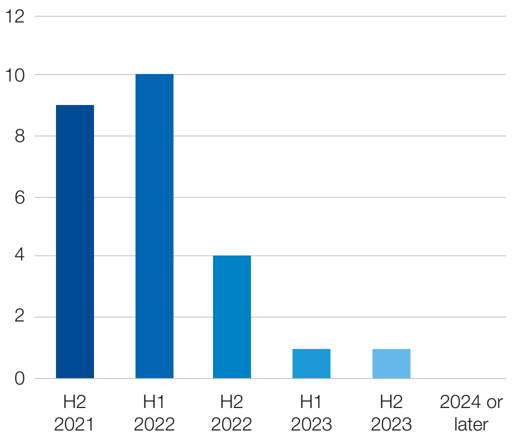
The second US stimulus package along with an acceleration in the roll-out of vaccines in high-income economies gave a boost to global growth forecasts this spring. The consensus among the World Economic Forum's Chief Economists Community is tending towards an expected average global growth rate in the range of 5.5% to 6% in 2021 (or possibly higher) and a recovery of global GDP to pre-COVID levels within the first half of 2022.

What is your global growth forecast for 2021?



Source: Chief Economists Survey

When do you expect global GDP to return to its pre-COVID level?



Source: Chief Economists Survey

In what follows, this edition of the Chief Economists Outlook explores the most important forces supporting the recovery as well as important developments and risks that could yet delay or derail it. Drawing on the collective views and individual perspectives of a group of leading Chief Economists, through the Forum's Chief Economists Survey and consultations with the Community, the Outlook aims to add some colour and nuance to current forecasts. The analysis focuses on economic variables and outcomes while recognizing that the single most important factor to shape the road to recovery is still the future trajectory of the virus. The latter will depend heavily on progress with vaccine roll-outs and the impact of future mutations.

In high-income countries, the recovery to date has been carried by generous government support. While emergency measures have generally been judged as commensurate and timely, questions have arisen over the proportionality and transformative power of stimulus packages. Measures vary widely across economies in their scale relative to output gaps and also in their level of ambition for economic and social transformation.

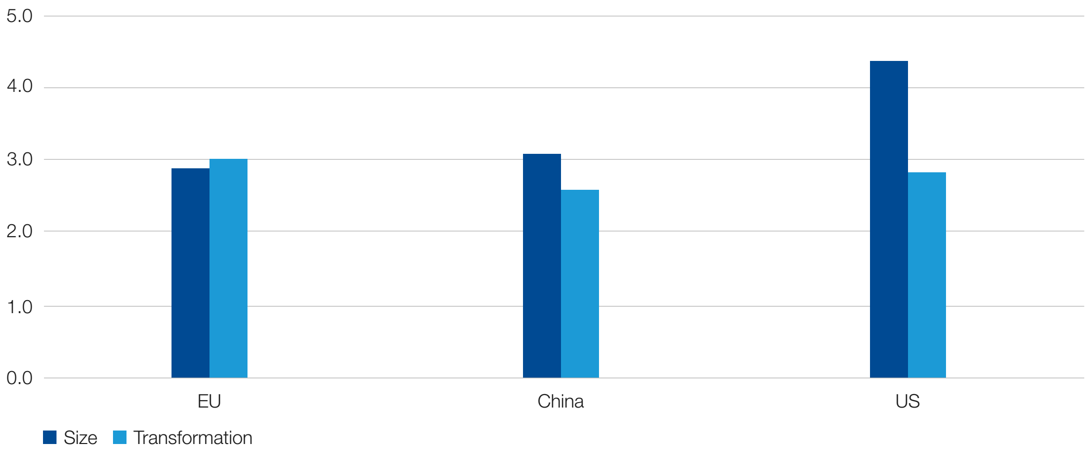
Three of the largest fiscal packages have been passed by the US, the EU and China. While stimulus measures put forward by the EU and China are judged as proportionate to existing output gaps by survey respondents, that of the US is seen as disproportionately large. Total COVID spending by the US government including emergency measures and fiscal stimulus adds up to almost 25% of GDP, compared to 4.7% for China, most of which was already implemented over the course of 2020. Given the comparatively lesser economic impact of the crisis, Chinese fiscal authorities were able to guard some room for manoeuvre on macro policy.[1] Measures taken by the EU add up to approximately 10% of EU27 GDP,[2] comprising the €750 billion ($906 billion) Next Generation EU (NGEU) recovery fund, finalized at the end of 2020, on top of €540 billion ($652 billion) emergency relief allocated by the European Commission.

In the US, the CARES Act passed in March 2020 allocated $2.3 trillion (11% of US GDP) of emergency measures. This was expanded at the end of the year, with a $868 billion (4.1% of GDP) COVID relief and government funding bill that topped up unemployment benefits and provided direct stimulus payments as well as additional resources for pandemic control. In March 2021, the American Rescue Plan came into force; this adds $1,844 billion of fiscal stimulus (approximately 8.8% of GDP) and was most recently topped up by an infrastructure plan ($2.3 trillion) and a families plan ($2 trillion over 10 years) of similar sizes.

1 HKEX, 2021.
2 IMF, 2021.

Proportionality and transformational power of recovery packages

Average score – for size: 1 = insufficient, 5 = disproportionate; for transformative power: 1 = not at all confident about transformative power; 5 = very confident about transformative power



Source: Chief Economists Survey

The transformative reach of the packages is judged as moderate in all three cases, with the EU's recovery plan coming out slightly ahead of the other two.

In China, the core measures have focused on increased spending on epidemic prevention and control, production of medical equipment, accelerated disbursement of unemployment insurance and extension to migrant workers, tax relief and waived social security contributions, and additional public investment.[3] While the immediate spending was focused mainly on public health measures, there are plans to significantly step up investment into digital infrastructure to support the recovery.

In the EU, the main beneficiaries are expected to be high-debt countries that suffered disproportionately in terms of the public health impact such as Italy and Spain, plus Eastern European countries. The NGEU combined with the 2021-27 EU budget have the highest climate component out of the major recovery packages, with 30% targeted towards climate change mitigation.

The US approach in the current phase consists of three pillars: the $1.9 trillion stimulus (the American Rescue Plan); an infrastructure plan; and a families plan to support educators, students and families. The American Rescue Plan stipulates additional funding for public health, including more money for vaccinations, temporary assistance to households and direct stimulus payments, as well as support for businesses, schools, and state and local governments. All objectives contained in the plans are in line with building a fairer and greener economy; however, the implementation of the planned measures, be they infrastructure or

3 Ibid.

education, is complex and requires attention to detail to become truly transformative.[4]

According to survey respondents, some dimensions are currently missing from recovery packages; several respondents point to the fact that too much emphasis has been given to short-term support over long-term structural transformation. It was suggested that the US has allocated too much in income transfers to households that did not suffer financially during the crisis and not enough in incentives for green infrastructure. More investment in the workforce would also be desirable, as would investment for innovation/transformation and alternative types of infrastructure, including digital. It was noted that, in the US, decisions over the direction of modernization are made difficult by extreme political polarization. In terms of structure and phasing, not enough provisions are being made for phase-out while, in the EU's case, more coordination among member states would be desirable and necessary to reach scale at the regional level.

Low- and middle-income countries have struggled even to allocate funds to address the immediate health crisis and will need continued financial support from the international community. While the allocation of a new round of special drawing rights (SDRs) by the IMF would be an important step in the right direction, the structure will most likely not be sufficient in the long run. Prominent commentators have argued for the international community to step up grants rather than extending more loans, supporting both the rollout of vaccines and, in the longer run, the green transition.[5] Given that global trade has been a significant contributor to poverty reduction in low- and middle-income countries in recent decades, it will also be important to ensure that domestic polarization in high-income economies is addressed via transfers rather than a move towards greater protectionism.[6]

There is also the larger question of where this leaves societies in terms of the deep structural transformation that many believe is necessary if market capitalism is to get a new lease of life post-COVID. A growing number of prominent voices are looking beyond the immediate challenge of fiscal stimulus and instead have called for a much deeper transformation of the existing economic system. They are pointing to the mismatch between value assigned by market interactions and value as experienced by individuals and society,[7] and are calling for a radical rethink of the social contract.[8] There is still a large gap between such visions of a different type of value creation within a new social contract and what is currently included in existing fiscal packages. Governments face the tremendous challenge of putting forward plans that are ambitious enough to truly transform, while not overshooting on spending to an extent that creates waste from bad targeting and hurried implementation.

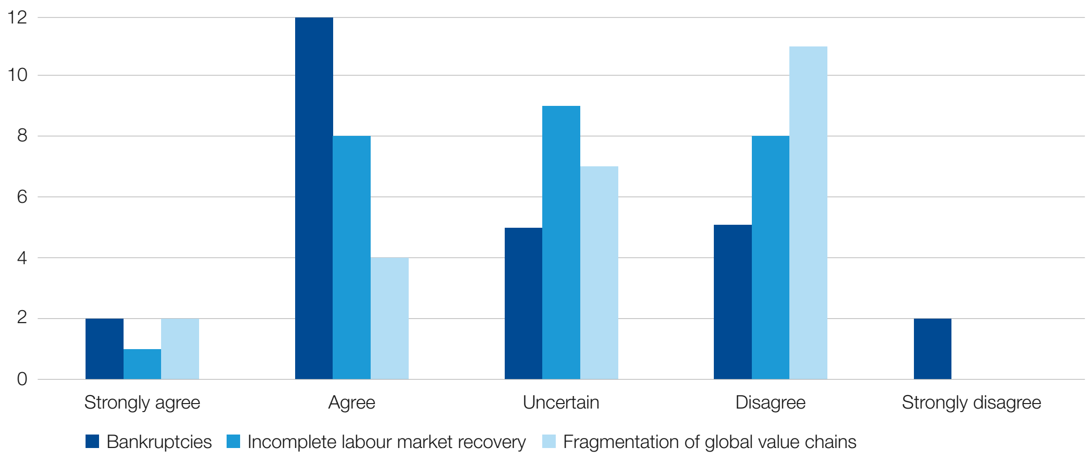
4 Bloomberg, 2021
5 Rogoff, 2021.
6 Ibid.
7 Coyle, 2014; Mazzucato, 2018; Shafik, 2021; Carney, 2021; Dasgupta, 2021.
8 Cottam, 2019; Shafik, 2021; Carney, 2021.

2. Avoiding economic scarring

A major open question concerns to what extent fiscal and monetary interventions can prevent scars in the economic and social fabric, be it from a delayed wave of bankruptcies, permanent drops in labour force participation or lasting damage to production networks and global value chains (GVCs).

Chief Economists currently see the greatest risk of scarring from bankruptcies that may yet materialize, followed by scarring in labour markets. The least risk is seen to come from permanent damage to global production networks.

There is a high probability of economic scarring due to:



Source: Chief Economists Survey

Generous emergency measures deployed during the first 15 months of the pandemic proved highly effective in keeping businesses afloat. Government support to companies included direct transfers, financing of wage bills, tax deferrals, debt moratoria and extensions of state loan guarantees as well as regulatory interventions.[9] Now, governments see themselves confronted with the difficult challenge of phasing out such measures without triggering a wave of bankruptcies. The European Central Bank (ECB) has warned that this is a significant risk and,

9 OECD, 2021.

if handled badly, holds the potential to set off the next financial crisis.[10] Survey responses confirm that this is the most important out of the three risks.

Long-term damage to the economy could also arise from an incomplete recovery of labour markets. The latest data highlights unusual patterns for the US labour market in particular, with jobs reappearing faster than job applicants. While US unemployment is still relatively high (at 7.6% adjusted), there were a large number of job openings, a record number of workers leaving their jobs, and composition-adjusted wages were growing at the same pace as in the much tighter 2017–2019 pre-pandemic labour market.[11] The question is whether this is merely a lag and therefore a temporary phenomenon or whether it points to deeper structural mismatches between post-pandemic jobs and the skills currently available in the market. Anecdotal evidence is emerging that part of the gap can be attributed to higher worker bargaining power stemming from more generous unemployment benefits.

A worrying development is that labour market participation has been dropping in recent months, taking some shine off any fall in unemployment figures. This has mostly concerned women. In the US, nearly 3 million women left the labour force during the pandemic, often due to burn-out and lack of childcare options.[12] While fathers have made up the ground lost during the pandemic, going back to work more quickly, mothers' labour force participation rate in the US is 2.8 percentage points below where it was in November 2019.[13]

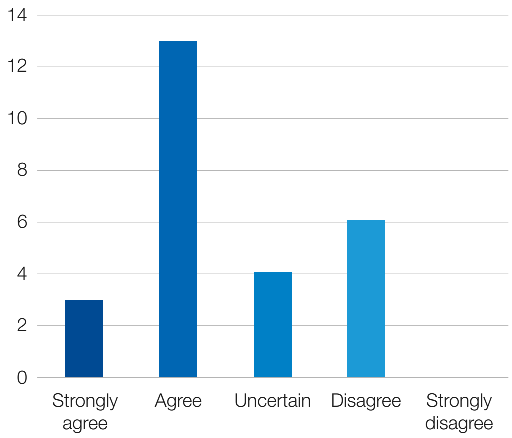
A permanent disruption to global production networks could be a third source of scarring, but this is seen as the least important of the three areas by survey respondents. Global value chains were severely disrupted during the early months of the pandemic in particular and may see a second hit if a wave of bankruptcies materializes. For now, however, global trade and GVC production is recovering to pre-pandemic levels, with the exception of the transport equipment sector. Preliminary data from this crisis and the experience of previous crises suggest that low levels of dismantling will probably materialize due to the high complexity and high restructuring costs.[14] It seems more likely that GVCs will see some diversification rather than reshoring. Overall, it is expected that the pandemic will reinforce the pre-existing dynamic of slowing offshoring activity and affect the design of future GVCs rather than the structure of existing ones.[15]

Much of the future recovery trajectory will depend on policy choices. Monetary policy has so far been highly accommodative of fiscal measures. Yet, in particular, the US government's rescue plan combined with increased savings rates, which rose significantly across advanced economies, have reawakened inflation. Some point out that leaders may currently be underestimating the strength of inflationary pressures, mistaking a structural shift for a temporary surge. If this is the case, there is a risk that higher inflation will become embedded before central banks decide to act. In addition, there is a worry that central bankers could give in to political pressures.[16] Furthermore, a number

10 Tooze, 2020.
11 Furman et al., 2021.
12 Tulshyan, 2021.
13 Boesch et al, 2021.
14 Simola, 2021.
15 Ibid.
16 Mallaby, 2021.

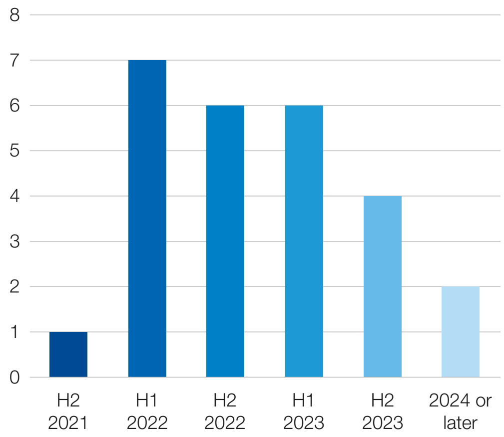
of central banks have recently added unemployment targets to their mandates and are exploring ways to actively support the green transition. The majority of survey respondents, however, believe that systemically important central banks will nevertheless continue to prioritize price stability.

Major central banks will continue to prioritize price stability.



Source: Chief Economists Survey

Given the current trajectory, when do you expect central banks in advanced economies to start raising rates?

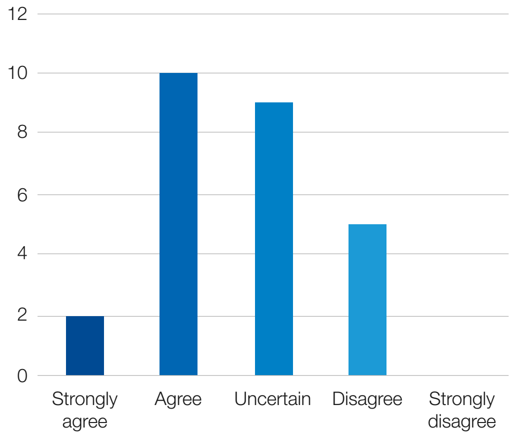


Source: Chief Economists Survey

Such a continued focus on prices implies that raises in rates may indeed be on the cards. A number of survey respondents believe that rate increases can be expected as early as the first half of 2022, while sequencing of tapering, rate increases and balance sheet shrinkages will vary between major central banks.

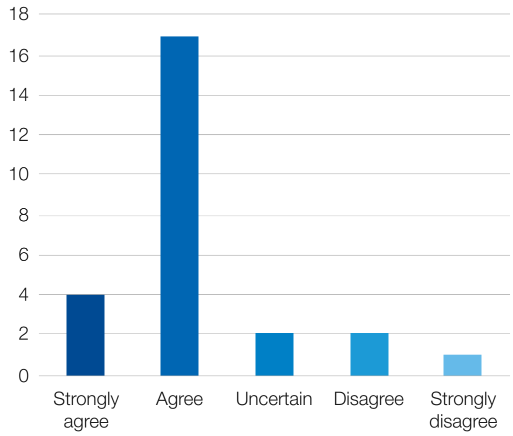
Should such rate increases indeed materialize, respondents expect to see a significant risk of debt defaults in low- and middle-income countries there is also a high likelihood of a significant correction for stock markets and other risky asset prices. Over the medium run, the assumption is, however, that asset prices will continue to stay disconnected from the real economy in the medium run.

A tightening of monetary conditions in the US is likely to trigger major debt crises in low- and middle-income countries.



Source: Chief Economists Survey

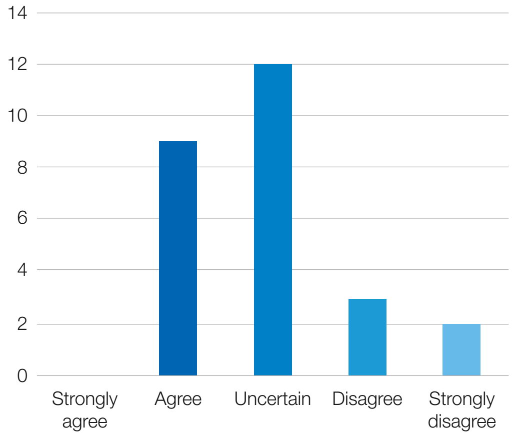
The disconnect between asset markets and the real economy will remain a feature of the global economy in the medium run.



Source: Chief Economists Survey

While central banks are largely expected to stick to their traditional mandate of price stability, a new direction is expected on the fiscal side. In addition to a revived discourse on making personal taxes more progressive, a global minimum corporate tax rate has become more likely in the wake of the recent US proposal. There is still much uncertainty about this question; however, most survey respondents who believe that such an agreement is now within reach expect such a global rate to land somewhere between 15% and 20%.

The US proposal for a global minimum corporate tax rate is likely to be adopted.



Source: Chief Economists Survey

3. Reversing domestic polarization and international divergence

Governments that could afford to offer payouts during the lockdown period were generous with emergency financial support to households and businesses. Still, the economic crisis had a disproportionately negative effect within countries on groups who have historically been disadvantaged based on their race, ethnicity, gender or socioeconomic status.

The younger generation is also facing a particular uphill battle, having experienced two global crises in just over a decade. According to a recent global workforce survey, 78% of Generation Z of 18–24 year olds saw their professional life affected by the crisis, and 39% lost their job, were furloughed or temporarily laid off. While still relatively high at 83%, optimism among Gen Z employees about their work life fell 10% during the pandemic, the biggest drop across all generations.[17]

The crisis accelerated automation, which has deepened labour market polarization within countries across all generations and is now turning into a recovery where some routine jobs will come back but will no longer be undertaken by human labour.

The climate transition is an additional challenge that looks set to further increase labour market tensions within countries and regions if not properly managed. The regions most in need of transformation away from carbon-intensive activity are often those with the lowest living standards; such regions tend to also have structural weaknesses in labour markets and will therefore have a tougher time transforming, requiring very targeted interventions from governments.[18] A lack of green skills is currently a major bottleneck for firms looking to transform their production.[19]

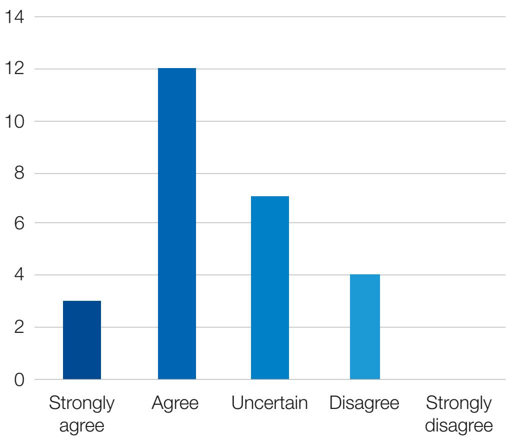
All of these forces together make for a challenging and complex dynamic that will need to be carefully managed through well-targeted government and business action. Beyond innovative labour and education policies, this will need to include a transformation of existing tax systems and greater efforts by firms to create true equality of opportunity in hiring, pay and progression.[20]

Upskilling and reskilling will be the most important pathways to countering labour market polarization and will require close coordination among governments, businesses and educational institutions.[21] The opportunities that lie in getting this right are tremendous. Recent models of potential gains from implementing OECD methodologies on upskilling suggest that even a conservative scenario could see a $5 trillion level shift in GDP globally as well as improvements in the quality of work and worker satisfaction.[22]

17 ADP, 2021.
18 EIB, 2021.
19 Ibid; Kimbrough, 2021a and 2021b.
20 See World Economic Forum, forthcoming, chapters 1 to 4.
21 See World Economic Forum, forthcoming, chapters 2 and 3.
22 PwC, 2021.

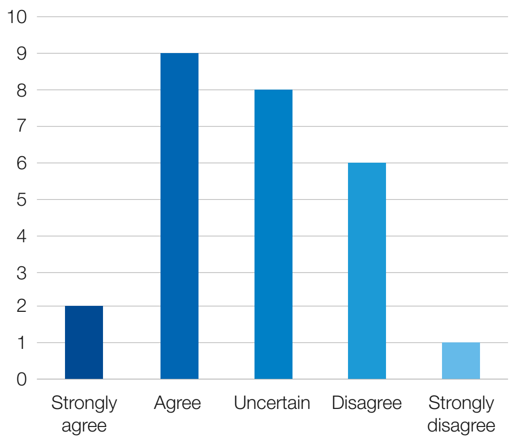
On the other hand, failure to address the deep and growing divisions in opportunities and outcomes could trigger more social unrest, providing new momentum to the wave that was gathering force around the world before the pandemic. Survey respondents feel there is indeed a significant risk of increased social unrest in the near future.

Social unrest can be expected to increase around the world in the near term.



Source: Chief Economists Survey

IP protection related to COVID-19 vaccines should be lifted in order to accelerate its production and distribution across the world.



Source: Chief Economists Survey

Across countries, convergence has also stalled, and gaps have increased between countries that were able to afford fiscal rescue measures and vaccines and those that were not. Internationally, growing divergence in resources and public health outcomes will have to be reversed through more generous fiscal support and faster access to vaccines for low- and middle-income countries.[23] The US made a recent push for lifting patents on vaccines, which has, however, faced international headwinds. A number of survey respondents agreed that a lifting of IP could help to accelerate the global roll-out, with the caveat that companies which developed the vaccines should be compensated in such a case as market incentives played an important role in the speediness with which COVID vaccines were developed. An alternative would be more generous funding for the COVID-19 Vaccines Global Access (COVAX) facility. The IMF has put forward a proposal for targets and means to end the pandemic costing $50 billion.[24]

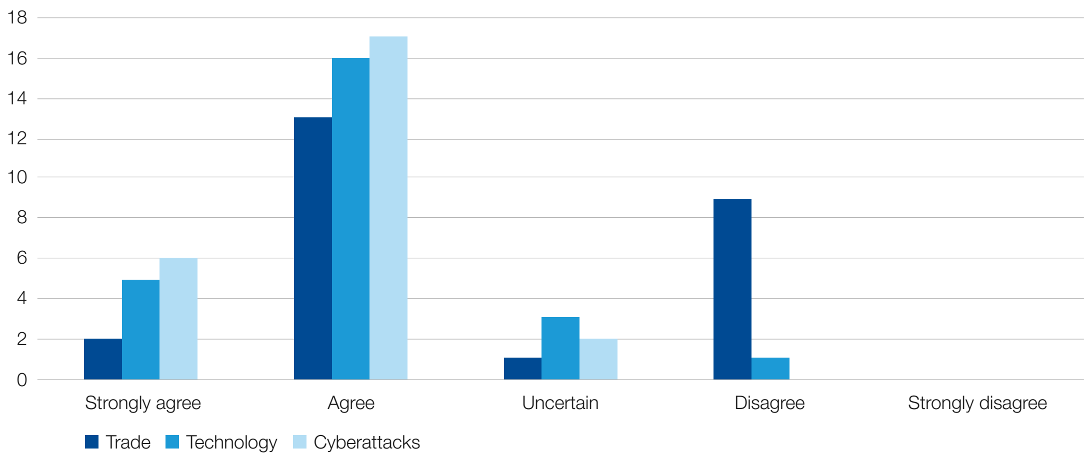
How governments now manage the transition to accelerate structural change that brings more inclusive outcomes within countries will be as critical as the action of the international community to bridge gaps across countries.

23 Rogoff, 2021.
24 Georgieva et al, 2021

The tougher the pressures domestically, the more temptation there will be for internal political forces to ramp up protectionist measures. While multilateralism is currently seeing a revival, political forces are building in many countries that may put this reopening into question.[25] Even in the current circumstances of a relative détente, tensions between large powers remain and are generally expected to increase over the medium run. While some point out that the high level of interconnectedness today will counteract political efforts to further escalate such tensions, the rhetoric of self-reliance is getting louder and dependence on other countries is portrayed as a vulnerability by politicians rather than a source of mutual gain. The COVID crisis made clear that trading relationships between countries cannot be taken for granted, as health measures and national interest took priority.

An additional and currently underestimated danger that could also derail the recovery and future growth are large-scale cyberattacks, including those performed by state actors. Indeed, survey respondents see the largest tensions or conflict potential internationally arising from cyberattacks, followed by technology and trade tensions.

Tensions between major economies can be expected to increase significantly in the medium run in the following areas:



Source: Chief Economists Survey

25 Rachman, 2021.

4. Accelerating the climate transition

As more recovery measures start to be implemented, the coming months will be critical for putting the climate transition on the right track. Expectations of policy-makers for timely guidance, public investments and reliable framework conditions are high, as the biggest bottleneck for private investment in the green transition currently is policy uncertainty.[26] Progress on this front will be critical to rein in the slowest burning but by far most destructive of the risks to the current recovery trajectory.

Investment has been hit hard by the pandemic, and investment shortfalls in Europe, for example, are much larger than recovery packages can compensate for. On the public side, 70% of surveyed European municipalities report investment gaps with respect to climate change mitigation and adaptation in the last three years.[27] On the private-sector side, the urgency to adapt post-pandemic and to close pre-pandemic investment gaps is well understood by firms. Yet important obstacles to climate investments, in particular uncertainty about regulation, investment costs and skills shortages, remain.

There is significant potential for firms to create new value at the intersection of green and digital, giving rise to the possibility of a twin transformation. Firms that are in the top 20% for both the green and digital transformation are seeing an acceleration of revenue and profitability and are 2.5 times more likely to become industry leaders.[28] Importantly, we are seeing a levelling of the playing field at this intersection. The cards are being reshuffled and the winners of tomorrow will not necessarily be the winners of the past.

There is hope for new progress on climate and environmental protection since the US rejoined the Paris Agreement earlier this year and an increasing number of countries and businesses are making commitments to carbon neutrality. A significant number of members of the Chief Economists Community believe that 2050 is not ambitious enough for net-zero targets and are instead looking for such targets to be advanced – some even suggest to before 2035. In particular, there is a feeling that climate action must be moved from being an afterthought to targets to becoming an immediate priority. This would need to entail more political will and bigger commitments from businesses. Survey respondents believe, on average, that the likelihood of 2050 targets to be reached is 50% for governments and 62% for businesses.

While national governments have hesitated to adopt a carbon tax, there is a consensus among survey respondents that this may well be the most effective instrument to reach targets for carbon

26 EIB, 2021.
27 ibid
28 Accenture, 2021.

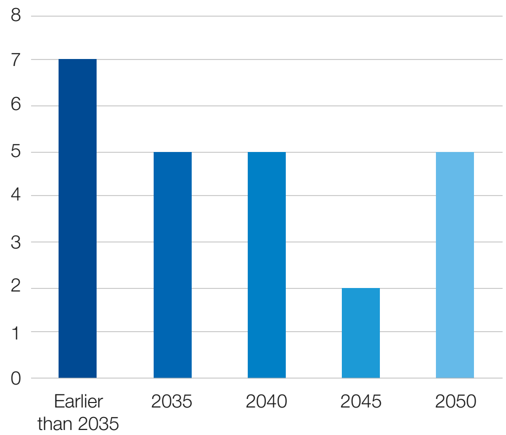
neutrality. A uniform carbon price would be a much-needed coordination signal for the massive public and private investment that will be required to prevent a climate catastrophe. At the same time, it would provide revenue to alleviate the burden of adaptation on the weakest households, firms and regions and provide funds for upgrading infrastructure.[29]

In order to serve as an effective and credible coordination mechanism, the carbon price faced by all actors, sectors, regions and technologies should be uniform. Governments may need to allow some time for convergence to a uniform price and financial transfers can help to bridge gaps between different adjustment speeds.[30]

Since prices set in existing schemes remain too low, cost-benefit analyses and other models should aim to use the shadow price of carbon that would be required to meet current climate ambitions. A uniform carbon price, however, while possibly being the most effective policy instrument, will need to be complemented with education as well as social and regulatory nudges.

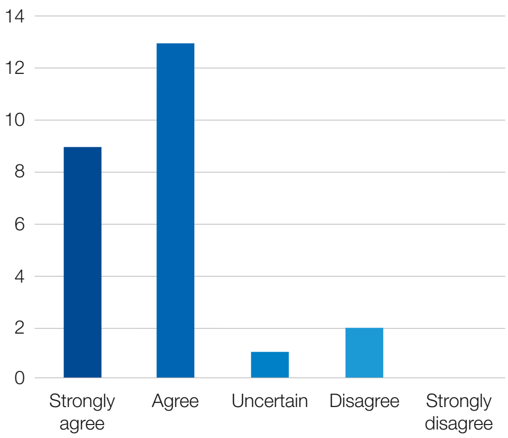
Taking a global approach to the green transition and supporting investments in green technology and skills, including lower-productivity firms and disadvantaged workers, seems to be one of the most constructive ways of countering the forces that are driving today's K-shaped recovery.

The optimal deadline for net-zero commitments by governments and businesses is:



Source: Chief Economists Survey

A carbon tax is among the most effective policy tools in the fight against climate change.



Source: Chief Economists Survey

29 Schmidt et al., 2021.
30 Ibid.

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