Chapter 1: Tailoring Fiscal Responses

The race to vaccinate against COVID-19 continues, but the pace of inoculations is widely different across countries, with access unavailable for many. Global vaccination is urgently needed. Global inoculation would pay for itself with stronger employment and economic activity, leading to increased tax revenues and sizable savings in fiscal support. Until the pandemic is brought under control globally, fiscal policy must remain flexible and supportive of health care systems, households, viable firms, and the economic recovery. The need and scope for support varies across economies, depending on the effect of the pandemic and the ability to access low-cost borrowing. Many governments in advanced economies are implementing sizable spending and revenue measures in 2021 (6 percent of GDP, on average). Support in emerging market economies and especially in low-income developing countries has been smaller and front-loaded, with a large share of measures expiring.

Fiscal support has prevented more severe economic contractions and larger job losses. Meanwhile, such support, along with drops in revenues, has raised government deficits and debt to unprecedented levels across all country income groups. Average overall deficits as a share of GDP in 2020 reached 11.7 percent for advanced economies, 9.8 percent for emerging market economies, and 5.5 percent for low-income developing countries. Countries’ ability to scale up spending has diverged. The rise in deficits in advanced economies and several emerging market economies resulted from roughly equal increases in spending and declines in revenues, whereas in many emerging market economies and most low-income developing countries, it stemmed primarily from the collapse in revenues caused by the economic downturn. Fiscal deficits in 2021 are projected to shrink in most countries as pandemic-related support expires or winds down, revenues recover somewhat, and the number of unemployment claims declines.

Average public debt worldwide reached an unprecedented 97 percent of GDP in 2020 and is projected to stabilize at around 99 percent of GDP in 2021. Despite higher debt, average interest payments are generally lower in advanced economies and many emerging markets, given the trend decline in market interest rates. In pursuit of their mandates, central banks have lowered policy rates and purchased government bonds, thereby facilitating the fiscal responses to the pandemic. For low-income countries, however, financing large deficits continues to be challenging, given limited market access and little scope to raise revenue in the near term. These countries need assistance through grants, concessional financing, or, in some cases, debt restructuring. Over the medium term, fiscal deficits are projected to shrink in all income groups as recoveries increase pace and fiscal adjustments resume. As a result, the debt-to-GDP ratios in most countries are projected to stabilize or decline, although public debt will continue to increase in a few countries because of factors such as aging and development needs.

Uncertainty concerning the fiscal outlook is unusually high. On the upside, faster-than-expected vaccinations could expedite an end to the pandemic, boosting revenue collections and reducing the need for additional fiscal support. On the downside, a more protracted economic downturn, an abrupt tightening of financing conditions amid high debt, a surge in corporate bankruptcies, volatility in commodity prices, or rising social discontent could inhibit the recovery. In general, the longer the pandemic lasts, the larger the challenge for the public finances.

Against this backdrop, fiscal policy priorities include continuing support as needed while vaccinations proceed and the recovery strengthens; promptly implementing the announced fiscal measures with upgraded project execution capacities and procurement procedures; pursuing a green, digital, and inclusive transformation of the economy; tackling long-standing weaknesses in public finances once the recovery is firmly in place; developing medium-term fiscal strategies to manage fiscal and financing risks; and renewing efforts to achieve the Sustainable Development Goals. To meet these priorities:

• Global cooperation must be scaled up to contain the pandemic, especially accelerated vaccination
at affordable cost in all countries. In an upside scenario in which the pandemic is controlled sooner in all countries (see the April 2021 World Economic Outlook), stronger economic growth would yield more than $1 trillion in additional tax revenues in advanced economies, cumulatively, by 2025, and save trillions more in fiscal support measures. Vaccination will, thus, more than pay for itself, providing excellent value for public money invested in ramping up global vaccine production and distribution.

- The targeting of measures must be improved and tailored to countries’ administrative capacity so that fiscal support can be maintained for the duration of the crisis—considering an uncertain and uneven recovery. Given the low-interest environment, a synchronized green public investment push by countries with fiscal space can foster global growth.

- Policymakers need to balance the risks from large and growing public and private debt with the risks from premature withdrawal of fiscal support, which could slow the recovery. Credible medium-term fiscal frameworks are critical for attaining such balance, setting a path for rebuilding fiscal buffers at a pace contingent on the recovery. This effort could be supported by improving the design of fiscal rules or recalibrating their limits to ensure a credible path of adjustments or legislation such as “preapproving” future tax reforms. Improving fiscal transparency and governance practices can help economies reap the full benefits of fiscal support.

- To help meet pandemic-related financing needs, policymakers could consider a temporary COVID-19 recovery contribution, levied on high incomes or wealth. To accumulate the resources needed to improve access to basic services, enhance safety nets, and reinvigorate efforts to achieve the Sustainable Development Goals, domestic and international tax reforms are necessary, especially as the recovery gains momentum.