Preface

In the midst of exceptional uncertainty, policy makers around the globe are grappling with the delicate task of scaling back the economic support measures put in place during the early stages of the COVID-19 pandemic while encouraging creation of the conditions needed to restore economic activity and growth.

One significant challenge is the lack of transparency—created or reinforced by the pandemic and (unintentionally) exacerbated by policy actions—about the risks in the balance sheets of the private and public sectors. What we do know is that the pandemic-induced recession of 2020 led to the largest single-year surge in global debt in decades. Before the pandemic, private debts were already at record highs in many advanced economies and emerging economies, leaving many households and firms poorly prepared to withstand an adverse income shock. Many governments were also facing record-high levels of debt prior to the pandemic, and many more significantly increased their debt burdens to fund vital response policies. In 2020, the average total debt burden of low- and middle-income countries increased by roughly 9 percentage points of the gross domestic product, compared with an average annual increase of 1.9 percentage points over the previous decade. Fifty-one countries (including 44 emerging economies) experienced a downgrade in their sovereign debt credit rating.

What we do not yet know, however, is the extent to which governments and private debtors are harboring hidden risks with the potential to stymie economic recovery. In particular, increased complexity and opacity in sovereign debt markets (as to who holds the debt and under what terms) often make it difficult to assess the full extent of risks in government balance sheets. On the private side, common elements of pandemic response programs, such as moratoria on bank loans, general forbearance policies, and a marked relaxation in financial reporting requirements, have made it difficult to determine whether debtors are facing short-term liquidity challenges or whether their incomes have been permanently affected. For both, the risk is insolvency on a scale and scope that are difficult to gauge in advance.

Within the context of uncertainty, the world is confronting the daunting challenge of continuing to navigate a global pandemic, while managing and reducing financial risks across household, business, financial, and government sectors. Problems in one area can and do reverberate across entire economies through mutually reinforcing channels that connect the financial health of all sectors. What at first blush appears to be an isolated disruption in one sector can very quickly spill over to the rest of the economy. For example, if households and firms are under financial stress, the financial sector faces a higher risk of loan defaults and is less willing or able to provide credit and support economic recovery.
As the financial position of the public sector deteriorates as a result of higher sovereign debt and lower tax revenue, many governments find that they are less able to support economic activity.

Policies that facilitate the early detection and swift resolution of economic and financial fragilities can make all the difference between an economic recovery that is robust and one that falters—or, worse, one that delays recovery altogether. Starting with an in-depth assessment of the severest and most regressive financial and economic impacts of the pandemic, this World Development Report puts forward a focused, actionable policy agenda that countries can adopt to cope with some of the harmful and potentially lasting economic effects of the pandemic. Some of these policies seek to reduce opacity in credit markets, for example, by ensuring that banks report accurate, timely indicators of loan quality or by increasing transparency around the scale and terms of sovereign debt. Other initiatives aim to accelerate the resolution of debt distress through improved insolvency proceedings for companies and individuals, and proactive efforts to reprofile or restructure sovereign debt.

Because there is no one-size-fits-all approach to economic recovery, the appropriate policy mix depends critically on prevailing conditions and policy capacity. Few if any governments have the resources and political leeway to tackle simultaneously all of the challenges they face as the pandemic recedes. Countries will need to prioritize. The potential for policy to contribute to a lasting, inclusive recovery will depend on the ability of governments, working in partnership with international financial institutions and other development professionals, to muster the political will for swift action.

Carmen M. Reinhart
Senior Vice President and Chief Economist
The World Bank Group