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COVID-19 and the fiscal and monetary challenges to implementing *Our Common Agenda*

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Abstract

This contribution examines the fiscal and monetary policy legacies of the COVID-19 pandemic. Thanks to exceptional support from governments and central banks, the world economy returned rapidly to growth following the dramatic global lockdowns of spring 2020. However, the huge fiscal and monetary interventions involved raise significant challenges for future growth and financial stability, especially given the sharp rise in inflation from mid-2021. These challenges make implementing the ambitious *Common Agenda* of the United Nations difficult, especially as the war in Ukraine has greatly weakened international cooperation.

1 | INTRODUCTION

In September 2021, the United Nations (UN) published *Our Common Agenda* following the 75th anniversary of the UN Charter. In the best traditions of multilateral cooperation, the *Agenda* calls for wide-ranging efforts to meet the immediate and longer term challenges the global community faces, including tackling the consequences of the pandemic, pursuing sustainable development and climate action, securing the future for young people, fostering inclusive growth and promoting women's rights (United Nations, 2021).

Unfortunately, the prospects for multilateral cooperation to achieve this *Agenda* look increasingly grim, given especially the war in Ukraine, started by Russia on 24 February 2022. The war has rekindled a strong antagonism between 'the West' and Russia, tacitly supported by China, while the Global South is not taking sides, noting perhaps that the Anglo-American war in Iraq in 2003 was launched without UN support.

This fragmentation of the international community follows the weakly-coordinated global response to dealing with the COVID-19 pandemic. In some ways, this failure was surprising, as the virus has truly affected

peoples everywhere similarly. Yet while it has been stated persistently that 'no one is safe until everyone is safe', collective action to fight the pandemic has been wanting, contrasting cruelly with the G20 response to the global financial crisis (GFC) in 2007–2009, when *The System Worked* (Drezner, 2014). The response to COVID-19 provides a poor template for implementing *Our Common Agenda*, let alone tackling climate change.

Moreover, the pandemic has led to further rises in public debt worldwide. Although the action involved minimal coordination, governments in the advanced economies and elsewhere pursued similar policies to support households and firms to weather the lockdowns of 2020. The world's major central banks too intervened massively to prevent economic collapse. These policies not only helped the world economy to rebound quickly but have also contributed to the unexpected rise in inflation as of mid-2021, which now poses major policy challenges.

Section 2 of this article reviews the fiscal and monetary policy response to COVID-19. The next section examines the legacy of these policies. Section 4 seeks to examine what this means for the *Agenda*. The last section concludes.

2 | MASSIVE FISCAL AND MONETARY SUPPORT TO PREVENT ECONOMIC BREAKDOWN

Before the war in Ukraine, forecasts by international institutions predicted a sustained rebound of the world economy in 2022, albeit with slower growth. This follows the slump of 2020, which was the worst economic setback since the Great Depression of the 1930s (Gopinath, 2020)—though China still recorded growth. Table 1 shows forecasts provided by the World Bank, for example, and indicates downgrades since the war began.

The rebound follows substantial intervention by public authorities across the world. When the pandemic led to the worldwide lockdown in March 2020, the major central banks, and especially the US Federal Reserve (Fed), stepped in to restrain asset price falls and ensure financial market stability. It cut the Federal funds rate to 0%–0.25% on 16 March 2020, and a new, huge round of quantitative easing (QE) was launched, with the Fed's assets jumping from \$4.2 to \$7.2 trillion by June, before rising more slowly to \$9.0 trillion by the end of March 2022 (FRED St Louis). Altogether, the central banks of Japan, the United Kingdom, the United States and the Eurozone increased their balance sheets by \$10.2 trillion, with total assets expanding to \$25.9 trillion, as of September 2021 (UN DESA, 2022). Also, 27 emerging market and developing economies (EMEDs) announced or implemented asset purchasing programmes during 2020 (including 10 countries in Africa, nine in Asia and eight in Latin America and the Caribbean). These programmes were much more modest, ranging from \$300 million to \$30 billion (i.e. between 0.3% and 6% of GDP), but EMEDs had more room to cut interest rates. In addition, the US Fed extended 'swap lines' (essentially reversible, short-term currency swaps) to key central banks to stabilise currency

movements and provided dollar liquidity across the global economy by buying dollar-denominated assets (Aizenman et al., 2021).

Simultaneously, governments across the world intervened to support households and companies. Policies were not coordinated, with the Trump administration showing little interest in international cooperation. Approaches also varied across countries, as European governments provided support for wages, keeping employees in jobs and ready to work after lockdowns. By contrast, the United States expanded benefits for the jobless, as unemployment surged to 15% by May 2020. Companies too were widely given access to government-backed loans or funding. In short, fiscal intervention was colossal: Public and private debt surged around the world (relative to contracting GDP) as shown by figures from the Bank of International Settlements (Table 2). This fiscal largesse was made possible by ultra-loose monetary policy and QE, which held down long-term interest rates.

These combined measures provided the basis for a rapid upturn in the global economy. By the end of 2021, world GDP had surpassed its level at the end of 2019, and so had international trade, especially from Asia. There China experienced a very early pick up in trade in 2020, while for other countries (e.g. Taiwan, Hong Kong, Malaysia, Thailand, Philippines, Singapore and Vietnam), trade exceeded 2019 levels by the end of 2021 (OECD, 2021).

3 | THE PANDEMIC AND THE RETURN OF INFLATION

Compared with the policy response following the GFC, governments at the time of writing (November 2022) have remained more supportive of growth, especially given the war in Ukraine which has prolonged fiscal

TABLE 1 World Bank growth figures as well as estimates (e) and forecasts (f) for growth, January and June 2022.

	2019	2020	2021e	2022f	2023f	2024f
Global economic prospects January 2022						
World	2.6	−3.4	5.5	4.1	3.2	
Advanced economies	1.7	−4.6	5.0	3.8	2.3	
Emerging market and developing economies	3.8	−1.7	6.3	4.6	4.4	
China	6.0	2.2	8.0	5.1	5.3	
Global economic prospects June 2022						
World	2.6	−3.3	5.7	2.9	3.0	3.0
Advanced economies	1.7	−4.6	5.1	2.6	2.2	1.9
Emerging market and developing economies	3.8	−1.6	6.6	3.4	4.2	4.4
China	6.0	2.2	8.1	4.3	5.2	5.1

Source: World Bank (2022).

TABLE 2 Credit to the non-financial sector.

	2018	2019	2020	2021Q4
Total credit to the non-financial sector (core debt) as a percentage of GDP				
All reporting countries	235.0	246.1	290.8	264.4
Advanced economies	264.4	273.6	320.9	320.9
United States	250.8	255.1	296.3	280.8
Euro area	257.5	258.0	289.3	279.4
Japan	371.8	380.4	420.8	419.9
Emerging market economies	188.8	203.0	243.2	227.8
China	254.3	263.1	291.7	286.6
Total credit to the government sector at nominal value (core debt) as a percentage of GDP				
All reporting countries	79.1	82.2	101.5	93.2
Advanced countries	98.1	100.3	123.0	111.9
United States	98.7	99.9	123.0	117.9
Euro area	85.8	83.8	97.3	95.7
Japan	200.5	203.0	226.9	224.9
Emerging market economies	49.2	53.7	67.4	65.5
China	53.7	57.6	69.1	72.2

Source: Bank of International Settlements (updated on 13 June 2022). Available from: <https://www.bis.org/statistics/totcredit.htm> [Accessed 11th August 2022].

support in Europe for households and firms to deal with surging energy prices. Care has been taken to avoid choking off activity following the pandemic, with the EU, for example taking the historical step of launching a joint recovery plan in the summer of 2020 worth €750 billion (in 2018 prices), and financed by collective borrowing (European Commission). This approach reflects the lessons of the GFC, when attention in Europe rapidly switched to not only reducing public deficits, partly out of conventional concerns about controlling public finances, but also following influential research by Carmine Reinhart and Kenneth Rogoff. In 2010, they published a cross-country, historical study indicating that when public sector debt rises above 90% of GDP, it leads to a median fall in growth of 1 percentage point (Reinhart & Rogoff, 2010). While contested at the time, this easy-to-understand finding had quite some impact on encouraging austerity policies among many leading advanced economies.

Moreover, shortly before the pandemic, thinking about fiscal policy became more accommodative, after Oliver Blanchard's notable presidential address to the American Economic Association in January 2019. While not 'argu[ing] for higher debt per se', Blanchard provided empirical evidence to show that over time, the growth rate in the United States tends to be higher than the real 'safe interest rate' paid by the government (Blanchard, 2019). In other words, public debt as a share of GDP has an in-built tendency to fall—at least in theory in the United States.

Then, as the pandemic unfolded, it even seemed that so long as governments and central banks were working together, the more traditional constraints of fiscal policy could be pushed back further. Commenting on the new policy environment in August 2020, Adam Tooze (a leading historian of the GFC) gave several reasons for this, including the fact that in moments of crisis, investors tend to turn to the security of government bonds, allowing governments to borrow very cheaply. Also, QE meant that central banks could support the demand for government bonds in secondary markets. Moreover, the global economy was still experiencing an excess of savings over investment, holding down interest rates (Tooze, interview with Levitz, 2020). Tooze, among others, has also repeatedly noted that compared with the stagflation of the 1970s, workers today have been fundamentally weakened and are in a poor position to push for wage rises (Tooze, 2022).

Such considerations led the incoming Biden administration in early 2021 to 'go big' with its first federal budget. Although the Trump administration had pumped \$2.9 trillion into the US economy in 2020, the new Biden team passed a \$1.9 trillion stimulus on taking office, despite warnings about inflation, notably from Lawrence Summers, a leading economist and prominent member of the Democratic establishment (Blanchard, 2021). And so it has come to pass. From spring 2021 onwards, prices began to surge strongly, in the United States and throughout the world. Initially, this was attributed to transitory bottlenecks of supply chain disruptions after COVID-19. As price rises persisted, other explanations emerged, like the overhang of savings accumulated by households during lockdowns that led to subsequent demand surges. Labour shortages too appeared to be playing a role, with the United States and the United Kingdom especially being affected by a 'great resignation': a varied phenomenon that saw employees reluctant to return to work as before, often looking for new jobs or retiring (OECD, 2021). Nor have the effects of COVID-19 disappeared entirely, as Shanghai went into another lockdown in spring 2022. While the supply chain consequences of this were less than of the Wuhan lockdown in 2020, China's zero-COVID policy means that possible future lockdowns could still be disruptive (Nie, 2022).

Furthermore, the pandemic is accelerating the global re-organisation of supply chains. This trend has been visible since the Fukushima disaster in 2011 and other events in the 2010s. Yet, it is also a result of the 'weaponisation' of supply chains as the geopolitical context is hardening, especially with the increased confrontation between China and the United States (Palit, 2022).

The weaponisation of trade since the start of the war in Ukraine has likewise played an immediate role in surging commodity prices. Energy prices were rising strongly in Europe and elsewhere *well before the war*. Yet, the start of hostilities has greatly

reinforced the price crunch, as Western countries have imposed sanctions on Russian oil and gas exports, while Russia began winding down gas supplies to Europe during the summer of 2022. The war has stoked up food price rises too, with grain and fertiliser exports from both countries severely curtailed (Krugman, 2022).

As inflation has become more entrenched, repeated references have been made to the stagflation of the 1970s—a time of intense monetary convulsions, as the dollar came off the gold standard in August 1971, ushering in the era of fiat money, the emergence of new financial instruments (like financial futures), and the accelerated development of international capital markets. Then, the Yom Kippur War in September 1973 triggered the first oil shock, causing growth to slump in the West and prices to spiral.

Today too, significant questions hang over the future of monetary policy and the legacy of QE. As inflation has surged, central banks have begun tightening policy, with the Fed in the lead: In early November 2022, it raised the federal funds rate from 3.75% to 4%, thus quite far off the lower bound. The hope remains that inflation will subside soon, notably as labour is weaker than in the 1970s, while the competitive pressures of international trade continue. But if inflation persists, interest rates could likely rise much more. This however could have a big impact on asset prices, much buoyed up by QE, and carry risks of financial instability. For the moment, the question of ‘financial dominance’ (i.e. the reluctance of central banks to tighten policy for fear of provoking financial shocks) seems to be held in check, as banks have been strengthened since the GFC and have weathered the COVID-19 storm (Gros & Shamsfakhr, 2021). Yet the cycle of monetary policy tightening may still have some way to go, as governments generally are reluctant to pursue strong fiscal consolidation to tackle inflation. Central banks are thus still the key players in leading macroeconomic policy, and financial instability cannot be ruled out in the medium term: The dramatic economic *and* political gyrations experienced by the UK in October 2022 (with sharp changes in policy and yet another change of Prime Minister) are an indicator of financial market nervousness. For its part, the Eurozone faces renewed worries about fragmentation, as markets speculate against the government bonds of weaker economies (Jones, 2022).

Indeed, the full, long-term consequences of QE and its unwinding remain unknown. In the 2010s, very low interest rates and QE contributed to asset price inflation but not consumer price inflation. Monetary policy was *The Only Game in Town*, with governments largely constrained to leaving macroeconomic policy-making to central banks (El-Erian, 2016). Low inflation even led the Fed to adjust its policy regime in 2019, to accept above-target inflation following periods of

below-target price rises (Powell, 2019). But there have always been doubters about QE and ultra-low interest rates, especially when pursued for years after the GFC (Leonard, 2022), and so completely disrupting the traditional functioning of credit, saving and banking. Instead of real interest rates rising with the length of loans, so-called yield curves became flat (as long-term market interest rates were low and close to short-term rates). This has led investors who can borrow cheaply to bet in asset markets like stocks and real estate (or speculative instruments like cryptocurrencies), whereas modest and young households have found it impossible to accumulate traditional savings (Ugeux, 2021), often locked out of homeownership by high prices.

Furthermore, while labour is weaker than it was during the 1970s, Charles Goodhart (one of Britain's most seasoned macroeconomists) and Manoj Pradhan published a significant book, in 2020, about *The Great Demographic Reversal*, arguing that global labour markets face a historic tightening (Goodhart & Pradhan, 2020). They observe that the age of globalisation from 1980 until COVID-19 was also a period of expanding world labour supply, first as women continued to integrate labour markets in the advanced economies and then as substantial new labour from Eastern Europe and especially China entered the global economy. For Goodhart and Pradhan, these historic developments are now over, notably as China is ageing. As a result, the downward pressure on wages in the advanced economies from labour elsewhere is giving way to tighter job markets. Production offshoring will no longer be so profitable, and workers in advanced economies will become more powerful. Ominously, they argue that these changes ‘will catch the authorities unawares’. The weaponisation of trade and the re-organisation of supply chains discussed above will moreover likely aggravate these trends.

4 | COVID-19'S ECONOMIC LEGACY AND THE AGENDA

The economic legacy of the *continuing* COVID-19 pandemic is challenging to the extreme. Government *and* private sector indebtedness has soared, following the public debt surges linked to the GFC. Quite what this new increase in debt means is difficult to tell. The experience of Japan, which has seen debt levels rise very strongly since its asset price crash at the start of the 1990s, suggests that considerable debt build-ups are possible, at least in advanced economies. However, a fundamental difference exists here between the world's major economies, where governments can issue debt in their own currency and sell it domestically and internationally, and other economies. The latter suffer from so-called ‘original

sin' and are constrained to borrow in dollars, often at floating interest rates (Eichengreen et al., 2003). As a result, they face substantial risks, especially when the Fed tightens policy.

This occurred spectacularly after the 'Volcker shock' in the early 1980s, when the Fed Chair Paul Volcker fought inflation by greatly raising interest rates (the Federal funds rate peaked at 19% in 1981). Such high rates contributed to the dollar soaring in international markets, and very many indebted developing countries were unable to service their debts. The ensuing Third World Debt Crisis plagued countries in Latin America and Africa for years. More recently, the mere announcement by the Fed in May 2013 that it would taper QE triggered a 'taper tantrum', as markets panicked worldwide, especially in EMDEs (Estrada et al., 2015).

Today's inflation is therefore worrying. Should it persist and interest rates rise significantly, the impact on capital markets risks being substantial. In the EMDEs, the spillovers of higher US interest rates and a rising dollar will put strong pressure on financing foreign debts and could also lead to 'sudden stops' in international capital inflows (Stiglitz & Gallagher, 2022). In advanced economies, many low interest-bearing assets (like bonds) are also likely to see their values fall, while government borrowing costs will likely rise, squeezing public finances across the world, and with possible risks of financial instability. All this will make financing international initiatives like the *Agenda* more difficult.

Tellingly, international cooperation has not succeeded well in fighting COVID-19. Although important, the costs of a global vaccination campaign have been repeatedly estimated at about \$50 billion (Horobin, 2021), a relatively modest sum compared with public monies mobilised in 2022. Similarly, for example, commitments made at successive COP climate summits by the advanced economies to transfer \$100 billion to developing countries by 2020 to tackle climate change are falling short. According to a report released by the UN Environment Programme (UNEP) on the eve of the COP27 summit in Egypt in November 2022, this target will only be met in 2025 on current trends. More significantly, the report estimates that for developing countries, 'annual adaptation costs/needs are in the range of US\$160–340 billion by 2030 and US\$315–565 billion by 2050' (UNEP, 2022). So, there need to be far greater transfers of resources from the North to the South. Yet the economic legacies of the COVID-19 pandemic have made financing the goals of the *Agenda*—let alone tackling climate change—more difficult. In the meantime, emerging countries like China and India continue to face strong human and political imperatives to facilitate rapid growth and development, entailing significant energy needs.

5 | CONCLUSION

From an international political economy perspective, the COVID-19 pandemic seems to have strengthened power political relationships between the world's dominant nations and blocs, a situation made dramatically worse by the war in Ukraine. The rule-based system created after World War II, and much fostered in the West by a US hegemon, is under increasing pressure. For internationalists (like myself), this is a tragedy. Whereas the World Wars were in fact regional disasters, the COVID-19 pandemic has been a truly global challenge. Yet instead of bringing peoples together for a common cause, it has led to divisiveness, domestically and internationally. The economic legacy of the pandemic discussed here will weigh on governments' future capacities to deal with domestic problems, let alone face up to the challenges set out in *Our Common Agenda*—not only *but most notably* climate change. The geopolitical situation which has emerged since the pandemic, especially since the start of hostilities in Ukraine, will most probably compound the difficulties of achieving the cooperation needed to implement the *Agenda*. It is also likely to divert precious resources into military spending.

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DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no new data were created or analysed in this study.

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