Pandemic widens divisions in global economy

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The semi-annual *Global Economic Prospects* report issued by the World Bank on Tuesday presents a picture of a deeply divided global economy.

Overall, the bank forecast is that the world economy will grow by 5.6 percent in 2021. But this figure masks the ever-widening divergence between the advanced economies and the rest of the world.

According to the bank, 94 percent of the higher-income advanced economies will recover the losses in gross domestic product per head within two years. This would make the recovery the largest in any recession in the post-war period. But the forecast for emerging and developing economies (EMDEs) is only 40 percent, making it the worst recovery from any post-war recession.

"While advanced economies are rebounding, many of the world's poorest countries are being left behind, and much remains to be done to reverse the pandemic's staggering human and economic costs," the report said.

"Moreover, the recovery is not assured: the possibility remains that additional COVID-19 waves, further vaccination delays, mounting debt levels or rising inflationary pressures deliver setbacks."

Even with the predicted recovery in the advanced economies in 2022, global economic output will still be about 2 percent lower than pre-pandemic projections and per capita income losses will "not be fully unwound in about two-thirds of EMDEs."

The report said the recovery in all EMDE regions "is expected to be insufficient to reverse the damage from the pandemic." Output would remain below pre-pandemic projections as these economies continue to be weighed down by their legacies, including "higher debt loads and damage to many drivers of potential output."

World Bank president David Malpass said the pandemic had "not only reversed gains in global poverty reduction for the first time in a generation but also deepened the challenges of food insecurity and rising food prices for many millions of people."

Malpass called for globally co-ordinated effects to accelerate vaccine distribution, particularly for low-income countries, where the World Bank report characterised the level of vaccination as "feeble."

But, as always, profit considerations dominate over the expressions of concern. The World Bank is not in favour of lifting intellectual property (IP) rights for pharmaceutical companies to enable enhanced production of vaccines.

Speaking to reporters on the report, Malpass said the World Bank did not support the suspension of IP rights because this would jeopardise spending by the pharmaceutical giants on research and development.

Malpass said the invention and creation of manufacturing techniques was a critical part of the supply chain, and flows of finance to research and development would be needed to create vaccines that can combat new variants.

These remarks were a regurgitation of the long-promoted fiction that protection of IP and pharmaceutical profits is necessary for advances in vaccine development. The reality is that the companies that developed the vaccines did so on the back of years of research in universities and other publicly-funded institutions, and then received billions of dollars from the US and other governments to finance the development of their medications.

Apart from the threat of further outbreaks of infections and development of new variants, the other major dangers, especially for less developed countries, are inflation and a rise in global interest rates.

It is estimated that half of all so-called low-income countries are already in debt distress and the danger extends further.

The World Bank report said the record level of world-wide debt meant the global financial system was vulnerable to a sudden rise in interest rates as a result of inflation. If inflation expectations became unanchored, central banks in EMDEs “may be compelled to tighten monetary policy more than would be appropriate.”

The director of the World Bank Prospects Group Ayhan Kose said: “Emerging market and developing economies are vulnerable because of their record high debts. In the event of market disruptions, capital outflows could force them to tighten policies in a manner that could throttle their recoveries.”

Wealthier countries have been able to borrow money at very low rates because of the financing provided by their central banks. But elsewhere it is a different story. For example, according to a report in the *Financial Times*, Egypt, which has to refinance debt equivalent to 38 percent of its gross domestic product (GDP) this year, is paying an interest rate of 12.1 percent while Ghana is paying 15 percent.

Malpass said debt relief was essential, especially for low-income countries. But the only measure on the table to address this issue is a proposal by the International Monetary Fund (IMF) to expand Special Drawing Rights (SDRs) by $650 billion, enabling countries to increase their foreign exchange reserves.

Critics of the proposal point out that as SDRs are allocated on the basis of each member’s IMF quota, which is tied to the country’s GDP, the main beneficiaries will be the more developed economies.

The future direction of interest rates will be the subject of intense scrutiny when the US Federal Reserve’s policy-making committee meets next week.

The Fed has said it does not intend to respond to the signs of growing inflation, insisting the present price rises are transitory, and will only begin to tighten its ultra-loose monetary policies when the US economy has made “substantial further progress” in meeting its goals of inflation at around 2 percent and full employment.

This has given rise to growing criticism that by allowing inflation to “run hot” the Fed is only creating the conditions for a harsh clampdown.

Financial Times columnist Martin Wolf again warned in a comment on Wednesday that by delaying the tightening of monetary policy, the Fed was creating the conditions for a repeat of the experience under Fed chair Paul Volcker in the early 1980s.

The so-called Volcker shock, in which interest rates went to record highs and produced two deep recessions in the US, also “triggered the Latin American debt crisis,” Wolf noted. “This time, there is much more debt around almost everywhere. A severe monetary tightening would create even more devastation than then.”

A similar warning has been issued by economists at Deutsche Bank, reflecting the outlook in German financial circles that the present monetary policies of the central banks, which have pumped trillions of dollars and euros into the financial system, have to be reined in.

Deutsche’s chief economist David Folkerts-Landau warned that by neglecting inflation the Fed was leaving economies “sitting on a time bomb.” He wrote that when the Fed did finally act, “this could create a significant recession and set off a chain of financial distress around the world, particularly in emerging markets.”