

Designing the COVID-19 Recovery for a Safer and More Resilient World

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As they respond to the unprecedented challenges of the current pandemic, Ministries of Finance can deliver on urgent social and economic priorities while addressing another major global risk — climate change.

The global economy will not be the same after the shock of the COVID-19 pandemic. Amid widespread sickness and death, supply and demand for goods have plummeted and unemployment has soared. In a matter of days or weeks, industries such as travel and tourism were disrupted at an unthinkable scale. The retail sector was transformed by social distancing, and companies worldwide dramatically intensified the use of remote working arrangements. The fragility and gaps in health systems, early warning systems, information systems and social safety nets have been exposed.

The first round of relief spending that governments worldwide are deploying is focused on maintaining liquidity across businesses and households; improving people's access to health services and essential supplies; and providing humanitarian support to hundreds of millions of highly impacted people. The magnitude of fiscal stimulus packages ranges from low percentages to over 20% of GDP. Some countries are already planning the next rounds of stimulus spending, focused on creating jobs and stimulating economic recovery.

This commentary offers practical suggestions to Ministries of Finance on how to deliver on urgent social and economic priorities while also addressing another major global risk — climate change — in highly socially and economically beneficial ways. Given that more than \$10 trillion will be pumped into economies around the world this year, it is important that this effort not only reflate overall economic activity but also promotes a better and healthier economy — one that is more efficient, more equal, more resilient and low-carbon. Addressing the climate challenge in parallel with the pandemic can bring immediate benefits for health by reducing pollution and increasing access to clean water; providing rapid employment benefits by mobilizing workers in labor-intensive and low-skill activities with high social returns; and improving preparedness and resilience prior to the onslaught of the next shock.

Benefits of Investing in Climate-aligned Stimulus Actions

Stimulus packages that address climate change and prioritize efficiency, equality, and resilience are likely to have much higher returns than those that merely shore up past investment patterns. Such approaches can help promote innovation, remove economic distortions, foster social cohesion, and reduce future systemic risks that can bring profoundly disruptive and often irreversible harm. Just as with epidemics, early action on climate change can substantially reduce financial and human costs. In both cases, the best response is not to retrench and build barriers among countries, but to work together to create stronger preparedness and institutional capacities. But the status quo is sticky. Even in normal circumstances, mobilizing public or private finance to support bold economic transformations is extremely difficult.

These are not normal circumstances. The current situation has profoundly altered the fiscal and credit calculus. Unprecedented outlays are already being made to bring economies back to full employment.

In the current situation, the question changes from whether actions are affordable to how major expenditures already being planned can maximize long-term gains as well as short-term gains. Using the pandemic stimulus packages to address climate change can create numerous opportunities for new jobs and businesses at little or no incremental cost.

The returns on investment in improved climate resilience are extremely high and in our strong economic self-interest. For example, the Global Commission on Adaptation found that the overall rate of return on climate adaptation investments has benefit-cost ratios ranging from 2:1 to more than 10:1. More fundamentally, if the high debt from today's stimulus packages *fails* to reduce future risk and move economies to safer and more productive systems, it will impose a double burden: first, because we didn't reduce climate risks when it would have been cheaper to do so, and second, because there will be less fiscal space to finance urgent climate-related expenditures.

Climate-aligned stimulus actions can range from simple low-skill, labor intensive programs focused on nature-based solutions, to high level initiatives harnessing the power of information technology. In many cases these actions can be taken by individual countries, but they will also benefit from global coordination, especially in the early phases of economic recovery when reanimating international trade and global demand are crucial. Finally, while overriding attention should be given to getting long-term policies and incentives in place, managing contextual factors from negatively affected sectors will be crucial to success. This should involve paying close attention to the social dimensions of job creation, training and safety nets.

Steps Toward a Healthier, More Resilient Future

Here are seven concrete areas in which Finance Ministries can better deliver on urgent social and economic priorities while also addressing climate risks.

1. Managing corporate bailouts. Preserving many companies will be essential to save jobs and maintain a strong foundation for economic recovery. To do this, the IMF has urged governments to offer loans, guarantees, capital injections and wage subsidies. In these circumstances, one lesson from the 2008 financial crisis is to avoid propping up pollution-intensive, outdated and inefficient industries and systems and instead encourage newer, yet proven, industries, standards, technologies and business models. Lessons from 2009 policy interventions demonstrate that attaching efficiency and emissions targets to financial support can give rescued corporations a competitive edge in a changing marketplace. For example, the automobile company bailouts in the American Recovery and Reinvestment Act of 2009 included requirements for higher fuel efficiency that successfully fostered a new generation of technologies and jobs. This time around, the same approach could be applied to include lower emissions targets in the bailout of airlines, hotels, carmakers and many other industries. In the coal sector, buyouts could save bankrupt utilities while reducing emissions. For example, assistance to South Africa's utility company Eskom could be provided in exchange for early retirement of coal fired power plants. Such stipulations can encourage recovering industries and companies to invest in energy efficiency and rely more on renewable energy.

Separately, stimulus measures should support workers and businesses impacted by transitional changes, including in the more volatile segments of the energy sector such as the oil industry. Rather than try to preserve unsustainable sectors on a business-as-usual approach, stimulus compensation can be used to

finance safety nets and employee retraining for businesses shuttered or downsized by permanent shifts in demand, such as those in the travel industry and the retail sector. Bold fiscal policies at this juncture can help compensate the social and short-term economic costs of accelerating the transition from coal to cleaner alternatives in countries such as Japan, Korea, China, the United States and Germany.

2. Investing in climate-smart infrastructure. Public investment will be an important part of fiscal stimulus after the most immediate needs for liquidity are met. Climate-friendly infrastructure can mobilize more labor and technology than traditional infrastructure; this is illustrated by the jobs and skills required to build smart grids to accommodate renewable electricity, early warning systems against natural disasters, transportation systems that respond to more flexible patterns of mobility, and nature-based solutions to floods, droughts and storms. Individual investments in a broad, climate-friendly infrastructure portfolio are not necessarily more difficult to prepare than conventional infrastructure. Also, stimulus investments can be designed to target job creation based on physical proximity to where job losses occur and where workers can be retrained (to ensure the equity of jobs being created). Here are examples that meet both short-term stimulus and long-term resilience objectives:

Global estimates show the high job creation potential of renewable energy and energy efficiency. One estimate is that the wind and solar sectors can create 52 million jobs worldwide over the next decade, far exceeding the estimated 27 million jobs lost in the transition of the fossil fuel industry during the same period. In parallel, the energy efficiency industry can respond quickly to new incentives, scale up readily available technologies, and create substantial savings and earnings for households and businesses. Estimates for the United States say that while 1 million USD spent in fossil fuels would create 2.7 full-time equivalent jobs (FTE), that same amount would create 7.5 FTE jobs in renewable energy and 7.7 FTE jobs in energy efficiency. Thus each 1 million USD shifted from brown to green energy would create a net increase of 5 jobs. The 2009 American Recovery Act leveraged approximately \$150 billion in private and other non-federal capital for clean energy investments and supported 900,000 job-years in clean energy fields from 2009 to 2015.

Nature-based solutions (NBS) use the forces of nature itself to achieve the triple wins of economic resilience (food and water security), reduced physical risks (flood control, coastal protection and ecosystem health), and reduced carbon emissions (through carbon sequestration and avoided emissions). NBS investments typically create low-skill and fast-implementing jobs — on average, an estimated 39.7 FTE jobs per 1 million USD invested, or over ten times the job creation rate of investments in fossil fuels.

Overall, the rates of return on resilient infrastructure — whether in transport, energy, water, agriculture or NBS — typically exceed those on traditional infrastructure, presenting benefit-cost ratios above 4:1, and make the entire economy more robust. A successful stimulus focus on green investments was demonstrated by South Korea following the 2008 financial crisis, with positive impact on quality of life. About 80% of its total stimulus spending was on green investments, and by the third quarter of 2009, South Korea had one of the highest growth rates in the OECD.

3. Promoting regulatory reform. Regulations come into play during times of economic crisis and recovery, with three considerations. The first is the importance of not weakening existing environmental and worker protections in pursuit of short-term gains. Examples include efforts in the United States and European Union to weaken automotive fuel efficiency standards, even though economic analysis shows negative impacts on jobs, innovation, air pollution, health outcomes and carbon

emissions. (Increasing air pollution also increases the severity of the coronavirus pandemic, putting even greater demands on an over-burdened health sector.) Once weakened, restoring current protections will not be easy. Such efforts to relax regulations can backfire on the businesses they are meant to support by inducing higher lifetime capital costs, especially for businesses investing in long-term assets. The second consideration is how regulatory and competition policies can lower the level of public stimulus expenditures required to bring an economy back to full activity. Of course, governments will have to use their political capital to achieve reforms that incorporate long-term gains, but it may be easier to do so when the sense of emergency, rather than protracted economic recession, is dominant. Examples of efficiency-inducing regulations that also reduce climate risks include improving interstate electricity markets in the United States; introducing new efficiency standards for buildings, appliances and vehicles to generate long-term savings and stimulate innovation; and promoting changes in zoning to avoid urban sprawl or in land tenure to increase agricultural productivity without jeopardizing rural jobs.

A third area of regulation is to seek far-reaching benefits through public purchasing. Implementing green public purchasing approaches — whether for low-emitting light bulbs, sustainable energy, building materials or better food choices in public provisioned canteens — can help shift markets and bring down the cost of clean alternatives through economies of scale in a way that can become permanent after the crisis. For example, an emerging opportunity exists for introducing new low-carbon formulations of concrete and construction materials in public investment.

4. Reforming tax and subsidy policies. Considering the large outlays required to manage the current crisis, reforming energy and agricultural subsidies may save resources to be deployed for other high-priority items. Reforms can facilitate more sustainable and efficient economic solutions and structures. The fact that oil prices are at historic lows, and that current future markets indicate that low prices may continue for several years, provides an opportunity to cut fossil fuel subsidies with low or no price increases. In fact, over 30 countries undertook fossil fuel subsidy reforms during periods of weak oil prices between 2013 and 2015. There is strong evidence that after proceeds of a consumer subsidy reform are used to compensate vulnerable and low-income households, funds are still left over for other priorities. For example, in India, savings from reduced oil and gas subsidies helped launch a large benefits transfer scheme using new information technology.

To complement subsidy reform, tax reform may also be considered. Even with economic activity below potential, the introduction of carbon taxes with an increasing schedule may be appropriate not only to align fiscal incentives with a lower-carbon future, but also to raise badly needed revenue. The simplicity of a carbon tax, and the long-term signal it gives, is particularly useful for countries that do not yet have a clear map toward a cleaner economy. It can also help governments continue to finance the transition to a cleaner economy when the fiscal stimulus is phased out. Lowering emissions can also be coordinated with other regulatory measures to facilitate an orderly transition away from fossil fuels and to avoid locking in inappropriate technologies during the stimulus phase.

Taxes and subsidies can also play a crucial role in harnessing the productivity gains from increased digitalization, helping distribute these gains across society with a positive impact on aggregate demand, education, health and family welfare.

5. Integrating climate risks in prudential and capital markets regulations. Global financial markets are already bracing for a credit crisis. Massive public sector support to banks and corporations should be

accompanied by climate-related stress testing by banks and increased analysis and disclosure by corporations of their climate-related risks. In response to the increasing demand by investors for reduced climate risks, both of these approaches are endorsed by increasing numbers of governments and central banks. They would provide asset managers and others with fiduciary responsibilities the instruments they need to protect their portfolios against future risks in turbulent after-crisis markets. They will also help protect sovereign risk against climate vulnerabilities and improve the pricing of bonds. The World Bank and IMF have found evidence that countries that invest in contingency finance to better manage risk, even if debt-financed, have shorter recoveries after extreme events and higher long-term growth rates.

6. Enhancing the role of development finance institutions. The multilateral development bank (MDB) architecture has weathered many crises and continues to evolve. Together with national and regional development banks and agencies, MDBs will be important for how many countries respond to shock waves from the global pandemic. Emerging and developing economies already face heightened credit risk, limited fiscal space, and pressures on their balance of payments, and these pressures are likely to grow. G20 country actions, in addition to dealing with bilateral debt in the short run, should extend to guiding national and multilateral, regional and national development banks in helping countries design, finance, and implement climate-based actions as an integral part of their pandemic response strategies. Development finance institutions should uphold their existing mandates to support economic recovery and growth in a way that adapts to climate risks and does not damage nature's contributions. Official climate finance, including standing international commitments, continues to be relevant both for its own sake and as a means for mobilizing private sector resources. Finance ministers worldwide should promote enhanced coordination across development institutions in the areas of debt forgiveness, expanded lending envelopes, and climate finance. They should also support the capitalization of development banks at the scale required and ensure that the banks' access to capital markets remains intact.

7. Sponsoring research and development (R&D). The takeoff of new technologies can be facilitated by bold government R&D programs, as China and Germany demonstrated with wind and solar energy after the 2008 financial crisis. International efforts to support new energy sources, such as green hydrogen and better batteries, along with a range of nature-based solutions to achieve lower cost and more resilient infrastructure, can be crucial in sparking a new cycle of sustained and equitable growth. As with the efforts to fight COVID-19, pairing technological development and innovation with global cooperation to manage climate risks and improve lives is an idea that Bill Gates flags as being "totally common between these two problems."

These seven action areas illustrate policy approaches that respond to the immediate social and economic needs caused by the pandemic, while reducing future climate risks. A wide range of instruments are available to finance ministers, starting with but also complementing scaled-up public expenditures. The exact design of fiscal stimulus plans will vary across countries, but the opportunity brought by massive public spending to build more efficient and sustainable economies cannot be overemphasized. It is propitious that countries will soon be asked to come forward with enhanced Nationally Determined Contributions (NDCs) to climate action under the aegis of the United Nations. Current stimulus packages can strongly support both the climate mitigation and adaptation aspects of the NDCs. If we do not seize these opportunities, our children will wonder, rightfully, why we missed them.

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