COVID-19 PANDEMIC AND THE GLOBAL ECONOMY

by Jamal Saghir

1. Introduction

When some experts described the COVID-19 pandemic as the most dangerous global challenge since World War II, potentially overshadowing the 2008-2009 financial crisis - they were correct. Although disasters diverge in their causes and scope of impact, they are connected by the necessity for coordinated international, regional, national, and local responses. The world is on the verge of major economic recession and the impact on every country, rich or poor, will be tremendous unless early actions are implemented quickly.

With markets experiencing levels of volatility not seen since the 2008 financial crisis, the current pandemic crisis has evolved differently from other major crises faced in recent decades. In fact, this pandemic’s impact on the economic and financial sector will be deep and lasting unless exceptional fiscal and monetary large stimulus packages are put forward. Not only is it occurring in a world of unprecedented financial globalization, where the financial sector plays a historically large role in economic activity, but it is also an “imported” crisis. The COVID-19 pandemic crisis is an “exogenous shock” provoking a major global shock that will significantly increase poverty and vulnerability.

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1 A shorter article originally appeared in Issam Fares Institute for Public Policy and International Affairs American University of Beirut, March 2020.
2 A stimulus package is a package of economic measures put together by a government to stimulate a floundering economy. The objective of a stimulus package is to reinvigorate the economy and prevent or reverse a recession by boosting employment and spending. The theory behind the usefulness of a stimulus package is rooted in Keynesian theory which argues that the impact of a recession can be lessened with increased government spending. This would include direct cash payments, support for small businesses, aid for industries and make it easier for companies to borrow money.
2. An Exogenous Shock

What is different about the COVID-19 shock is that it is affecting the supply chain - production and distribution of goods and services - and demand - consumption - sides of the economy at the same time. Worldwide economies and systems are failing. The uniqueness of the current configuration of economic challenges has important policy implications and action options available to country governments.

It implies that the policy responses maybe ineffective in stemming the looming global crisis. However, actions of individual countries can affect the impact of the crisis on their own economies. Policymakers around the world need to react forcibly and quickly at the signs of domestic weakness, including the rapid involvement of external assistance as necessary. Only few countries including the US, EU, UK, China and Japan are evolving in that direction. The rest of the World is in a “wait and see” mode.

As the global economy comes to a grinding halt, many countries and in particular developing countries could be moving into a new danger zone, with heightened risk to exports, investment, credit, banking systems, budgets, and to the balance of payments. With border closures and import restrictions exports are falling, capital could be withdrawn from emerging markets and short-term credit could also dry up. Sharply tighter credit conditions and weaker growth are likely to cut into government revenues and governments’ ability to invest to meet education, health, and infrastructure sectors. Countries dependent on exports, remittances, or foreign investment (as many of the Arab countries), exhibiting high current account deficits or rising inflation, and those with extensive fuel/food subsidies are most vulnerable to a sharp slowdown—especially if accompanied by a significant tightening of financial market conditions.

Virtually no country, developing or industrial, would escape the impact of the widening COVID-19 crisis on the financial and economic situation. Past crises show that the deterioration in financing conditions has been most severe for countries with large current account deficits. Of the several countries whose economies have reacted most sharply to the deterioration in conditions, the US is moving quickly toward a substantial initial fiscal stimulus package, which is focused on practical steps. European countries are also moving to prevent the economy freezing up. But this is only the beginning and we should expect more as the crisis unfold.

During the 2008 financial crises, the IMF and World Bank Group stepped up with a commitment of over $1 trillion in finance to countries. These international organizations should quickly assess the impact from COVID-19 to sustainability and external financing at the international and national levels and should increase support for the health response in countries. The World Bank Group has approved a $14 billion package of fast-track financing to assist companies and countries in their efforts to prevent, detect and respond to the rapid spread of COVID-19. The package will strengthen national systems for public health preparedness, including for disease containment, diagnosis, and treatment, and support the private sector. The IMF has also announced it will make available up to $50 billion in rapid disbursing emergency finance. However, I believe that as a knock-on effect, with the crisis taking its toll on even the most well-off countries, there is a serious risk that some donors
might consider stepping back from aid commitments when they are most needed in developing countries.


In my opinion, the impact of the financial crisis caused by COVID-19 would be felt the most as following:

- Many countries can expect to see a decline in GDP per capita; unsustainable debt will make it impossible to execute their budgets and will reduce their capacity to pay public sector wages, severely disrupting public services, including first and foremost education and health. As the economy worldwide continues to face uncharted territory, recovery will come from aggressive action in term of policy response and size of stimulus. On the other hand, most countries’ tight fiscal positions will limit their ability to respond to the crisis. They will need international support and aid beyond current development budgets allocated to countries by International Financial Institutions and bilateral partners.

- Investment is expected to suffer as it bears much of the direct impact of the financial crisis. Investment was the main driving force for developing-country growth over the past few years. There is a risk that investment in developing countries may be headed for a “perfect storm,” with a convergence of slowing world growth, withdrawal of equity and term lending from the private sector, with a further risk that commodity prices fluctuation in the medium term will deter new investment in natural resource sectors.

- Financing conditions are deteriorating rapidly. Sound domestic financial sectors could find themselves unable to borrow or unwilling to lend both internationally and domestically, and domestic productive sectors would be deprived of working and long-term capital.

- Remittances from host countries are expected to decline in response to the expected recession and global slowdown but the impact on flows to recipient countries will depend significantly on exchange rates.

4. Challenges

The test for policymakers around the World is not just to prevent the escalation of the crisis compounded by COVID-19 and to mitigate the downturn, but also to realize that we have failed to deal with decades of warnings about other crisis in the making such climate change, such as by shifting investments in the energy networks away from fossil fuels and adapt to new realities. But I see more challenges we will be facing:

- As political and financial investments will be deterred, Governments will be obliged to highlight public health and support struggling financial institutions and Banks as they may change lending criteria and use the crisis to revise green and CO2 emission
reductions targets. Regulation could still force the shift to clean energy, but that’s unlikely this will be aggressive enough when the industries specially in China, US and Europe are suffering financial losses.

- With oil prices down, more people working from home and public transport a place where coronavirus spreads, consumer energy use will go up. On the other hand, the average number of “good quality air days” increased 21.5% in February, compared to the same period last year, according to China’s Ministry of Ecology and Environment. From February 3 to March 1, CO2 emissions were down by at least 25% because of the measures to contain the coronavirus, according to the Center for Research on Energy and Clean Air (CREA).

- Almost all sectors are affected: the tourism sector, the hotel industry, restaurants, theaters, cinemas, the world of entertainment, amusement parks etc. Agriculture and farmers are also suffering. Packaged products seem to prevail over fresh products.

- While lockdown measures designed to halt the spread of the virus have caused a momentary pause in most G20 countries’ pollution levels, I believe that this is only documentary and we could see a bounce-back effect and higher levels than before the epidemic hit because of the catch up needed when the countries ramp up activity to avoid steeper economic downturn.

- Once the COVID-19 pandemic is behind us, measures taken to spur economic growth could lead into another health crisis in terms of climate change. Gernot Wagner, a climate economist at New York University has called the virus “climate change on warp speed.” I believe there is an urgent need for more funding and innovative solutions for adaptation to climate change.

- The round of economic stimulus if not well targeted to preserve and increase funding for adaptation and mitigation to climate change and include tough agreed environmental standards for projects funding could result in increasing pollutants, especially if cheap credits are provided to heavy traditional pollutant large-scale industries.

Today, the economic crisis created by COVID-19 is the result of a combination of supply and demand crises, and a short-term economic downturn leading to a recession. The disorganization of logistics is creating a supply crisis, as supplier delivery times have been extended. No doubt the decline in Chinese production in February followed by EU and US decline in March, and its slow recovery, disrupted customer and value chain activities. This complexity would have justified a coordinated international mobilization. Unfortunately, we are witnessing a withdrawal, the closing of the borders in a dispersed order and a global panic causing human anxiety and financial disorder.
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