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The Economic Consequences of COVID-19

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As a human tragedy unfolds, as governments face an unprecedented crisis and as we anticipate a forthcoming economic catastrophe, we are watching, studying and reacting as researchers situated at the junction of economic and social policies. The first economic consequences of the COVID-19 pandemic are already felt. Although policymakers are in uncharted territory, the first economic response measures are starting to be implemented. No preceding crisis in the recent times has had such a worldwide impact and it may perhaps be the time for bold measures. At the Department of Applied Economics of the Université Libre de Bruxelles (DULBEA, @dulbea_ulb) we have long and broad experience in supporting Belgian public institutions as they draw up public policies. In this context, we are preparing every two-weeks an updated short overview of the latest papers and insights on the economic consequences of the COVID-19 for policymakers, other researchers and concerned citizens. The first one can be found here… Enjoy the new one below.

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Policy responses.

IMF's world economic outlook for April 2020 estimates that global GDP growth is projected to hit a -3% rate, downgrading 6.3 percentage points with respect to January 2020. This is expected to be the worse economic downturn since the Great Depression. As Kenneth Rogoff notes, the economic catastrophe wrought by the 2008 crisis looks like a mere dry run for this economic catastrophe.

Whereas countries' responses to the crisis are argued to be diverse in magnitude, the majority of them include similar measures. Gentilini et al. update weekly a review on countries' economic responses to COVID-19. Their latest version of April 17, 2020 states that 133 countries have introduced 564 social protection and job programs involving around 622 million beneficiaries. Social assistance measures are the most common, specifically cash transfers are the most frequently used and represent up to one-fifth of monthly GDP per capita. Cash transfers are followed by social insurance measures such as paid sick leave and labour market interventions such as wage subsidies.

Unequal impact on workers.

Christina Patterson's working paper finds that young and low-income workers both have higher marginal propensities to consume and are most exposed to aggregate fluctuations. As she argues, during hard economic times, firms lay off young and low-income workers first. However, this cohort also represents individuals without savings whose spending is, therefore, more sensitive to their own income. Aggregate demand will, in this way, continue to fall leading to more layoffs. In this context, it is crucial to protect these consumers in order to alleviate the impact of the recession. States have already implemented most of the optimal policies presented such as increasing unemployment benefits or giving financial support for firms to maintain wage levels. Nonetheless, these measures imply an overflow of demands with backlogs that risk reducing the efficiency of the taken measures. Dube & Rothstein (2020) present a solution to bureaucratic congestion: “assume all applications are eligible for state aid and then, once the first wave has passed, review again the claims, and, if necessary, collect overpayments.”

Additional evidence on the difficult implications for young and low-income workers is found in Adams-Prassl et al. Their research shows that high-income individuals report being able to do more of their work tasks from home relative to low-income individuals. In addition, they provide evidence that individuals without paid sick leave were more likely to show up at work despite feeling ill, thereby increasing the probability of contagion. This segment of the population was mostly associated with low-paid jobs associated with high levels of physical proximity.

Conversely, Coveney et al. use the example of the Great Recession in Europe to show that income-related health inequalities do not have to increase if the state response is large enough. They found that social transfers mitigated negative income effects because of the high degree of “stickiness” of these government transfers that are largely targeted at older and poorer individuals. As long as this group of individuals reported worsening health, the income-related health inequalities remained unchanged. However, income originating from state transfers should not be considered equal to income generated from work.

Business reactions.

Bartik et al. provide evidence from a survey conducted among small enterprises in the U.S. to estimate the impact of the COVID-19. The results exhibit that 43% of businesses have temporarily closed due to the medical crisis and that they have reduced their labour force by 40% since January. Additionally, they show that sectors with specific needs for face-to-face contact exhibit lower prospects for riding out the pandemic. The duration of the crisis exacerbates the negative results: if the crisis lasts 4 months, 47% of businesses expect to be open in December against 72% if the crisis lasts only 1 month. Government policies are crucial to ensure the medium-term solvency of small businesses.

Policies addressing essential workers.

In most European countries, health workers receive nightly standing ovations for their invaluable work during the current crisis. According to eurostat, health occupations represent 7% of employed individuals in the European Union whilst the highest shares of health workers were generally recorded in the northern regions of the EU. Furthermore, the vast majority of health workers (78%) are women. As mentioned in the previous review, childcare due to schools closure is likely to have a higher impact on working mothers. In this context, essential workers and their partners might encounter difficulties to balance work with childcare. As O’Dorchai points out, governments should intervene more to protect workers with children who have difficulties continuing their job tasks due to the closure of schools and nurseries. These policies do not need to be limited to the current situation and, thus, can lead the way for future sustainable development policies.

EU response

National fiscal stimulus varies across EU countries. According to the think tank Bruegel, Germany’s fiscal impulse amounts to a 6.9% of its GDP whereas for Italy and Belgium, they are of 0.9 and 0.7% respectively. In this context, the EU plays an important role if it does not want asymmetries today to become divergences tomorrow. The EU response has translated into three instruments: an ESM liquidity line to finance health expenditure, a guarantee fund of the European Investment Bank and a SURE program to ensure the financing of short-term work schemes. However, many concerned voices argue that "this is not enough." As Münchau explains: "EU member states borrowing from the ESM liquidity line will subject themselves to fiscal supervision". High levels of debt and of unemployment as well as slow growth and no fiscal sovereignty might trigger the rise of Eurosceptic political parties. Whereas some countries propose to mutualize risk with mechanisms such as the *coronabonds* (explained in detail here), their proposal has been critiqued with "moral hazard" arguments. Ahead of the EU Council meeting on Thursday 23rd April, Spain has proposed to create a 1.5 trillion euros EU recovery fund given in the form of grants, rather than loans, to member states who demand it.