The Effects of the COVID-19 Pandemic on the Global Economy.

The COVID-19 pandemic is having devastating effects on the world economy. But forecasts about the future vary.

Some economists have dire predictions. The International Monetary Fund just this week called the crisis caused by the COVID-19 pandemic “a crisis like no other” and indicates that “the adverse impact on low-income households is particularly acute, imperiling the significant progress made in reducing extreme poverty in the world since the 1990s.”[1] Some economists even argue that the COVID-19 pandemic marks the end of globalization. Indeed, the popular publication *The Economist* wondered recently whether COVID-19 had killed globalization, stating: “Wave goodbye to the greatest era of globalization—and worry about what is going to take its place.”[2]

But others disagree. Some expect a V-shaped recession, with the negative growth displayed in March through May of 2020 wiped out quickly by a strong economic recovery, possibly beginning in the Summer months. This includes, not surprisingly, economists working in President Donald Trump’s administration, such as Kevin Hassett, an economic advisor to the White House who just resigned. As the Washington Post reports: “[Hassett] said recently: “I’ve been really positively impressed by how quickly things are turning around.” He added at a separate White House event: “I was pretty depressed about how bad it looked a few weeks ago, but you can really see it turning on faster than I thought“.[3] But there are other –less biased-- observers with the same view. Jason Furman, a professor at Harvard’s JFK School of Government and Chair of the Council of Economic Advisers under President Obama, said recently: “we are about to see the best economic data we’ve seen in the history of this country” 1990s.”[4]

Who is correct? What does the evidence and the most serious research suggest is the impact of the COVID-19 pandemic and want will be the effects on the world economy?

A Global Debacle or Temporary Hiccup?

[1] International Monetary Fund, World Economic Outlook, June 2020. https://www.imf.org/en/Publications/WEO/Issues/2020/06/24/WEOUpdateJune2020
[2] The Economist. Globalisation unwound: Has covid-19 killed globalisation?**:** The flow of people, trade and capital will be slowed, May 14th, 2020 (https://www.economist.com/leaders/2020/05/14/has-covid-19-killed-globalisation).
[3] Washington Post, May 19, 2020.
[4] Politico, May 25, 2000. https://www.vox.com/policy-and-politics/2020/6/9/21279076/2020-election-trump-economy-democrats-jason-furman

So far, the evidence points to a severe global debacle. In contrast to other recent recessionary episodes, the COVID-19 pandemic is a truly worldwide phenomenon, one that has affected every corner of the planet's population almost at the same time, from New York City to the Amazon (not the company but the region in South America). In China, real Gross Domestic Product (GDP) declined (on an annual basis) by close to 10% during the first quarter of 2020 and in the euro area the drop was equal to 3.6%. In the US, real GDP dropped by 5% in the first quarter of 2020 and the official estimate of the unemployment rate for May 2020 was 16.3%: the highest since the Great Depression.[5]

Recently-released projections by the World Bank put the global contraction in global GDP to be 5.2% in 2020, including a 7.2% drop in Latin American and the Caribbean (LAC).[6] The IMF just released earlier this week a similar forecast for global GDP (5% decline in 2020), putting the US GDP contraction at 8% and the European drop at 10%, with developing countries also suffering from a reduction of GDP. The LAC region is expected to face a 9.4% collapse of GDP in 2020.[7]

The consequences of the pandemic will be severe, particularly for developing countries. The World Bank forecasts that when compared with the pre-crisis situation COVID-19 could push 71 million people into extreme poverty in 2020 under their baseline scenario and 100 million under their downside scenario. Almost half of the projected new poor will be in South Asia, and more than a third in Sub-Saharan Africa.

The Role of Uncertainty

Why these dismal projections? One of the idiosyncratic characteristics of this pandemic is not only its geographical spread but also the uncertainty that it has generated about the future. Although most business cycles, such as the 2008-2009 Great Recession, are accompanied by unpredictability, the current crisis takes it to a higher level. There are several reasons for this. The pandemic is really a novel event in the modern history of infectious diseases as other recent episodes have been much more limited geographically and quickly contained. You must go back to the influenza pandemic of 1918-1920 to find a similar global phenomenon. In addition, the nature of the disease is such that there is no easy way to predict when the

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[5] The official unemployment rate for May 2020 published by the Bureau of Labor Statistics (BLS) was 13.3%, but there appears to be a measurement error noted by the BLS itself which raises the rate by 3 percentage points;. see Bureau of Labor Statistics, "The Employment Situation: May 2020," https://www.bls.gov/news.release/pdf/empsit.pdf). Even this is likely to be an under-estimate, with unemployment most likely close to 20%; see Jack Kelly, "There is a Glaring, Misleading Error in the May Jobs Report: US May Be at 20% Unemployment*." Forbes*, June 8, 2020 (https://www.forbes.com/sites/jackkelly/2020/06/08/theres-a-glaring-misleading-error-in-the-may-jobs-report-us-may-be-at-20-unemployment/#7fed931460d3).

[6] The World Bank, *Global Economic Prospects*, Washington DC, June 2020 (https://www.worldbank.org/en/news/feature/2020/06/08/the-global-economic-outlook-during-the-covid-19-pandemic-a-changed-world).

[7] International Monetary Fund, World Economic Outlook, June 2020.

contagion –both medical and economic-- will end. There is too little knowledge about how, when and where new hot spots of the virus will emerge, whether there will be second or third waves of the epidemic, and it is not even clear when a vaccine will be available for massive global distribution. In terms of the economic impact, it is still to be assessed how the sudden stops of economic activity and the lockdowns will have on longer-term employment, business closures, non-performing loans, fiscal insolvency, commodity prices, etc.

Although we do not know the answers to how the disease and the economy will behave in the future, we are all aware of the increased uncertainty it has generated (we are all suffering through it) and can, therefore, make future predictions on what the rise of uncertainty can do to the economy. Studies that forecast of the consequences of the COVID-19 pandemic incorporating this uncertainty tend to produce more negative impacts. The World Bank and the IMF forecasts mentioned earlier do take into account some of this into their analysis. But a recent paper published by some of the most prominent economists in the profession carefully considers the effects of uncertainty. They conclude that the effects of the pandemic could be much more severe than many suspect.[8] These economists assess the effects of COVID-19 on the US economy through two mechanisms: 1. the immediate, direct consequences of the crisis on production, trade, etc. (the so-called first moment impact of the crisis), and 2. the indirect, secondary impact of the COVID-19 shock by raising uncertainty about the future and leading to severe stress in financial markets (which reduces investment and economic activity as well). They predict the economic recession could be severe, last until next year and –under the worse scenarios—until 2022. And as the World Bank and IMF both forecast, emerging market and developing economies would be affected more deeply because of poor health care systems, climbing debt, and a weak and inequitable socioeconomic environment that was already slowing-down economic development to start with.

The Collapse of World Trade

There is no question that flows of international trade in goods, services, capital, and people have fallen precipitously since the covid-19 crisis started and will continue to do so for an extended period. And there is the worry that the pandemic –together with a wave of economic nationalism-- will sharply reduce trade and economic growth for the foreseeable future. Richard Baldwin, a professor at the Graduate Institute of International and Development Studies in Geneva refers to what is coming as "the great trade collapse"[9].

The drop of trade flows is already having serious repercussions. Commodity exporters are struggling from sharply lower prices and declining export earnings and are among the most deeply affected countries in the world. But the drop in trade cuts across most goods and

[8] Scott R. Baker, Nicholas Bloom, Steven J. Davis and Stephen J. Terry, "Covid-Induced Economic Uncertainty, National Bureau of Economic Research, April 13, 2020.
[9] R. Baldwin, The Greater Trade Collapse of 2020: Learnings from the 2008-09 Great Trade Collapse, *VOX CEPR Policy Research Portal*, April 7 2020 (https://voxeu.org/article/greater-trade-collapse-2020).

services worldwide. The poorest economies are suffering the most as they are heavily dependent on trade, not only in terms of export earnings but even in terms of the import of immediate health supplies. As Alvaro Espitia, Nadia Rocha and Michele Ruta have pointed out: "most developing countries rely heavily on imports to meet their needs of medical supplies essential to combat COVID-19. Recently imposed export restrictions by leading producing countries could thus cause significant disruptions in supplies for developing countries and might further contribute to price increases of medical supplies. Taking multiplier effects into account, prices for medical supplies are estimated to rise by up to 23% on average. Tariffs and other restrictions to imports further impair the flow of critical products to developing countries".[10]

It is not just the fall of trade in goods and services that is having deep global consequences. Capital flows around the world have also sharply slowed down, particularly those into developing countries. For instance, the United Nations Conference on Trade and Development (UNCTAD) forecasts that global foreign direct investment (FDI) flows will decline by up to 40% in 2020, from their 2019 value of $1.54 trillion, reducing FDI below $1 trillion for the first time since 2005. Furthermore, FDI is projected to drop between 5% and 10% in 2021.[11]

Migration flows do not fare better than investment. Movements of people globally have slowed down precipitously, as countries impose short-term –and some of them long-term—restrictions on travel and immigration. And migrants already in destination countries are facing enormous economic challenges, thus reducing the remittances they send back home. The World Bank estimates that there will be a historical decline in global remittances in 2020 of $110 billion, with sub-Saharan Africa (SSA) expected to experience a drop of 23% in remittance inflows.[12]

The Great Policy Challenge

The health and socioeconomic impacts of the COVID-19 pandemic constitute a massive policy challenge. Most governments have reacted –even if some of them in a protracted way—to counteract the pandemic through various policies intended to contain the epidemic itself as well as its economic effects. Lockdowns and social distancing appear to have contained the spread of the disease in some countries. Massive monetary and fiscal policy measures have been undertaken worldwide.

But much more short-term policy actions will be required. The sustained growth of the pandemic in the US, Latin America and the rest of the world, the emergence of new hot spots around the world, and the fears of second and third waves, suggests that the pandemic is not nearly over anywhere.

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[10] A. Espitia, N. Rocha, M. Ruta, "Trade and the COVID-19 Crisis in Developing Countries," VOX, April 9, 2020,
[11] UNCTAD, World Investment Report: 2020, Geneva, June 2020.
https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=2769
[12] World Bank, COVID-19 Through a Migration Lens, April 2020.
http://documents.worldbank.org/curated/en/989721587512418006/COVID-19-Crisis-Through-a-Migration-Lens.

But the bigger challenges involve long-term policy initiatives. The pandemic has brought forth into vivid display the consequences of the rising socioeconomic inequality of the last thirty years, both in high-income and in developing countries. The pandemic has been fueled in part by the lack of adequate access to health care, particularly in developing countries and in the United States. Increased public investments in health care are therefore urgently needed both to protect the most vulnerable low-income populations and to minimize the risks from future epidemics. The erosion of social safety nets over the past decades also needs to be reversed, to ameliorate the socioeconomic impact on poor and low-income population. In developing countries, where the informal sector constitutes a huge share of employment opportunities, access to public services urgently needs to be expanded, including not only health care and social safety nets but also access to quality education, clean water, sanitation, etc.

These short-term and long-term increases in public investment have their own, domino-like consequences. Exploding government budget deficits will lead to the risk of sovereign debt crises in both high-income and developing countries. International organizations, like the IMF, the World Bank and the regional development banks, are already gearing up for the storm ahead. Debt restructurings and forgiveness, debt service suspensions, etc. will be required to prevent the current crisis from becoming a long-term, Depression-era collapse of the world economy. And this will require significant multilateral cooperation. It is not the time for an America-first or Italy-first or a whatever my-own first approach to policymaking.

As noted earlier, the global pandemic will tend to sharply curtail global trade in the short-run and very possibly in the medium-term. But the forces that have sustained globalization continue to exist. Comparative advantage indicates that the production of many goods and services should locate in developing countries, where lower wages still provide unsurmountable cost advantages. And although automation and artificial intelligence will slow-down this process and diminish the growth of global value chains, they are unlikely to reverse this motor of globalization. High-income countries will also continue to have the demographic forces that will eventually provide an incentive for a rebound of migration flows.

A long-term resurgence of trade, capital, and labor flows, however, can be sabotaged by the growth of economic nationalism, which has already led to a rise of protectionist policies in an array of high-income countries. Most emerging markets and developing countries depend crucially on globalization for their economic development, whether in the form of the extraction and export of oil, copper and natural gas, the manufacturing of automobiles and iPhones, the export of agricultural products, remittances from their workers abroad, etc.

The COVID-19 epidemic requires policy actions that reverse the existing socioeconomic inequities that have grown over the years in the global economy and within many countries. Ignoring them risks plunging the world deeper into crisis and making the global economy even more susceptible to future pandemics and other shocks.

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