LONG TERM CONSEQUENCES OF COVID-19

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GLOBALIZATION
Not the first shock to GVCs but this time is different

- Uncertainty about trade policy
  - US-China trade war
  - Weakened WTO

- COVID exposes excessive concentration of suppliers

- Both types of shocks likely to come back
Rethinking of global value chains

- More focus on **resilience**
- Building in **redundancy**
- Move **away from zero-inventory** approach

- Greater weight given to resilience by **credit rating agencies**

- Some **reshoring** thanks to automation

- **Opportunities for lesser known investment destinations**
Will globalization be rolled back?

- Contrary to popular fears, it did not happen during the financial crisis
Limited scope for tariff hikes under the WTO and Preferential Trade Agreements rules

<table>
<thead>
<tr>
<th>Country</th>
<th>MFN Tariff</th>
<th>Bound Tariff</th>
<th>Tariff Water</th>
<th>Smoke in the Water</th>
<th>Meaningful Water</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Countries</td>
<td>0.05</td>
<td>0.15</td>
<td>0.11</td>
<td>0.04</td>
<td>0.07</td>
</tr>
<tr>
<td>High Income</td>
<td>0.04</td>
<td>0.11</td>
<td>0.07</td>
<td>0.02</td>
<td>0.05</td>
</tr>
<tr>
<td>Middle Income</td>
<td>0.08</td>
<td>0.24</td>
<td>0.16</td>
<td>0.06</td>
<td>0.10</td>
</tr>
<tr>
<td>Low Income</td>
<td>0.09</td>
<td>0.45</td>
<td>0.36</td>
<td>0.11</td>
<td>0.25</td>
</tr>
</tbody>
</table>

Source: Foletti et al. (2009)

MFN tariff = tariff actually applied
Bound tariff = maximum tariff allowed under the WTO commitments
Tariff water = bound tariff – MFN tariff
Smoke in the water = meaningless policy space (applied tariff is already prohibitive or most trade occurs under preferential trade agreements subject to different rules)
Meaningful water = economically meaningful policy space
Will globalization be rolled back?

• Weakened WTO

• Export restrictions on medical supplies even within the EU

• Export restrictions on agricultural products

• Security concerns could be used to justify protectionism

• Possible under WTO rules
  – US paved way to using National Security Exceptions (Article XXI)
  – Counterveiling (anti-subsidy) duties

Resurgence of protectionism possible, even if trade is needed to stimulate the recovery.
Inability to insure trade contributed to the Great Trade collapse of 2008/9

<table>
<thead>
<tr>
<th>Quintile of TII index</th>
<th>1st</th>
<th>2nd</th>
<th>3rd</th>
<th>4th</th>
<th>5th</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade value 2007 ($B)</td>
<td>1361.3</td>
<td>1314.2</td>
<td>1226.9</td>
<td>1070.4</td>
<td>1833.8</td>
<td>6806.6</td>
</tr>
<tr>
<td>Trade value 2009 ($B)</td>
<td>1247.2</td>
<td>1019.5</td>
<td>1018.0</td>
<td>872.1</td>
<td>1473.3</td>
<td>5630.2</td>
</tr>
<tr>
<td>Trade collapse ($B)</td>
<td>114.1</td>
<td>294.7</td>
<td>208.9</td>
<td>198.3</td>
<td>360.5</td>
<td>1176.5</td>
</tr>
<tr>
<td>Trade collapse (% of 2007 trade)</td>
<td>8.4</td>
<td>22.4</td>
<td>17.0</td>
<td>18.5</td>
<td>19.7</td>
<td>17.3</td>
</tr>
</tbody>
</table>

**Counterfactual: Trade collapse due to insurance channel**

Based on estimated coef. in col. (4)

<table>
<thead>
<tr>
<th>Billion US$</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>-</td>
<td>7.9</td>
<td>12.9</td>
<td>18.2</td>
<td>79.2</td>
<td>118.1</td>
<td></td>
</tr>
<tr>
<td>% of trade collapse</td>
<td>-</td>
<td>2.7</td>
<td>6.2</td>
<td>9.2</td>
<td>22.0</td>
<td>10.0</td>
</tr>
</tbody>
</table>

Crozet, Demir and Javorcik (2020)

**PROBLEM:** too conservative treatment of trade finance in prudential regulations
CLIMATE CHANGE
Climate Change Mitigation

Threats

• Risk that the COVID-19 crisis will eclipse the climate action, which is desperately and urgently needed

• The COVID crisis risks to cause a dangerous ‘pause’ in the drive to green

• Low oil prices lower incentives for energy-saving measures and investment in renewables

• Industry pressure to lower standards
Climate Change Mitigation

Opportunities

• Remote work & less business travel => less emissions

• Signal strong commitment to green => impact on new GVCs

• Climate change likely to lead to extreme weather events and new disease outbreaks => now is the time to build public support for action

• Tilting to Green

Reasons for not adopting energy efficiency measures vary

Source: Transition Report 2019
Tilting to Green

• An immense amount of money is being spent to counteract the COVID-19 crisis.

• This creates an opportunity to ‘tilt to green’ the government’s funds currently dedicated to COVID-19 and turn this stimulus into the key accelerator to a low-carbon economy.
REMOTE WORK
Remote working is here to stay

- Less demand for office space => impact on real estate market
- In some occupations, more monitoring via software
- Epidemics of loneliness?
- More involvement in local community?

US Health Resources & Services Administration
Remote working is here to stay

- Less frequent visits to the office => longer commute is feasible => **decoupling of where we live and where we work**

- **Home office** => demand for more space at home => greater attractiveness of cheaper locations

- Less incentive for firms to locate in the capital city

- **Boost to medium-sized and smaller cities**
Boost to secondary cities

GDP per capita in the largest city’s metropolitan region, 2017
(National average=100)

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP</th>
<th>Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>7.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Romania</td>
<td>6.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>4.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Croatia</td>
<td>3.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>0.0</td>
<td>-1.0</td>
</tr>
<tr>
<td>Latvia</td>
<td>-1.0</td>
<td>-2.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-2.0</td>
<td>-3.0</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>-3.0</td>
<td>-4.0</td>
</tr>
<tr>
<td>Germany</td>
<td>-4.0</td>
<td>-5.0</td>
</tr>
</tbody>
</table>


Notes: 2016 data for Ireland, France, Croatia, Italy, Latvia, Lithuania, the Netherlands, Norway, North Macedonia and Albania.
Boost to secondary cities

Average annual GDP growth, 2000-2016 (Per cent)

With implications for

- **Density of ideas => innovation**
- **Spatial inequality**
- **Politics** (spatial inequality less of a source of discontent?)
- **Low carbon transition**

Notes: 2000-2015 data for Croatia, Greece, Latvia, Lithuania, Poland and Germany.
Global gig economy

Opportunity for ECA countries
THE STATE STRIKES BACK
The State strikes back

• The COVID crisis exposed weaknesses of gig economy & zero hour contracts => rethinking of the labour market rules

• More expected of the state => rethinking of the social contract => acceptance of higher taxes as long as taxation perceived as fair

• Increased indebtedness & higher expenditure
Where to find tax revenue?

- Steadily **declining corporate tax rates**
- High profile **tax avoidance** cases
  - Apple’s tax rate of 0.005% in Ireland in 2014
- **Tightening rules on multinationals** popular with voters
  - France & Denmark made firms with HQs or subsidiaries in tax heavens ineligible for state aid

Trends in statutory CIT rates
Will COVID-19 cure tax ailments?

- G20/OECD initiative on Tax Base Erosion & Profit Shifting

- Nov 2019 OECD’s proposal to allow countries to tax operations in their jurisdiction even if companies have no physical presence there

- A global minimum corporate tax rate?
Populism & Democracy

• Mixing of anti-crisis response with politics

• Open power grab justified by the outbreak

• Erosion of privacy protections

• Stimulus creates opportunities for corruption
Populism & Democracy

• Will the outbreak expose incompetence of some populist leaders?

• Will trust in experts be restored? More delegation to technocrats?

• Or will propaganda manage to counteract that?
Planning for post-Covid world

URGENT ISSUES

• How will international travel be regulated? Impact on migration, remittances, tourism, exports of goods & services

• Global health monitoring and early warning system

• Commitment to free trade

• Treatment of trade finance in prudential regulations
Planning for post-Covid world

LONG-TERM ISSUES

• Dealing with tax base erosion and profit shifting

• Agreement on not offering tax holidays to MNCs

• Debt accumulation in developing countries

• How to make the case for foreign aid in the post-COVID world?

Need a “Bretton Woods” conference to think about the post-Covid international cooperation and economic order