

Macroeconomic Policy in the Time of COVID-19: A Primer for Developing Countries

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WORLD BANK GROUP

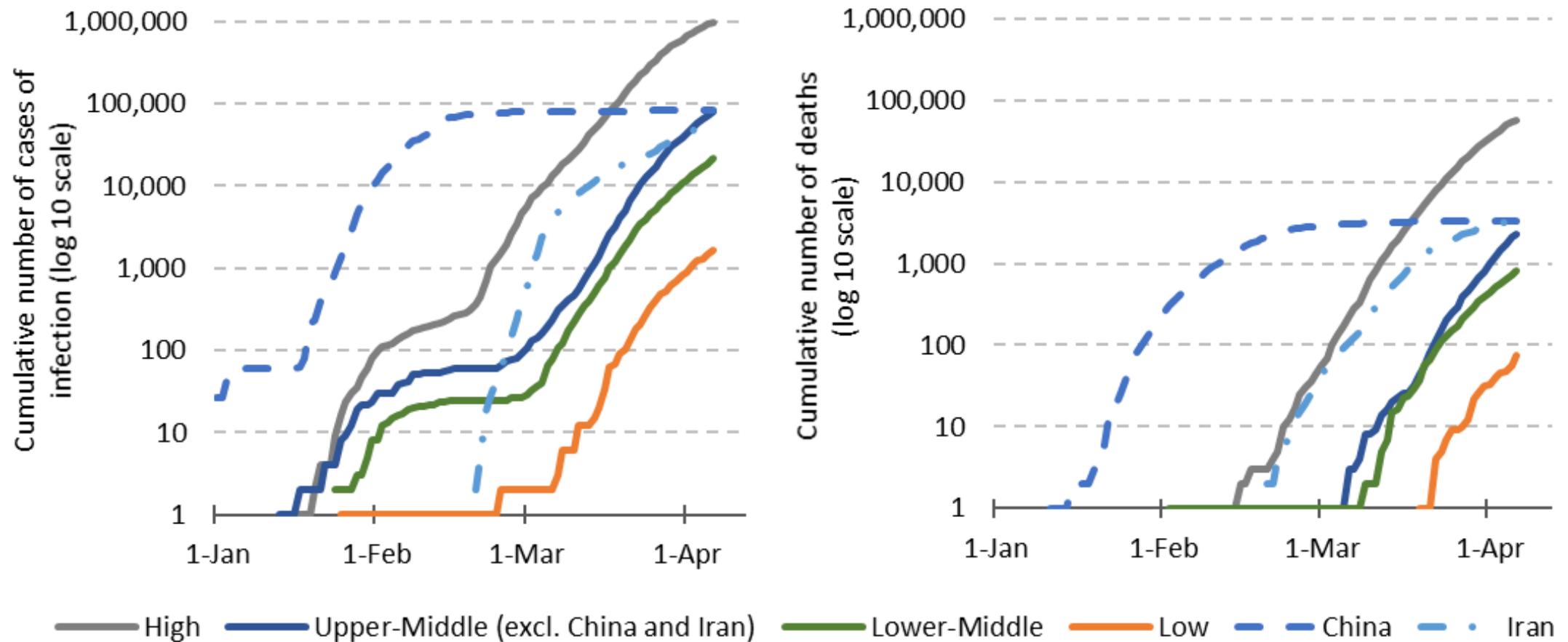


**DEVELOPMENT
RESEARCH**

A Public Health and Economic Crisis

- Public health emergency: COVID-19
 - Three to thirty times deadlier than seasonal influenza
 - At least ten times more contagious than SARS
 - If unattended, millions of people could die
- An economic crisis:
 - The measures to contain the spread the disease (social distancing) imply a sharp reduction in economic activity
 - The adverse shock is massive and global, worse than the global financial crisis
 - If unattended, it can lead to mass unemployment and business closures
 - And its ripple effects can produce a set of other crises: financial, sectoral, balance-of-payments, and debt crises

Cumulative number of cases of infection and deaths from COVID-19 by country income group (6th April 2020)



Source: Loayza and Pennings (2020), European Centre for Disease Prevention and Control (2020) and World Health Organization (2020) (via Our World in Data by University of Oxford, <https://ourworldindata.org/coronavirus-source-data>, accessed on 6 April 2020).

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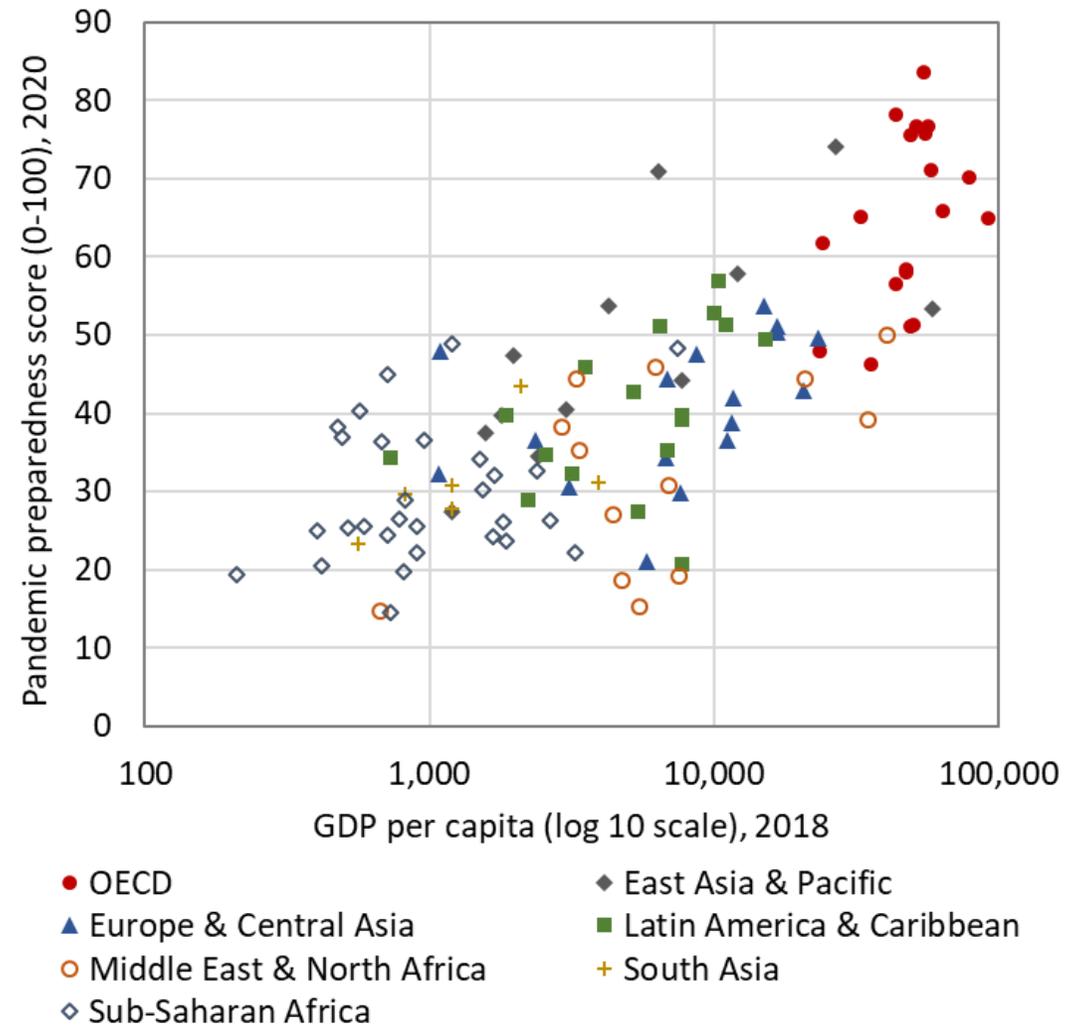
In poor, developing countries, the crisis can be worse

- A humanitarian crisis:
 - Worsening poverty
 - Dire decline of basic social services in education, health, and safety
 - Social conflict, violence, and crime

Why worse in developing countries?

- Global economic shock:
 - Reduction of exports, especially raw materials
 - Drop of commodity prices to historical lows
 - Sharp decline in services such as tourism
 - Steep decline in remittances
 - Difficult and more expensive access to international financial markets
- Structural conditions:
 - Dismal public health care capacity
 - Low fiscal space to deploy funds and resources
 - Poor governance capacity to manage shocks
 - Widespread labor informality

Pandemic preparedness score versus GDP per capita



Note 1. Pandemic preparedness score is based on 64 indicators on early detection of epidemics and surveillance capacity, emergency preparedness, response planning to prevent the spread of epidemics, risk communication, access to infrastructure, history of travel restriction, health sector robustness, accessibility and quality, availability of financing, as well as government effectiveness and public confidence in its institutions.

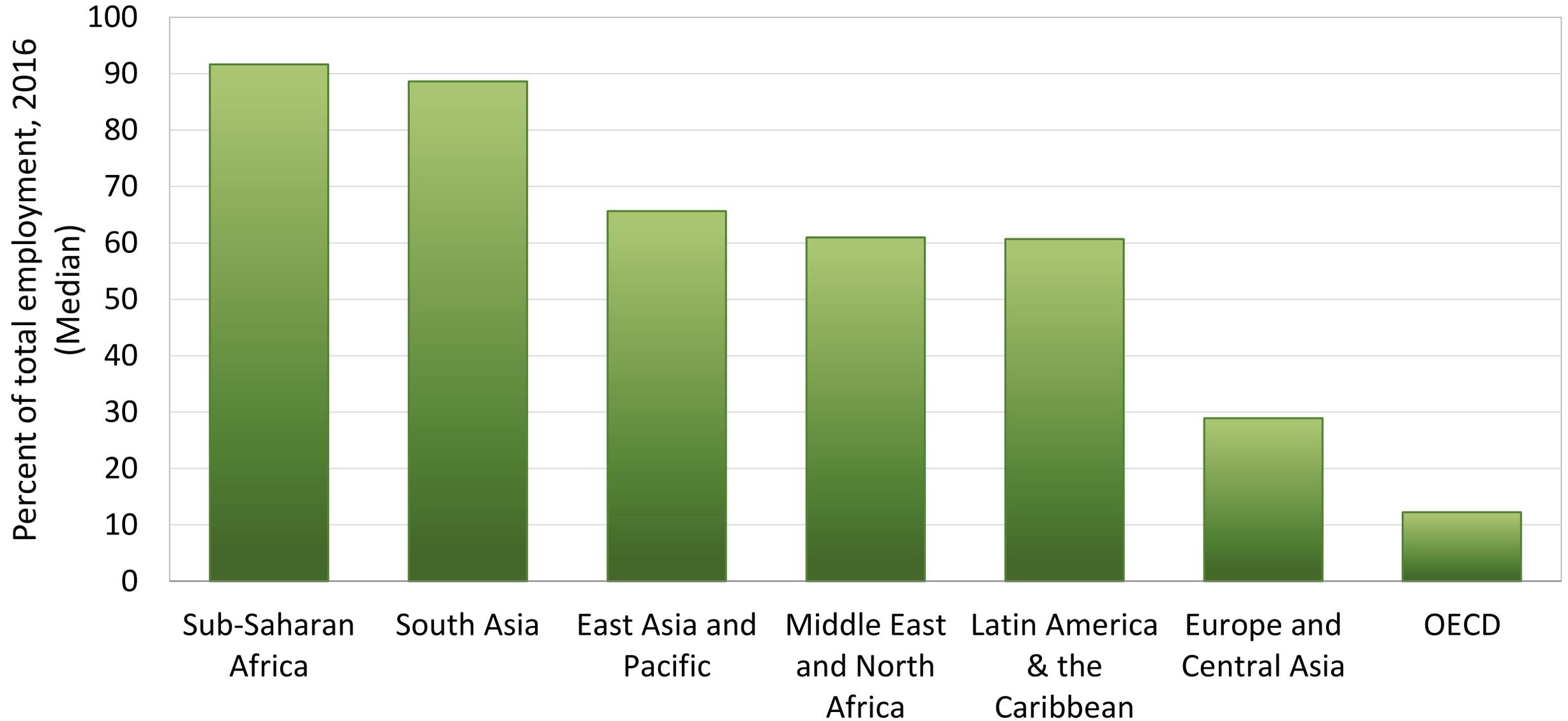
Note 2. OECD includes high-income countries who have been a member of OECD for more than 40 years (as of 2018).

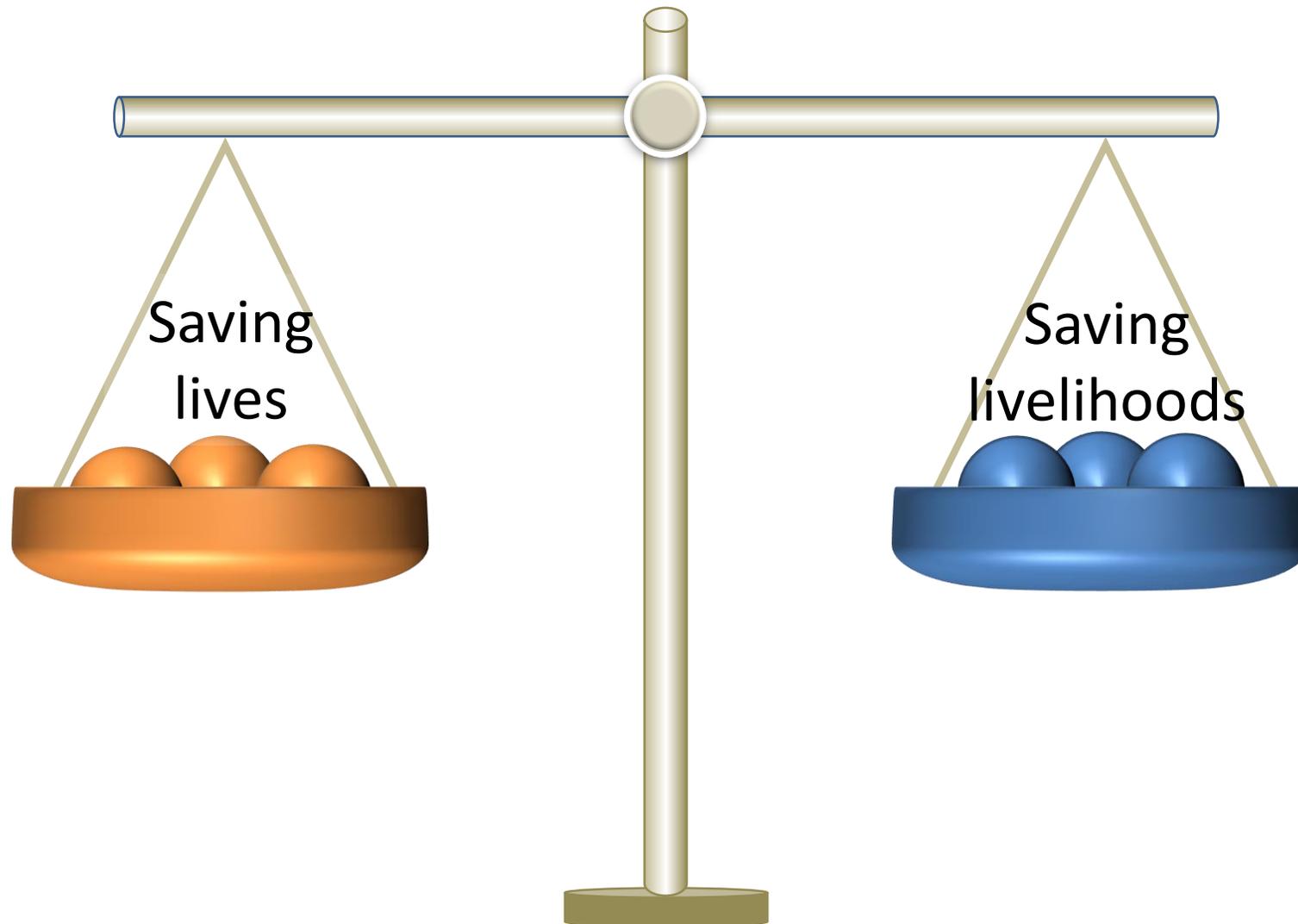
Source. EAP Economic Update, World Bank (2020).

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- Structural conditions:
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 - Poor governance capacity to manage shocks
 - Widespread labor informality (no unemployment insurance, no paid leave, no stable earnings, little savings)

Informal labor is widespread in most developing countries



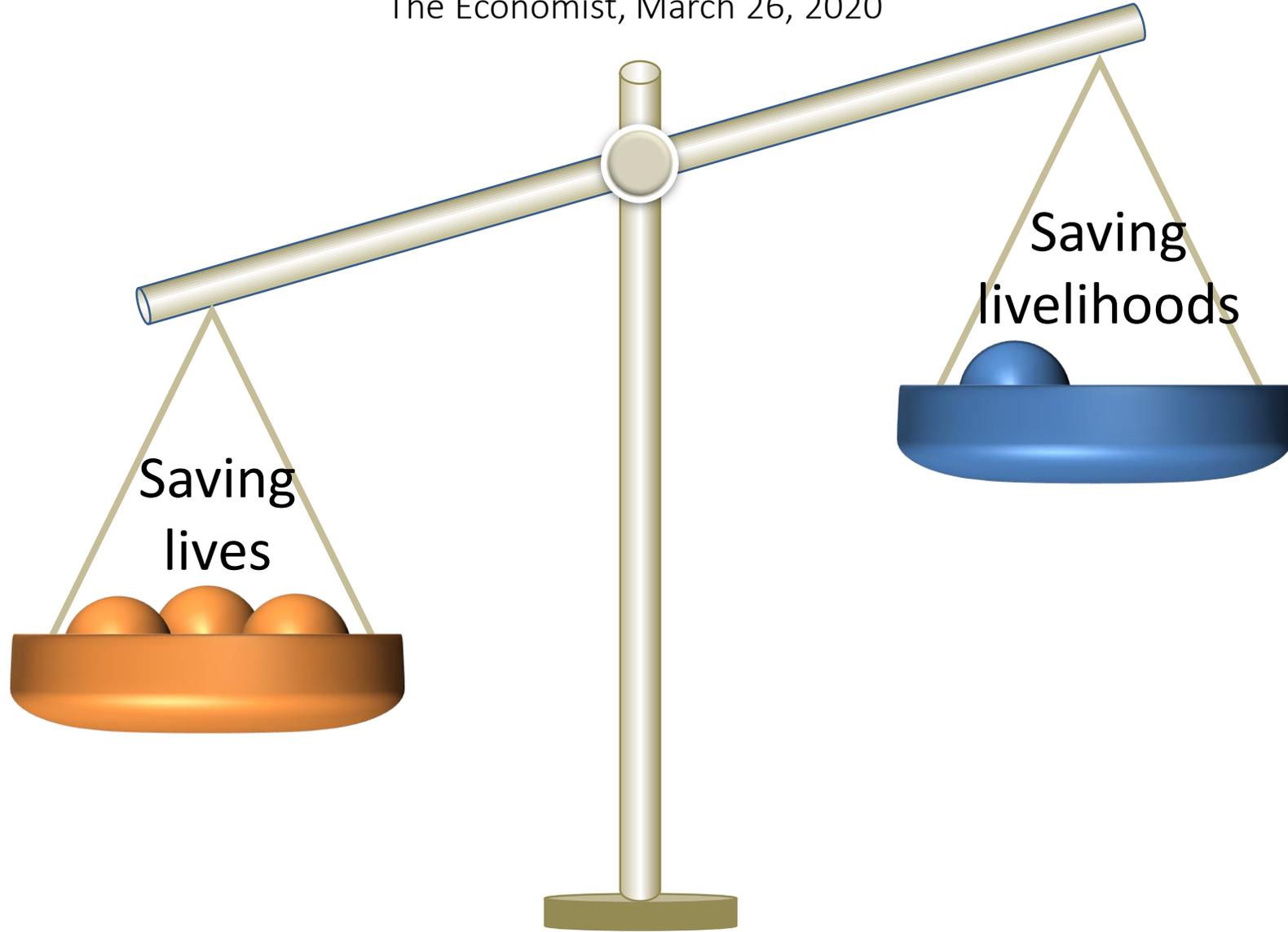


Saving
lives

Saving
livelihoods

“The trade-off between saving lives and saving livelihoods is excruciating”

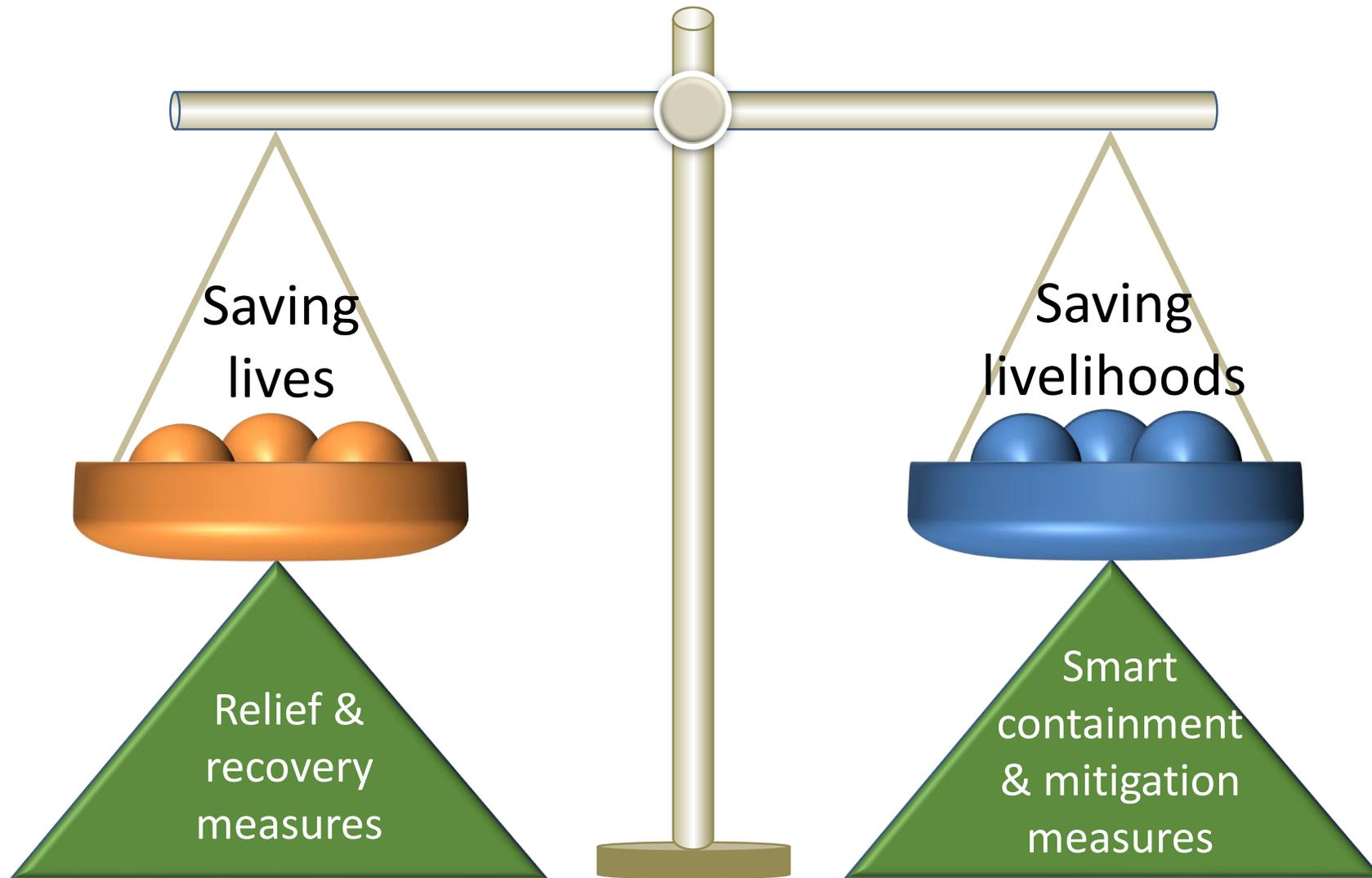
The Economist, March 26, 2020



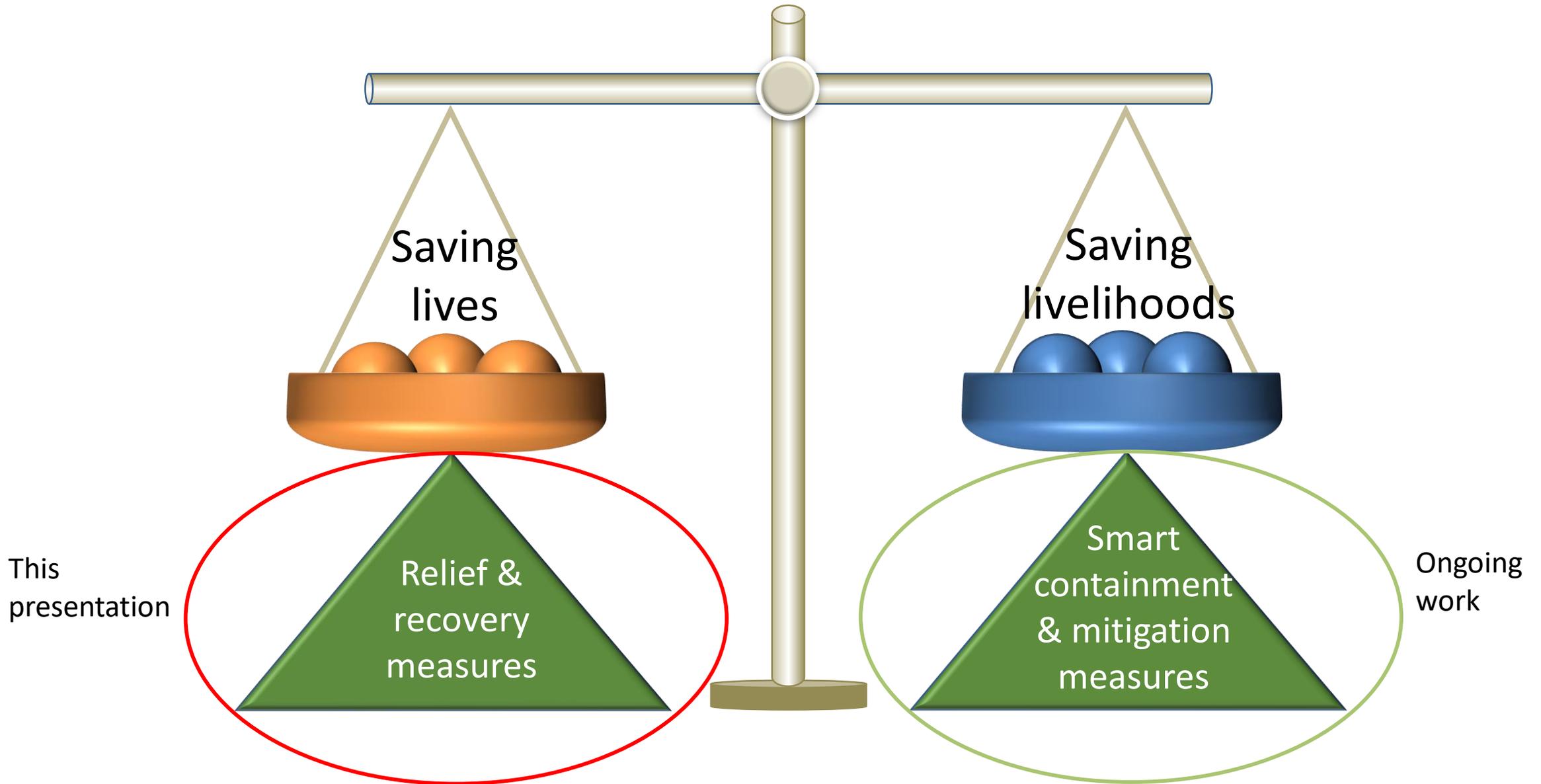
The trade-off between saving lives and saving livelihoods is excruciating... It is also real and unavoidable

However, the terms of this tradeoff can be eased by public policy

Easing a difficult trade-off



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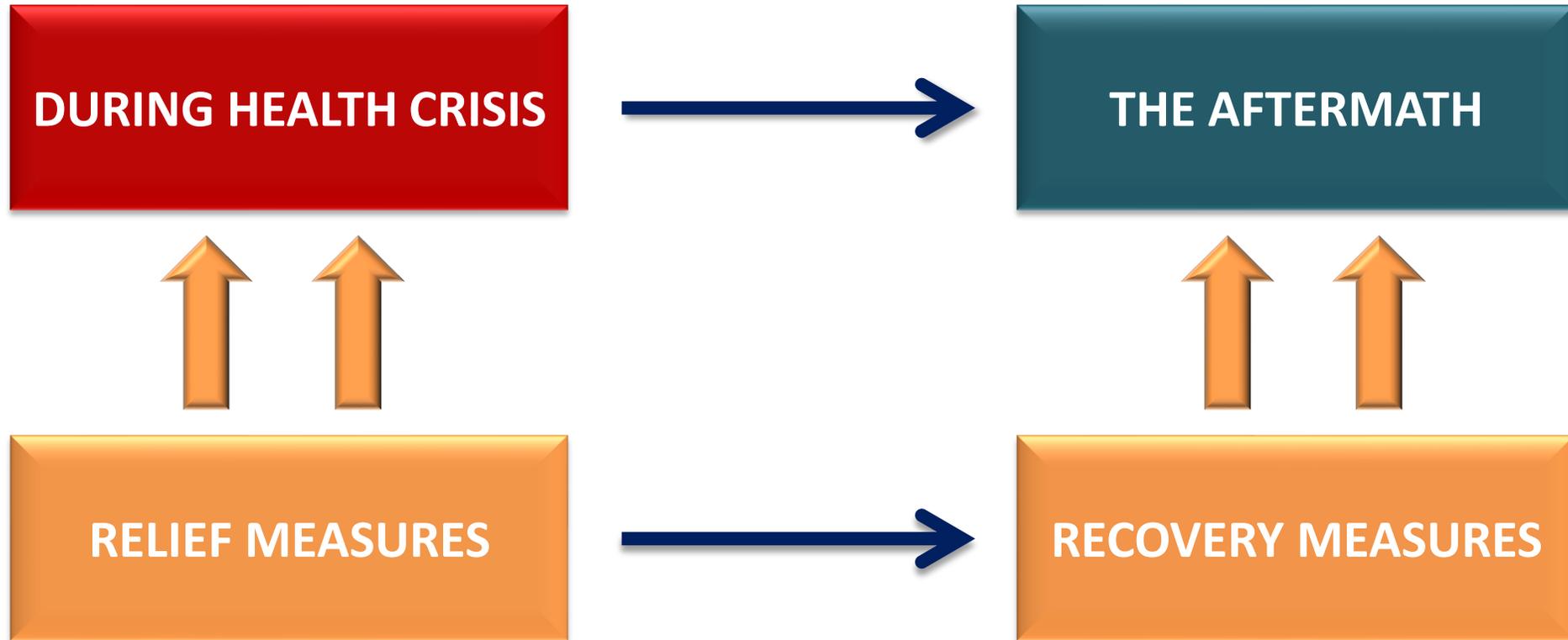


Macroeconomic policies: timing

- It's instructive to distinguish two phases for different types of macro response
- Recognizing, however, that the duration of each phase is uncertain and that dynamic interactions between the two occur



Macroeconomic policies: timing



Relief measures

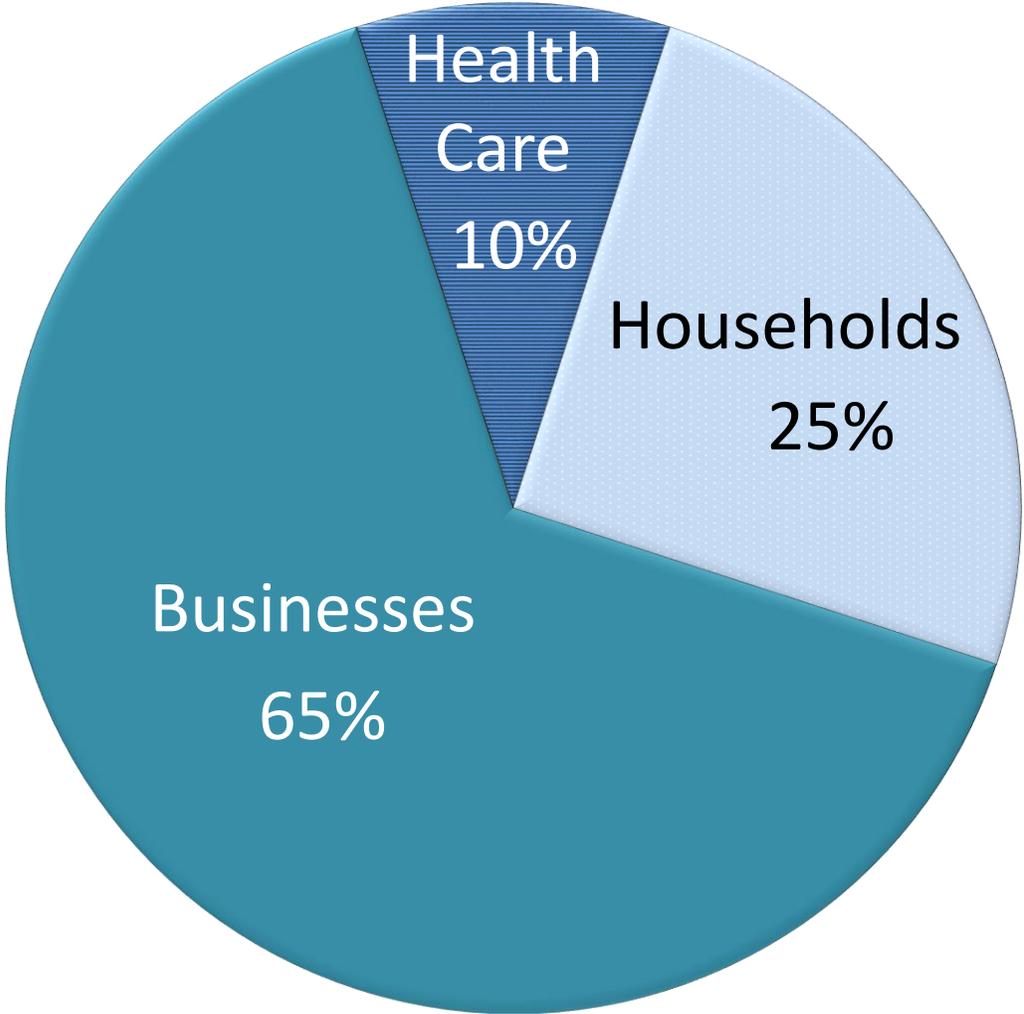
- **Objective:** The goal of macroeconomic policy in the near term is not to stimulate the economy—which is impossible, given the supply-restricting containment measures—but rather to increase public health care capacity, to support those affected by the public health measures, and to align incentives to comply with social distancing
- **How:**
 1. *Redirect public expenditures to health care.* Emergency hospital space, ventilators, protective medical equipment, medical personnel
 2. *Provide income support to people.* Formal workers: extended unemployment and leave benefits. Informal and poor: General or targeted cash transfers
 3. *Assist affected business.* Wage subsidies, tax cuts, moratoriums on debt repayments, credit lines
 4. *Reduce stress on financial system.* Interest rate cuts, reduced reserve requirements, lower rates/longer maturity on discount window

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Korea's fiscal budget allocation for relief measures -- 1.5% of GDP or \$425 per capita

These expenditure shares may be appropriate for upper middle-income countries. For low- and lower-middle income countries, or where informality is large, the share devoted to households would have to be larger, while that for businesses smaller



- Disease prevention and treatment which includes funding for testing, quarantine, isolation and treatment; purchasing medical equipment; and loans to hospitals.
- Support for households and young adults, through such means as cash vouchers for low-income families, childcare subsidies, and an expansion of the existing employment support package for young adults.
- Support for small-and-medium enterprises and local economies, through loans and guarantees and wage subsidies to preserve employment.

Source: Republic of Korea, Ministry of Economy and Finance 2020

Recovery measures

- **Objective:** Switch from crisis management to macroeconomic stimulus, helping the economy to regain its pre-crisis pattern (a “V-shaped” recovery)
- **How:**
 1. *Avoiding collapse through relief measures*
 2. *Monetary policy.* In principle effective because developing countries are above the zero lower bound. In practice, monetary transmission mechanism is weak, specially in low-income countries
 3. *Fiscal policy.* In practice limited too because fiscal space is small and fiscal multipliers are low (0-1). Transfers? Investment? In recession?
- **A viable objective (when expansionary fiscal and monetary policy are not likely to work):** Avoid procyclicality, ensure continuity of public goods and services (including health care!), provide for vulnerable people, maintain macroeconomic stability

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Conclusions

- “Desperate times call for desperate measures”?
 - The problem with desperate measures is that they are often wrong
 - Critical times call for well-designed government action and effective public service delivery—preserving, rather than ignoring, the practices for macroeconomic stability and proper governance that serve in good and bad times
- International cooperation and coordination
 - A global, highly contagious shock like COVID-19 requires international coordination that internalizes:
 - the positive externalities of reducing first- and second-wave infections
 - the negative externalities of unilateral actions that hurt other countries economically
 - Given the magnitude of the negative shock that COVID-19 represents,
 - Developing countries will see their revenues drop and their access to financial markets dry up
 - Countries with savings (sovereign wealth funds/reserves) may need to tap them
 - Most will need financial assistance, depending on their level of income, as grants, credit lines, and debt renegotiation and moratorium
 - International coordination and cooperation may yet prevent the worst effects of the COVID-19 pandemic.

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Thanks