

Platform for Shaping the Future of the New Economy and Society

Emerging Priorities and Principles for Managing the Global Economic Impact of COVID-19

Chief Economists Outlook

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This briefing is the outcome of consultations with leading chief economists from both the public and private sectors and leaders from the Stewardship Board of the World Economic Forum's Platform for Shaping the Future of the New Economy and Society.

It aims to summarize the emerging contours of the current economic environment, assess perceived policy effectiveness and identify priorities for further action by policy-makers and business leaders in response to the global economic crisis triggered by the COVID-19 pandemic.

1 An unprecedented economic shock – and response

Governments and central banks in the economies most affected by the COVID-19 pandemic have rapidly mobilized to keep their economies on “life support” while societies fight the most dramatic health crisis of our time. Unprecedented levels of government transfers, credit lines and loan guarantees have been lined up and liquidity has been injected into the economy extremely rapidly to avoid the collapse of the financial system.

There is still immense uncertainty about the future trajectory of the virus, and analysts and policy-makers cannot predict the full extent of both the health and economic impact of the pandemic.¹

Initial indicators point towards a global recession that might be the deepest in the last 150 years, although a fairly rapid recovery may still be a possibility at this stage.² In China, which faced the first wave of the health crisis and subsequent economic shock, the National Bureau of Statistics reported on 16 March that Chinese manufacturing decreased by 15.7% in the first two months of 2020, while private-sector output fell by 20.2% and fixed-asset investments by 24.5% year-on-year.³

In the US and Europe, the Purchasing Managers’ Index, one of the leading indicators for GDP, has plunged more than during the financial crisis of 2008-2009. The US is experiencing a labour market shock of never-before-seen proportions, with more than 3 million workers filing for unemployment benefits during the first week of lockdowns and 6.6 million more during the second week.

While economic activity in China is slowly resuming, hopes for a steep recovery have been dampened as new outbreaks cannot be ruled out and drops in demand globally are affecting key Chinese export markets. There is also some indication that citizens might be hesitant to go back to normal economic and social life, at least temporarily, even where state-imposed confinement measures have been lifted, providing a potential precursor of the low likelihood of a rapid return to past consumer behaviours in other parts of the world.⁴

At the time of writing, financial markets may have found a bottom given decisive interventions by monetary authorities to provide liquidity, yet new information on the spread and socioeconomic fallout from the virus might trigger more volatility.⁵

¹ Thompson, 2020

² Reinhart and Rogoff, 2020

³ Huang et al., 2020

⁴ as indicated by very low box office figures, Financial Times, 2020

⁵ El Erian, 2020

2 Assessment of current policy effectiveness: which policies are most promising?

A number of possible economic scenarios have been put forward by public and private organizations, including those represented in the World Economic Forum's Community of Chief Economists. The length of the economic downturn will depend not only on the different trajectories for the virus and the public health response, but also on the effectiveness (speed, precision and quality) of economic policy measures to:

- Prevent corporate insolvencies
- Short-circuit negative demand spirals
- Stabilize financial markets
- Expand healthcare capacity

These measures focus on stabilizing the economy and building capacity for a rapid rebound while it is in forced hibernation, rather than being traditional stimulus policies. The latter will become more relevant as the economy heads towards higher activity.

If effective, policies that attempt to influence these factors can help make it more likely that the economy will fully recover once “social distancing” restrictions are lifted, i.e. more likely that contraction and recovery will take a V-shape, or possibly a U-shape if the bottom of the contraction is drawn out. If policies are ineffective at influencing these

measures, it will be more likely that the path of economic output in the near future will look like an L.

In addition, the distributional impact of the crisis and the longer-term quality of the recovery will depend on efforts to protect the most vulnerable and measures to steer economies on to a greener and fairer track. The crisis has revealed an inadequate past focus on the quality of growth. The present moment offers an opportunity to combine urgent support with conscious efforts to build back better economic systems.

Based on a survey and virtual dialogue between members of the Forum's Community of Chief Economists as well as other leaders, we aim to provide an initial assessment of the policies being implemented, the constraints to their effectiveness, and their likely impact on shaping our economic future. These views are summarized below. Figure 1 shows ex ante perceived effectiveness of available policy tools for the current situation.

There are relatively positive views of the overall speed and magnitude of policy actions

There is some cautious optimism that monetary and fiscal measures taken to date by governments of advanced economies could, in principle, be sufficient to short-circuit negative demand spirals and therefore the worst knock-on effects beyond the initial shutdown-related supply and demand shocks (see Figure 2). The average perception is also that policy looks to be on track to restore a certain degree of calm in financial markets.

Borrowing costs are not considered a strong concern for advanced economies, as much of their debt can be serviced in their own currency (see Figure 3). Further, for the standing dollar liquidity swap lines that were established in 2007 between the US Federal Reserve, the European Central Bank, the Bank of England, the Bank of Japan, the Bank of Canada and the Swiss National Bank, the terms of the swaps were lengthened and interest margins reduced in response to the crisis.⁶

However, this does not apply to the increasing number of low- and middle-income countries affected by the virus and experiencing sudden-stops and financial flow reversals.

While targeted measures for health, households and firms are considered to be most effective in principle – there is concern about their execution

Targeted measures to keep afloat households and firms as well as those that can target improvements in the healthcare response are

seen as some of the most effective in the current situation (see Figure 1); indeed, they form part of most countries' policy responses.

At the same time, there are doubts as to whether newly allocated healthcare spending is sufficient. Additionally, there is concern that the implementation of fiscal measures proposed for firms and households might not be straightforward (see Figure 3). Time is of the essence as cash buffers are already running low for many households and smaller firms, yet bureaucratic processes could slow efforts and government support risks arriving too late. In particular, responses suggest that digital distribution channels currently in place might not be sufficient to reach recipients with the speed required.

There is concern about the short-term impact on the most vulnerable as well as the medium- to longer-term impact on inequality and sustainability

The survey and consultations further surfaced concerns that current policy measures do not adequately address the asymmetric effects of the crisis on the most vulnerable households, which need the most immediate support (see Figure 2). The crisis has brought to light a legacy of eroded social safety nets, low wages and precarious work.

Survey responses reveal the need to shift policy priorities to a broader set of metrics beyond just GDP growth to prevent such negative societal outcomes during future shocks. Additionally, responses indicate that policy measures now on the table could do a better job at balancing shorter-term considerations against the longer-term need to pivot economies towards greener and fairer economic outcomes (see Figure 2).

⁶ Tooze, 2020

Figure 1: Effectiveness of policy instruments

Source: World Economic Forum, 2020 (1 = highly ineffective, 5 = highly effective)

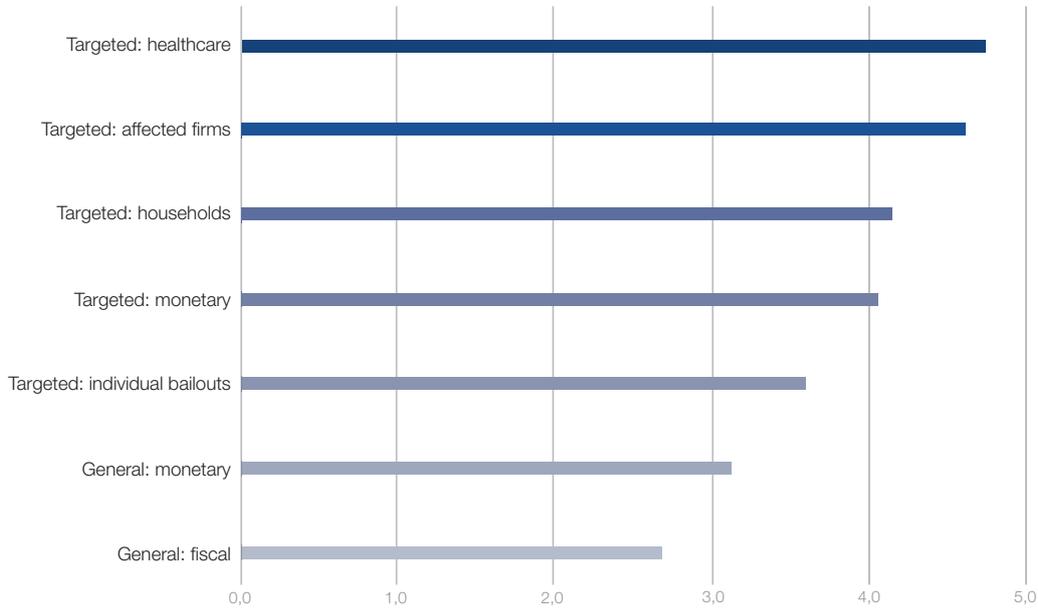
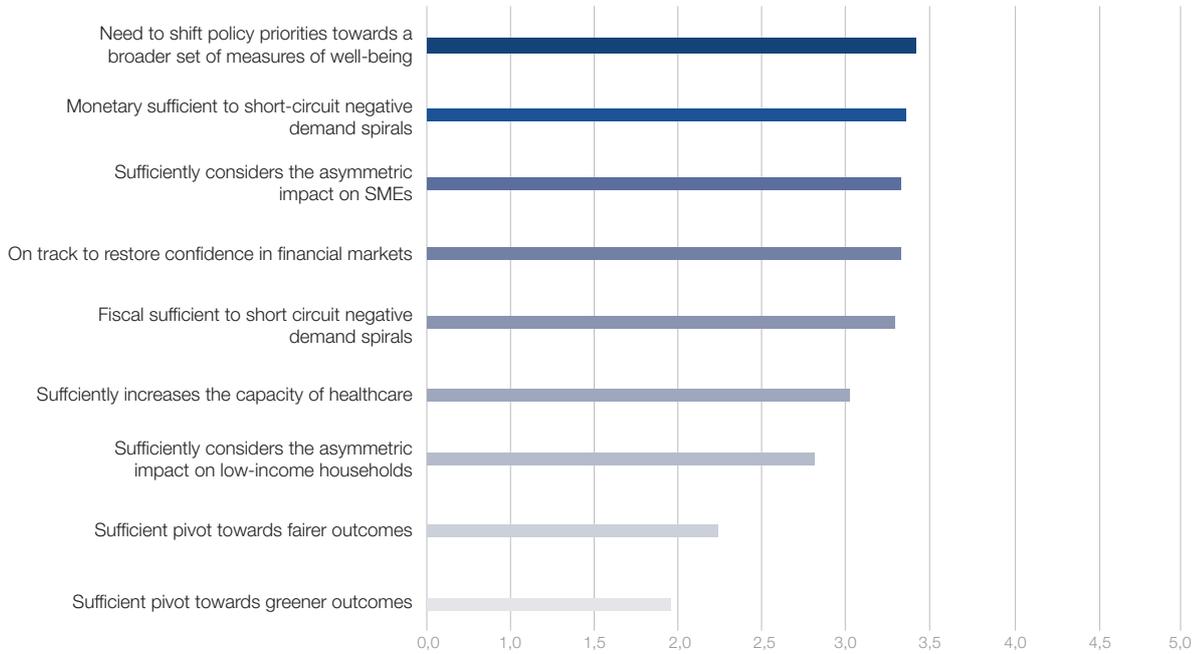


Figure 2: Assessment of proposed policies

Source: World Economic Forum, 2020 (1 = strongly disagree, 2 = disagree, 3 = uncertain, 4 = agree, 5 = strongly agree)



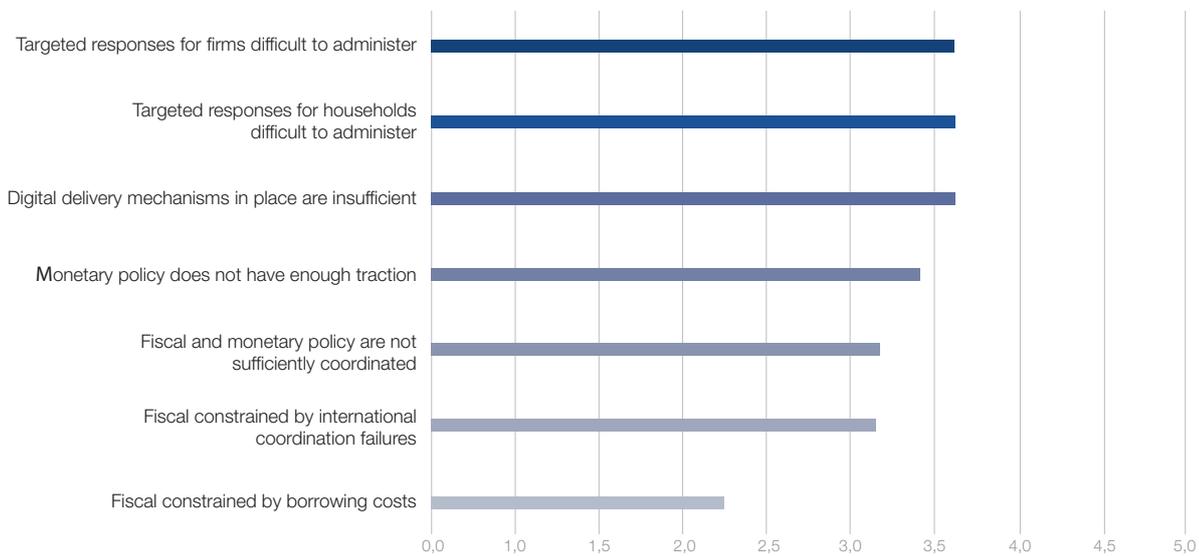
There is a perceived risk that insufficient policy coordination nationally and globally could hinder the effectiveness of the efforts underway

Insufficient policy coordination is considered a potential bottleneck. For measures to be effective, coordination is needed along three dimensions: between national fiscal and monetary policy authorities; internationally, among monetary authorities; and among fiscal authorities.

While most governments have reacted rapidly to build an economic “life support” system that is closely calibrated to their national economy, international fiscal coordination will become more critical in the next phase as countries apply more conventional stimulus measures, which will deliver their full potential when implemented in sync with major trading partners.

Figure 3: Potential constraints to proposed policies

Source: World Economic Forum, 2020 (1 = strongly disagree, 2 = disagree, 3 = uncertain, 4 = agree, 5 = strongly agree)





Recommendations: What principles and policy actions should be prioritized next?

Public health must remain at the core of the policy response, keeping people safe and supporting rapid progress on treatment options and a vaccine over the coming months. In addition, four issues were found to deserve particular attention as policy-makers think about next steps to achieve a robust recovery: identifying effective channels for rapid disbursements to firms; supporting vulnerable workers and households with precision; overcoming borrowing constraints for low- and middle-income countries affected by the crisis; and balancing emergency responses with expanding policy priorities beyond GDP growth.

Rapid disbursements to firms

Rescue packages around the world include provisions to help small and medium-sized enterprises. However, there is a concern whether the necessary pipelines are in place to distribute funding rapidly enough and before companies drift into insolvency with dire consequences for workers and the rise of new systemic risks.

In many cases, accessing government support funds has time-intensive processes attached, yet SMEs have cash buffers that will last them for only some weeks, and

sometimes just days.⁷ In addition, most central bank interventions to date have focused on backing investment-grade assets, creating a danger for more highly leveraged businesses to fall through the cracks of the rescue effort.

In China, a survey by Tsinghua University and Peking University of 995 SMEs found that 85% of them had cash reserves for three months or less.⁸ In the Eurozone, 13,000 SMEs could be at risk of insolvency (7% of the total), accounting for 4% of Eurozone GDP.⁹ At-risk firms are likely to be concentrated in construction, agri-food and services but also include energy, metals, materials and automotive due to their high exposure to the global economic cycle.¹⁰

The Chinese experience may provide useful insight on speeding up the provision of liquidity for SMEs. Integrating outcomes and lessons from the 2003 SARS outbreak, China's digital economy has the structures to mobilize private capital and provide rapidly targeted support to SMEs via internet financing, with fintech platforms using big-data-driven credit rating systems, real-time monitoring of debtors and wide geographical reach.

⁷ Surico et al., 2020

⁸ Huang et al., 2020

⁹ Allianz, 2020

¹⁰ Allianz, 2020

¹¹ See Huang et al., 2020, for details

Digital financial platforms have also been key in serving as a conduit for emergency loans in the current crisis, with direct encouragement from the Chinese central bank to make borrowing easier for small and micro businesses. Ant Financial and its virtual bank MYbank are working with other financial institutions in China to support around 10 million micro and small enterprises.¹²

Supporting vulnerable workers and households with precision

Already stressed safety-net measures for vulnerable households and workers have proved insufficient in the current crisis.

Several groups of workers are being hit particularly hard by the economic fallout of the crisis, including those whose work relies on face-to-face interactions or physical presence and who are therefore not able to work from home. In the UK for example, this is true for 76% of workers,¹³ while approximately 30%-35% of UK households have practically no cash reserves,¹⁴ leading to severe economic stress in the absence of rapid government support. At the same time, many essential workers are among the most vulnerable, serving on the frontline of providing basic services, including healthcare, food and logistics, but under conditions of low wages, significant physical exposure and mental stress.

Protecting as many jobs as possible is critical for people's lives and livelihoods – as well as for positioning the economy in the best place for a recovery. Several European countries, including Germany, Denmark, Sweden, Norway and the UK, have introduced schemes to subsidize employees to work on reduced-hours schedules in order to sustain

ties between employers and employees.¹⁵ In cases where firms receive government bailouts, conditions should require that a rescued company cannot lay off employees for a certain period of time.

In cases where wage subsidies and other targeted firm-related measures fall short, rapid access to social safety nets in parallel will be key. Unemployment programmes in several economies are being extended to reach those in non-standard employment situations, such as gig workers, and a discussion on the need for a universal basic income is being revived in the current context. In addition, debt moratoria for households with mortgages may also need to be considered as a policy tool to rapidly provide additional financial space.¹⁶

Several proposals for digital disbursements by central banks are under early discussion, including one in the US for cash payments to households via pre-paid digital cash cards funded by the Federal Reserve. A digital dollar wallet managed by the Federal Reserve was initially considered by some to facilitate cash transfers associated with the \$2 trillion US Coronavirus Aid Relief and Economic Security (CARES) act. The Bank of England has also discussed central-bank-issued digital currency in the context of their COVID-19 response. While the need for precision calls for rapid innovation and data-based approaches, the privacy and long-term distributional implications of such programmes will also need scrutiny.¹⁷

Financial support for low- and middle-income countries

The global spread of the virus entails that support to and solidarity with lower-income

¹² Huang et al., 2020

¹³ PwC, 2020

¹⁴ Surico et al., 2020

¹⁵ Chazan and Milne, 2020

¹⁶ Reinhard and Rogoff, 2020

¹⁷ Kaminska, 2020

economies is both ethically and economically the most responsible course of action. The impact for low- and middle-income countries will be severe due to several compounding factors. Weak health systems will come under strain quickly as will social safety nets; especially as the natural resource exporters among this group of countries are already being hit by a collapse in oil and other commodity prices.

Countries that borrow in dollars will be severely constrained to raise the necessary funds for government intervention. Capital flow reversals are already occurring in major emerging economies. The IMF reports that the MENA region has seen a decline in portfolio flows of close to \$2 billion since the middle of February, along with falling equity prices and rising bond spreads, while \$35 billion of sovereign debt is due to mature in 2020.¹⁸

While the IMF and World Bank have expressed their readiness to lend, their resources may have to be complemented with debt moratoria and additional support from advanced economies.¹⁹

Expanding policy priorities beyond traditional GDP growth

While the climate change and green transition agenda had already become a critical matter of global debate and national policy exploration, the present crisis has starkly revealed the inadequacies in healthcare, wages, job quality and social safety net systems, and societal concerns about inequality. There is both apprehension about the loss of these agendas in the midst of urgent measures to address the health, social and economic fallout of the current

crisis, and a potential opportunity to build back better, fairer and greener economies.

The policy measures on the table do not yet show a major change in direction, with the perception that even the most obvious place to spend in this situation – the healthcare sector – is not getting enough attention. Additionally, some experts and commentators argue that the time to direct such structural change should not be right now. Rather, the priority at this moment should be to safeguard as many businesses and jobs as possible.²⁰

However, others have noted that the present moment is an opportunity to embed the structural changes that have long been necessary to develop more sustainable, dynamic and inclusive economies. For example, in response to the SARS crisis, the Chinese government focused on building digital infrastructure, which greatly enhanced the earning capacity of millions of people.

A similar pivot towards green investments and structures that yield fairer outcomes could be made by governments as they implement measures to overcome the current crisis, including new types of institutions and public-private partnerships, coordinating R&D activities towards solving public health challenges, enhancing job quality and training, and rewiring industries to reduce carbon emissions.²¹

¹⁸ IMF, 2020

¹⁹ Reinhard and Rogoff, 2020

²⁰ Tooze, 2020

²¹ Mazzucato, 2020

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